



Tax Cases and Interpretation webinar

Tax Practice on the Move Series

YOUR KEY TO THE TAX COMMUNITY

Presenter: Keitumetse Sesana



Keitumetse Sesana is the Tax Technical Specialist at the South African Institute of Taxation.

She holds a BCom (Law), LLB and Master of Law (Tax Law). Keitumetse is currently a registered SARS practitioner and holds the designation of Master Tax Practitioner.

Keitumetse has substantial tax advisory experience in international corporate tax matters and related matters. After gaining this experience at one of the “Big Four”, Keitumetse joined the South African Institute of Taxation and is presently mandated to manage stakeholder relations by driving and facilitating meaningful engagement with Government departments regarding legislative design and policy on the varying areas of taxation.

Expert Guest: Nishana Gosai



Nishana Gosai is the in-house tax lead for a South African listed company. She has held various positions in the advisory sector. Notably, Nishana has worked at the South African Revenue Services where she headed the transfer pricing unit. Nishana is currently a serving member of the Tax Court

What's new in the Court Room:

ABD Limited vs CSARS

ABD Limited v CSARS

- ABD Limited (hereinafter referred to as “ABD”)
 - ABD is a South African telecommunication company with subsidiaries (operating companies) worldwide.
 - ABD is the significant shareholder of all the operating companies.
 - ABD licences its intellectual property to these operating companies in return for a royalty payment.
 - The facts concern themselves with the royalty payments made by fourteen operating companies during the period 2009 – 2012.
 - These companies were located in, Afghanistan, Benin, Cameroon, Congo, **Cyprus**, Ghana, Guinea-Bissau, Ivory Coast, Rwanda, Sudan, Syria, Uganda, Yemen and Zambia.
 - All fourteen operating subsidiary companies made a royalty payment of 1% to ABD in return for their use of its intellectual property during this period.
 - Acting on advise from its consultancy firm, ABD justified the imposition of the 1% royalty payment.

ABD Limited v CSARS

- SARS
 - The dispute between ABD and SARS had its origins with ABD's 2009 assessment. SARS had originally accepted ABD's transfer pricing position.
 - In 2014 SARS undertook a transfer pricing audit. The outcome was that in March 2014, SARS issued an additional assessment for ABD's 2009 tax year. Several more adjustments followed.
 - As opposed to ABD's flat royalty rate of 1% that was charged for all the Operating Companies during the period in question, SARS alleged that a royalty rate of 1% was not arm's length and that a variable royalty rate should be charged depending on the country of residence and the year it was earned.
 - These assessments were considered excessive by ABD thus prompting this appeal and the central question of how one determines an arm's length price. ABD seeks to have the appeal upheld and for the court to set aside the additional assessments for the years 2009 -2012.

ABD Limited v CSARS

Relief sought

- ABD's principal relief is for the court to uphold its appeal and for the court to set aside the additional assessments for the 2009-2012 tax years.
- SARS relief is for the court to alter the additional assessments in terms of section 129(2)(b) of the Tax Administration Act, 28 of 2011, to reflect the quantifications done by Dr Slate.

ARMS LENGTH

What is arms-length pricing?

- Internationally - OECD Guidelines
- Domestic - Section 31 of the Act requires the transfer price of specified international transactions between connected persons or associated enterprises to be based on the arm's length principle when determining taxable income.

Arm's Length Transaction



An arm's length price is broadly a price negotiated on the open market between a willing buyer and a willing seller. This principle specifies that a company must charge a similar price for a controlled transaction as an uncontrolled transaction made by a third party.

What is arms-length pricing?

What happens when the transactions are not arm's length?

- Primary adjustment
- Secondary adjustment
- Relief from Double Taxation?

Arm's length and Royalty payments?

In transfer pricing, royalties are payments that are charged when **intangible property** is transferred or licensed to a company subsidiary in a controlled **intercompany transaction**.



Arm's length and Intangibles

Intangible assets – Guidance on Transfer Pricing Aspects of Intangibles

Identifying intangibles

Intangible:

“is intended to address something which is not a physical asset or a financial asset which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances.”

- Rather than focusing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction.
- The identification of an item as an intangible is separate and distinct from the process for determining the price for the use or transfer of the item under the facts and circumstances of a given case. Depending on the industry sector and other facts specific to a particular case, exploitation of intangibles can account for either a large or small part of the MNE’s value creation.

Arm's length and intangibles

Intangible assets: Brand

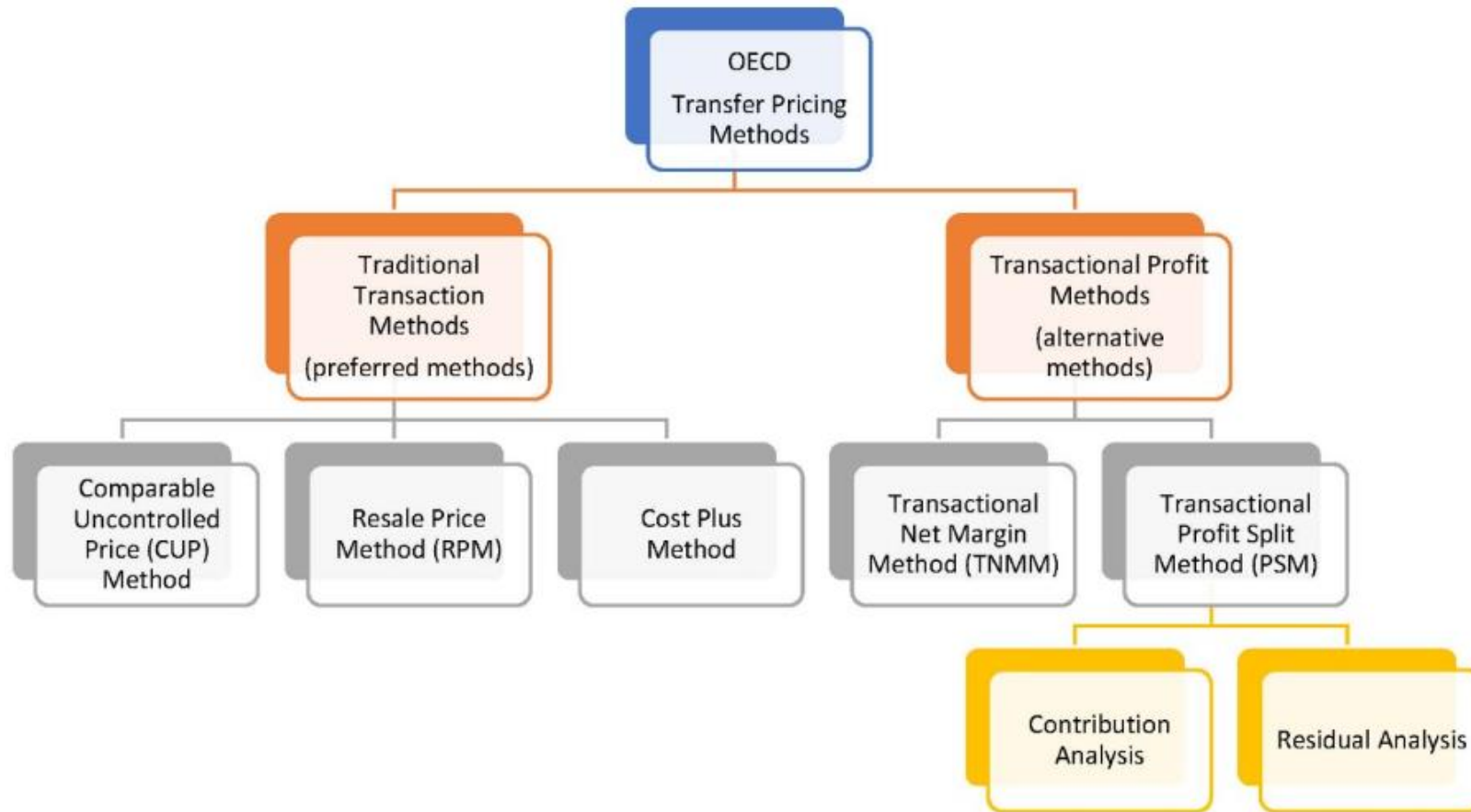
- Sometime used interchangeably with the terms “trademark” and “trade name.”
- In other contexts, a brand is thought of as a trademark or trade name imbued with social and commercial significance.
- A brand may, in fact, represent a **combination of intangibles** and/or other items, including among others, trademarks, trade names, customer relationships, reputational characteristics, and **goodwill**.

Intangible asset: Goodwill

- Goodwill is sometimes described as a representation of the future economic benefits associated with business assets that are not individually identified and separately recognised.
- In still other contexts goodwill is referred to as the expectation of future trade from existing customers.

TP METHODOLOGY

TP METHODS



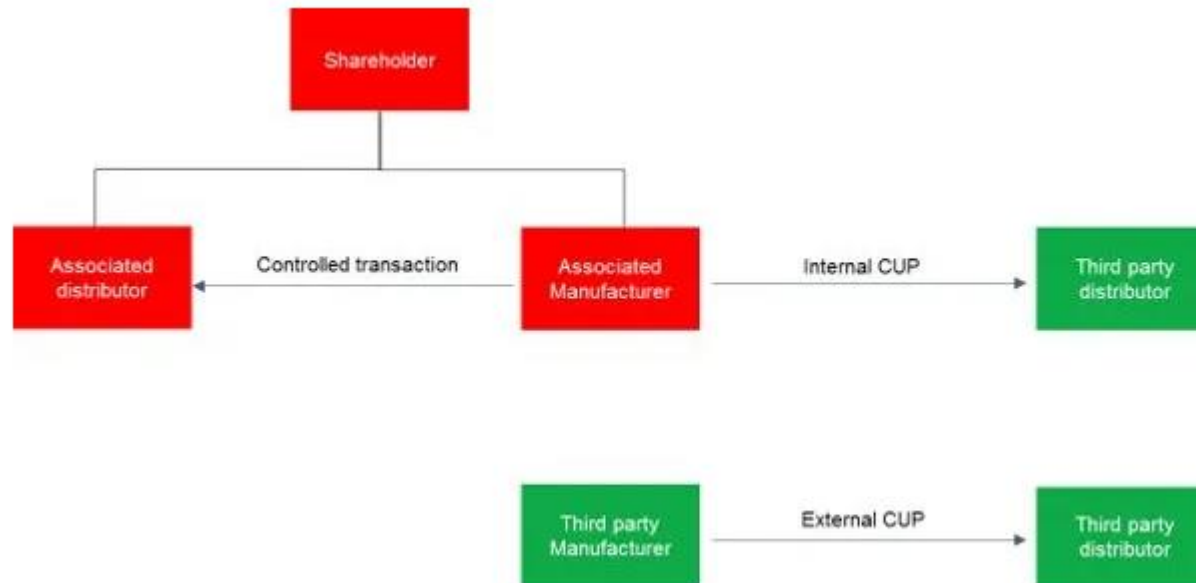
TP METHODOLOGY

Traditional Methods	Basic overview
Comparable Uncontrolled Price (CUP)	A transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.
Resale Price Method (RPM)	The RPM uses the end external selling price of a product or service, otherwise known as the resale price as the starting point of the analysis.
Cost Plus Method	Uses direct costs as the starting point for the analysis. The parties then add an arm's length gross profit mark-up.
Transactional Methods	Basic overview
Transactional Net Margin Method (TNNM)	Focuses on the net profit margin earned in the related party transaction compared to the net profit margin earned by a comparable independent party
Profit Split Method (PSM)	This approach examines the terms and conditions of interrelated, controlled transactions by figuring out how profits would be divided between third parties making similar transactions, in cases where the transaction and roles of each party are intertwined.

TP METHODOLOGY

Comparable Uncontrolled Price (CUP Method)

- The most appropriate transfer pricing method for establishing the arm's length price for transferring commodities between associated enterprises.
- Traditional, direct and easy method to determine the transfer price.



SIZE OF THE PIE AND WILLINGNESS TO PAY?

SIZE OF THE PIE

- The calculation of the royalty rate is based on two factors.
 - The size of the profit earned by the Opco from the use of the IP and then how that profit is divided between the Opco and ABD.
 - Analogy: first determination is about the **size of the pie** and the second about how to **divide the pie**.
- Mr David relied on ABD's consultant's figures for the size of the pie as 3% of turnover- ABD was liable for the full 3%.
 - ABD whilst agreeing with his determination of the size of the pie disagrees with his determination of its division.
- By contrast Dr Slate recalculated the size of the pie (leading to a much larger pie; on average 47% as opposed to Slate's 3%); but divided the pie between ABD and the Operating Companies, thus reducing ABD's share of the pie to 6% .
 - ABD disagrees with Slate's calculation of the size of the pie but agrees with his division of the pie.

WILLINGNESS TO PAY?

- Dr Slate made use of a technique known as the willingness to pay ('WTP'), a method which attempts to calculate the incremental price consumers are willing to pay for a brand used
- This technique has previously been used by the United Kingdom's erstwhile Competition Commission.
- To affect this technique, Dr Slate concluded a survey with customers in some of the fourteen jurisdictions where the Operating Companies were situated.
- The survey questioned their preferences for the ABD brand versus a hypothetical brand and in doing so directed questions relating to the goodwill of ABD.
- The purpose of the survey was to review ABD's customers' preference for paying a premium or incremental price for its mobile services versus that of a hypothetical company. From this information Dr Slate then calculated the suggested suitable royalty rate.

WILLINGNESS TO PAY?

- **As the conclusion of his testimony the court asked him if the WTP methodology had been used previously in a transfer pricing case.** Dr Slate said he was not aware if it had been used in any litigation although he said he had used the technique for many years in dealing with tax authorities. He also cited its usage by the United Kingdom's then regulator the Competition Commission
- **"...no authority in transfer pricing compliance".**
- Dr Slate remarked that he had been using WTP for fifteen years in dealings with tax authorities who had accepted it.
- The fact that the WTP methodology has been used by a competition regulator for one purpose **does not signify widespread acceptance by the transfer pricing community for its purposes. Given that this community is an active one, regularly preparing and updating guidelines one might have expected this technique to gain some mention if it was accepted.**

Expert Guest Speaker Insights

Key take aways for tax for tax practitioners and taxpayers on defending their transfer pricing position(s).



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