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TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

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DON'T BE TAKEN BY SURPRISE: EXCHANGE CONTROL RULINGS AND MANUAL REPLACED

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CUSTOMS AND EXCISE HIGHLIGHTS

This week's selected highlights in the Customs and Excise environment.

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CLIFFE DEKKER HOFMEYR

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The EC explained that s107(1) of the TFEU provides that any aid granted by an EU member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the provision of certain goods shall be incompatible with the EU's common market, in so far as it affects trade between member states.

History of the EC's investigation into Apple

In its decision on State Aid SA.38373 (2014/C) (ex2014'/NN) (ex 2014/CP) – Ireland (2014 decision) handed down on 11 June 2014, the EC informed Ireland that it had decided to invoke Article 108(2) of the Treaty on the Functioning of the European Union (TFEU). Its preliminary view was that two tax rulings given by the Irish tax authorities in 1991 and 2007 (Rulings) in favour of Apple Sales International (ASI) and Apple Operations Europe (AOE) constituted state aid according to Article 107(1) of the TFEU. Both ASI and AOE were incorporated in Ireland. The Rulings were to validate transfer pricing arrangements, also known as advance pricing arrangements (APAs). APAs are arrangements that determine, in advance of intra-group transactions, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time.

In the 2014 decision, the EC explained that s107(1) of the TFEU provides that any aid granted by an EU member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the provision of certain goods shall be incompatible with the EU's common market, in so far as it affects trade between member states. One of the criteria to determine whether the state aid in question is illegal, is whether the advantage conferred on the recipient is selective in nature. To determine whether the Rulings in favour of ASI and AOE gave them an advantage, the EC compared the method of tax assessment in terms of the Rulings to the ordinary tax system, based on the difference between profits and losses (P&L) of an undertaking carrying on its activities under normal market conditions. It found that these market conditions could be arrived at through transfer pricing established in terms of the arm's length principle, as contained in Article 9 of the OECD Model Tax Convention. It found that the Rulings were inconsistent with the arm's length principle. Based on these initial findings, the EC requested the following information from the Irish tax authorities:

- The financial accounts of ASI and AOE for 2004-2013, in particular the P&L accounts.
- In the case of ASI, it asked that the Irish tax authorities single out in the P&L the amount of passive income each year and specifying if such passive income came from Ireland.

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The EC's investigation found that the Rulings endorsed a way to establish the taxable profits for ASI and AOE, which did not correspond to economic reality.

- The number of full time equivalent employees (FTE) of ASI and of AOE over the same period (each end of reporting period).
- The FTE of the Irish branch of ASI and of AOE for the same period (each end of accounting period).
- The cost sharing agreement between Apple Inc., ASI and AOE in all its variations since 1989 until the last modification and a detailed description of the type of intellectual property covered by the cost sharing agreement.

The EC's findings as set out in the press release

The EC's investigation found that the Rulings endorsed a way to establish the taxable profits for ASI and AOE, which did not correspond to economic reality. Almost all sales profits recorded by the two companies were internally attributed to a "head office" which existed only on paper and could not have generated such profits. In the case of ASI, this "head office" was not based in any country and did not have any employees or own premises. Its activities consisted solely of occasional board meetings. Only a fraction of ASI's profits were allocated to its Irish branch and subject to tax in Ireland. The remaining vast majority of profits were allocated to the "head office", where they remained untaxed. Therefore, only a small percentage of ASI's profits were taxed in Ireland, and the rest was not taxed anywhere. In 2011, for example (according to figures released at US Senate public hearings), ASI recorded profits of $22 billion (approximately €16 billion) but under the terms of the 2007 Ruling only around €50 million was considered taxable in Ireland, leaving €15,95 billion of profits untaxed. As a result, ASI paid less than €10 million of corporate tax in Ireland in 2011, constituting an effective tax rate of about 0.05% on its overall annual profits. In subsequent years, ASI's recorded profits continued to increase but the profits considered taxable in Ireland under the terms of the Ruling did not. Thus, the effective tax rate decreased further to only 0.005% in 2014.

AOE benefitted from a similar tax arrangement in terms of the Rulings. AOE was responsible for manufacturing certain lines of computers for the Apple group. The majority of its profits were also allocated internally to its "head office" and were not taxed anywhere. The "head office" did not have any employees or its own premises. The only activities that can be associated with the "head offices" of AOE and ASI are limited decisions taken by its directors (many of which were simultaneously working full-time as executives for Apple Inc.) on the distribution of dividends, administrative arrangements and cash management. According to the EC's press release, this constituted an "artificial allocation of profits within ASI and AOE, which has no factual or economic justification". The tax treatment in Ireland enabled ASI and AOE to avoid taxation on almost all profits generated by sales of Apple products in the entire EU single market. This is due to Apple's decision to record all sales in Ireland rather than in the countries where the products were sold.

The EC further stated in the press release that in terms of EU state aid rules, the incompatible state aid must be recovered

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The EC's decision will not be binding on South African courts, although it is very possible that courts could revert to the decision as persuasive authority, in determining the meaning of "arm's length" in s31 of the Income Tax Act.

in order to remove the distortion of competition created by the aid. The EU state aid rules do not impose a fine and the recovery does not penalise the company in question as it merely aims to restore equal treatment with other companies. Therefore, Ireland must allocate to each branch all profits from sales previously indirectly allocated to the "head office" of ASI and AOE, respectively, and apply the normal corporation tax in Ireland on these re-allocated profits. This illegal state aid is payable in respect of the period from 2003 to 2013 in terms of EU state aid rules, which amounts to up to €13 billion, plus interest. The recovery period stops in 2014, as Apple changed its structure in Ireland as of 2015 and the 2007 ruling no longer applies. The amount of unpaid taxes to be recovered by the Irish authorities would be reduced if other countries were to require Apple to pay more taxes on the profits recorded by ASI and AOE for this period and if the US authorities were to require AOE and ASI to pay larger amounts of money to Apple Inc. for this period to finance research and development efforts under the cost sharing agreement with Apple Inc.

Comment

The findings of the EC could very well strengthen the efforts that have been made in respect of the BEPS project. Recent developments regarding BEPS are set out in our Tax and Exchange Control Alert of 12 August 2016 *(Off down the rabbit-hole in pursuit of the OECD/G20 BEPS project developments in a world run mad)*. The EC announced in the press release that the complete non-confidential version of the decisions in the Apple investigation will only be released once any confidentiality issues have been resolved. From a South African perspective, it will be interesting to see exactly how the arm's length principle was applied by the EC when the non-confidential version of the decision is released. The EC's decision will not be binding on South African courts, although it is possible that courts could rely on the decision as persuasive authority, in determining the meaning of "arm's length" in s31 of the Income Tax Act, No 58 of 1962.

Louis Botha

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DON'T BE TAKEN BY SURPRISE: EXCHANGE CONTROL RULINGS AND MANUAL REPLACED

This Circular effectively replaces the current exchange control rulings and exchange control manual, which have been in existence since 2005, with two currency and exchanges manuals and two currency and exchanges guideline documents.

On 29 July 2016, the Financial Services Department of the South African Reserve Bank (SARB), in reaction to the Minister of Finance's announcements in the 2014 and 2016 Budget Speeches, released Exchange Control Circular No.7/2016 (Circular).

This Circular effectively replaces the current exchange control rulings and exchange control manual, which have been in existence since 2005, with two currency and exchanges manuals and two currency and exchanges guideline documents.

The exchange control rulings are replaced by:

- the currency and exchanges manual for authorised dealers; and
- the currency and exchanges manual for authorised dealers in foreign exchange with limited authority (Manuals).

The exchange control manual is replaced by:

- the currency and exchanges guidelines for individuals; and
- the currency and exchanges guidelines for business entities (Guidelines).

The Manuals and Guidelines are not intended to replace or supersede the Currency and Exchanges Act, No 9 of 1933 (Act), or the regulations, orders and rules issued in respect thereof; nor are the documents intended to replace the general norms and policies applied by SARB.

Rather, the aim of the documents seems to be to assist authorised dealers, their customers and other interested parties by providing a general understanding of the purpose, scope and operation of the exchange control system in South Africa and the common monetary area which, for many, can often appear to be clouded in mystery.

The aim of the documents seems to be to assist authorised dealers, their customers and other interested parties by providing a general understanding of the purpose, scope and operation of the exchange control system in South Africa and the common monetary area.

In addition, the Circular states that the Manuals and Guidelines will be available on the SARB website. We assume that this will include future amendments thereto.

It is clear that the objective of National Treasury and SARB was to streamline and facilitate a simplified understanding, interpretation and practical application of the Act and its regulations in order to ensure the best compliance.

The Manuals and Guidelines took effect on 1 August 2016.

Mark Morgan and Heinrich Louw

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CUSTOMS AND EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

This week's selected highlights in the Customs and Excise environment.

1. Draft technical amendments to Schedule 1 Part 1 and Schedule 4 Part 1. The draft explanatory memorandum provides as follows:

   Amendments of the General Notes to Schedule No. 1 as well as Schedules Nos. 1, and 4 to the Customs and Excise Act, 1964 (the Act), are technical in nature and will have no effect on the duty structure. The amendments are as a result of requests by industry, SARS and other government agencies and they are scheduled for implementation on 1 January 2017.

   .....

   General Note G which provides for abbreviations and symbols is substituted to include various abbreviations used in the Schedule to the Act.

   .....

   Mango juice is classified in a residual tariff subheading 2009.89.50, which provides for other fruit juices. It is, therefore, difficult for the mango industry to monitor the movement of competitive products.

   The new 8-digit tariff subheading will enable industry to monitor volumes of the mango juice concentrates.

   .....

   Tariff subheading 2008.99.60 provides for sweet corn (Zea mays var. saccharata). This tariff subheading was created to facilitate the implementation of the European Free Trade Agreement (EFTA), which was implemented on 1 January 2008. It has, however, transpired that the 8-digit subheading is not in line with the 4-digit classification of sweetcorn.

   Sweetcorn is provided for in tariff subheading 2005.80 as a vegetable that is prepared or preserved. As a result the 8-digit subheading in 2008.99 is reduntant and should be deleted.

   .....

   The opportunity is also used to amend the reference to the tariff subheadings in Note 2(d) in Chapter 27 to align the Note with the current tariff structure under heading 27.10 to read as follows:

   The use of goods classified under 2710.12.07, 2710.12.15, 2710.12.26, 2710.12.37 and 2710.12.39 are subject to the provisions of section 37A of the rules.

   .....

   Rebate item 410.03/87.00/01.02 ... is substituted to remove the reference to rebate item 317.04 applicable to Motor Industry

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CUSTOMS AND EXCISE HIGHLIGHTS

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The second draft of the Customs Duty Rules made under the Customs Duty Act, No 30 of 2014, has been published for public comment.

Development Programme (MIDP). MIDP provisions were deleted with effect from 1 January 2016. The MIDP has been replaced with the Automotive Production and Development Programme (APDP) with effect from 1 January 2013.

Due date for comment:
8 September 2016
[comments to: MMaphosa@sars.gov.za].

2. The second draft of the Customs Duty Rules made under the Customs Duty Act, No 30 of 2014, has been published for public comment.

   Due date for comments:
   30 November 2016
   [comments to: sauthar@sars.gov.za].

3. Draft amendment in Schedule 6 Part 6 by the insertion of refund items 681.06 and 681.07. The Explanatory note provides as follows:

   > The proposed provision will allow a refund claim to a licensee of customs and excise manufacturing warehouse, in respect of new and retreaded pneumatic tyres on which an environmental levy has been paid and are subsequently exported by a licensee of a customs and excise manufacturing warehouse through the licensee's own distribution centre to a BLNS country as defined in rule 54F.01.

   Due date for comments:
   15 September 2016
   [comments to: mradebe3@sars.gov.za].

Petr Erasmus

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BBBEE STATUS: LEVEL THREE CONTRIBUTOR
Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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