Deloitte.

SANEC
Facilitating International Business

Transfer Pricing
Attention points for doing business abroad

Rotterdam, 9 September 2014

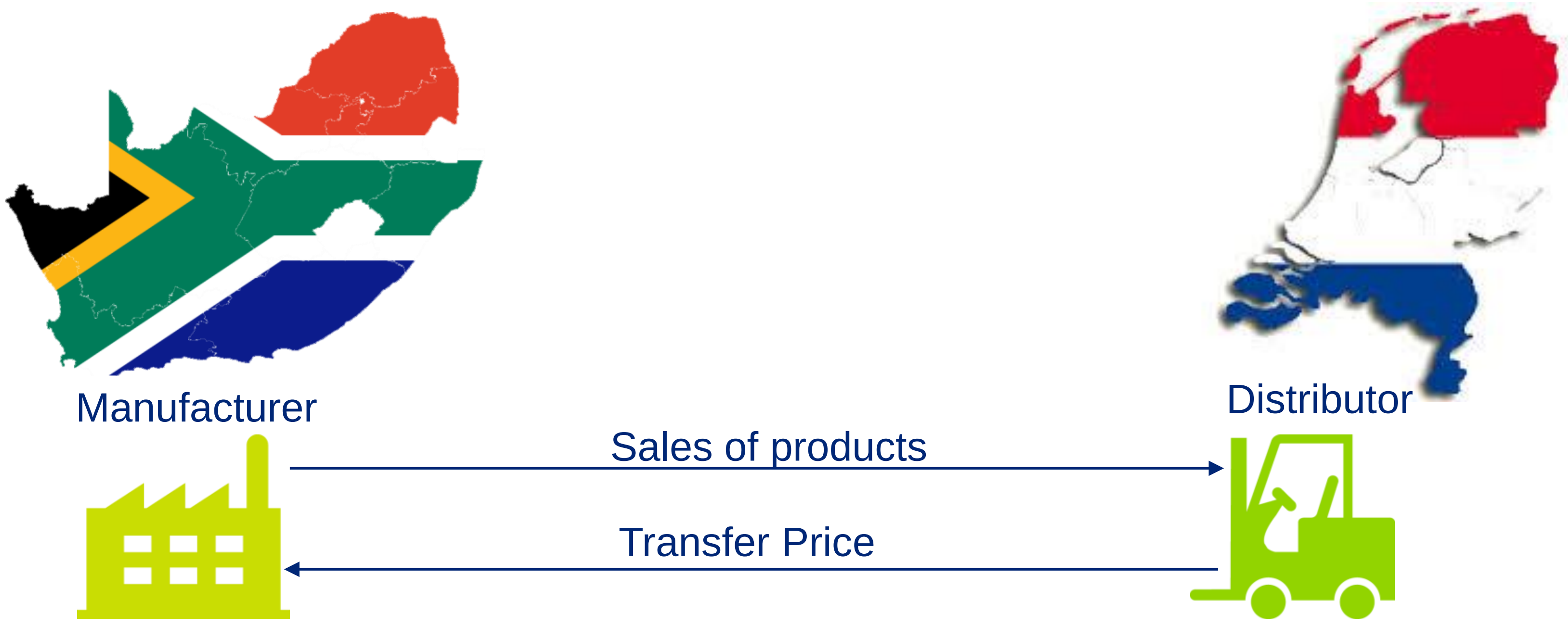
Agenda

1. What is Transfer Pricing?

- There is nothing intrinsically complex in the term: the price at which goods, services, (including financial services) and intellectual property are transferred between <u>related</u> parties.

- Transfer pricing applies to intercompany transactions between <u>related</u> companies located in different jurisdictions.

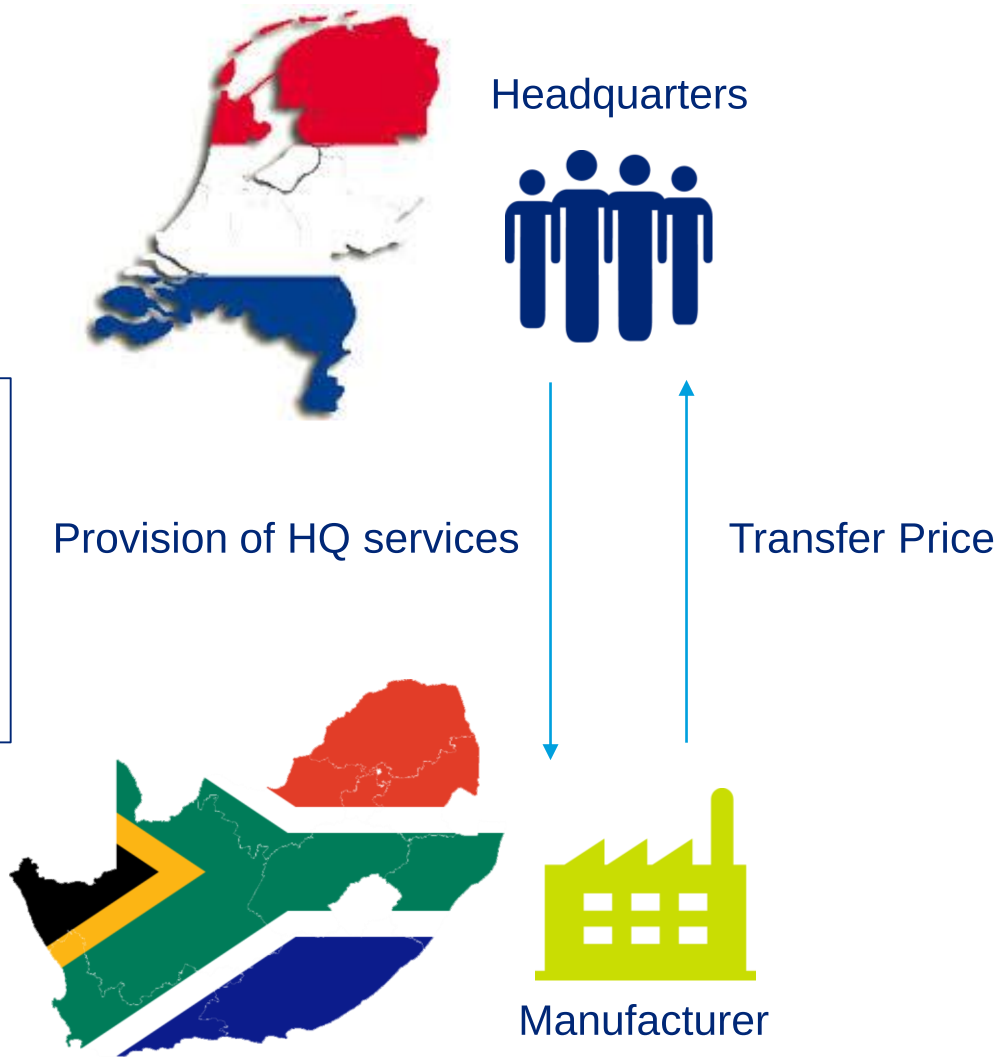
- Differences exist in the definition of related parties, e.g. for financial transactions in South Africa, only 20% ownership is required.



1. What is Transfer Pricing?

- ❑ Example for the provision of intra-group services

Specifically for this type of service transaction, an Exchange Control approval is required. The South African taxpayer needs to demonstrate that the costs of the services are reasonably allocated and that the mark-up applied is at arm’s length.



2. Why is transfer pricing important?

- Multinational Enterprises but also many mid market companies operate in different countries which each have different tax systems with different tax rates.

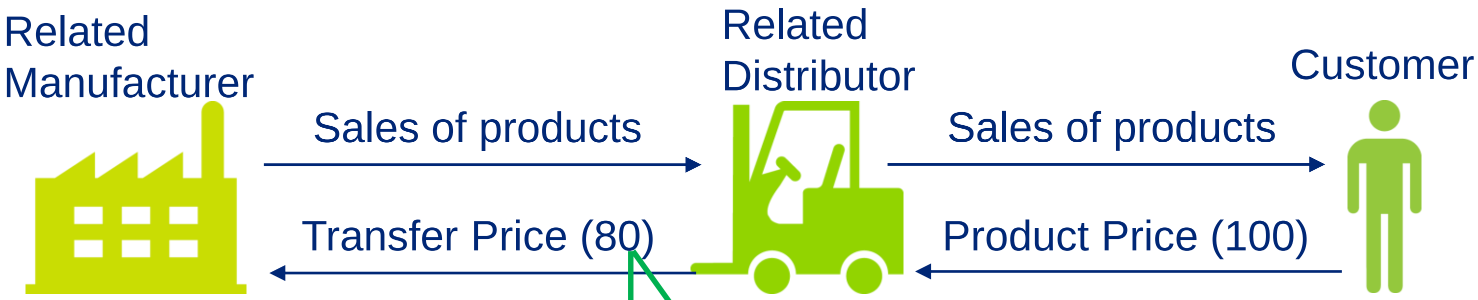
- For taxpayers: this can be an incentive to generate income in low tax jurisdictions, and to price intercompany transactions accordingly.

- For tax authorities: since Transfer Pricing has direct impact on the taxable basis of the taxpayer, inappropriate transfer prices can result in tax authorities earning or losing a lot of money.

- Focus on transfer pricing is important since:

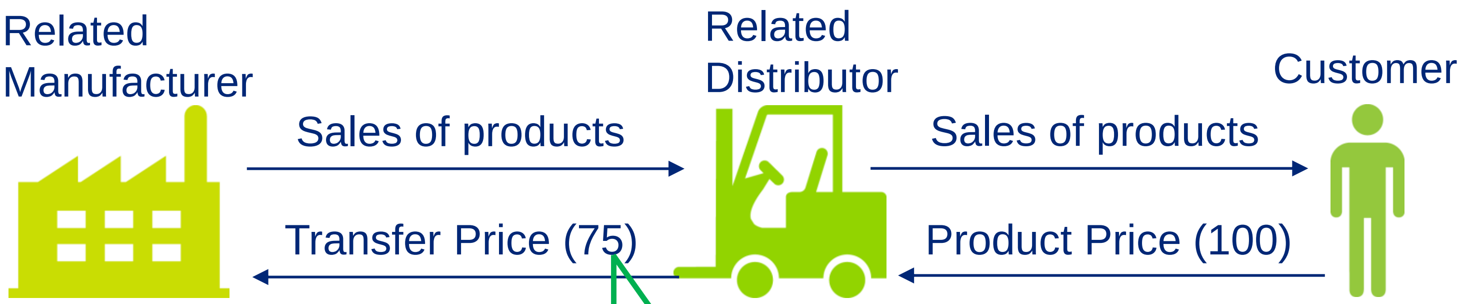
  - Transfer pricing adjustments made by tax authorities can result in double taxation;
  - Non-compliance with various transfer pricing rules can lead to penalties or in-depth audits.

2. Why is Transfer Pricing important? – example



	Manufacturer	Distributor	
Country	A	B	
Revenues	**80**	100	
Cost of Goods Sold	60	**80**	
Gross Profit	20	20	
Operating Expenses	15	15	
Operating Profit	5	5	
Tax rate	40%	20%	Total
Tax Burden	2	1	**3**

2. Why is Transfer Pricing important? – example



	Manufacturer	Distributor	
Country	A	B	
Revenues	**75**	100	
Cost of Goods Sold	60	**75**	
Gross Profit	15	25	
Operating Expenses	15	15	
Operating Profit	0	10	
Tax rate	40%	20%	Total
Tax Burden	0	2	**2**

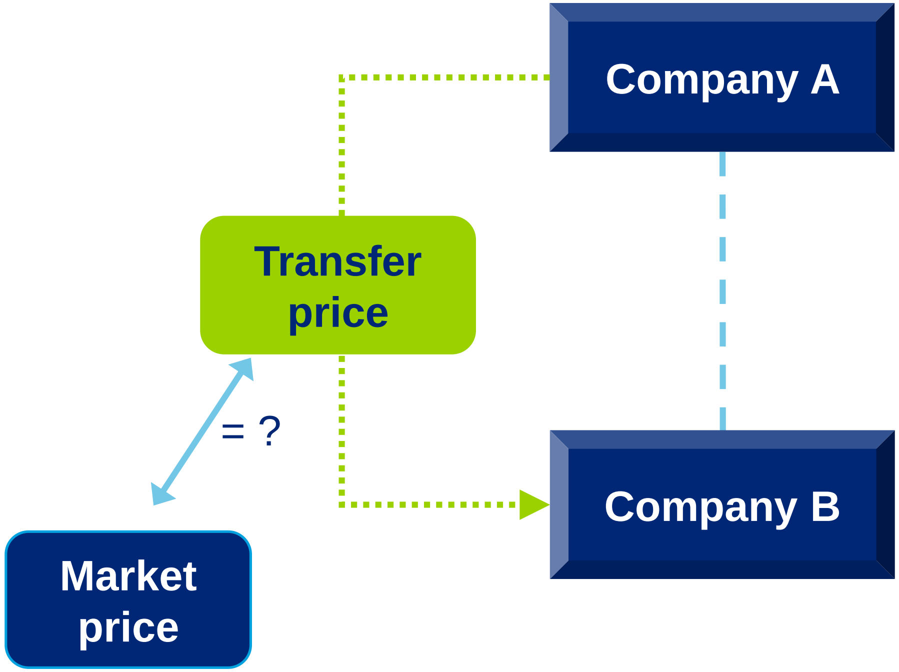
By optimizing the set-up of business operations over various countries, transfer pricing can be used to realize **tax savings.**

3. Determining appropriate transfer prices

- For determining appropriate transfer prices, OECD member countries (and also many non-member countries) have agreed upon applying the arm's principle.

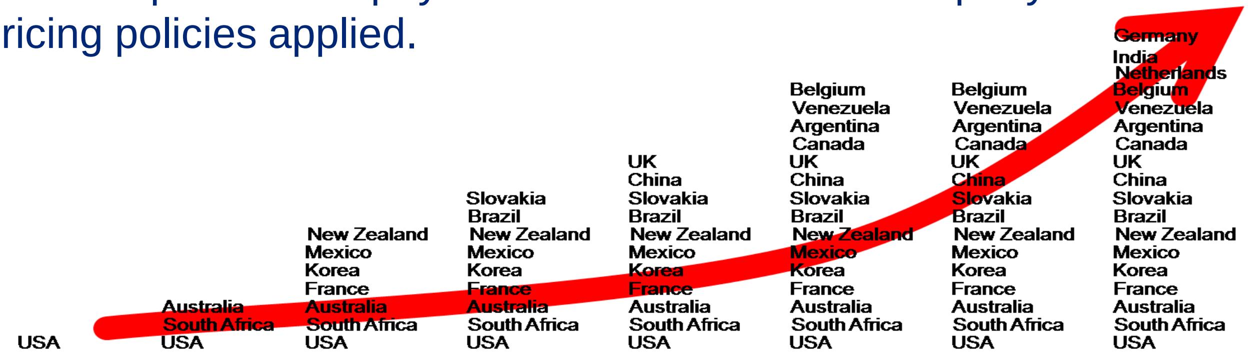
- The arm's length principle is an internationally broadly accepted standard for evaluating the "normal" character of intercompany transactions and its application is explained into detail in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TP Guidelines").

- Transactions between related companies should be based on what independent companies would or should have agreed upon in similar circumstances.



4. Transfer Pricing Documentation

- Over the last years, more and more countries introduced Transfer Pricing regulations which require the taxpayer to document its intercompany transactions and its transfer pricing policies applied.



- In the Netherlands, taxpayers engaged in transactions with related parties have to prepare transfer pricing documentation indicating how its transfer prices have been established including the arm's length nature of its transfer prices.

- In South Africa, although there is no formal transfer pricing documentation requirement, taxpayers are required to disclose in their tax return whether they have a transfer pricing policy document. Submission of the document is optional, although it must be available upon request. The new SA legislation stipulated that the onus to perform transfer pricing adjustments (in case taxpayer's transactions with related entities are not at arm's length,) lies with the taxpayer and not the tax authorities.

- Not having transfer pricing available may result in the reversal of the burden of proof leading to the taxpayer having to prove to the tax authorities that its transfer prices are at arm's length.

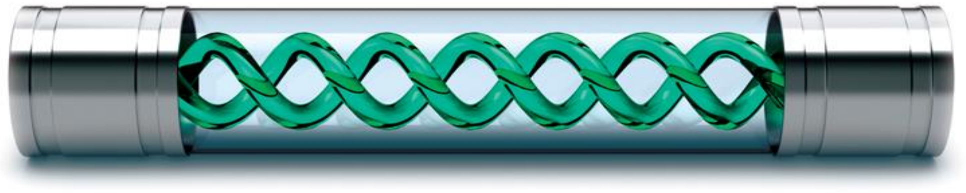
5. Transfer Pricing comparison

	The Netherlands	South Africa
TP documentation	- Required by law in case of intragroup transactions	- Not compulsory, but strongly recommended by SARS in case of significant cross-border intragroup transactions - Requirements to documentation are very similar to OECD TP Guidelines
Advanced Pricing Agreement	Available	Not available
Management fees	- In general deductible - No withholding tax	- Deductible in most cases, however ExCon approval required. - Withholding tax may apply effective 1 January 2016.
Penalty on TP assessment	- No specific Transfer Pricing penalty charges - General penalty applies with a maximum of 100% in case of malicious intent	- General penalty regime applies, ranging from 5 – 200% of unpaid tax plus secondary adjustment of deemed loan. Soon to be converted to deemed dividend.
TP Adjustments	- Imposed by the Dutch Tax Authorities	- Onus is on the taxpayer

6. Transfer Pricing – the current state of affairs

- Increasing Transfer Pricing regulations and globalization gain importance for a sophisticated Transfer Pricing strategy
- Transfer Pricing can be an incentive to generate income in low tax jurisdictions, and to price intercompany transactions accordingly
- Transfer pricing adjustments made by tax authorities can result in double taxation
- Non-compliance with various transfer pricing rules can lead to penalties or in-depth audits
- There is increased international scrutiny of transfer pricing policies by NGO’s such as Tax Justice International, Oxfam Novib, etc. who engage in “naming and shaming” Multinational Enterprises based on their transfer pricing policy.
- The Base Erosion and Profit Shifting (BEPS) initiative is likely to dramatically change the TP landscape over the next years.

Investment in South Africa
Exchange Control



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1. Brief History

- South Africa has legislated Exchange Control ("Excon") since 1939;
- The current Regulations have been imposed since 1961;
- Control over South Africa's foreign currency reserves vests with National Treasury;
- The Financial Surveillance Department of the S A Reserve Bank ("FinSurv") has been delegated the authority to administer Exchange Control and is responsible for the day to day monitoring thereof;
- The Minister of Finance appointed certain Banks as Authorised Dealers who may undertake cross border transactions on behalf of their clients;
- FinSurv issued the Exchange Control Rulings to Authorised Dealers which contains certain administrative responsibilities as well as permissions, conditions and limits applicable to foreign exchange transactions which may be transacted by them and/or on behalf of their clients.

1. Brief History, continued

- From 1961 to 1994 the main objective of the Exchange Control legislation was to preserve the foreign currency reserves and prevent capital flight;

- In 1995 the Government announced the gradual dismantling of Exchange Controls and commenced with abolishing control over non-resident held assets.

2. Why do we still have exchange controls?

- Capital flight fears are still in evidence albeit far less than previously;

- Exchange Control legislation has become a handy tool to stop gaps in other legislation. Evidence of this can be found in it being used to assist the South African Revenue Services in pursuit of some of their objectives as well as assisting the Gambling Board in filling gaps in gambling legislation.

- It is also used in assisting with money laundering and related matters.

3. Matters of note when investing in South Africa

General comments relating to exchange control and non-residents

- Exchange controls over non-residents were officially abolished in 1995.
- Non-residents can be defined as a person i.e. natural person or legal entity, whose normal place of residence, domicile or registration is outside the Common Monetary Area (CMA).
- The Common Monetary Area consist of Swaziland, Lesotho, Namibia and South Africa.
- Whilst exchange controls over non-residents have been abolished there is still indirect exchange controls applicable to them by virtue of the fact that exchange controls over South African residents remain in force restricting certain transactions between residents and non-residents.

3. Matters of note when investing in South Africa, continued

Equity investment in South African entity

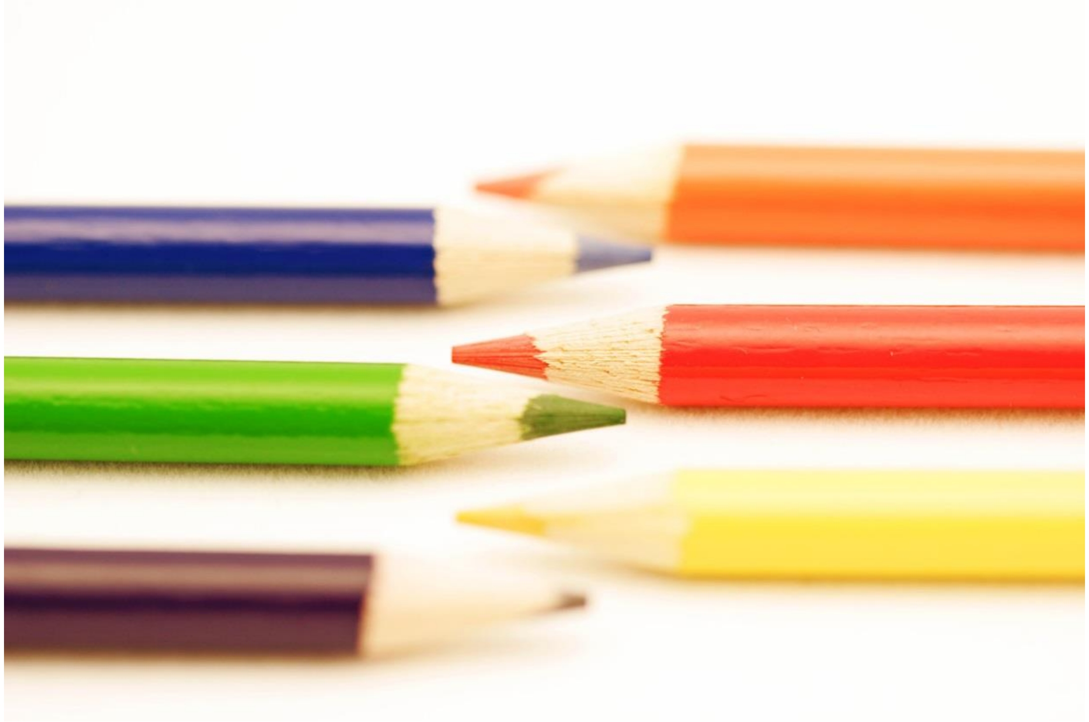
- Non-residents are free to make equity investments in South Africa.
- Any shares acquired by purchasing from a South African resident obliges the resident selling to prove that the transaction was concluded at fair and market related prices.
- Income originating from the South African investment is freely remittable to the non-resident investor.
- When income is to be transferred, the South African resident remitting it will need to present documentary proof of the nature of the transaction to the Authorised Dealer.
- Any shares issued to the non-resident as a result of the acquisition of shares in a South African entity will need to be endorsed “Non-Resident”. It is a matter of presenting the certificates to an Authorised Dealer for this to be done.

4. Loans

- South African residents, as a rule, are not permitted to extend loans to non-residents.
- Exchange control approval is required for South African residents accepting foreign loans i.e. loans from non-residents.
- Certain parameters apply for the acceptance of foreign loans.
- The tenor is a minimum period of 30 days (no limitation on the maximum period) and loan is from a lender in which there is no direct or indirect South African interest.
- The interest rate in respect of third party foreign denominated loans may not exceed the base lending rate applicable to the currency of denomination plus 2 per cent or, in the case of shareholders loans, the base lending rate.
- The base lending rate is the rate determined by commercial banks in the country of denomination and is also known as the prime rate.

4. Loans, continued

- The interest rate in respect of Rand denominated loans may not exceed the South African prime rate plus 3 per cent on third party loans or the prime rate in the case of shareholders loans.



5. General

Remittance of management fees to non-residents

- ❑ It is policy that South African residents only pay for services actually rendered.
- ❑ The remittance of management fees by South African entities is subject to exchange control approval.
- ❑ In most instances obtaining approval will require that the application be accompanied by documentation from a professional firm, such as Deloitte, confirming that the fees payable are in line with OECD and South African transfer pricing rules.

5. General, continued

Royalty payments

- Royalty payments need to be split into two categories namely those from agreements relating to local manufacture under licence and those not involving local manufacture.

- Agreements not relating to local manufacture under licence and if between two related parties require exchange control approval.

- Agreements containing clauses relating to down payments or upfront payments, minimum payments and once off payments are considered on merit but can lead to applications being declined.

- Where royalties are payable in terms of an agreement relating to the local manufacture under licence, the matter is considered for approval by the Department of Trade and Industry and not the exchange control authorities.

6. Questions?

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