

Country By Country Reporting, BEPS and Transfer Pricing

By Michael Hewson

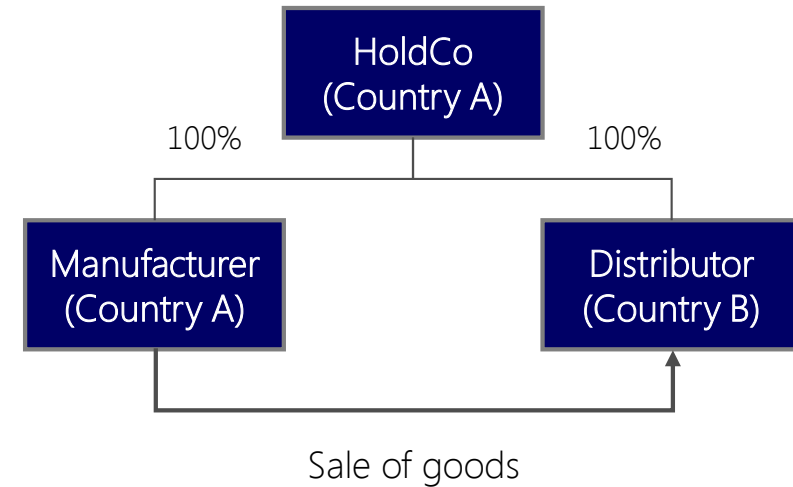
13 February 2019

Introduction to transfer pricing



Example

- Transfer pricing: the setting of the price for goods and services sold between related parties
- In principle a transfer price should match what the seller would charge an independent customer, or what the buyer would pay an independent supplier.
- Example:
 - Manufacturer in Country A sells products to related-party Distributor in Country B
 - Corporate income tax rate in Country A is 40%
 - Corporate income tax rate in Country B is 20%



Example

(*1,000 USD)	ManufCo	SalesCo
Sales	25,000	50,000
Costs of goods sold	5,000	25,000
Gross profit	20,000	25,000
Operating expenses	5,000	10,000
Operating profit	15,000	15,000
Tax	6,000	3,000
Net profit	9,000	12,000

When transfer pricing is set at USD 25,000:

- Total operating profit: USD 30M
- Total net profit: USD 21M



“What happens to the total net profit if I change the transfer price between ManufCo and SalesCo Ltd, given the differences in statutory tax rates?”

Example (cont.)

(*1,000 USD)	ManufCo	SalesCo
Sales	20,000	50,000
Costs of goods sold	5,000	20,000
Gross profit	15,000	30,000
Operating expenses	5,000	10,000
Operating profit	10,000	20,000
Tax	4,000	4,000
Net profit	6,000	16,000

When transfer pricing is set at USD 20,000:

- Total operating profit: USD 30M
- Total net profit: USD 22M



“So total net profit increases if I lower the price! That’s an easy way of creating shareholder value (and let’s not forget about my bonus).”

Why is it important?



Why is transfer pricing important?

- Multinationals account for roughly 60%-70% of world trade
- Multinationals need to minimise risk of double taxation to invest and to grow (macro-economic benefits)
- BEPS Project
- Aggressive transfer pricing audits in Africa
- Reputational risks

Why is transfer pricing important?

- In recent years, multinational companies that avoid or evade tax by shifting taxable income to low-tax regimes or tax havens have come under the global spotlight
- South Africa has been proactive in taking policy action in this area and has joined the Group of Twenty (G20) and the OECD to examine base erosion and profit shifting.
- South Africa has also taken the following steps:
 - Improving the quality of information that corporates are required to provide to the South African Revenue Authority (SARS) for SARS to identify aggressive or abusive tax planning schemes.
 - SARS will soon have access to country-by-country information on all large multinationals operating in South Africa.
 - Enhancing rules on foreign companies controlled by a South Africa resident to ensure that a portion of the profits earned by a South African-owned subsidiary, operating in another country, is taxed in South Africa if no meaningful economic activity took place in the other country.
 - Introducing rules that limit excessive interest deductions.

TP regulations across Africa continue to increase

1995-2000: South Africa and Zambia

2001-2005: Egypt and Namibia

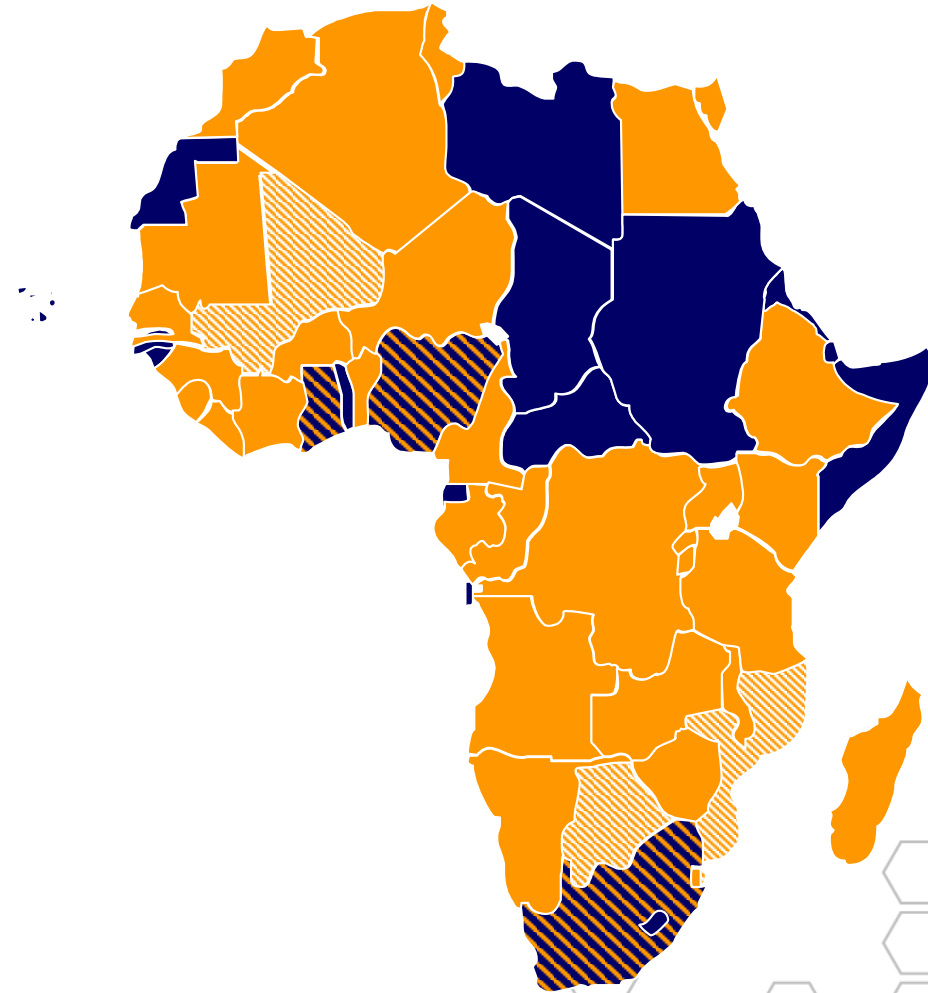
2006-2010: Algeria, Burkina Faso, Gabon, Kenya, Malawi, Rwanda and Tunisia

2011-2015: Angola, Benin, Burundi, Cameroon, Cape Verde, Congo (the Republic of), DRC, Ethiopia, Guinea, Ghana, Ivory Coast, Nigeria, Madagascar, Morocco, Senegal, Seychelles, Sierra Leone, Tanzania, Uganda

2016-2017: Liberia, Mauritania, Niger, Swaziland and Zimbabwe

2018: Mozambique

2019: Botswana

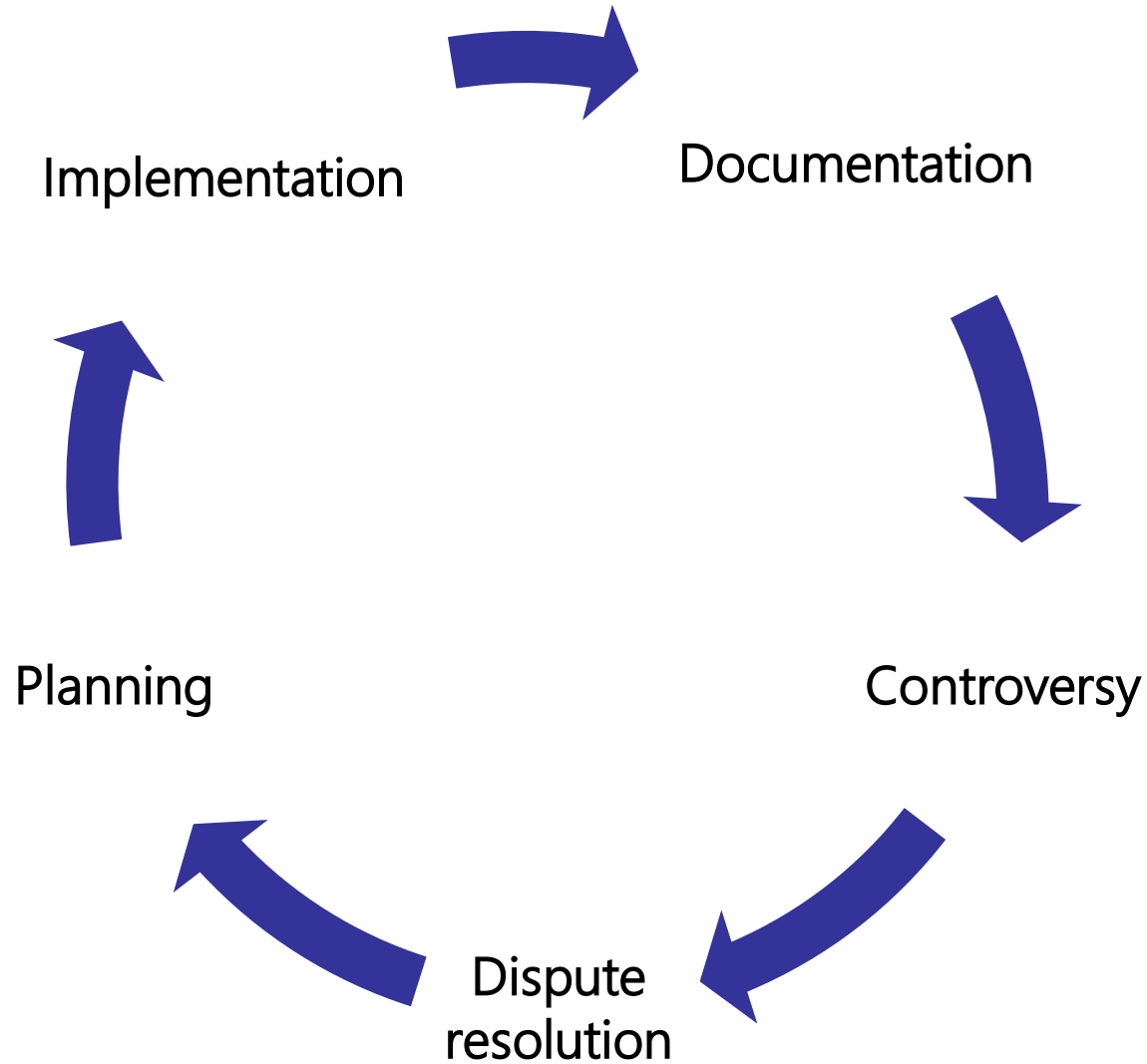


Additional recordkeeping or disclosure requirements: Ghana, Nigeria and South Africa

How is the data used?



Transfer pricing lifecycle



Relevant data is required during each stage of the transfer pricing life cycle. Sometimes additional levels or aspects of data are required for the different stages of the lifecycle.

Specific considerations in Africa – the argument for segmented data



What are the different data requirements?

BEPS Action 13 – MF, LF and CbCR

Increased transparency

- Increased transparency by providing tax authorities with a line of sight into a company's entire global footprint.
- Requires companies to use a consistent three-tier framework for providing information on global allocation of income, economic activity and intercompany pricing across all of a company's global operations.
- As per OECD guidance, Country-by-country (CbC) reporting applies to all multinational enterprises (MNEs) with aggregate annual revenue of €750m or more.
- First reporting will cover years beginning on or after 1 January 2016.

Master file

High-level information about the MNE's business, transfer pricing policies and agreements with tax authorities in a single document available to all tax authorities where the MNE has operations

Local file

Detailed information about the local business, including related-party payments and receipts for products, services, royalties, interest, etc.

CbC report

High-level information about the jurisdictional allocation of revenues, profits, taxes, assets and employees

Countries that have implemented Country-by-Country Reporting



Transfer Pricing analysis requires entity level data

Item	Formula	Related party A	Related party B	Related party C	Related party D
Revenue	A	31 638 238	27 819 349	17 821 646	4 236 898
Expenses	B	24 293 009	19 678 331	13 623 498	2 567 723
Operating profit	C	7 345 229	8 141 018	4 198 148	1 669 175
Mark-up on costs	$D = C/B$	30.24%	41.37%	30.82%	65%

Transfer Pricing analysis requires segmented financial data

Customer name	Country	Relationship	Revenue	Material cost	Conversion costs	Gross profit	Gross margin
Foreign related party	South Africa	Related	55 718.18	32 520.87	14 843.31	8 354	14.99%
Customer A	South Africa	External	350 928.33	287 851.64	27 066.13	36 011	10.26%
Customer B	South Africa	External	24 650.76	11 352.46	8 995.26	4 303	17.46%
Customer C	South Africa	External	2 295 793.00	858 869.27	996 486.12	440 438	19.18%
Customer D	South Africa	External	28 422 252.16	7 398 528.13	14 924 162.41	6 099 562	21.46%
Customer E	South Africa	External	2 635 830.36	995 743.40	1 136 347.55	503 739	19.11%

Guidance on what Information is required: Overview of allocation of income, taxes and business activities by tax jurisdiction

Tax Jurisdiction	Revenue			Profit (loss) before Income Tax	Income Tax Paid (On Cash Basis)	Income Tax Accrued (Current Year)	Stated Capital	Accumulated Earnings	Number of employees	Tangible Assets other than Cash and Cash equivalents
	Unrelated Party	Related Party	Total							
<ul style="list-style-type: none"> All tax jurisdictions in which Entities of the Group are resident for tax purposes. If an Entity is resident in more than one tax jurisdiction, the applicable tax treaty tie breaker should be applied to determine the tax jurisdiction of residence. where no applicable tax treaty exists, the Place of Effective Management should be reported as the tax jurisdiction of the Entity. 	<ul style="list-style-type: none"> This should include revenue from sales of inventory and properties, services, royalties, interest, premiums and any other amounts Revenues should exclude payments received from other Constituent Entities that are treated as dividends in the payor's tax jurisdiction. Extraordinary income and gains from investment activities are to be included in "Revenue". 			<ul style="list-style-type: none"> The sum of the profit (loss) before income tax for all the Entities resident for tax purposes in the relevant tax jurisdiction. 	<ul style="list-style-type: none"> The total amount of income tax actually paid during the relevant fiscal year by all the Entities resident for tax purposes in the relevant tax jurisdiction including withholding taxes paid by other entities. 	<ul style="list-style-type: none"> The sum of the accrued current tax expense recorded on taxable profits or losses of the year of reporting. Do not include deferred taxes or provisions for uncertain tax liabilities. 	<ul style="list-style-type: none"> The sum of the stated capital of all the Entities resident for tax purposes in the relevant tax jurisdiction. 	<ul style="list-style-type: none"> The sum of the total accumulated earnings of all the Entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year.. 	<ul style="list-style-type: none"> The number of employees at year end may be reported, on the basis of average employment levels for the year, or on any other basis consistently applied across tax jurisdictions and from year to year. May include independent contractors. 	<ul style="list-style-type: none"> The sum of the net book values of tangible assets of all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. Does not include cash or cash equivalents, intangibles or financial assets.

Amounts for each column in this table should be aggregated per jurisdiction (not consolidated). If a permanent establishment exists in a tax jurisdiction, the amounts for that permanent establishment need to be included in the tax jurisdiction where the permanent establishment exists.

Guidance on what Information is required: List of all Constituent Entities of the group included in each aggregation per tax jurisdiction

Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organisation or incorporation if different from Tax Jurisdiction of Residence	Main business activities												
			Research and development	Holding or managing intellectual property	Purchasing or procurement	Manufacturing or production	Sales, Marketing or distribution	Administrative, Management or support services	Provision of Services to unrelated parties	Internal Group finance	Regulated Financial Services	Insurance	Holding Shares or Other Equity Instruments	Dormant	Other
South Africa	1. Constituent entity 1		✓		✓		✓		✓		✓	✓			
	2. Constituent entity 2			✓		✓			✓						
Botswana	1. Constituent entity 3			✓		✓			✓						✓
	2. Constituent entity 4														✓
Lesotho	1. Constituent entity 5									✓					
	2. Constituent entity 6									✓		✓			
Malawi	1. Constituent entity 7												✓		
	2. Constituent entity 8													✓	

Guidance on what Information is required: Additional information

Multinational Enterprise 2018 Financial Year

- Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the previous two tabs.

Top 5 Country-by-Country Reporting challenges



Conclusion

Therefore, with today's BEPS-focussed environment, the success of a planning project or defending a controversy matter is more likely than not to depend on your ability to demonstrate the value attributable to each entity within a MNE. This requires access to accurate and sufficiently segmented data.



Contact details

Should you have any questions please let us know

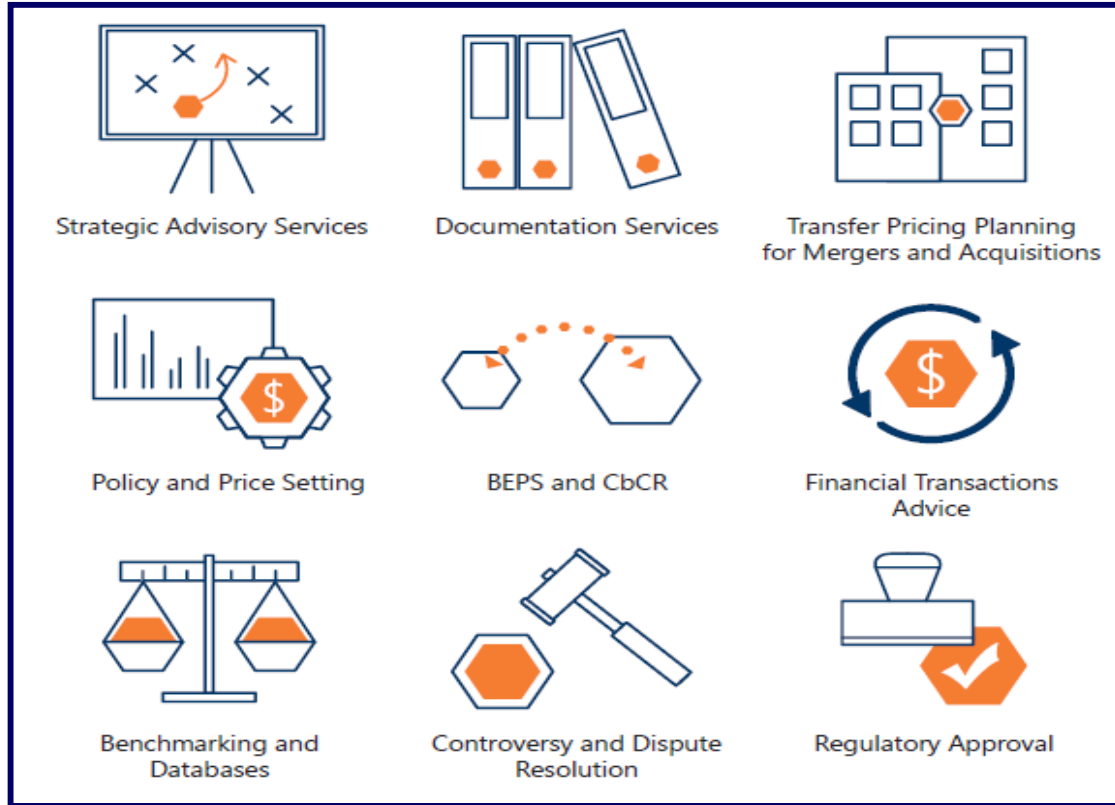
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Graphene Economics Services

Transfer pricing advisory



The image displays a 3x3 grid of icons representing various transfer pricing advisory services. Each icon is accompanied by a text label below it. The icons include: a whiteboard with 'x' marks and an arrow, three binders, a building with a hexagon, a bar chart with a gear containing a dollar sign, two hexagons with arrows, a circular arrow with a dollar sign, a balance scale, a gavel, and a stamp with a checkmark.

- Strategic Advisory Services
- Documentation Services
- Transfer Pricing Planning for Mergers and Acquisitions
- Policy and Price Setting
- BEPS and CbCR
- Financial Transactions Advice
- Benchmarking and Databases
- Controversy and Dispute Resolution
- Regulatory Approval

International tax advisory

- Permanent establishments
- Place of effective management
- Withholding taxes
- Controlled foreign companies
- Reportable arrangements

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