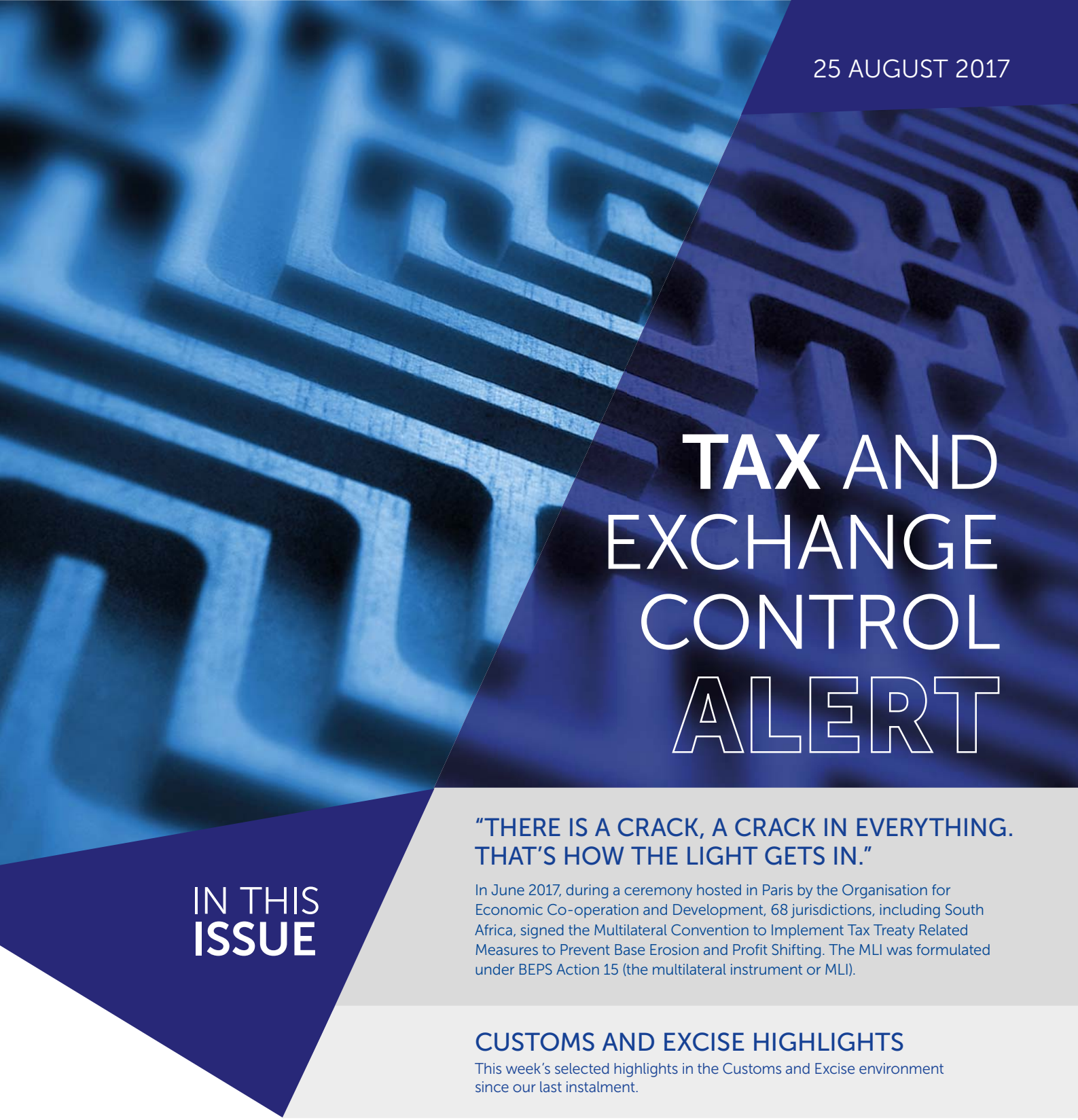

25 AUGUST 2017

TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

"THERE IS A CRACK, A CRACK IN EVERYTHING. THAT'S HOW THE LIGHT GETS IN."

In June 2017, during a ceremony hosted in Paris by the Organisation for Economic Co-operation and Development, 68 jurisdictions, including South Africa, signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. The MLI was formulated under BEPS Action 15 (the multilateral instrument or MLI).

CUSTOMS AND EXCISE HIGHLIGHTS

This week's selected highlights in the Customs and Excise environment since our last instalment.

CDH
CLIFFE DEKKER HOFMEYR

"THERE IS A CRACK, A CRACK IN EVERYTHING. THAT'S HOW THE LIGHT GETS IN."

The signing ceremony marked another significant milestone in the G20/OECD BEPS project, particularly with respect to the implementation of the treaty-related BEPS minimum standards.

In June 2017, during a ceremony hosted in Paris by the Organisation for Economic Co-operation and Development (OECD), 68 jurisdictions, including South Africa, signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) (MLI). The MLI was formulated under BEPS Action 15 (the multilateral instrument or MLI).

At the time, several other jurisdictions expressed their intent to sign the MLI in the near future. The signing ceremony marked another significant milestone in the G20/OECD BEPS project, particularly with respect to the implementation of the treaty-related BEPS minimum standards. Given the fractured world in which we live, the collaborative signing and willingness to adhere to the measures of the MLI by so many countries across the globe, is nothing short of miraculous – it is the light shining through the crack.

At the time of signature, signatories submitted a list of their operative tax treaties that they wish to designate as Covered Tax Agreements (CTAs). CTAs are to be amended through the MLI. However, the MLI will not operate in the same manner as an amending protocol to an existing treaty, nor will it directly amend the provisions of existing bilateral treaties. Rather, it will apply alongside the existing treaties.

At this stage, it is anticipated that over 1,100 tax treaties will be modified based on matching the specific provisions that jurisdictions wish to add or change within the CTAs nominated by the signatories.

At this stage, it is anticipated that over 1,100 tax treaties will be modified based on matching the specific provisions that jurisdictions wish to add or change within the CTAs nominated by the signatories. The expectation that 1,100 tax treaties will be modified as a result of 68 jurisdictions signing the MLI, constitutes an unprecedented moment in international taxation. It is indicative of the global determination to cooperate on corporate taxation with a view to minimising base erosion while simultaneously striving to eliminate economically harmful double taxation.

The MLI includes a set of minimum standards that all participating jurisdictions have agreed to implement, namely rules dealing with hybrid mismatches, treaty abuse, permanent establishments (PEs) and dispute resolution.

With regard to hybrid mismatches, the MLI provides recommendations to address hybrid scenarios arising from differences in the tax classification of an entity under the domestic laws of two or more jurisdictions that could result in tax benefits (eg double non-taxation).

Since treaty abuse has been identified as a significant source of BEPS; the MLI provides various approaches to achieve the minimum standard in this regard. The principal purpose test (PPT) operates to deny treaty benefits in situations where one of the main objectives of an arrangement is to obtain treaty benefits. Alternative remedial options include the adoption of a simplified limitation on benefits (LOB) clause, or a combination of a detailed LOB clause and either specific rules to address conduit financing structures or a PPT.

CDH
CLIFFE DEKKER HOFMEYR

"THERE IS A CRACK, A CRACK IN EVERYTHING. THAT'S HOW THE LIGHT GETS IN."

CONTINUED

Based upon the 25 signatories that signed up for MBTA, the OECD anticipates that this provision will apply to more than 150 existing treaties.

Specific provisions of the MLI, such as the extension of the scope of the dependent agent test and the curtailment of the existing exemptions from PE status, will lower the PE threshold considerably. The provisions also recommend an anti-fragmentation rule designed to prevent the splitting of activities across separate legal entities to circumvent PE status.

Further, as part of the options contained in the MLI, jurisdictions can opt into mandatory binding treaty arbitration (MBTA), an element of BEPS Action 14 on dispute resolution. Unlike the other articles of the MLI, Part VI of the MLI applies only between jurisdictions that expressly choose to apply MBTA with respect to their treaties. Of the 68 countries that signed the MLI, 25 opted in for MBTA. South Africa was not amongst the 25.

Based upon the 25 signatories that signed up for MBTA, the OECD anticipates that this provision will apply to more than 150 existing treaties.

The MBTA provision will apply to all cases of taxation contrary to the relevant treaty, unless a country has made a reservation specifying a more limited scope. The MLI provides flexibility for jurisdictions to bilaterally agree on the mode of application of the MBTA, including the form of arbitration. However, the default rules defined in the MLI will apply in the absence of agreement having been reached by countries before a case materialises that is eligible for arbitration.

For those jurisdictions that elect to implement MBTA through the MLI, the MLI provisions will apply to all treaties that do not have such a provision, or instead of existing provisions that provide for MBTA. However, countries may reserve the right not to apply the MBTA provision of the MLI to some or all of their treaties that already embody a MBTA provision.

The inventory of unresolved mutual agreement procedure (MAP) cases has increased significantly over the past several years. This is due in part to the

CDH
CLIFFE DEKKER HOFMEYR

"THERE IS A CRACK, A CRACK IN EVERYTHING. THAT'S HOW THE LIGHT GETS IN."

CONTINUED

Should a country fail to make a specific reservation with respect to the scope of the cases eligible for arbitration, all treaty related disputes that could not be resolved through MAP could potentially be subject to arbitration.

fact that the MAP process does not always function effectively and further, fails to provide enforcement mechanisms. It is anticipated that in consequence of the implementation of the BEPS recommendations, the number of MAP cases will increase even more in the future. The OECD acknowledged this back in 2015 and proposed the development of MBTA provisions as part of the MLI, as a method of resolving the gridlock. This notwithstanding, MBTA has not been elevated to a minimum standard.

The MBTA rules allow a person to request arbitration if the competent authorities have not been able to reach an agreement under a MAP within two years. The competent authorities may agree on a shorter or longer period to resolve a particular case through a MAP provided they notify the affected person before the expiration of the two-year period. In addition, jurisdictions that subscribe to MBTA rules are able to make a reservation and substitute the two-year period with a three-year period in all their treaties.

Should a country fail to make a specific reservation with respect to the scope of the cases eligible for arbitration, all treaty related disputes that could not be resolved through MAP could potentially be subject to arbitration.

The competent authorities of jurisdictions that have implemented MBTA in their treaties are required to agree on its mode of application, including the minimum information necessary for accepting a case for substantive consideration, before the date on which unresolved issues under MAP become eligible for arbitration. Such agreement must include the default rules provided by the MLI itself, such as on the appointment of arbitrators. Further, the OECD is expected to release a model competent authority agreement that will serve as the basis for the procedural arbitration rules. The default rules are meant to ensure that the absence of such rules does not delay the arbitration process for cases that would be eligible for arbitration. As such, the competent authorities are at liberty to deviate from the default rules as they see fit.

The MLI sets out default rules for the composition of an arbitration panel and the appointment and qualifications of arbitrators. Under such rules, the arbitration panel is composed of three independent individual members. Each competent authority appoints a member and those two members then appoint a third member who is not a national or resident of either country to chair the arbitration panel.

"THERE IS A CRACK, A CRACK IN EVERYTHING. THAT'S HOW THE LIGHT GETS IN."

CONTINUED

Under the MLI provisions, jurisdictions are required to bear the cost incurred in connection with the arbitration proceedings. The MLI also contains rules to ensure that any information shared with the arbitration panel and its staff, remains confidential.

Under the MLI provisions, jurisdictions are required to bear the cost incurred in connection with the arbitration proceedings. The MLI also contains rules to ensure that any information shared with the arbitration panel and its staff, remains confidential. Also, the competent authorities may require that each taxpayer, and its advisers, agree in writing that none of the information received from the competent authorities or the arbitration panel during the arbitration proceedings is made public.

As regards the type of arbitration process, the MLI provides for 'final offer' arbitration as the default arbitration process. Under final offer arbitration, each competent authority is required to submit a proposed resolution addressing all the issues under review. The proposed resolution must address each adjustment in the case that has been brought to arbitration and is required to include the allocation of monetary amounts (income or expenses) or a maximum tax rate to be charged under the relevant treaty. The competent authorities are allowed to propose alternative resolutions contingent upon the resolution of underlying questions, such as the existence of a PE or the determination of a taxpayer's residence under the relevant treaty. Supporting position papers may be submitted, as well as reply submissions to the proposed resolution of the other competent authority. Under 'final offer' proceedings, the arbitration panel selects one of the proposed resolutions as its decision, for which decision it is not required to provide any rationale.

Jurisdictions are entitled to make a reservation on the 'final offer' type of arbitration proceedings and instead, opt for 'independent opinion' proceedings. Under the latter approach, each competent authority provides all necessary information to the arbitration panel. The arbitration panel then decides the case by applying the provisions of the relevant treaty; subject always to the applicable domestic provisions of the treaty partners. Decisions formulated under 'independent opinion' proceedings must indicate the sources of law relied upon and the reasoning applied.

Under both types of arbitration proceedings, the ultimate decision must be adopted by simple majority. Such decision does not carry precedential value.

Once the arbitration decision has been delivered, the competent authorities of the jurisdictions involved must conclude a mutual agreement implementing the arbitration decision.

The arbitration decision is final and binding, unless:

- The taxpayer directly affected by the decision doesn't accept the mutual agreement implementing the arbitration decision, or does not withdraw all issues related to the MAP from consideration of courts or administrative tribunals within 60 days from being notified.
- A court of one of the treaty jurisdictions issues a decision advising that the arbitration decision is invalid. In such circumstances, another request for arbitration may be made.
- The taxpayer pursues litigation on issues that were resolved through a mutual agreement implementing the arbitration decision.

As stated at the outset, the MLI constitutes an unprecedented change in international taxation, which will indubitably impact significantly on the taxation of multinational enterprises. In addition, for the taxpayers of jurisdictions that adopt the MBTA provisions of the MLI, one hopes there will be greater certainty and predictability with regard to the resolution of their double taxation disputes.

Lisa Brunton

CDH
CLIFFE DEKKER HOFMEYR

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.

Herewith below selected highlights in the Customs and Excise environment since our last instalment (the Customs & Excise Act, No 91 of 1964 will be referred to herein as 'the Act'):

1. Amendment of Schedule 2 to the Act:

   1.1 Insertion of items 260.03/72.08/01.04, 260.03/7211.14/01.06, 260.03/7211.19/01.06, 260.03/7225.30/01.06, 260.03/7225.40/01.06, 260.03/7225.99/01.06, 260.03/7226.91/01.06 and 260.03/7266.99/01.06 for remedial action in the form of a safeguard duty against the importation of certain flat hot-rolled steel products;

   1.2 Substitution of items 260.03/72.08/01.04, 260.03/7211.14/01.06, 260.03/7211.19/01.06, 260.03/7225.30/01.06, 260.03/7225.40/01.06, 260.03/7225.99/01.06, 260.03/7226.91/01.06 and 260.03/7266.99/01.06 to reduce the rate of safeguard duty against the importation of certain flat hot-rolled steel products from 12% to 10%;

   1.3 Substitution of items 260.03/72.08/01.04, 260.03/7211.14/01.06, 260.03/7211.19/01.06, 260.03/7225.30/01.06, 260.03/7225.40/01.06, 260.03/7225.99/01.06, 260.03/7226.91/01.06 and 260.03/7266.99/01.06 to reduce the rate of safeguard duty against the importation of certain flat hot-rolled steel products from 10% to 8%;

2. Draft amendments of the Rules to the Act regarding the insertion of forms DA 104 and DA 105 to the English version of the Schedule to the Rules as only Afrikaans versions exist. The draft Rule amendment inserts English versions of these forms. Comments can be submitted to C&E_LegislativeComments@sars.gov.za.

The due date for comments is 1 September 2017.

Please advise if additional information is required.

Petr Erasmus

CDH
CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Tax and Exchange Control practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Mark Linington
Private Equity Sector Head
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

Gerhard Badenhorst
Director
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com

Petr Erasmus
Director
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@cdhlegal.com

Mareli Treurnicht
Director
T +27 (0)11 562 1103
E mareli.treurnicht@cdhlegal.com

Lisa Brunton
Senior Associate
T +27 (0)21 481 6390
E lisa.brunton@cdhlegal.com

Candice Gibson
Senior Associate
T +27 (0)11 562 1602
E candice.gibson@cdhlegal.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Varusha Moodaley
Senior Associate
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com

Louis Botha
Associate
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

Jerome Brink
Associate
T +27 (0)11 562 1484
E jerome.brink@cdhlega.com

Gigi Nyanin
Associate
T +27 (0)11 562 1120
E gigi.nyanin@cdhlegal.com

Nandipha Mzizi
Candidate Attorney
T +27 (0)11 562 1741
E nandipha.mzizi@cdhlegal.com

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com