

# Multinationals under the spotlight in 2017 Budget Speech

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In his budget speech on Wednesday 22 February 2017, South African Minister of Finance, Pravin Gordhan, emphasised that combating tax avoidance by multinational enterprises is still a top priority. South Africa is poised to sign a multilateral instrument that will assist with updating of tax treaties and reduce the scope for aggressive tax avoidance by multinational enterprises.



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## Automatic exchange of information and Special Voluntary Disclosure Programme

The Minister highlighted that the automatic exchange of information between tax authorities is set to come into operation in September 2017. Globally, country-by-country reporting is required to be submitted by the “ultimate parent entity” of a multinational entity in the jurisdiction in which it is a tax resident, providing the tax authorities with an overview of the global allocation of income, business activities and taxes paid within the group. Automatic exchange of information mechanisms are in place, for the tax authorities to share this information, including with SARS. This detailed information will support SARS’ efforts to identify and correctly tax relevant cross-border activities, including applying the transfer pricing rules. The Special Voluntary Disclosure Programme will be open until 31 August 2017, to give an opportunity to regularise tax affairs prior to being “caught out” by the automatic exchange of information.

## Transfer pricing documentation including country-by-country reporting

Regulations with regards to compliance with the country-by-country reporting requirement were gazetted in December 2016. In terms of these regulations, the first country-by-country reports for multinational enterprises with fiscal years starting on or after 1 January 2016, will be required to be filed with SARS from 31 December 2017. It is critical for affected taxpayers to know what documentation should be included in the various reports and take action in good time, as a significantly increased compliance burden has been handed to the taxpayer.

SARS has updated the corporate income tax return to include important disclosure requirements in respect of transfer pricing. These include the recommendations by the Davis Tax Committee that, as an emerging economy, South Africa requires, in disclosures with the relevant tax return, the inclusion of more transactional data than what is currently

recommended by the Organisation for Economic Co-Operation and Development (OECD) in relation to associated party payments for interest, royalty and service fees.

## **Changes to transfer pricing provisions**

Section 31 of the Income Tax Act deals with the transfer pricing of goods and services between related parties. The gist of this provision is that all related party transactions must be at arm's length. While no specific legislative amendments to the transfer pricing provisions were proposed, it was stated that government is strengthening its efforts to curb excessive debt financing, which erodes the tax base, and will review the current regime in light of OECD recommendations. There may accordingly be draft tax legislation in the near future in relation to cross-border debt.

In addition, Budget Review 2017 highlighted that SARS is updating the Transfer Pricing Practice Note in line with OECD Transfer Pricing Guidelines to include new guidance on the arms-length principle and an agreed approach to ensure appropriate pricing on intangibles that are difficult to value. From a legal interpretation perspective, therefore, it appears that changes to the transfer pricing provisions are forthcoming.

If either the potential draft legislation or the practice note provide some certainty, for example a "safe harbour" debt-to-equity ratio, this would be welcomed by the industry.

## **Enforcement of transfer pricing: significant SARS audits expected**

The Minister also stated that, from an enforcement perspective, SARS must continue to develop the skills and capacity needed to enforce legislation and strengthen its efforts to curb tax avoidance and evasion, including specifically transfer pricing, which was described very strongly as "a component of illicit financial flows".

It is also important to note that transfer pricing is one of the key focal points in the SARS Strategic Plan 2016-2021. Base Erosion and Profit Shifting (which includes transfer pricing) is one of the listed "opportunities" as regards a broader tax base to pursue and tax gap to close. In the discussion of balancing the three levers of SARS' mandate (being Service, Education and Enforcement), automatic exchange of information is identified as introducing new leverage. SARS lists "complex schemes used by large businesses to evade and avoid tax" as a key strategic risk, with a proposed solution "development of the skills pipeline for auditors in the transfer pricing unit to proactively deal with BEPS and Transfer pricing". On this basis, Base Erosion and Profit Shifting in large corporates is listed as one of the high risk areas for targeted compliance interventions by SARS over the next five years.

Many large corporates have identified the need to comply with transfer pricing principles and have spent significant time and effort in doing so. It may be that many large corporates have adopted sufficient measures to ensure full compliance. However, given the potential changes to SARS' Transfer Pricing Practice Note, what was done in the past may not agree to SARS' current or future interpretations. In addition, if a dispute does arise, the amounts involved are significant. To put into context the potential magnitude of transfer pricing assessments, the transfer pricing dispute between SARS and Sishen Iron Ore (Kumba Iron Ore's subsidiary) has been widely reported in the media recently, in terms of which SARS assessed

Sishen with a hefty tax bill of R6.5bn (including interest and penalties). The two parties avoided the pain and cost of litigation by eventually agreeing on a settlement of R2.5bn.

SARS, National Treasury and Davis Committee are all in agreement that is imperative for them to proactively deal with transfer pricing. Given the likely extent and magnitude of transfer pricing audits and assessments, it would appear that taxpayers would be well served by taking an equally proactive approach.

## ABOUT THE AUTHOR

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