TAX

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PROPOSED MODIFICATIONS TO THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

The Organisation for Economic Co-operation and Development released a public discussion draft (DD) pertaining to the Base Erosion and Profit Shifting Action Plan 10 on 3 November 2014. The DD intends to reduce the scope for erosion of the tax base by means of the charging of excessive management fees and head office expenses.

In establishing an approach, reference is made to so-called low value-adding intra-group services where a simplified approach can be adopted. In such instance the mark-up selected by the taxpayer cannot be less than 2% of the cost, nor should it be greater than 5% thereof.

The concept of low value-adding intra-group services has been identified as services that are performed by one member of a multinational group to other group members which:

- are of a supportive nature;
- are not part of the core business of the multinational group;
- do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles; and
- do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk.

Examples of these types of services are the following:

- accounting and auditing;
- processing and management of accounts;
- human-resource activities, for example staffing and recruitment, training and employee development and remuneration services;
- information technology services where they do not form part of the principal activity of the group;
- legal services; and
- activities with regard to tax obligations, for instance information gathering and preparation of tax returns.

In determining what services should be subject to a cost recovery and mark-up, it is specifically indicated that so-called 'shareholder activities' cannot be charged for as they are performed solely because of the ownership interest by the holding entity. It is indicated that the concept of a shareholder activity is narrower from the broader term that was previously used, being a 'stewardship activity'. It is indicated that stewardship activities covered a range of activities, including the provision of services that could justify a charge, for instance emergency management and technical advice. However, the following shareholder activities are not regarded as services:

- costs relating to the juridical structure of the parent company itself, such as shareholders' meetings, the issuing of shares, listing costs and the costs of a supervisory board;
- costs relating to reporting requirements of the parent company, including the consolidation of reports;
- costs of raising funds for the acquisition of participations and costs relating to the parent company's investor relations such as communication strategy with shareholders;
- costs relating to compliance of the parent company with tax laws; and
- costs which are ancillary to the corporate governance of the multinational entity as a whole.

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RULING ON WITHHOLDING TAX ON INTEREST AND THE APPLICATION OF A TREATY

The South African Revenue Service (SARS) issued Binding Private Ruling No 181 (Ruling) on 4 November 2014, which deals with the application of a treaty for the avoidance of double taxation to withholding tax on interest.

The applicants were three companies incorporated and tax resident in South Africa, who intend to construct wind farms in South Africa. The Danish Government, through a funding scheme, intends to provide funding to the applicants for purposes of constructing the wind farms. Once the projects are complete, interest will become payable by the applicants to the Danish Government (via the funding scheme) in respect of the funding, the term being a period of 15 years.

The funding scheme will be the beneficial owner of the interest, and will not have a permanent establishment (PE) in South Africa.

Section 50B of the Income Tax Act, No 58 of 1962 (Act) will impose a withholding tax on interest payable to non-residents at the rate of 15% as of 1 January 2015.

The applicants were clearly concerned that they would have to withhold tax on the interest that will become payable to the Danish Government through the funding scheme (who are clearly non-resident).

However, s50E(3) of the Act provides that a person paying interest to a non-resident may withhold tax at a reduced rate as a result of the application of an agreement for the avoidance of double taxation, provided that the non-resident submits a relevant declaration and undertaking.

Article 11(1) of the international treaty between South Africa and Denmark in respect of the avoidance of double taxation (Treaty) provides that interest arising in South Africa, and paid to a resident of Denmark, may only be taxed in Denmark, where the resident of Denmark is the beneficial owner of the interest. Article 11(3) of the Treaty does, however, provide that Article 11(1) will not apply where the debt is connected to a PE of the Danish resident in South Africa.

It should be noted that the Treaty does not as such provide for tax on interest to be levied at a reduced rate, but rather that South Africa may not tax interest payable to a resident of Denmark at all (where the Denmark resident is the beneficial owner of the interest and the debt is not connected to a PE of a Danish resident in South Africa).

SARS ruled that section 50E(3) of the Act will apply in respect of the interest payable to the Danish Government (via the funding scheme) and that the interest will be subject to tax in South Africa at the reduced rate of 0%, provided that the relevant declarations and undertakings are submitted by the funding scheme. The ruling will be, however, only valid for a period of five years from the estimated date of completion of the wind farms, and not the entire term of the funding.

The Ruling is interesting because:

- SARS has construed the forfeiture of taxing rights in terms of article 11(1) of the Treaty as tax at a reduced rate of 0% in the context of s50E(3) of the Act; and
- it concerns the application of legislation that has not yet come into operation – withholding tax on interest will only come into operation on 1 January 2015.

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Cliffe Dekker Hofmeyr's Tax practice supports
Movember 2014

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