

Transfer Pricing & the erosion of the tax, wage, and local investment base in South Africa

Presentation to the Portfolio Committee on Trade & Industry
29 April 2015



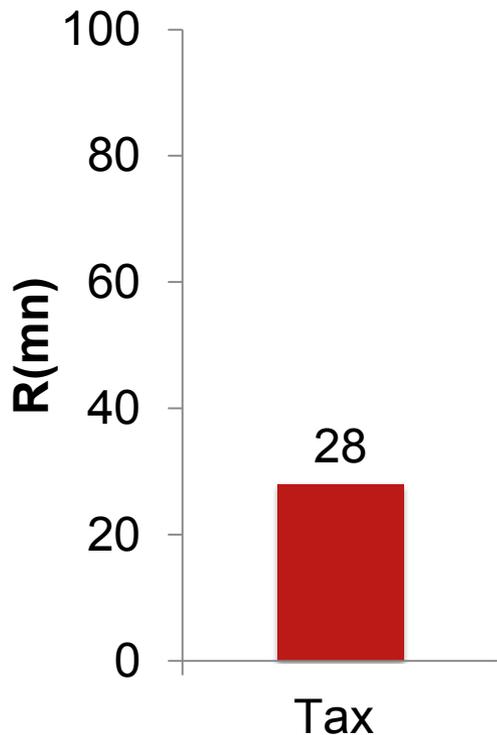
Four main findings emerge from our research

- 1 The consequences of unacceptable transfer pricing, illicit outflows and aggressive tax planning go much deeper than eroding the tax base. **It reduces the monetary base for living wages and local investment**
- 2 **Transfer pricing¹** is not only an international and cross-border concern; **it starts within South Africa** between local firms and subsidiaries of MNEs before funds flow across borders
- 3 Government entities that monitor and investigate corporate transparency and transfer pricing are under-resourced. The long **“tradition of acceptance”** continues...
- 4 The “all or nothing” approach to clamping down on transfer pricing for fear of losing FDI must be questioned. It ignores the precarious nature of investment in the face of large capital outflows. **What is the NET inflow, if illicit outflows is taken into account?**

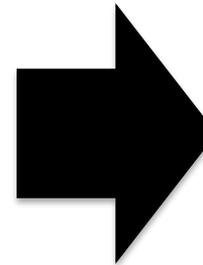
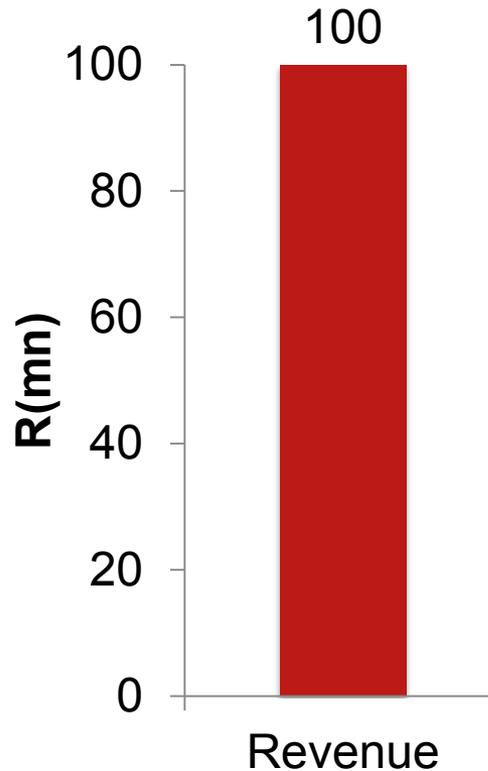
¹ Some forms of transfer pricing are acceptable and commercially necessary. This term is used to denote **unacceptable transfer pricing**

The problem is bigger than tax...

1 At a corporate tax rate of 28%, you save R28mn



2 ...by removing revenue of R100mn

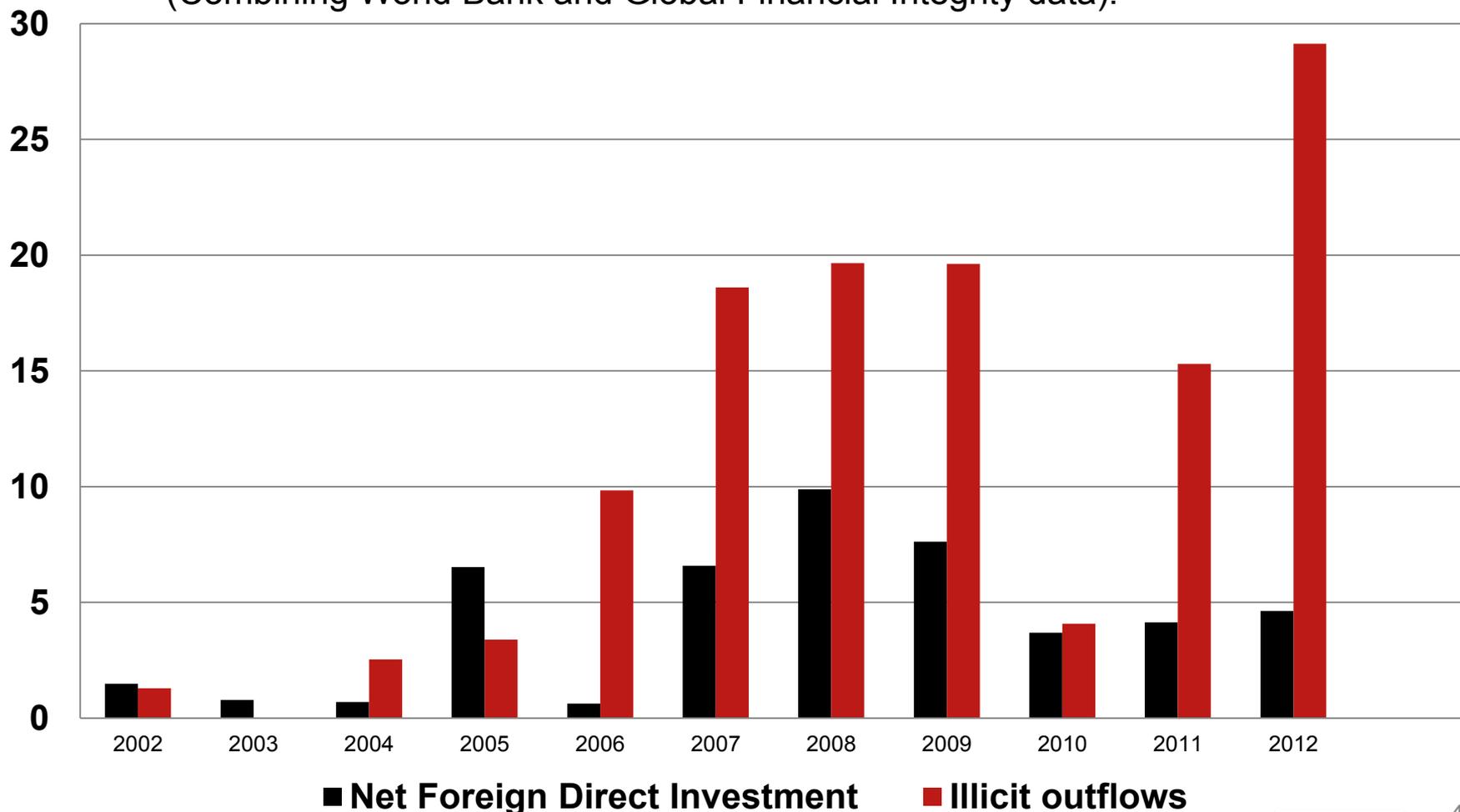


R28mn saved in tax;
R100mn removed from the bargaining table and investment

The net inflow forces us to think differently about FDI ...

AIDC work in progress: Net Foreign Direct Investment & illicit capital outflows in billions of current US\$ (South Africa)

(Combining World Bank and Global Financial Integrity data).



These findings lead to three key recommendations

A decisive shift to transparency

- Public pressure, critical research and investigative journalism can expose these practices
- Financial Statements of MNEs and their SA-based subsidiaries must be readily available to the public
- Foreign companies that receive regular income from SA, must file financial statements with CIPC

Increased resources for monitoring

- Additional resources required by both **CIPC** to monitor corporate compliance with disclosure rules
- **SARS** requires additional resources to evaluate, interrogate and clamp down on transfer pricing

Narrowing the ambit of “accepted” practice

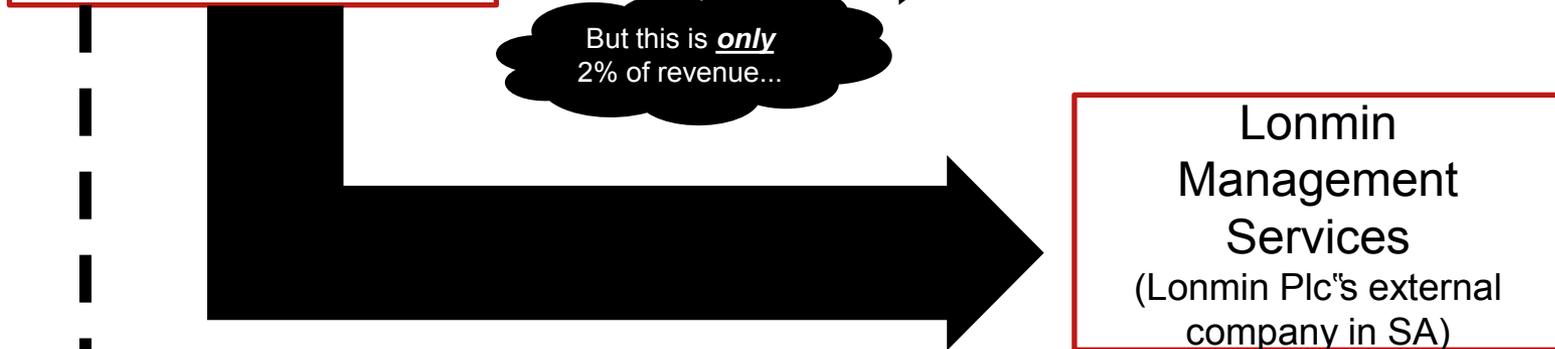
- Research shows that transfers are accepted as long as they seem “low” and reasonable
- That is not the correct test; the **substance** of a transaction must be interrogated
- The **role of accounting firms** must be interrogated

The Lonmin example shows the importance of questioning **substance**

„Shares“ Office
with law firm,
Appleby Services



But this is only
2% of revenue...

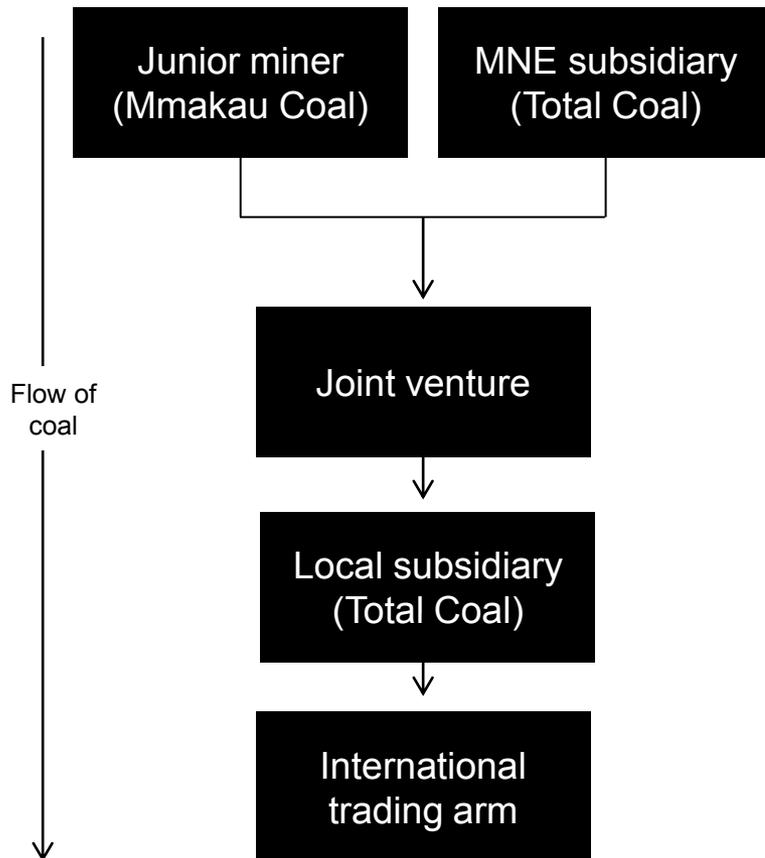


Significant group-wide marketing fees paid to external providers

- Insurance fees to *Lonmin Insurance Ltd (Guernsey)*
- Acquisition of „worthless“ Messina mine from its own mother company 2006; declared worthless in 2008.

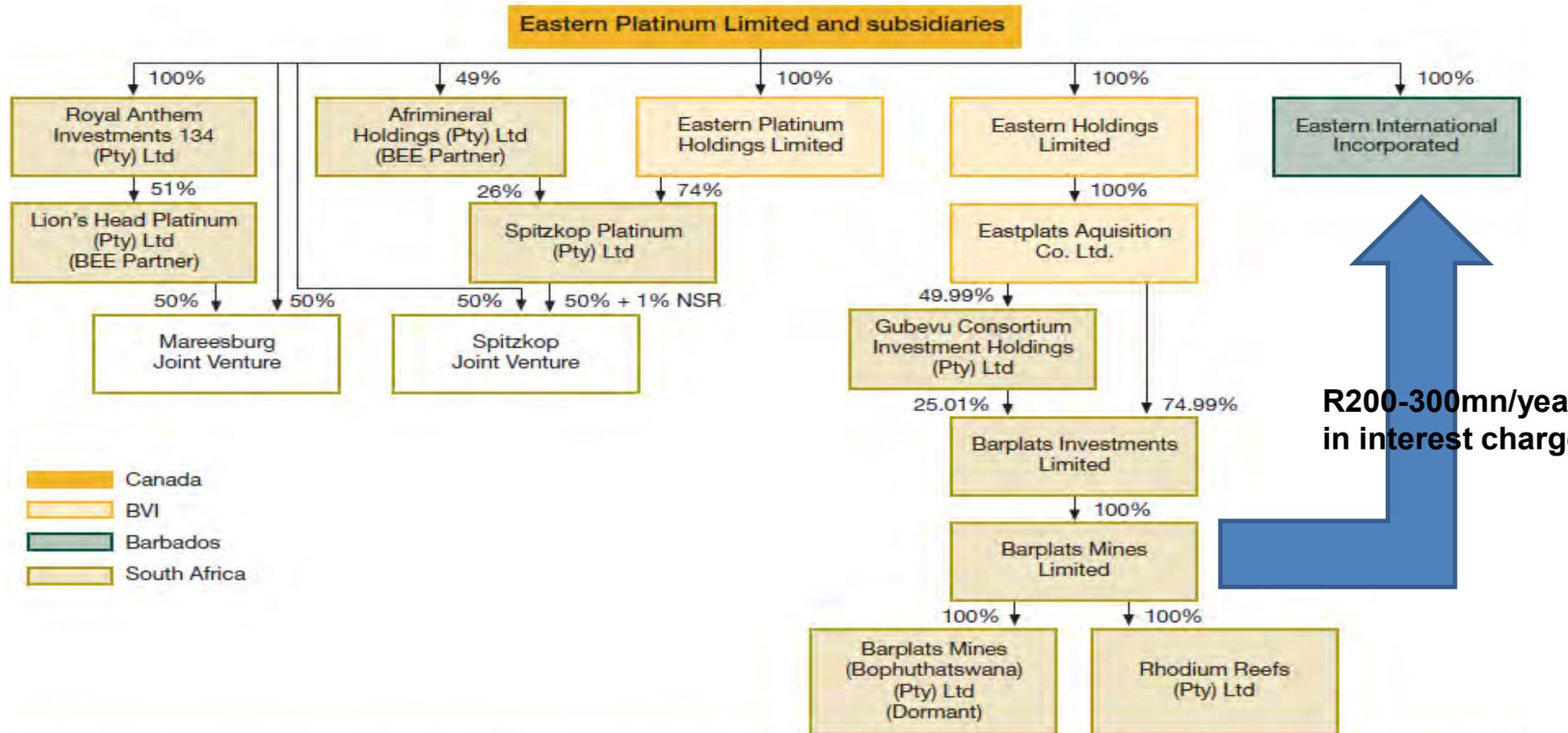
UK Head office

The **Total** case study emphasises issues of substance and local subsidiaries



- Exclusive supply agreement between junior & MNE subsidiary; i.e. mine must sell entire off-take to MNE
- **Secure supply of coal highly desirable**
- Yet, MNE levies 4% “marketing fee” on junior to facilitate this
- International trading arm levies further 7% “sales commission” to trade coal on international market
- In addition, local subsidiary owns railway sidings and receives beneficial prices for access to rail and port
- The benefit is not passed on to junior miner
- **Revenue of junior miner reduced by fees and by opportunistic pricing**

Eastplats (Canada) lending R2.9bn “to itself” from Bahamas



Barplats Investments Limited (Barplats), is the Eastplats operating subsidiary in South Africa and Eastplats has a 74.99% interest in it. The BEE company, Gubevu Consortium Holdings (Pty) Ltd (Gubevu) has a 25.01% interest in Barplats. Eastplats has a 49.9% stake in Gubevu, giving it a beneficial interest of 87.5% in Barplats.

The independent „Big Four“ accounting firms

Western Platinum Limited

(Registration number 1963/003589/06)

Annual Financial Statements for the year ended 30 September 2010

Notes to the Annual Financial Statements

	Group		Company	
	2010 \$ '000	2009 \$ '000	2010 \$ '000	2009 \$ '000
31. Related parties				
The ultimate holding company of Western Platinum Limited is Lonmin Plc. incorporated in the United Kingdom, which effectively holds 86.241% (2009: 86.241%) of the company's issued share capital.				
The company has made and received loans from its fellow subsidiary companies. In addition the holding company and fellow subsidiary company perform certain administrative duties for the company.				
The company has a related party relationship with its holding company and fellow subsidiaries and with its directors and executive officers.				
The company jointly controls the Dwaalkop Joint Venture which is regarded as a jointly controlled entity. Refer to the director's report.				
The company jointly controls The Lonmin Platinum Pollution Control and Rehabilitation Trust which is regarded as a special purpose entity.				
Related party balances				
Loan accounts - Owing (to) by related parties				
Refer to note 8 for related party balances				
Pandora Joint Venture (Creditor)	8,992	19,500	8,992	19,500
Investments				
Refer to notes 4 & 5 for investment balances				
Transactions				
Interest paid to Lonmin Plc (see note 24)	8,070	3,339	8,070	3,339
Fees for managerial, technical, administrative and secretarial services paid to Lonmin Management Services (see note 22)	30,123	20,313	30,094	20,292
Interest received from Eastern Platinum Limited (see note 23)	(2,890)	-	(2,890)	-
Sales commission paid to Western Metal Sales Limited	31,566	20,738	31,566	20,738
Purchase of concentrate stocks from Eastern Platinum Limited	255,977	92,282	255,977	92,282
Purchase of concentrate stocks from Pandora Joint Venture	42,323	40,750	42,323	40,750
Compensation to other key management				
Short-term employee benefits	2,248	1,754	2,248	1,754



Thank you

