INPUTS BY THE DEPARTMENT OF TRADE AND INDUSTRY ON TRANSFER PRICING

PORTFOLIO COMMITTEE ON TRADE & INDUSTRY

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WHAT IS TRANFER PRICING

- The process by which related entities set prices at which they transfer goods or services between each other.
- When multinational companies operate in different countries, where they are subject to different laws, they might resort to fictitious transfer pricing whereby they manipulate profits so that they appear lower in a country with higher tax rates and higher in a country with lower tax rate.

Elements that constitute transfer pricing (TP)

- Misinvoicing
- Capital flight / illicit financial flow
- Tax Evasion
- Base erosion and profit shifting

Elements of TP continued…..

- Illicit financial flows due to trade miss invoicing include flows both out of and into the country which:
  - Allow multiple forms of tax evasion for both buyers and sellers
  - Deprive governments of tax revenue both in Africa and in other countries.
- The ultimate destination and ownership of the missing funds retained by those involved in these transactions is unclear, and much of it could end up in tax havens in third countries (Africa focus bulletin 26 May 2014)

HISTORICAL BACKGROUND ON TRANSFER PRICING IN SA

- The report from the Mail and Guardian dated 16 Dec 2014 indicated that South Africa lost roughly R147-billion per year to the illegal movement of money out of the country.
- The report also indicates that out of 151 countries, South Africa loses the 12^{th} highest amount of money through illegal financial flows .
- On 29 January 2015 the Director of African Monitor, indicated that the country has lost R237bn in illicit financial flow in 2011 and over R1trn between 2002 and 2010

HISTORICAL BACKGROUND ON TRANSFER PRICING IN SA CONTINUED………..

- Economic Development Conference held in 2011 in Addis Ababa called for the establishment of a High Level Panel to look into illicit financial flows from Africa and make practical recommendations in this regard.

CONSEQUENCES AND DAMAGES CAUSED TP

- Transfer pricing goes beyond tax revenue loss and is a threat to:
  - economic development and poverty alleviation.
  - effective redistribution policies.
  - labour empowerment and welfare
  - entrepreneurial development and investment
  - resource optimization
  - Dodging tax is unethical, infectious and must be stopped

INTERNATIONAL PRACTICE

- In Singapore Inland Revenue Authority (IRAS) tax officials may audit the prices of transactions between related parties to verify if they are reflective of the market prices. They believe that the audit could provide a useful lead to transfer pricing adjustments.
- To reduce the risk of audits and double taxation, taxpayers transacting with their related parties are expected to apply the internationally endorsed arm's length principle so that the transfer between them should be an arm's length price as if they were unrelated parties negotiating in a normal market.

International practice

- Three steps to be followed when implementing arm's length principle are:
  - Conduct comparability analysis
  - Identify the most appropriate transfer pricing method
  - Determine the arm's length results
- Russia also introduced penalties for possible non-compliance:
  - 20% of the amount of additional tax payable was introduced in 2014 to be increased to 40% in 2017

Recommendations

- The South African government needs to:
  - ensure that the SARS looks at different approaches towards dealing with this transfer pricing habit.
  - Benchmark with different countries that are successful in dealing with transfer pricing
  - ensure that the SARS develops clear and precise legislation that can address the transfer pricing challenge
  - ensure that the SARS has well trained and dedicated people that deal with cross border transactions.

Thank you