Assessment of the purpose of South Africa's controlled foreign company rules

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Abstract

Controlled foreign company (CFC) rules are anti-avoidance provisions designed to deter taxpayers from shifting their capital (and resultant income) to low-tax jurisdictions. Adoption of these rules in South Africa coincided with the relaxation of exchange control laws which opened up borders to inward and outward capital flows. South Africa's CFC regime has been amended over the years to become one of the most sophisticated amongst the G20 and aligned with the Organisation for Economic Co-operation and Development's (OECD) Action 3 recommendations (per the OECD's Base Erosion and Profit Shifting Action Project).

Abusive profit-shifting tactics committed by multinational enterprises (MNEs) have caused the OECD to recommend that CFC rules be strengthened globally to combat this behaviour. However, in the United States and the United Kingdom, recent reforms appear to have weakened these countries' CFC (or CFC-equivalent) legislation, countering the OECD's recommendations. Such manoeuvres improve the profitability of these nations' MNEs by allowing their tax bills to remain lower than their international competitors'. As such, there is a danger of starting a race to the corporate tax-rate bottom where developing nations will be the losers, considering their greater reliance on corporate tax revenues than their developed counterparts.

India and Brazil, both developing nations and BRICS members like South Africa, also aren't prioritising the strengthening of their CFC regulations – their focus is rather on improving transfer pricing (TP) legislation and enforcement to combat the damaging effects MNEs' avoidance practices are having on tax revenue collections in those countries. The existence of South Africa's advanced CFC legislation amongst a global trend of a weakening in, or the non-adoption of, CFC rules may hinder the competitiveness of South African MNEs. The current CFC regime could thus serve the purpose of stifling growth and foreign direct investment, instead of only deterring profit-shifting behaviour.

TP legislation targeted at MNEs (the biggest profit-shifting culprits) may yield the most effective anti-avoidance results. South Africa's recently enhanced TP reporting requirements are key to solving the offshore profit-shifting puzzle, as these reports will reveal information about an MNE's global operations and resultant profit-shifting activities. In addition, the revision to the TP arm's length principle to align compensation and value creation, will see profit-shifting MNEs bear the tax they were trying to avoid. It appears that the anti-avoidance purpose embodied within CFC regulations overlaps with the anti-avoidance mechanisms that

these enhanced TP rules are designed to achieve. Thus, in a South African context, the most efficient way to curb tax avoidance may be to rely on TP, rather than CFC, legislation. As such, it is recommended that South Africa's CFC regulations be repealed.

Abbreviations

AFS	Annual financial statements
BEPS	Base erosion and profit shifting
BRIC	Brazil, Russia, India and China
BRICS	Brazil, Russia, India, China and South Africa
BRS	Business requirements specifications
CbC	Country-by-country
CFC	Controlled foreign company
CPM	Cost-plus method
CRS	Common Reporting Standard
CUP	Comparable uncontrolled price method
DEMPE	Development, enhancement, maintenance, protection and exploitation
Draft TLAB	2019 Draft Taxation Laws Amendment Bill issued on 21 July 2019
DTA	Double tax agreement
EBITDA	Earnings before interest, taxation, depreciation and amortisation
EC	European Commission
EU	European Union
FA	Foreign affiliate entity
FATCA	2010 US Foreign Account Tax Compliance Act
FBE	Foreign business establishment
FCC	Foreign controlled company
FDII	Foreign derived intangible income
G20	Group of Twenty
GDP	Gross domestic product
GILTI	Global intangible low-taxed income
IDTC	Indian Direct Tax Code
IFRS	International Financial Reporting Standards
IITA	Indian Income Tax Act of 1961
IP	Intellectual property
IRS	The Internal Revenue Service of the United States of America
IT10B	Income Tax Schedule 10B
ITA	Income Tax Act, No. 58 of 1962

ITPR	Indian transfer pricing regulations
LIBOR	London Inter-bank Offered Rate
MNE	Multinational enterprise
OECD	Organisation for Economic Co-operation and Development
PN7	Practice Note 7
PoEM	Place of effective management
RSP	Resale price method
SARS	South African Revenue Service
TAA	Tax Administration Act, No. 28 of 2011
The Guidelines	The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
The Vale case	National Treasury v. Companhia Vale do Rio Doce
The Eagle case	Eagle Distribuidora de Bebidas S/A v. National Treasury
TP	Transfer pricing
UK	United Kingdom
US	United States of America

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CHAPTER 1: INTRODUCTION AND OVERVIEW

1.1. BACKGROUND

1.1.1. The origin of South Africa's controlled foreign company rules

At the end of the apartheid era, South African businesses were able to integrate into the global economy. Relaxation of local exchange control regulations accelerated this integration by allowing residents to broaden their offshore investment and business operations horizons. At the same time, however, the South African Revenue authorities raised concerns regarding the erosion of the South African tax base[1]: taxpayers could devise ways to defer or reduce their South African tax liabilities by either rerouting passive income through an offshore entity or by accumulating income (and thus deferring tax) in a foreign entity[2].

In a post-democratic South Africa, the Katz Commission was established to assist with the reform of South Africa's tax policies[3]. In addition to concerns raised regarding capital flight[4], the commission understood the importance of balancing this risk with the country's need to ensure competitive tax neutrality of South African foreign direct investment[5]. It is with these and the anti-avoidance objectives in mind, combined with the imminent overhaul of South Africa's tax system from a source to a residence basis, that it was recommended that South Africa introduce controlled foreign company (CFC) legislation[6].

CFC rules are anti-avoidance provisions that are designed to deter taxpayers from shifting their capital (and resultant income) to low-tax jurisdictions or tax havens. This mechanism ensures that offshore profits remain within the tax base of the parent/shareholder[7], by taxing the undistributed income of a CFC in the hands of its shareholders on a current basis[8]. The anti-deferral principle embodied within these rules is, however, anti-competitive from a business perspective, since anti-deferral calls for complete taxation whilst the desire to remain competitive necessitates complete exemption[9].

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[1] South Africa, Commission of Inquiry into certain Aspects of the Tax Structure of South Africa [Katz Commission], 1997:para 2.2.1
[2] Katz Commission, 1997:para 8.1.1
[3] Koch, Schoeman & Van Tonder, 2005:194
[4] Katz Commission, 1997:para 2.2.1
[5] Katz Commission, 1997:para 3.1.2.7
[6] Katz Commission, 1997:para 8.3.1.1
[7] OECD, 2015:para 7
[8] Oguttu, 2009:74
[9] South Africa, National Treasury [National Treasury], 2002:2

When it came to designing South Africa's CFC rules to curb avoidance behaviour, the government was sensitive to the fact that South African multinational enterprises (MNEs) required investment, as well as the ability to compete in global markets. The government needed to perform a balancing act – the South African corporate need to remain globally competitive had to be accommodated, whilst the revenue authority had to ensure that the tax base didn't disappear altogether. In attempting to manage this balance, it was observed that overly strict CFC regulations could hamper an MNE's international competitiveness[10], while lax CFC rules could result in capital outflows. It is for these reasons that the revenue authority employed the expertise of foreign experts to draft South Africa's CFC legislation[11] to achieve a balance between taxing foreign income and remaining globally competitive.

Since their adoption in the 1990s, South Africa's CFC rules have evolved to become one of the more sophisticated and complicated versions of these rules amongst countries forming part of the Group of Twenty organisation (G20)[12], with little need to strengthen them further[13]. Although South Africa's CFC rules were drafted to be as closely in line with international standards as possible (as these rules were tailored according to the norms of the foreign experts' home (developed) countries), what was needed for South Africa's unique economic environment may not have been adequately taken into account[14].

1.1.2. The global CFC regime

The setting of the international tax standards has largely been administered by the Organisation for Economic Co-operation and Development (OECD). However, these norms have been viewed as biased towards wealthier OECD member states[15]. Since the global financial crisis, however, geopolitical changes saw the power of influence shift towards the G20, such that these countries, including the economies of Brazil, Russia, India, China and South Africa (BRICS), played an active role in the development of the OECD's Base Erosion

[10] For example, where an MNE (subject to CFC rules in its resident country) operates in a low-tax jurisdiction, profits earned in this jurisdiction would be made subject to tax in the MNE's resident country, thereby eroding profitability and potentially hampering the MNE's ability to compete in that foreign territory.
[11] South Africa, Davis Tax Committee [Davis Tax Committee], 2016:15
[12] Brauner, 2016:984 – The G20 includes both OECD member countries and developing countries (such as BRICS) that don't belong to the OECD. All members of the G20 are considered to have an equal voice.
[13] Davis Tax Committee, 2016:36
[14] Davis Tax Committee, 2016:15
[15] Brauner, 2016:981

and Profit Shifting (BEPS) project[16]. Fifteen Actions were identified along three key pillars[17] as part of the OECD's 2013 Action Plan to address BEPS[18]. On 5 October 2015, the OECD published thirteen final reports outlining thirteen of the project's fifteen consensus actions[19]. Issuing these recommendations didn't equate to immediate adoption as their enactment into law is largely dependent on independent countries' consideration and subsequent regulatory implementation (this is required for these standards to have the "teeth" of legal enforceability).

These developments brought the standard of CFC rules into question, with the OECD encouraging countries to adopt stricter CFC policies as recommended in the BEPS Action 3 report. The report, however, acknowledged that global improvements in base-erosion monitoring will only be adequately achieved through the universal adoption of enhanced CFC rules. Despite these recommendations, many European countries, such as the United Kingdom (UK) and the Netherlands, have relaxed their CFC rules to enhance the global competitiveness of their resident MNEs [20]. South Africa appears to be one of the few countries that brought its rules somewhat in line with the recommendations of the BEPS Action 3 report.

After a global outcry (largely triggered by the global financial crisis) over the ability of MNEs to garner large profits whilst paying minimal tax[21], the OECD further recommended that CFCs should not only protect a resident country's tax base, but also the tax base of other countries[22]. This has become a sensitive topic between Europe and the United States of America (US), as many US MNEs have caused base erosion across an array of European countries. This has largely been as a result of the US Congress extending the benefits of exempt interest and dividends (combined with other exemptions under its Subpart F[23] rules) to these MNEs at the expense of many European regimes[24]. With the existence of such self-serving motives, it's hard to imagine that countries would actively seek to adopt more stringent CFC rules in the hope that other countries would act in the same way. The world thus faces a prisoner's dilemma[25] with regards to the adoption of the BEPS Action 3 recommendations.

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[16] Brauner, 2016:984
[17] OECD, 2015:3 – The three pillars are: (i) "*introducing coherence in the domestic rules that affect cross-border activities*", (ii) "*reinforcing substance requirements in the existing international standards*", and (iii) "*improving transparency as well as certainty*".
[18] OECD, 2015:3
[19] Deloitte.com, 2019
[20] Davis Tax Committee, 2016:36
[21] Brauner, 2016:989
[22] OECD, 2015:para 17
[23] United States, Internal Revenue Service, 2014 – "*The Subpart F provisions eliminate deferral of US tax on some categories of foreign income by taxing certain US persons currently on their pro rata share of such income earned by their controlled foreign corporations.*"
[24] Davis Tax Committee, 2016:13
[25] The prisoner's dilemma is a principle derived from game theory. It illustrates how cooperation between two rational individuals is not always guaranteed even though cooperative behaviour would

Despite the involvement of the BRICS countries in the compilation of the BEPS project actions (and therefore Action 3), India and Brazil have been slow to adopt a more stringent CFC regime. Brazil's rules have been criticised for being used as a tax collection tool[26], while India hasn't yet adopted its own CFC rules. It instead places reliance on the place of effective management (PoEM) rules to curb cross-border anti-avoidance[27]. It is also interesting to observe the trend followed by developed OECD countries (as described above) that has seen a consistent weakening of CFC rules, despite the opposite being recommended by the OECD.

1.1.3. Administering South African CFC compliance

With increased legislative complexity comes an enhancement of administrative requirements. Many South African tax practitioners have expressed concern regarding the effort and costs associated with CFC compliance in light of the limited benefit this provides to the fiscus[28]. South African taxpayers subject to the CFC rules find themselves burdened with either performing time-consuming and complex calculations or submitting extensive documentation on their foreign operations, in order to prove that they qualify for applicable CFC exemptions[29].

In 2013, the Minister of Finance established the Davis Tax Committee to "*inquire into the role of the tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability*"[30]. As part of its approach, the committee has commented on South Africa's existing CFC rules and their interaction with the BEPS Action 3 report, and made various recommendations to the Minister. The committee has provided suggestions to National Treasury to simplify CFC legislation (such as the creation of a country white list[31]), yet many of these recommendations have not been considered for enactment[32]. This is curious considering the time-saving benefit these recommendations could bring to the revenue authorities whilst yielding the same result on revenue collections. Although recommendations to lower the hurdle inclusion rate[33] have been proposed in the recent draft

be in both individuals' best interests. The overall outcome of the experiment is dependent on an individual's perceived reward for individualistic compared to cooperative behaviour.

[26] Teijeiro, 2015

[27] Deloitte.com, 2017b:45

[28] Deloitte.com, 2018a

[29] Deloitte.com, 2018a

[30] South Africa, n.d.

[31] If an entity that is considered to be a CFC of a South African taxpayer is also resident in a predefined list of countries (i.e., a white list), income earned from this entity will qualify for an automatic exemption.

[32] Deloitte.com, 2018

[33] For the purpose of determining whether a CFC's net income (as defined in Section 9D(2A) of the South African Income Tax Act No. 58 of 1962 (ITA)) is to be included as part of a taxpayer's taxable income, the foreign tax payable on this income must be at least 75% of the South African tax payable on this same income.

Taxation Laws Amendment Bill (Draft TLAB; proposed change from 75% to 67.5%[34]), it will be interesting to observe whether this will be sufficient to prevent the CFC rules from turning into a tax collection tool, given the global trend in the reduction of corporate tax rates[35]. Furthermore, given the global uncertainty regarding the adoption of more stringent CFC rules, and considering that South Africa should rather follow international trends than set them[36], now would be an ideal time to incorporate such suggestions until the rest of the world leads with revised CFC enforcement.

1.1.4. Transfer pricing and country-by-country reporting aid the fight against profit shifting

In addition to the South African MNEs' administrative burden of ensuring CFC regulatory compliance, these entities are also required to comply with recently amended transfer pricing (TP) rules, and potentially with country-by-country (CbC) reporting. The revision of the TP documentation required for submission and the introduction of CbC reports are additional initiatives that came out of the BEPS project (Action 13 specifically), which have been adopted by the South African Revenue Service (SARS)[37]. The idea is that the enhanced transparency created between MNEs and global revenue authorities would assist with tackling the tax-base erosion challenges.

The objective of TP reporting is to ensure that cross-border transactions between related parties occur at market-related prices[38], while the purpose of CbC reporting is to enable authorities to view related/inter-group transactions from a big-picture perspective[39]. The documentary requirements for TP and CbC reporting require the extensive disclosure of MNE information through master files[40], local files[41], specified transaction records and specified group disclosure[42] (to name a few). Although this may seem burdensome, this level of reporting enhances the transparency between revenue authorities and taxpayers, and thereby assists in the achievement of the BEPS project objective[43]. In addition, the recent revisions to

[34] South Africa, Taxation Laws Amendment Bill [Taxation Laws Amendment Bill], 2019:11
[35] Davis Tax Committee, 2016:5
[36] Davis Tax Committee, 2016:3
[37] Deloitte.com, 2018b
[38] Deloitte.com, 2018b
[39] EY.com, 2017
[40] A master file includes details of an MNE's global operations (i.e., a group operational overview) and TP policies.
[41] A local file is prepared per local legal entity, as it's designed to include details of intercompany transactions between each local entity and their foreign related parties.
[42] PKF.co.za, 2017
[43] TheSAIT.org, 2018 – Namely, the objective of eliminating or minimising transactions that erode a country's tax base by routing profits to low-tax jurisdictions or tax havens.

the interpretation of the arm's length principle to align compensation with the underlying creation of value has revolutionised how arm's length prices in transactions are to be interpreted and treated by both taxpayers and SARS[44]. The combination of these anti-avoidance mechanisms thus appears to overlap with the purpose of South Africa's CFC rules – the prevention of the erosion of the local tax base.

1.2. RESEARCH QUESTION

When CFC rules were first introduced in South Africa's tax legislation, SARS' intentions of curbing avoidance practices were well-founded. Since then, however, MNEs' cross-border transactions have grown in volume and have also become increasingly complex, which has resulted in intensified taxpayer compliance requirements[45]. Enhanced scrutiny of MNEs by the revenue authorities is understandable, given that recent studies have shown that a small number of firms are responsible for most cross-border profit-shifting transactions[46]. As such, the TP approach to determining an arm's length price between related parties has been enhanced to align compensation and value creation, thereby ensuring equitable remuneration for all (related) parties involved in a transaction. Thus, the anti-avoidance purpose of the CFC rules (both in principle and in terms of reporting) appears to complement the mechanisms to prevent tax-base erosion that the TP arm's length requirements, TP rules and CbC reports are designed to achieve.

After taking the above into consideration, the following primary research question was derived:

Can the purpose of curbing tax avoidance embedded within South Africa's CFC rules be more simply achieved?

1.3. SCOPE OF THIS DISSERTATION

This dissertation focuses on the currently enacted CFC legislation in South Africa and considers elements relating to interpretation notes, explanatory memoranda, recent developments and judgements, as well as proposed amendments. Commentary to the extent that these items relate to the research question are provided. Although Section 9D of the ITA has rules to specifically deal with insurers (captive cell companies) and financial institutions, these sectors are not covered in detail, as such an analysis could deviate from answering the

[44] KPMG.us, 2019
[45] OECD, 2015b:11
[46] Reynolds & Wier, 2018:2

research question. The overall consideration of Section 9D's principles and purpose, however, applies to these entities.

The current CFC (or CFC-equivalent) legislation adopted by Brazil and India respectively is assessed in terms of how effectively these rules achieve the anti-avoidance purpose. In addition, commentary (including articles from reliable and well-recognised sources) and publications (from universities and/or globally recognised organisations) addressing the economic viability of the adoption of CFC rules in these capital-importing economies, as well as the desire for their MNEs to remain internationally competitive, are considered and commented on within the context of the research question.

Furthermore, this dissertation expands its focus to assess the current CFC and Subpart F legislation in the UK and the US respectively, and to examine the reasons for these recent amendments despite the recommendations of BEPS Action 3. The UK's and the US' positions on implementing Action 3 recommendations are only considered for the purposes of assessing the developed world's view on new proposals for CFC rules. These amendments are considered and commented on to the extent that they address the research question.

Publications and commentary (as described above) assessing and explaining the impact of BEPS Actions 3 and 13, as well as Action 13's interaction with Actions 8, 9 and 10, are also incorporated as part of the focus of this dissertation. These documents are used to assess the extent of the adoption of Action 3 in a South African context, and whether such adoption assists in answering the research question. Consideration is also given to whether items addressed in Action 13 (as proposed and/or enacted in South African legislation) overlap with the purpose of CFC legislation and whether this purpose can also be achieved through the use of TP and (potentially) CbC reporting. A further assessment considers the amendments to the arm's length principle embodied in South African TP rules and the potential overlap this has with existing CFC principles. Conclusions are then drawn to the extent that the research question was addressed.

1.4. LIMITATION OF THIS DISSERTATION

This dissertation focuses on the impact of tax legislation and policies on avoidance behaviour. Considerations regarding the impact of legislation and policies on illegal behaviour, such as tax evasion, do not fall within the ambit of this paper.

Legislation in the context of the South African ITA refers to the law as applicable following the promulgation of the 2018 Taxation Laws Amendment Act. BEPS Actions 3, 8, 9, 10 and 13, the UK CFC rules and the US Subpart F rules, TP regulations and CbC reporting requirements affecting India and Brazil, as well as those countries' CFC (or CFC-equivalent) legislation are only considered for this dissertation where all internationally recommended frameworks are as they stand at 28 February 2019 and all necessary laws have been enacted by 28 February 2019. Any amendments, draft documents or proposals made thereafter are considered for light commentary only.

1.5. RESEARCH METHOD

As the prime focus of this research is to evaluate the purpose of South African CFC legislation, this study is conducted within a critical and evaluative theoretical framework – a method which incorporates the interpretivist and positivist paradigms. In assessing the regulation's purpose, a qualitative approach is adopted, allowing for questioning whether proposals made under BEPS Action 3 and Action 13 would assist in simplifying compliance concerns, as well as whether other comparable BRICS countries (India and Brazil) face similar challenges.

1.6. STRUCTURE

Chapter 2 provides a historic overview of the origination of the CFC rules both globally and in South Africa, how these rules have come to evolve and how the current mechanisms work to curb avoidance.

Chapter 3 explores the appropriateness of South Africa adopting first-world policies, and considers the role the international community will need to play in the implementation of BEPS Action 3 recommendations. Considerations of the likelihood of universal adoption are also explored (especially considering the UK's and the US' recent amendments to their respective CFC and Subpart F rules, which counter the BEPS project recommendations).

Chapter 4 explores both the revision to the arm's length principle and the mechanics behind the current TP and CbC reporting requirements (within the context of Action 13). Whether these aspects share the same purpose of deterring base erosion as CFC rules do, are considered. The burden of compliance on taxpayers (especially MNEs) with regards to CFC rules, TP rules and CbC reporting are also explored.

Chapter 5 considers how other BRICS countries (Brazil and India) combat avoidance with their CFC (or CFC-equivalent) rules, given the developing nature of their economies, the desire for

their MNEs to remain internationally competitive, as well as their stance on the adoption of BEPS Actions.

Chapter 6 provides conclusions and recommendations.

CHAPTER 2: THE HISTORY AND MECHANICS OF THE CFC RULES

2.1. HISTORIC OVERVIEW

CFC legislation was initially adopted by the US as part of its Subpart F rules in 1962, with the intention to introduce capital export neutrality[47]. In the 1970s, West Germany, Japan and Canada introduced similar legislation, with more countries adopting the rules during the 1980s and 1990s[48]. By the mid-1990s at least fifteen countries had enacted CFC legislation[49], and on 1 July 1997 South Africa became the nineteenth country to introduce CFC legislation[50]. By 1998, the OECD Council had recommended that CFC rules should be adopted globally[51].

The worldwide adoption of CFC rules largely came about as a result of the relaxation of exchange control laws in many OECD countries between the 1970s and 1990s. The removal of these capital barriers opened up borders to inward and outward capital flows[52]. This not only enhanced the cross-border activities of many MNEs[53], but also allowed these entities to design their operational structures in ways which could be perceived as an abuse of tax regimes[54].

Corporates (and their shareholders) were thus in a position to take advantage of the international tax arbitrage made available to them through the variation in tax rules from jurisdiction to jurisdiction. Generally (subject to the applicable tax rules in varying jurisdictions), a foreign corporation would be taxed on its foreign-source income while shareholders would be taxed on distributions received from the foreign entity (either in the foreign jurisdiction, the shareholders' resident country or both)[55] – this is due to the fact that corporations and their shareholders are treated as separate persons for tax purposes, thus their respective income streams are taxed separately[56]. Instances could arise in which shareholders and the foreign entity pay very little tax compared to the taxes that would've been paid if the foreign entity was

[47] Schmidt, 2016:89;
Davis Tax Committee, 2016:11 – Capital export neutrality is achieved when resident taxpayers are taxed equally, regardless of whether they invest in the local economy or abroad. Similarly, capital import neutrality is achieved when income earned from an offshore investment is taxed at the same rate as the taxpayer's resident tax rate.
[48] Schmidt, 2016:89
[49] *Ibid*
[50] Sandler, 1998:xv
[51] Schmidt, 2016:89
[52] Sandler, 1998:1
[53] *Ibid*
[54] Sandler, 1998:2
[55] Sandler, 1998:5
[56] Sandler, 1998:4

incorporated in the same jurisdiction as its shareholders, or shareholders could avoid[57] tax altogether if the foreign entity was incorporated in a low-tax jurisdiction or tax haven[58]. Instances could also arise in which shareholders could defer tax (indefinitely) if a foreign entity did not declare dividends.

It is important to note that a taxpayer's freedom to legally avoid taxes (tax avoidance) is not the same as illegal activities involving non-compliance with laws and regulations (tax evasion)[59]. The freedom to transfer capital abroad resulted in a legal arbitrage which greatly enhanced taxpayers' means to defer or avoid tax in their resident countries. As a result, Revenue authorities sought to curb this avoidance[60] through legislative amendments to both domestic laws and international double tax agreements (DTAs) and by adhering to international anti-avoidance initiatives (such as the BEPS Action Plan)[61]. Thus, in the wake of the elimination of exchange control regulations[62], many countries enacted domestic CFC legislation. This was seen as international best practice to guard against domestic tax-base erosion through the export of capital to foreign entities[63].

2.2. RECENT INTERNATIONAL ANTI-AVOIDANCE DEVELOPMENTS

Since the OECD's initial recommendation for the global adoption of CFC legislation, the rules have once again come under the spotlight. In the wake of the global financial crisis[64], the OECD was given the responsibility of developing solutions to tackle the problem of large MNEs' aggressive tax planning schemes and the adverse impact this had on countries' tax-revenue collections[65]. As the global economy became increasingly characterised by MNEs' cross-border activities[66], mismatches in domestic legislation and cross-border economic behaviour resulted in uncoordinated tax rules, and corporates were able to develop structures to take advantage of these domestic and international tax asymmetries[67]. Some MNEs were found to not be paying their "fair share" of taxes by using structures that exploited these mismatches and allowed for the artificial shifting of profits from the jurisdiction where they were

[57] Oguttu, 2015:518 – "*Tax avoidance involves using legal methods of arranging one's affairs, so as to pay less tax. This is done by using loopholes in tax laws and exploiting them within legal parameters*."
[58] *Ibid*
[59] Oguttu, 2015:518
[60] Sandler, 1998:4
[61] Oguttu, 2015:517-518
[62] Sandler, 1998:8
[63] Schmidt, 2018:89
[64] Oguttu, 2015:517
[65] Brauner, 2016:989; 976
[66] Oguttu, 2015:524
[67] *Ibid*

earned to tax havens with limited economic activity[68]. It was in response to media interest in these MNE schemes that G20 politicians initiated the BEPS project[69] and called on the OECD to develop an Action Plan that would provide countries with instruments that would better align taxing rights with economic activity[70]. Of the fifteen actions coming out of the Action Plan, Action 3 relates to the development of recommendations for the design of CFC rules[71].

2.3. THE DESIGN OF CFC LEGISLATION ACCORDING TO THE BEPS PROJECT

CFC rules are designed to deter taxpayers from shifting profits offshore for the purpose of reducing or deferring tax, as well as to protect a shareholder's resident-country's tax revenues by ensuring that certain profits remain in that country's tax base[72].

In order to effectively identify and tackle base-stripping (the shifting of profits from a taxpayer's resident country to another foreign entity which that taxpayer controls[73]), the OECD's Action 3 report lays out recommendations in the form of six building blocks which are necessary for CFC rules to act as an effective preventative measure. These rules can be broken down into the following categories[74]:

i. **Control over a CFC:** The first building block defines what a CFC is by including the definition of control, while the second building block lists various exemptions and threshold requirements which could cause an entity to fall outside of the CFC ambit;
ii. **Income of a CFC:** The third building block defines CFC income, the fourth lays out the requirements for computing income, while the fifth describes the rules for attributing income (in their design, these building blocks factor in typical avoidance techniques and include measures to counter them); and
iii. **Prevention of double taxation:** The sixth building block addresses the prevention or elimination of double taxation.

Once it has been established that these factors are evident, a CFC is considered to exist and imputation of the CFC's income back into the tax net of the country of the resident shareholder may be required[75].

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[68] Oguttu, 2018:325
[69] Brauner, 2016:989
[70] OECD, 2013:11
[71] Schmidt, 2018:90 – Action 3 falls under the first pillar, namely coherence in domestic tax rules that affect cross-border transactions.
[72] OECD, 2015:13
[73] OECD, 2015:16
[74] OECD, 2015:9
[75] Note that this is a high-level summary of the general application of the rules. Whether an entity is deemed to be a CFC, and thus whether its income is imputed, is subject to the applicable legislation of various countries.

2.3.1. Control over a CFC

When a resident taxpayer influences the actions of a foreign entity it controls, such actions, including those that relate to the movement of capital and profits, can be seen as a mere extension of those of the resident taxpayer. Action 3 defines control as either legal control (a shareholder's percentage of voting rights by holding share capital), economic control (a shareholder's rights to profits, capital and assets, i.e., control by entitlement), *de facto* control (consideration of who has the ability to direct or influence day-to-day activities) or control based on consolidation (by considering whether a foreign entity has been consolidated for accounting purposes) [76]. In testing whether control is evident, the impact of legal and economic control needs to be considered primarily, while *de facto* elements should be secondary considerations. A combination of the two (legal and *de facto* control) can be used to test the impact of control based on consolidation[77]. Overall, Action 3 recommends that if residents hold a minimum of 50% control in a foreign entity (however that control might come about), it should be treated as "controlled"[78].

When control can be exerted (either directly or indirectly), the controlling party/parties has/have the ability to dictate the financial and economic actions of the CFC. With this control comes the risk of BEPS, which the CFC rules attempt to address by limiting the CFC's scope through exemptions and threshold requirements[79]. As the risk is that profits could be artificially shifted to low-tax jurisdictions, Action 3 recommends the use of exemptions[80] (such as a country blacklist that would subject listed countries' CFC income to imputation or exempt the income if the jurisdiction is listed on a white list[81]) and threshold requirements[82] (such as a de-minimis threshold where CFC income is not considered for attribution if it falls under a certain threshold or a tax rate threshold which exempts attribution of a CFC's income if the foreign entity's local tax rate is higher than the local rate of its shareholder[83]). The aim of these recommendations is to make the CFC rules more targeted and effective.

In summary, the purpose of the control consideration is to subject foreign entities located in low-tax jurisdictions, that are controlled by non-resident shareholders and where a risk for artificial profit shifting exists, to Action 3's recommended CFC rules (under specific circumstances).

[76] OECD, 2015:26, 27, para 35
[77] *Ibid*
[78] OECD, 2015:21
[79] OECD, 2015:33, para 50
[80] OECD, 2015:33, para 52
[81] OECD, 2015:36, 37, para 62
[82] OECD, 2015:33, para 52
[83] OECD, 2015:33, para 52-53

2.3.2. Income of a CFC and anti-avoidance considerations

It is evident that the CFC rules aim to identify instances of artificial profit shifting by adopting a risk-based approach. Once a CFC has been identified, the next steps are to attribute income (with certain BEPS risks associated with it) to the controlling parties of the CFC in their relevant jurisdiction[84]. The separation of income from the activity which created it, in an effort to reduce taxes payable, is a key BEPS risk indicator and certain factors are considered to identify this income[85]. These factors include considering how mobile (geographically) the income could be, whether the income was earned with the assistance of related parties, and whether any (or what underlying) activities occurred within the CFC[86].

As income varies from jurisdiction to jurisdiction, flexibility remains important to allow countries to define CFC income in accordance with their domestic laws[87]. To help establish this definition, Action 3 outlines the following three approaches which could be applied in isolation or combination:

i. **Categorical analysis:** Current CFC rules attribute income based on how it is categorised (this is often subject to jurisdictional discretion). These categories include: (i) the legal classification of income (such as dividends, interest, insurance income, royalties and sales/service income), (ii) how related transaction parties are to be treated, and (iii) the source of the income[88]. Many existing CFC rules consider (i) and (ii) in combination, as profit shifting could be made easier through the construct of favourable transactions between related parties. In addition, the source of the CFC's income is considered with the premise that income earned from *bona fide* business activities employed by the CFC are less likely to raise concerns about profit shifting[89].

ii. **Substance analysis:** In a slightly more comprehensive take on the source analysis noted in sub-category (iii) above, one needs to consider the substance of the activities of the CFC in detail in order to determine whether the CFC had the ability to earn the income itself[90]. Either a threshold test (a set level of activity could result in CFC income from being excluded from the definition) or a proportionate analysis test (the proportionate amount of income earned in relation to a proportionate

[84] OECD, 2015:43, para 72
[85] OECD, 2015:43, para 74
[86] OECD, 2015:43, para 74
[87] OECD, 2015:43, para 73
[88] OECD, 2015:44, para 78
[89] OECD, 2015:46, para 80
[90] OECD, 2015:47, para 81

amount of activity) can be applied to assist with establishing whether there was substance to the earning of the CFC's income[91].

iii. **Excessive profits analysis:** At the time of issuing the Action 3 report, this approach wasn't featured in any country's CFC rules. The analysis considers whether income was earned in excess of a "normal" return that would be expected from an investment in the CFC, after taking into account the facts and circumstances associated with that particular investment. The excess profits earned over and above the normal return should be treated as attributable CFC income. This is targeted at mispriced transactions which typically occur between related parties where profits are inflated in excess of what is considered to be "normal" – for example, in relation to the price charged to local shareholders for the use of offshore-located intangible assets: such royalties may be artificially inflated to shift profits from the shareholder's country to the CFC's low-tax jurisdiction[92].

Regardless of which analysis is used to define CFC income, such an analysis needs to be applied either on an entity-by-entity basis or a transactional basis. On an entity-by-entity basis, either all of the entity's income or none of it, will be attributed to the shareholder depending on whether the entity's total income meets certain threshold criteria before it can be considered for inclusion. The transactional basis, on the other hand, considers the characteristic of each income stream to determine whether it should be attributed to the shareholder, as defined.[93]

Once it has been established that a CFC's income is attributable to the controlling party/parties, the amount to be attributed needs to be determined. The tax laws of the controlling party/parties' jurisdiction should be used to calculate the CFC's income, with limitations of losses incurred by the CFC to also be taken into account when performing this calculation[94]. Attribution of the income to the controlling parties should be made in proportion to their ownership, over their period of influence. This income would be included as part of their taxable income calculation in their jurisdiction, to which the local tax rate applies[95].

[91] OECD, 2015:47, para 82
[92] OECD, 2015:49, 50, para 87
[93] OECD, 2015:50, 51, para 95
[94] OECD, 2015:57, para 99
[95] OECD, 2015:61, para 110

2.3.4. Prevention of double taxation

There are certain instances which could result in double taxation as a result of the application of CFC rules, such as when (i) a CFC's attributed income is also subject to foreign tax, (ii) CFC rules in more than one jurisdiction apply to the attributed income, and/or (iii) a CFC distributes attributed income as a dividend[96]. To reduce the risk of double taxation occurring, countries which have adopted CFC legislation must amend their domestic laws and tax treaties accordingly. For example, a foreign-tax credit system in the controlling party/parties' jurisdiction would eliminate a double-tax impact in scenarios (i) and (ii) above, while dividends under example (iii) could be made exempt if they were already subject to tax in that jurisdiction[97].

2.3.5. Overview of Action 3 recommendations

In conclusion, these recommendations aim to deter a CFC's shareholders from engaging in tax-avoidance behaviour[98], such as the stripping of a shareholder's resident-country tax base to reduce taxation and the deferral of a resident shareholder's local-tax liability. From the OECD's perspective, the global adoption of these recommendations would greatly assist in reducing the artificial shifting of profits for the purposes of such avoidance.

2.4. SOUTH AFRICA'S CFC FRAMEWORK

South African CFC rules are largely focussed on acting as a tax-avoidance deterrent[99] – an objective which is shared by the OECD. The current legislation appears to be in line with the rules adopted by many developed countries, to the extent that the legislation is considered to be one of the most sophisticated amongst G20 countries[100].

The structure of South Africa's CFC rules, as contained in Section 9D of the ITA, largely follows the recommended building blocks set out by the OECD in Action 3. Section 9D defines what constitutes control of a CFC, defines CFC income that is required to be attributed to residents and how this calculation should be performed, and interacts with the foreign-tax credit provisions in Section 6*quat* to avoid double taxation.

[96] OECD, 2015:65, para 122
[97] OECD, 2015:65, para 123
[98] OECD, 2015:13
[99] Davis Tax Committee, 2016:13
[100] Davis Tax Committee, 2016:6

2.4.1. Defining control over a CFC in the context of Section 9D

A foreign company is defined as a CFC if more than 50% of its participation or voting rights are directly or indirectly held by one or more South African residents, regardless of whether those residents are connected persons[101]. Participation rights are defined as rights to receive the economic benefits attached to ownership of a share, such that this mirrors legal and economic control (for example, equity shares with the right to participate in share capital, current or accumulated profits, or reserves, as well as other types of shares, such as preference shares[102]). Voting rights is considered in determining control if a company doesn't have shares but only voting rights[103]. If a person holds less than 5% of the participation rights of the entity, this person will not be considered to be a resident for the purposes of aggregating other residents' ownership in a foreign entity to meet the 50% control requirement.

In effect from 1 January 2018, an additional control consideration is included in the CFC definition – the consideration of control based on consolidation in terms of International Financial Reporting Standards (IFRS)[104] 10, as recommended in BEPS Action 3. The reason for this addition was to include entities, other than companies, that are consolidated for accounting purposes. This was in response to SARS' concern that entities other than companies (such as foreign trusts) were being used to artificially break the connection between a resident and a CFC[105]. South Africa's consideration of economic control, legal control and control based on consolidation is thus in line with the OECD's recommendations.

To further address the risk that profits can be made to flow to low-tax jurisdictions to artificially reduce the South African tax liability, both a tax rate threshold and a *de minimis* rule were introduced to Section 9D. The tax-rate threshold only considers CFC income for inclusion if the foreign tax payable is less than 75%[106] of the South African tax that would have been paid had the CFC been a resident[107]. The *de minimis* rule, on the other hand, includes tainted income earned by a CFC from a financial instrument if this exceeds more than 5% of the entity's total receipts and accruals (excluding other specified types of passive income). Section

[101] Section 9D(1)
[102] Oguttu, 2007:115
[103] Oguttu, 2007:118
[104] This is an accounting framework that has been globally adopted for financial accounting and reporting purposes.
[105] National Treasury, 2017:58
[106] It is proposed that this threshold is revised to 67.5% per the comments noted in the 2019 Draft TLAB.
[107] Section 9D(2A)Proviso

9D has thus incorporated provisions to make its application more targeted and effective in addressing the risk of artificial profit shifting[108].

2.4.2. Section 9D's anti-avoidance considerations and attribution CFC of income

South Africa uses the categorical analysis approach in which passive forms of income are listed as tainted (subject to certain exemptions)[109]. Tainted income is typically seen as either mobile income, which is predominantly made up of passive income (interest, royalties, dividends, etc.) or non-commercially sourced income, which is derived through diversionary transactions (e.g., the provision of goods or services to a connected person for no commercial reason other than to derive a tax benefit)[110]. These income categories are considered part of the resident participation-rights holder's income, from which net income is determined (provided this resident holds at least 10% of the participation rights). Net income, as defined in Section 9D(2A), determines the taxable income of a CFC in accordance with specific provisions of the ITA, had the CFC been a resident.

Section 9D not only considers the legal classification of income and how related transaction parties are, but also the source of the income, as income earned from real economic activity in a CFC (i.e., the generation of active income through *bona fide* business activities in competition with other local businesses) is less likely to raise a profit-shifting concern. The concept of a foreign business establishment (FBE) is related to this income-source test and has been defined in Section 9D. In order for an entity to meet the definition of an FBE, certain criteria proving the existence of *bona fide* business operations need to be met. Thus, from a risk-assessment perspective, active income derived from an FBE's real economic activity is not typically considered for attribution[111]. In certain circumstances, however, even though economic activity may exist, tax-avoidance behaviour through the application of non-commercial and diversionary transactions may arise. Since the CFC rules are aimed at deterring such behaviour, Section 9D incorporated specific anti-diversionary rules to prevent the artificial movement of profits offshore through non-commercial transactions with connected persons[112].

Section 9D thus closely follows the Action 3 recommendations by identifying a CFC's attributable income stream on a transaction-by-transaction basis, applying South African tax

[108] Section 9D(9A)(a)(iii)
[109] Davis Tax Committee, 2016:28
[110] Davis Tax Committee, 2016:16
[111] Davis Tax Committee, 2016:12
[112] Oguttu, 2007:130

laws to determine the taxable income of the CFC (had it been a South African resident) and then allocating this income in proportion to the controlling parties' ownership share over the period of influence. Certain anti-avoidance provisions are also incorporated into the legislation to penalise non-commercial behaviour through diversionary transactions.

2.4.3. Avoidance of double taxation in the context of Section 9D

The prevention of double taxation is a key component of Section 9D and is largely in line with the Action 3 recommendations. This is seen in the Section's reference to the tax credit available under Section 6*quat* and the application of DTA provisions where applicable:

i. **Tax credits:** If a CFC's attributed income was also subject to foreign tax, a resident can reduce his or her South African taxes payable by applying the tax credit available under Section 6*quat* and thus avoid being taxed twice on the same income[113].
ii. **DTAs:** Section 9D mentions that all attributed income must first be treated in terms of the applicable DTA before the CFC attribution rules are applied[114].

Instances may also arise in which a foreign subsidiary could be subject to multiple country CFC imputation claims and thus multiple instances of taxation (e.g., Country X has a CFC in South Africa, which in turn has a CFC in Country Y, and both Country X and South Africa's CFC regimes apply to the CFC in Country Y). The headquarter-company rules in Section 9I of the ITA were created specifically for this instance, such that qualifying headquarter companies are exempt from CFC rules[115]. However, should a resident shareholder holding multiple layers of CFC entities in various jurisdictions not be classified as a headquarter company, the tax-credit methodology should suffice to prevent double taxation. Assuming that the relevant jurisdictions apply (Action 3-equivalent) CFC rules, all the CFCs' income would be attributed and taxed at each level. In South Africa, each CFC's income would be separately imputed according to the rules of the ITA. Should any tax be payable, the taxes paid in the relevant jurisdictions will be offset against this liability, thereby preventing double taxation. South Africa has thus made strides in amending its applicable legislation and DTAs with the goal of preventing double taxation in the application of the CFC rules.

[113] Section 6*quat*
[114] Section 9D(2A) Proviso
[115] Davis Tax Committee, 2016:34

2.5. CHAPTER CONCLUSION

In the wake of the relaxation of South Africa's exchange control regulations, a new set of rules were required to balance the country's need to remain competitive on the international stage with its need to protect its tax base[116]. Although their introduction was initially very limited, the timing of the introduction of these rules (1997) is interesting, considering that it occurred before South Africa's adoption of a residency tax system (2001) but soon after the country's return to global trade after the 1994 democratic elections[117].

It is evident that South Africa has attempted to keep its CFC legislation in line with international trends by closely following the BEPS Action 3 recommendations. This is seen in Section 9D's adoption of the recommended control and income attribution considerations, anti-avoidance elements, as well as double-taxation prevention provisions. As a result, South Africa's CFC rules are some of the most sophisticated and complex rules among G20 nations, all with the purpose of deterring the tax-avoidance behaviour of resident taxpayers. Although the intention may have been to adopt international best practice and to remain relevant on the global stage, the success of the implementation of the Action 3 recommendations are dependent on the global adoption of the recommendations[118]. These considerations, amongst others, are dealt with in the next chapter.

[116] Davis Tax Committee, 2016:15
[117] Oguttu, 2007:191
[118] Davis Tax Committee, 2016:12

CHAPTER 3: RELEVANCE OF SOUTH AFRICA'S CFC LEGISLATION IN THE CONTEXT OF GLOBAL (NON-)ADOPTION

3.1. SOUTH AFRICA – A DEVELOPING NATION ADOPTING FIRST-WORLD LEGISLATION

In 2001[119], South Africa's tax system was significantly reformed when its income tax policy was changed from a source-based to a residence-based tax system. One of the reasons for this change was to bring South African policies in line with international standards, and to broaden and protect the existing tax base[120] (especially in light of the relaxation of exchange control regulations). At that stage, South Africa was an inexperienced international market participant both from an economic and an international tax standpoint, as it had re-entered the international trade arena only post-1994[121].

Understandably, South Africa had lagged behind its trading partners on the international tax front and thus required the assistance of foreign experts to aid in the development of the country's legislation. When CFC regulations were initially drafted, first-world concepts were incorporated into the legislation and limited consideration was given to South Africa's prevailing economic conditions[122].

3.1.1. The challenges faced by a developing economy

Despite the first-world capabilities of South Africa's economy, it is still regarded as a developing country. A key difference between developing and developed countries is that, generally, the former are capital importers while the latter are capital exporters[123]. As such, the economic interests of developed and developing countries are poles apart, which results in these two categories of countries applying different tax principles to protect their respective tax bases (amongst other objectives). Exporters of capital have historically taxed their residents' income to capture the tax on the value derived at the production stage (referred to as a residence basis of taxation). This method ensures that offshore revenues earned from exported capital are incorporated into the country's tax net. Capital importers, however, tax locally generated sales derived from the use of foreign capital deployed within their borders (referred to as the source basis of taxation)[124].

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[119] South Africa, National Treasury, 2000 – The changes from a source-based to a residence-based tax system were announced in 2000 and were effective from 1 January 2001.
[120] Nyamongo & Schoeman, 2007:481
[121] Oguttu, 2007:191
[122] *Ibid*
[123] Oguttu, 2018:315
[124] *Ibid*

The tax revenue collection challenges faced by developing countries in Africa are very different from those encountered by developed nations. As developing African countries struggle to raise revenues from individual income and consumption taxes, they have become more heavily reliant on the generation of revenue from corporate income taxes than their developed counterparts[125]. This is because developing African nations typically rely on the small formal sector of those economies to carry their tax bases, as limited tax reporting (caused by the lack of financial record keeping and low levels of tax education), non-compliant cultures and inadequate resourcing of tax administrations cause a disproportionate dependence on a small number of compliant taxpayers[126].

Not only do developing countries encounter revenue collection hardships within their own borders, but they are subjected to further collection pressures by wealthier trading partners when it comes to negotiating cross-border DTAs. DTAs are used to prevent double taxation from arising, as well as to ensure that there is balance between a developing nation's need to garner its "fair share" of the tax revenues generated and a foreign investor's requirement to earn a reasonable return from deployed capital[127]. However, developed countries tend to weigh the terms of these treaties in their favour as they often have stronger negotiating power[128]. This has made securing corporate tax collections that much harder for developing nations.

3.1.2. The impact of transplanting foreign tax rules to South Africa's domestic legislation

In 1997, the government incorporated a very limited version of the residence-based CFC regime into its domestic legislation (before South Africa changed its own tax system to the worldwide basis in 2001). Some may argue that the adoption of these "trial" rules appeared to be in haste. The race to adopt international best practice appears to have continued in subsequent years, to the extent that South Africa has developed one of the most sophisticated and complex set of CFC rules amongst the G20[129]. It is understandable, however, that SARS would want to take steps to ensure the tax base isn't eroded by tax-avoidance structures, considering the country's dependence on corporates to generate 18% of tax revenues[130] (almost double the average of the corporate collections in developed countries[131]).

[125] Oguttu, 2015:526
[126] Oguttu, 2015:528-529
[127] Oguttu, 2018:315
[128] *Ibid*
[129] Davis Tax Committee, 2016:3
[130] South Africa, National Treasury & the South African Revenue Service, 2018:vii
[131] Reynolds & Wier, 2018:9

As South Africa attempts to position itself as a global competitor, it can't ignore the impact of the international tax system on its domestic legislation. It is on the international stage where countries promote themselves to attract investment as they compete with each other for mobile capital[132] and indirectly for tax revenues (the presence of this additional capital helps to grow countries' economies and thus their tax bases). A common component of international taxation is the ability to transplant one country's tax rules to another[133], something which South Africa's CFC rules are no stranger to. South Africa's international tax rules are considered to be complex – both from a legal (i.e., reading and understanding of the law) and an effective (i.e., administrative compliance) standpoint[134] – partly as a result of these "imported" aspects of the legislation[135].

This complexity comes from a divergence of general legal systems from domestic tax regulations, as the accessory nature of tax laws arising from their reliance on other domestic legislation (such as the legal nature of revenue, the definition of a company or whether a partnership is a juristic person) means that cross-border interpretations may differ before taxation regimes are even considered[136]. As such, South Africa should be careful to not incorporate other countries' (or even international bodies') tax concepts too hastily into domestic legislation since unnecessary legal and effective complexities could arise. There is a risk that such additional complexities could create interpretation confusion, which could result in the incorrect taxes being reported or levied.

Just as the transplanting of foreign jurisdictions' tax laws can create unforeseen complexities, the incorporation of accounting concepts into a legal framework has the potential to create similar problems. South Africa's CFC rules make direct reference to the accounting standard, IFRS 10, for the purposes of defining a CFC. The insertion was made to expand the CFC definition to include entities other than companies that are consolidated for accounting purposes (under IFRS 10), to align the legislation with the Action 3 recommendations. South Africa's ITA is complex enough, such that only dedicated tax professionals can understand it[137]: A direct reference to an accounting standard now means that these professionals, as well as the revenue authority, must become acquainted with the unfamiliar provisions of IFRS 10. This has the potential to become a conflicting area of interpretation, which could cause both taxpayers and SARS to apply the legislation incorrectly.

[132] Li & Pidduck, 2019:10
[133] Li & Pidduck, 2019:11-12
[134] Li & Pidduck, 2019:5-6
[135] Li & Pidduck, 2019:38
[136] Li & Pidduck, 2019:13
[137] Li & Pidduck, 2019:7

CFC rules are considered part of South Africa's outbound tax policies: Their goal is to facilitate the competitiveness of South African outbound investments by preventing double taxation, whilst simultaneously combating tax-avoidance practices[138]. Preventing double taxation appears to have been adequately dealt with through the tax credit system in Section 9D, but there is an additional risk that excessive taxation may arise if CFC rules are applied too stringently. This could ultimately reduce the available cash in, and throttle the competitiveness of, South African MNEs. For instance, considering the trend of the reductions in global corporate tax rates, the proposed reduction of Section 9D's 75% tax rate threshold to 67.5% may still inappropriately impute income from jurisdictions that aren't considered to be tax havens (such as the UK and US), thereby risking altering the purpose of the CFC rules from deterring avoidance to becoming a revenue collection tool[139].

Should the CFC rules be turned into a tax collection tool, this would be counter to both the purpose of the rules and the country's tax policy, and damage the growth of corporate South Africa. Although this tax threshold concept was adopted in the South African legislation with reference to other international regulations, consideration needs to be given to the effect the country's high corporate tax rate may have on the application of this exemption. South Africa thus needs to adjust its focus to protecting its economic interests[140] by carefully considering how international tax recommendations (such as the BEPS Action Plan) should be applied to its domestic legislation.

Transplanting other regions' tax rules without due consideration of their impact on the legal and effective complexities of the ITA risks creating an incorrect assessment of taxpayer income. The risk of overtaxation as a result of overly stringent CFC legislation is of greater import, considering the adverse impact this could have on South African MNE growth and international competitiveness.

3.2. BEPS AND THE POLITICAL WILL TO INITIATE GLOBAL ADOPTION

The BEPS project is not the first OECD initiative aimed at curtailing BEPS behaviour. During the 1990s, the European Union (EU) raised its concern about the depletion of certain member countries' tax bases through CFCs' strategic use of other member countries' tax rules, with the purpose of exploiting these other jurisdictions' lower tax rates[141]. Off the back of this, the OECD issued a Report on Harmful Tax Competition in 1998, which included recommendations

[138] Li & Pidduck, 2019:21
[139] OECD, 2015:13
[140] Davis Tax Committee, 2016:3
[141] Oguttu, 2015:522

for anti-avoidance measures to curb such offshore avoidance. However, the political will to implement these recommendations into enforceable legislation didn't materialise[142].

After the global financial crisis, however, the political stance on anti-avoidance appeared to change when politicians were faced with public outrage against MNEs' abusive use of tax-planning schemes. In reaction to this, G20 politicians initiated the BEPS project and charged the OECD with tackling this problem – a perceived "win" for the OECD which had tried to obtain political support for such a reform for many years[143]. However, in its quest to revolutionise international tax policies, the OECD found itself in hot water by being accused of bias towards the agendas of developed nations[144]. For instance, when the global financial crisis saw many European nations revert to being capital importers (something which developing nations had been for years prior to this crisis), it was suggested that the BEPS project was merely reactionary to the needs of those nations to aid the stimulation of revenues for their benefit[145].

Questions were also raised as to whether the proposed strengthening of existing anti-avoidance provisions (as suggested under the Action Plan) would be instrumental in preventing BEPS, considering that taxpayers had been manipulating these provisions for years, rendering them virtually ineffective[146]. Furthermore, BEPS issues faced by developing countries aren't only as a result of legal loopholes exploited by MNEs but also due to illicit capital outflows. Such unlawful behaviour won't be fixed by strengthening legislation, but rather through the implementation of criminal sanctions[147].

In the context of the Action 3 recommendations, the best anti-shifting results would come from a universal strengthening of CFC legislation. To test the adoption of these recommendations, consideration has been given to the outlook on these proposals by two of the world's largest developed economies, the US and the UK. Considering only limited worldwide adoption has taken place[148], South Africa should consider the effectiveness its existing CFC rules has in achieving its anti-avoidance objective. Developing nations, like South Africa, should consider waiting for concepts to be tried and tested on the international stage before implementing them

[142] Oguttu, 2015:523
[143] Brauner, 2016:989
[144] Oguttu, 2015:541
[145] *Ibid*
[146] *Ibid*
[147] Oguttu, 2015:533
[148] Deloitte.com, 2017d – The Deloitte Action 3 Implementation report lists jurisdictions according to whether they have or haven't adopted CFC legislation. According to this list, 36 countries have CFC rules. However, not all of these countries' rules are of the same standard as the Action 3 recommendations.

in their domestic legislation. However, the outcome of such a trial period can only be examined if these BEPS recommended policies were (ever) universally adopted.

3.2.1. How the "double Irish with a Dutch sandwich" scheme achieved foreign to foreign base-stripping[149]

Even though the BEPS project actions supposedly have political backing in many G20 nations to strengthen domestic anti-avoidance legislation, certain anomalies still openly exist in first-world taxing systems that allow MNEs to pay negligible amounts of tax.

The "double Irish with a Dutch sandwich" manoeuvre, which was used by many US tech companies (such as Apple, Google and Microsoft)[150], is an example of what the BEPS project was designed to prevent. From an American perspective, this tax-avoidance scheme made use of cross-border loopholes through a creative combination of the US' Subpart F exemptions (i.e., the exemptions in its CFC-equivalent legislation), favourable EU treaties and the 0% tax rate available in tax havens. This scheme allowed Apple and Google to achieve incredibly low effective tax rates of 2% and 2.4% respectively[151], for instance.

Essentially, the scheme took advantage of the 0% royalty withholding tax agreement between Ireland and the Netherlands, and exploited an Irish residency loophole which based the residency of Irish companies on the place where management and control was exercised (not necessarily where an entity was incorporated). In order to take advantage of this, a US parent company would firstly relocate its sales-generating intellectual property (IP) from the US (a high-tax jurisdiction) to a tax haven by sharing the IP development costs with this "paper subsidiary". This allowed the US parent company to pay "costs" to this subsidiary and enable the sharing of royalties earned in proportion to this cost-sharing arrangement. The next step would be to set up another entity incorporated in Ireland that was managed and controlled in a tax haven (for Irish tax purposes, this entity would be seen to be resident in the tax haven). *Bona fide* sales income would then be earned by a separate Irish entity (a true Irish tax resident company). By setting up IP sublicencing agreements between these group entities and a Dutch middleman, the sales income would morph into royalty income, be routed through the Netherlands (where the withholding tax rate between Ireland and the Netherlands was 0%), and ultimately find its way to the Irish-incorporated company's tax haven, where it wouldn't be

[149] OECD, 2015:13 – Foreign to foreign base stripping is defined as the simultaneous stripping of a MNE's resident country's tax base and other countries' tax bases.
[150] Burkadze, 2016:367
[151] Burkadze, 2016:367

subject to Irish tax.[152] The result of this structure was that none of the royalty revenues were subjected to tax in a high-tax jurisdiction (the US), while most of the revenues were taxed in a low-tax jurisdiction (Ireland) or weren't taxed at all when they were rerouted to the tax haven (either through the separate Irish entity and/or through the cost-sharing arrangement between the US and the paper subsidiary in the first tax haven). This is the type of foreign to foreign base-stripping behaviour that the BEPS Action 3 recommendations strive to avoid.

It was only a matter of time before the arrangement of such a tax-saving magnitude would attract the attention of government officials. In 2013, Tim Cook (chief executive of Apple) testified before an investigative subcommittee of the US Senate to explain Apple's avoidance of US taxes, which in turn sparked a series of investigations into the avoidance structure[153]. After mounting public pressure, the Irish government amended its legislation (effective from 2020) to prevent its tax laws from being used to support cross-border base erosion through the "double Irish" structure[154]. Apple was also rapped over the knuckles by the European Commission (EC) for its dealings in Ireland where it was required to pay €14.5 billion plus interest in unpaid taxes garnered from 2003 to 2014[155]. This fine wasn't related to the "double Irish with a Dutch sandwich" scheme[156], but rather to "illegal deals" between Apple and the Irish government[157] (these deals saw Apple's Irish operating companies pay tax below the Irish statutory tax rate on all EU sales income[158]). Agreements like these showcase both the corporate and governmental disregard for anti-avoidance legislation and principles.

3.2.2. US tax amendments not in line with BEPS recommendations

With the "double Irish" tax-avoidance scheme out in the open, one would think that American politicians were motivated to bring these lost taxes back to the US by driving legislative changes.

In December 2017, US lawmakers reduced the corporate tax rate from 35% to 21% and simultaneously introduced tax reforms that were supposedly designed to incentivise US MNEs to stop their use of offshore tax-avoidance structures[159]. One of the reforms introduced was the Global Intangible Low-taxed Income (GILTI) provision, which taxes US parent companies (at a rate of 10.5%) on offshore subsidiary profits that exceed a 10% return on offshore tangible

[152] Burkadze, 2016:367-371
[153] Bowers & Drucker, 2017
[154] *Ibid*
[155] Wang, 2018:540
[156] Wang, 2018:542
[157] Wang, 2018:542
[158] Wang, 2018:554
[159] Walters, 2018

investments[160]. US parent companies can claim a foreign tax credit against the GILTI tax in respect of foreign taxes paid on these profits[161]. The amendments also made provision for the tax-free repatriation of dividends from profits generated offshore, even if those dividends weren't ever subject to foreign tax[162]. An additional rule, the Foreign Derived Intangible Income (FDII) provision, was introduced to give US companies a favourable tax rate on their income derived from exports[163]. This was to supposedly incentivise US MNEs to bring their IP back into the US to allow them to take advantage of favourable tax rates on the export of their IP-related services[164].

These reforms have been criticised for encouraging MNEs to continue to use offshore tax-avoidance structures rather than to change their behaviour, thus bringing into question the legislation's supposed purpose to discourage tax-avoidance behaviour in the first place[165]. For instance, MNEs can determine whether they meet the 10% threshold for offshore returns by increasing their offshore cost base. This can be achieved by shifting US operations to the relevant foreign jurisdictions. As US tax won't be payable if a MNE's foreign return is less than this 10% threshold, and considering that this return can be manipulated, the incentive to bring these lost offshore profits back to the US is diminished. Even when the 10% threshold is exceeded, offshore profits are subject to the already low 10.5% GILTI tax, which can be eroded further if any foreign tax credits are applied against the US tax payable. The likely outcome is minimal tax dollars being collected in the US, combined with a potentially adverse impact on the US economy and job creation. To add fuel to the fire, the exemption of repatriated dividends (on which the tax was effectively the last barrier to profit-shifting before the amendments came into effect) has provided further incentive for US MNEs to continue utilising their offshore tax-efficient structures to deliver tax-free returns to their US shareholders[166].

The FDII provision, which was designed to work with the GILTI provision in bringing back US-developed IP and providing MNEs with favourable exporting tax rates, is also unlikely to have its desired effect. This is because MNEs still derive a larger tax benefit from keeping their IP offshore, even after taking these new reforms into account[167].

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[160] Avi-Yonah, 2018
[161] Walters, 2018
[162] Avi-Yonah, 2018
[163] Avi-Yonah, 2018 – These favourable export taxes were found to be in violation of the World Trade Organisation's export subsidy rules.
[164] Walters, 2018
[165] *Ibid*
[166] Avi-Yonah, 2018
[167] Avi-Yonah, 2018

US politicians caved to public pressure to address the blatant tax-avoidance techniques adopted by many US MNEs, yet this didn't render any tax-avoidance transformation. The GILTI and FDII workarounds illustrate how ineffective these recent reforms have been in the fight against profit shifting and foreign to foreign base-stripping. The implementation of such weak CFC standards is counter-productive to the deterrents implemented by other nations to tackle profit shifting, as this merely encourages tax-rate reductions and spurs on the race to the corporate-tax bottom[168]. In terms of its approach to working with fellow BEPS project countries to curb tax avoidance, it comes as no surprise that the US has resisted the adoption of the BEPS Actions, despite being involved in their development. The US has a history of avoiding ties to international tax norms by instead adopting rules and regulations that Congress believes will work best for America[169].

3.2.3. Recent amendments to the UK's CFC rules

The US isn't the only major economy to have amended its CFC-equivalent rules to make its international tax system more competitive. The UK reformed its CFC regulations with effect from 1 January 2013, hoping it would encourage MNEs to set up their headquarters in the UK[170]. This strategy incorporated the adoption of various exemption categories, such as[171]:

i. A full exemption during the first 12 months after the CFC becomes UK-controlled;
ii. A full exemption if the CFC resides in one of the specified excluded territories (these are mostly countries that have a tax rate of at least 75% of the UK's);
iii. A full exemption if the CFC's local taxes paid are at least 75% of the UK tax rate; and
iv. A full exemption if the CFC is considered to generate low profits[172].

Certain business profits of a CFC are also exempt if the CFC is considered to generate *bona fide* trading income[173]. The updated rules also incorporated a "CFC charge gateway" test, whereby CFC profits that are seen to "pass through the gateway" are subject to UK tax. This

[168] Kadet & Picciotto, 2015:1
[169] Maine, 2017:267
[170] Smith, 2013:127
[171] Smith, 2013:127
[172] Smith, 2013:127 – Low profits are considered to occur (i) if accounting profits are less than £50 000, (ii) if accounting profits don't exceed £500 000 and non-trading income is less than £50 000 and (iii) if accounting profits don't exceed 10% of the entity's operating expenditure.
[173] Smith, 2013:128 – All of the following conditions must be met in order for these business profits to be exempt: (i) The CFC operates from physical business premises; (ii) no more than 20% of the CFC's trading income and 20% of its salary expenses is derived from the UK and is paid to UK staff respectively; (iii) less than 20% of the CFC's exports are to the UK; and (iv) any income earned by the CFC from IP that was transferred to the CFC by a UK related party within the last six years, provided there wasn't a significant reduction in the UK related party's value.

test assesses the source of a CFC's capital[174] from which it generates income, the purpose for a CFC's existence[175], and indications of external control in relation to the generation of the CFC's profits[176]. If a CFC is generating income from UK-sourced capital, the purpose for the generation of certain CFC profits is to reduce UK or foreign taxes and/or there is strong evidence of external control over a particular aspect of the CFC's operations, then the CFC's profits are considered to "pass through the gateway". The profits will then be apportioned and taxed in the hands of the UK shareholders.

Not all income "passing through the gateway" are subject to UK tax, however. If a CFC generates *bona fide* trading profits or earns dividend income by holding shares in group-controlled subsidiaries, and it also earns non-trading finance income which may be considered to have "passed through the gateway", the finance income is exempt when it is less than 5% of the entity's total income (known as the *de minimis* rule)[177]. In addition to this, the UK created a special exemption for CFCs operating as MNE group financing companies[178]. These entities may elect whether 0%[179] or 25%[180] of their total financing income earned from the provision of inter-group loans can be subjected to taxation. This choice, which must be performed annually, can be made regardless of whether this financing income was derived from UK-related activities or from the use of UK-connected capital. Without this exemption option, all such financing income would "pass through the gateway" and be fully taxable in the UK. This group financing exemption was welcomed by MNEs when it was introduced, as it was anticipated that this exemption would aid UK MNEs in expanding their operations overseas[181].

In comparison to South Africa's CFC rules[182], the UK's aren't considered to be as aggressive[183], largely because the UK's CFC rules provide a far wider scope for CFC exemptions than the South African legislation. For instance, the only comparable exemptions

[174] Smith, 2013:128 – This considers the extent of "free-capital" contributions made by way of UK-sourced equity funding.
[175] Smith, 2013:128 – Consideration is given to whether the CFC was created to derive a tax benefit.
[176] Smith, 2013:128 – This considers whether significant UK control over and management of the CFC's assets/risks exists, or whether the CFC is dependent on third-party assistance for the management of UK assets/risks.
[177] Smith, 2013:129
[178] Smith, 2013:129
[179] Smith, 2013:129 – The full exemption can be elected if the CFC's own local assets or new group capital is specified and identified as the source of funding. The choice needs to be made for each individual loan (or part thereof) provided by the group financing company.
[180] Smith, 2013:129 – The partial exemption may be chosen if no consideration is to be given to the source of the CFC's funds. The choice needs to be made for each individual loan (or part thereof) provided by the group financing company.
[181] Smith, 2013:131
[182] Appendix I includes a high-level comparison between the South African, UK and US (and Brazilian) CFC rules.
[183] Davis Tax Committee, 2016:12

in the South African and UK CFC legislation are those relating to the purpose test (one of the requirements of the "CFC charge gateway" test is that the purpose of the CFC isn't to create a tax benefit), the *de minimis* rule (according to which less than 5% of total income is attributable to non-trading finance income), the business-profits test (whether a CFC participates in *bona fide* profit-generating activities) and the tax-rate threshold consideration (whether a CFC's local taxes are at least 75% of the taxes that would be payable in the controlling shareholders' resident country). Most notably, South African legislation doesn't include any provisions like the UK's group financing provision – a key tool that has aided the growth of the UK's MNEs. It is an interesting observation that the UK's CFC rules, whilst not being as stringent South Africa's, are considered to be broadly consistent with the BEPS Action 3 recommendations[184].

3.2.4. BEPS, Brexit and the EU crossfire

The UK's group financing exemption doesn't impute a UK CFC charge on the profits earned by foreign group financing companies[185] (more often than not, these entities would be located in low-tax jurisdictions and have favourable DTAs in place with all other jurisdictions in which other group subsidiaries are located[186]). The UK revenue authorities justified this exemption by stating that it addressed "*the difficult issues which arise as a result of the fungibility of money within a multinational group. The rules represent to a large extent a proxy for establishing the exact source and history of a group's financing arrangements and the extent these are borne by the UK.*"[187]

Despite the UK's perceived compliance with the Action 3 recommendations, this didn't stop the EC from commencing an investigation in 2017 into whether the UK's group financing exemption constituted state aid[188]. It is alleged that the investigation may have been prompted by the Paradise Papers scandal and that media coverage of the leaks highlighted a group financing structure of a particular UK MNE, whereby loans were advanced to German group companies from the UK via an Isle of Man financing conduit[189]. In 2019, the EC concluded its investigation and found that only certain aspects of the exemption constituted unlawful state aid:

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[184] PWC.co.uk, 2015:2
[185] Habershon, McKnight & Theodoiou, 2019
[186] Smith, 2013:129
[187] Habershon, *et al*., 2019
[188] Habershon, *et al*., 2019 – State aid happens when "*a company which receives government support gains an advantage over its competitors*" such that the "*…state measure… [is] selective [and] it must favour certain undertakings or the production of certain goods*". Under EU law, state aid is unlawful as a result of the competitive distortion it creates in the market.
[189] TaxJournal.com, 2017

i. Aspects of the exemption relating to the generation of finance income from UK-connected capital are justified (as this avoids burdensome tracing exercises required to assess the exact amount of profits derived from the provision of such UK assets)[190];
ii. The exemption is justified if a CFC's profits were not derived from UK activities; and
iii. The exemption of a CFC's income that was derived from profit-generating activities performed in the UK constitutes state aid[191]. The provision of these tax benefits was also found to not be available to third-party financiers[192].

The impact of the ruling was that the UK government was required to recover the taxes owed to it by the UK MNEs that had benefitted from this aspect of the UK CFC regulations[193]. In response to this, the UK applied to the EU courts for an annulment of the EC's ruling on the basis that the ruling misunderstood how the UK's CFC rules worked[194]. In the interim, however, the UK has amended its CFC rules (with effect from 1 January 2019) to ensure that the exemption isn't available to CFC profits derived from UK activities[195]. This ruling showcases the variation in opinion between the EU and the UK with regards to what constitutes a state-provided tax benefit in the context of these regions' CFC regimes. There is a possibility that these interpretations may again change as the outcome of revisiting these interpretations through the UK's EU court applications is yet to be seen. Such fluidity highlights the impact different interpretations can have, which ultimately leads to confusion, especially in the context of the OECD's encouragement of global Action 3 adoption.

In light of the above, there appears to be a consistent theme of tax-reform confusion in both the UK and the US. American politicians introduced CFC tax reforms which promised to change the tax-avoidance behaviour of US MNEs, whilst the UK government pledged to work with the OECD to ensure that the UK tax laws "*do not allow or encourage multinational enterprises to cut their tax bills by artificially shifting profits to low-tax jurisdictions*"[196]. From the above synopses detailing the US' GILTI and FDII provisions, as well as the UK's group financing exemptions, there is little evidence that the tax-avoidance changes promised by politicians in the US and the UK will become a reality. This is further exacerbated by speculation that the UK government is considering implementing a "Singapore-on-Thames"

[190] KMPG.com, 2019
[191] Habershon, *et al*., 2019
[192] TaxJournal.com, 2019
[193] *Ibid*
[194] Lallemand, 2019
[195] Habershon, *et al*., 2019
[196] BBC.com, 2019

tax-haven strategy to stimulate growth in a post-Brexit economy[197]. If such a race to the corporate-tax bottom was to be started by the UK's post-Brexit government, it would be in direct contravention of the OECD recommendations which that same government had pledged to adhere to. These mixed signals call into question whether there is the political will to enact true anti-avoidance tax reform.

3.3. CHAPTER CONCLUSION

The OECD has noted that the struggle against BEPS requires a global solution, as the use of outdated strategies combined with a lack of domestic coordination could render any attempts to prevent this avoidance behaviour ineffective[198]. As BEPS is often achieved through the use of complicated cross-border structures by MNEs, and considering that the Action 3 recommendations need to be enacted in domestic law in order for them to have the "teeth" of enforceability, global adoption of the recommendations may aid the fight against this tax-avoidance behaviour. Despite this objective, it appears that major first-world countries, such as the US and the UK, haven't taken the Action 3 recommendations, and its principles, to heart. Amendments that have been made to the US' Subpart F legislation don't appear to target MNEs' elaborate tax-avoidance structures nor do they deter these MNEs from entering into tax-avoidance arrangements. If anything, the US legislation protects these MNEs from paying tax at the "normal" rate, which gives them an international competitive edge. The UK's perception that its 2013 reforms to CFC legislation (which was designed to attract international businesses to the UK) didn't constitute harmful, anti-competitive practices (by aligning itself with the Action 3 recommendations), conflicted with the EC's interpretation. This interpretation mismatch has created confusion, yet the final outcome is still to be determined.

The tax-reform confusion created by UK and US politicians casts doubt over whether these major global economies will ever adhere to the Action 3 recommendations requiring the strengthening of the CFC provisions. Furthermore, the US and UK's prioritisation of domestic corporate incentives risks spurring on the race to the corporate-tax bottom, in which developing nations will be the losers (largely because of their weakened bargaining power when it comes to the pressure of offering corporate-tax incentives).

As South Africa is a developing country which places a greater reliance on revenue collections from corporate-income tax than its developed counterparts, one can understand why the revenue authority would not want to waste any time in preventing a drop in these collections

[197] TaxJustice.net, 2019
[198] OECD, 2015:3

by implementing anti-avoidance measures. However, hasty implementation may not help this cause. Caution must be taken to ensure that the existing rules aren't used as a tax collection tool, considering the recent amendments to the tax-rate exemption threshold in light of the worldwide decrease in corporate tax rates. In addition, seeing that the US, the UK and other BRICS countries (as addressed in Chapter 5) are holding back on the implementation of the Action 3 recommendations, it may not be ideal for a developing country, like South Africa, to be a leading adopter of these recommendations.

CHAPTER 4: TP VERSUS CFCS – THE REPORTING AND ARM'S LENGTH OVERLAP

4.1. THE PURPOSE OF DETERRING AVOIDANCE BEHAVIOUR

As briefly outlined in Chapter 1, CFC rules were introduced into South African legislation to prevent the erosion of the local tax base (and the resultant deferral of tax on income earned offshore) caused by shifting capital offshore to low-tax jurisdictions. The ultimate purpose of the rules was to discourage residents from creating complex foreign corporate structures to effect a shift in their capital, and from indefinitely deferring taxation on offshore income. In order to achieve this, the rules eliminated the incentives for taxpayers to transfer profits to low-tax jurisdictions by imputing such income into the South African tax net (and effectively taxing it at a higher rate).

TP legislation is another type of anti-avoidance mechanism that was incorporated into the ITA to combat BEPS – these rules attempt to regulate profit shifting by ensuring that prices at which goods and services are transferred are at arm's length[199]. One of the ways in which MNEs shift profits is by manipulating inter-group cross-border prices charged for goods and services, as well as for the functions and risks associated therewith, with the objective of reducing the group's overall tax liability (for instance, by increasing expenditure in high-tax countries to create income in low-tax jurisdictions)[200].

Another common tactic is for MNEs to relocate valuable IP to low-tax jurisdictions. Market-comparable royalty payments for specific-firm IP are often difficult to estimate, so MNEs mask their value through relocation to further distort cross-border pricing[201]. TP legislation was introduced to deter such pricing manipulation by ensuring that these cross-border transactions take place at the same price and on the same terms as they would have had the parties not been related[202].

In recent years, the reporting obligations of large MNEs has intensified through the enactment of enhanced transparency requirements which necessitate the submission of additional TP documentation when certain threshold levels are met (such as the submission of a master file, local file and CbC report as recommended in Action 13)[203]. The reason for requiring these

[199] Stiglingh, Koekemoer, Van Schalkwyk, Wilcocks & De Swardt, 2019: Section 17.54
[200] Stiglingh, *et al*., 2019: Section 15.54
[201] Lohse & Riedel, 2013:4
[202] Deloitte.com, 2018b
[203] Stiglingh, *et al*., 2019: Section 4.3.10

additional submissions was to enhance transparency for tax administrators: By understanding an MNE's global activities, having sight of its global income streams, and knowing where its taxes are paid (all of which would be disclosed as part of these requirements) revenue authorities are better equipped to identify BEPS risks[204].

CFC rules prevent profit-shifting behaviour through the reinstatement of taxing rights to a foreign entity's resident shareholder, by capturing income that might not have been earned by the CFC had the transfer price of the CFC's income-earning capital been at arm's length[205]. TP rules prevent this same behaviour by, on the other hand, enforcing the restoration of a cross-border arm's length normality. An overlap of purpose appears to exist between these two anti-avoidance methods, although the mechanics behind how these two aspects of legislation achieve this purpose somewhat differs.

4.2. COMPLEX AND DETAILED REPORTING REQUIREMENTS FOR GLOBAL SOUTH AFRICAN TAXPAYERS

An increase in the complexity and volume of cross-border intra-group trade, combined with a shortfall in tax revenues following the global financial crisis, has heightened revenue authorities' scrutiny. This has resulted in intensified compliance requirements (most notably TP reporting requirements as laid out in Action 13) as well as increased compliance costs for taxpayers [206]. Legislating the requirement for MNEs to disclose information about their global operations to revenue authorities is an important move in deterring profit shifting, as having a bird's eye view of an MNE's global operations yields a host of unprecedented benefits in combating tax avoidance. This is especially relevant in a South African context, considering that the largest 10% of foreign-owned entities account for 98% of profits shifted to low-tax jurisdictions or tax havens[207].

4.2.1. TP reporting amendments as recommended in BEPS Action 13

The South African TP rules are embedded within Section 31 of the ITA and are based on the OECD's arm's length standard[208]. Although this section is concerned with TP, no definition is in fact provided for this term – the section is instead titled "*Tax payable in respect of international transactions to be based on arm's length principle*". Section 31 applies to "affected transactions", when any terms/conditions of direct or indirect transactions entered

[204] OECD, 2015b:9
[205] Burkdaze, 2016:373
[206] OECD, 2015b:11
[207] Reynolds & Wier, 2018:2
[208] Thomson Reuters, 2018

into between connected persons[209] aren't considered to be standard commercial terms (standard commercial terms are those that would apply if unconnected parties were transacting). If a transaction is not considered to be at arm's length, a taxpayer must, when filing an income tax return, adjust the transfer price to an arm's length amount (this is known as the "primary adjustment"). Non-compliance with the arm's length provision of the section attracts a charge known as the "secondary adjustment" which deems the value of the primary adjustment to be treated as a dividend, on which the dividend tax rate of 20% (per Section 64) is applied[210]. If a TP adjustment is required, the allocation of taxable profits between South Africa and the other transaction countries are determined with reference to the applicable DTAs in place[211]. In terms of monitoring the reporting requirements of this section, sections 25 and 29 of the Tax Administration Act (TAA) govern TP documentary submissions with regards to the CbC report and TP documentation retentions respectively.

To allow SARS to determine whether these transactions were at market-related prices, MNEs are required to submit extensive documentation justifying the adoption of pricing assumptions applied to these transactions. The requirement for the submission of mandatory documents to SARS (depending on whether certain requirements are met) relating to an MNE's cross-border related-party transactions was gazetted in 2016, and by 2017 an external business requirements specifications (BRS) document was issued to regulate the content of these documents. The submission requirements came into effect for years of assessment commencing on or after 1 January 2016. MNEs are required to file the new mandatory Action 13 documents within 12 months after their year-end[212].

The enhanced cross-border reporting requirements that arose from the introduction of CbC reports, master files and local files (as well as additions to the corporate income tax return), are explored below. The details required from taxpayers in these reports are further considered with a view to assessing their impact on the TP and anti-BEPS objective.

4.2.1.1. CbC reports

The CbC report is part of Action 13's three-tiered approach to standardising TP documentation. The key objective of this report is to provide high-level operational and

[209] A connected person is defined in Section 1 of the ITA. In the case of an MNE, connected persons include members of a group who have a common shareholding of at least 50% as well as entities in which it has a 20% minimum holding, provided other shareholders don't own the majority of voting rights.
[210] It should be noted that since this is a secondary adjustment rather than a true dividend as defined, the 20% dividend tax rate applied will not be reduced by the applicable DTAs.
[211] Thomson Reuters, 2018
[212] Mazars.co.za, 2019

economic information to SARS to allow for a South African assessment of BEPS and TP risks. The report is in line with the Action 13 recommended template[213] (using a template ensures that all cross-border information is provided in the same format to allow for ease of cross-border transmission and comparison[214]).

The South African CbC regulations only apply to MNE groups[215] that have total consolidated revenue of more than R10 billion (€750 million) and need to be filed by an MNE group's head office in its resident jurisdiction. In order to effect the Action 13 recommendations for CbC reporting into South African legislation, amendments to the TAA were enacted in 2015, which incorporated a new definition of "international tax standard" in Section 1 (this refers to the South African CbC regulations, which emulate Action 13). In addition to these legislative changes, treaty amendments were also required, as a key element of CbC reporting includes sharing this information with other revenue authorities outside South Africa. In 2016, South Africa signed a multilateral competent authority agreement, which laid the groundwork to allow South Africa to receive CbC reports[216]. SARS also has the power to share these reports with other countries as prescribed in Section 3 of the TAA – if SARS is under obligation in terms of an international agreement to exchange information with other revenue authorities, it must do so either automatically (in the case of CbC reports) or on request (in the case of master and local files)[217].

In order to provide SARS with the required CbC report, an MNE group must submit the specified information using the CBC01 form[218]. The form requires the entity's details (name, company registration number, tax number and address), total group revenue (split between revenues earned between related and unrelated parties), total group profits, total group income tax paid and accrued, stated capital, group accumulated earnings, total group assets and total number of group employees[219]. The form also requires information on "constituent entities"[220], including all constituent entities' details (name, company registration number, tax number and address), and information on business activities conducted[221]. The information

[213] See the example of the Action 13 recommended template in Appendix II
[214] South Africa, South African Revenue Service [SARS], 2017:12
[215] SARS, 2017:11 – Note that a "group of companies" as defined in Section 1 is not the same as an MNE group as defined in the South African CbC regulations. While a group of companies may constitute an MNE group, an MNE group is required to have consolidated revenue in excess of R10 billion (€750 million).
[216] SARS, 2017:9-10
[217] SARS, 2017:14
[218] SARS, 2018:4-5
[219] SARS, 2018:11-16
[220] SARS, 2017:4 – These are separate business units of an MNE group that have been consolidated into the group's financial statements.
[221] SARS, 2018:16-19

required in the CBC01 form closely follows the Action 13 recommendations for CbC reports. Extracts of both these reports have been included in Appendix II for illustrative purposes.

All MNEs that submit CbC information are also required to submit master files and local files (described below). As the threshold for filing a CbC report is a lot higher than the threshold required for filing master and local files, there may be instances where an MNE group is required to submit master and local files whilst not being required to submit a CbC report.

4.2.1.2. Master files

The master file serves the same purpose as the CbC report by enabling SARS and other revenue authorities to assess BEPS and TP risks. The file is typically prepared by the MNE group's head office (from where it is then made available to all MNE group entities) and includes high-level information that highlights the MNE's global TP practices[222].

As noted above, a master file (and a local file) must be submitted when an MNE group meets the CbC reporting threshold requirements. However, if a CbC report is not required, a master file (and a local file) still need to be submitted when the quantum of related-party transactions is in excess of R100 million[223].

Unlike the CbC report, a master file (and local file) template hasn't been prescribed and MNEs are required to use their judgement in determining the appropriate level of detail to be disclosed[224]. The following information is required, at a minimum, in justifying adopted inter-group policies[225]:

i. **Organisational structure:** This includes an organogram of the group's corporate structure, as well as information on the geographical location of the various group entities.
ii. **Description of the MNE group's business(es):** This includes an overview of the group's supply chain, including the five largest products/services by revenue, coupled with any other products/services making up more than 5% of turnover (noting the main geographic markets for these products/services), service agreements between various group entities, including pricing policies and service costs, and a brief overview of value-creating entities based on inputs received. A

[222] SARS, 2017:15
[223] Mazars.co.za, 2019
[224] SARS, 2017:19
[225] SARS, 2017:29-30

description of recent material acquisitions, disposals, restructuring transactions and other corporate activity undertaken would also need to be disclosed.

iii. **MNE intangibles:** This includes a description of the overall strategy relating to the development of intangible assets, as well as the management and location of the research and development facilities linked to these intangibles. A list of intangibles that are important for TP purposes (including a brief description of how these assets affect TP policies), as well as relevant cost-contribution and/or licencing agreements will also need to be disclosed. If there have been any transfers in ownership amongst group entities, the entities, countries and pricing involved will also need to be noted.

iv. **MNE inter-company financial activities:** An overview of how the group is financed must be provided, including a description of financing terms and policies between group entities, as well as whether the group makes use of a central treasury function (noting the treasury function's resident country, as well as details regarding its effective management).

v. **MNE financial and tax positions:** This includes the MNE group's annual financial statements (AFS) as well as a brief summary and listing of the group's unilateral advance-pricing agreements, as well as tax rulings relating to the allocation of income across various countries.

4.2.1.3. Local files

The local file is required from individual MNE group entities. It provides more detailed information relating to specific inter-company transactions and supplements the information provided in the master file. The file focuses on cross-border transactions between connected persons for the purpose of performing TP analyses (i.e., assessing whether these transactions have complied with the arm's length principle)[226].

The threshold requirements for local file submission have been laid out in Section 4.2.1.2. above and the following information (as stipulated by the BRS) must be included[227]:

i. **Local entity:** Information on the entity's management structure (including foreign persons to whom local management reports and their locations), details about key competitors and disclosure of the entity's strategies are required.

[226] SARS, 2017:15
[227] SARS, 2017:31-32

ii. **Financial information:** This includes the local entity's AFS (preferably audited), as well as illustrations showing how financial data applied in TP methods agrees with this financial information.

iii. **Controlled transactions:** The list noted in the BRS is extensive. In summary, disclosure should include copies of intra-group agreements, a description of and amounts of intra-group transactions and related payments and receipts, an overview of assumptions adopted in determining TP methodology and descriptions or reasons for asserting that relevant transactions were concluded on an arm's length basis. Uni-, bi- and multilateral advance-pricing agreements, as well as other tax rulings in which South Africa is not a party, should also be disclosed.

4.2.1.4. Other submission requirements

Although some MNEs may not be required to submit master and local files to SARS because they don't meet the threshold requirements, it is strongly advised that documents in line with the master and local file formats are kept on hand upon the filing of an income tax return should SARS conduct a TP audit (in these circumstances SARS would require a taxpayer to submit the requested TP information within 21 days)[228]. This is in line with Section 29 of the TAA, which requires taxpayers to keep records, books of account or documents on hand.

All corporate taxpayers are also required to disclose the nature of their cross-border related-party transactions, as well as income received or expenditure incurred in relation to these transactions, on their income tax returns (known as the ITR14 form), even if they don't submit a master or local file. The return requires the disclosure of various financial ratios (such as debt to equity and debt to EBITDA[229]), as well as the answering of various compliance questions (such as whether TP documentation exists to support these transactions, whether any of the abovementioned transactions occurred in tax havens, and whether any operational changes occurred in the group)[230].

4.2.2. CFC reporting requirements

A company that holds at least 10% of the participation rights in a CFC is required to submit an IT10B schedule[231] as a supporting document to SARS when filing an income tax return[232].

[228] Mazars.co.za, 2019
[229] Earnings before interest, taxation, depreciation and amortisation – This approximates operational cash generated by an entity.
[230] Mazars.co.za, 2019
[231] SARS.gov.za, 2019b – See the example of the IT10B schedule in Appendix III that is required to be submitted with a taxpayer's return providing information for an entity declared as a CFC.
[232] PKF.co.za, 2018

This schedule is in addition to the compliance questions that a taxpayer is required to complete on the return in relation to its CFC holding. The IT10B schedule requires the disclosure of a CFC's contact details (its name, address, and country of incorporation and effective management), its foreign tax number, details of its operations and number of employees, its reported net profit, and financial year-end. A taxpayer is also required to stipulate the net income imputed into its return (indicating what portion of this income is attributable to an FBE) and to also note the foreign tax credit applied (if any) in terms of Section 6*quat*. Where no net income has been imputed, the taxpayer is required to state that one of the exemptions applied (i.e., that a taxpayer holds less than 10% of the CFC's participation or voting rights, the CFC operates as an FBE or the CFC's foreign taxes amount to at least 75%[233] of the taxes that would've been payable had the CFC been a South African tax resident). If income was earned from transactions with related parties as stipulated in Section 9D(9A)(a), this information must be disclosed. Even if net income is deemed to be a nil amount, the IT10B schedule, along with most of its required fields, still needs to be completed and submitted.

The submission of CFC information to SARS has been criticised for bringing little benefit to the fiscus when compared to the cost and time consumption experienced by taxpayers in making these submissions[234]. In most cases for taxpayers holding in excess of a 10% shareholding in a CFC that qualifies for the CFC income exemption(s), they would either need to prove the FBE exemption requirements or perform a South African tax calculation using the CFC's income and expenditure to determine whether the entity qualifies for the high-tax exemption[235]. Taxpayers are either required to keep records on hand to prove that the FBE requirement has been met should this be queried by SARS or they may find themselves spending long periods of time and incurring costs on resources to calculate a CFC's imputed income, only to find that the income is exempt in terms of the high-tax rate exemption. The net income calculation has also re-introduced an additional layer of complexity through the inclusion of transactions between a CFC and connected residents in terms of Section 9D(9A)(a) (i.e., the diversionary rules). It may seem inefficient for taxpayers to keep track of these individual transactions, over and above the other net income calculation requirements[236], when the net result amounts to a nil inclusion in a taxpayer's return.

[233] 67.5% per the 2019 Draft TLAB
[234] Deloitte.com, 2018a
[235] *Ibid*
[236] Such requirements also include keeping track of CFC income earned that was subject to withholding taxes, as well as the payment of intra-group dividends.

4.2.3. The global sharing of taxpayer information

In addition to introducing transparent reporting requirements, a critical aspect of the new regulations involves the sharing of this information between cooperating countries. Not only is SARS able to obtain access to MNE-submitted tax documents from an array of global revenue authorities, additional third-party institution reporting tools, such as the US Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS), are also at SARS' disposal to help assess BEPS risks. The legislative and treaty amendments described in Section 4.2.1.1. above required to enact the global sharing of CbC report information from a South African perspective, are also in place to facilitate the sharing of FATCA and CRS data[237].

4.2.3.1. Third-party institutions submitting taxpayer information to revenue authorities: FATCA and CRS

Amendments to the TAA allowing for the consolidation of taxpayer information isn't limited to the relationship between the taxpayer and the revenue authorities, but also extends to third parties, such as financial institutions.

FATCA, which was introduced in the US in 2010, requires foreign financial institutions to report information on American account holders (specified US persons or passive entities with controlling persons that are specified US persons) to the US Internal Revenue Service (IRS). To effect compliance by South African financial institutions, South Africa and the US signed a model inter-governmental agreement in 2014[238]. In that same year, the OECD, together with the G20, developed the Automatic Exchange of Financial Account Information in Tax Matters. This guide encompasses CRS requirements which are similar to FATCA, as they also necessitate the reporting of foreigners' account information by local financial institutions to local revenue authorities[239]. The enactment of compliance was achieved through the signing or updating of information-exchange agreements between South Africa and other countries. In addition, South Africa became one of 135 signatories to the Convention on Mutual Administrative Assistance in Tax Matters (effective from 2014[240]) which facilitates cross-border cooperation for exchanging taxpayer information and recovering foreign tax claims[241]. Through this agreement, South Africa can share and receive information with 135 other countries.

[237] Stiglingh, *et al*., 2019: Section 11.13:1
[238] SARS.gov.za, 2019a
[239] SARS.gov.za, 2019a
[240] OECD.org, 2019b:5
[241] OECD.org, 2019c

Where none of the above agreements are yet in place, SARS retains the information gathered to date until such agreements are signed and effective[242].

South African financial institutions are required to capture information on foreign account holders (such as name, identification number, jurisdiction of residence, tax identification numbers, account number, account balance and account type) and report this information to SARS, which will then automatically share the information with the account holders' respective countries of residence once a year on 31 May, provided that an information-sharing agreement is in place. In the case of US citizens who are South African account holders, FATCA information is automatically shared with the US on this date. Similarly, foreign jurisdictions that have an information-sharing agreement with South Africa will disclose information to SARS about South African residents who are account holders at financial institutions in those countries. The information shared can be that of both natural and juristic persons[243]. More than 100 countries have committed from September 2018 to exchange CRS information under more than 3 200 bilateral agreements[244].

Through the application of CRS, SARS has unprecedented insight into taxpayers' foreign accounts. Utilising the information received from foreign jurisdictions and cross-referencing this with the information disclosed by those taxpayers in their annual tax returns and/or received as part of their (mandatory) TP reporting, gives SARS greater transparency of the international affairs of taxpayers. Having an eagle-eye view of a taxpayer's global affairs improves the likelihood of identifying profit-shifting risks and other tax-avoidance behaviours that may not have been recognised before[245].

4.2.4. The overlap of CFC and TP mechanisms to target profit shifting

Both sections 31 and 9D(9A) target the same related-party transactions, and thus the same income. When it comes to cross-border transacting, Section 31's TP rules are geared to catch "affected transactions" by not only limiting it to those transactions between an entity and its shareholder(s), but also those transactions between fellow group entities (even inter-CFC transactions), provided that these entities are connected persons. In comparison, CFC rules only consider diversionary transactions in terms of Section 9D(9A)(a) between a CFC and connected persons and subject these to imputation, provided that there is a CFC to begin with

[242] SARS.gov.za, 2019a
[243] *Ibid*
[244] KPMG.com, 2018
[245] Note that this is within the scope of identifying tax-avoidance behaviour and not tax-evasion schemes.

(i.e., a foreign entity of which more than 50% is held by residents). From an income perspective, CFC rules deem both income from an FBE (i.e., active income), and net income that's effectively taxed in the CFC's country at (a minimum of) 21%[246], to be nil for imputation purposes. TP rules, on the other hand, scrutinise all categories of related-party income, regardless of the offshore entity' definition as a CFC, the source of the entity's income or the rate at which the income is taxed at. TP rules thus appear to be better positioned to capture a wider spectrum of income and related-party transactions than CFC rules.

In addition to targeting the same related-party income, there also appears to be a TP and CFC reporting overlap. Considering the TP and CFC disclosure requirements laid out above, there are many similarities between the information reported in the IT10B schedule and the information submitted in a master file, a local file, and a CbC report. In effect, the master and local files provide the detail of the high-level information that's disclosed in an IT10B schedule. In a master file, details of an MNE group's structure, including the geographical locations of the various group entities, as well as information relating to the group's supply chain and its top products/services, overlaps with the IT10B schedule's requirement to understand an MNE's place of incorporation or effective management and its business activities. In a local file, detailed information on related-party transactions is disclosed, while the IT10B schedule merely requires disclosure of whether income was derived from related-party transactions listed in Section 9D(9A)(a). Over and above these locally submitted reports, SARS receives taxpayers' offshore financial information from other countries by way of frequent CRS reporting. Essentially, once the four reports (the CbC report, master file, local file and IT10B schedule) are filed by taxpayers, SARS would have gathered the same information from these four sets of reporting tools that happen to be required by two sets of anti-avoidance rules, which overlap to achieve the same purpose. Foreign CRS reporting adds to the ever-growing database of collected taxpayer information – this multitude of reporting provides SARS with an array of BEPS risk-assessment data at its disposal. The sheer quantity of data provided means that the revenue authority would be equipped with the information to leave very few BEPS stones unturned.

4.3. REVOLUTIONARY AMENDMENTS TO THE ARM'S LENGTH PRINCIPLE

Action 13 helped transform the way in which MNEs report their inter-group TP to revenue authorities, which has greatly improved the monitoring and assessment of BEPS risks. This reporting ensures that MNEs make use of arm's length pricing – if such a price can't be justified, an MNE could face penalties for non-compliance. Reporting wasn't the only aspect

[246] To be 18.9% per the 2019 Draft TLAB.

of TP that was revolutionised as part of the BEPS Actions: Actions 8, 9 and 10 broadened the scope of the OECD's traditional arm's length pricing requirements to better align TP transactional outcomes with the cause of their created value[247]. In order to bring this envisaged alignment into effect, a revision of the arm's length principle was required.

MNEs can earn significant profits in low-tax jurisdictions (despite little operational activity occurring in those locations) as a result of transfers of their valuable intangibles to those regions. In order to address concerns about the alignment of value with the underlying economic activity creating it, the OECD identified three BEPS Project Actions to ensure this – these related to intangibles (Action 8), risks and capital (Action 9) and other high-risk transactions (Action 10). In order to meet the objectives of Actions 8, 9 and 10, the OECD concluded that special measures beyond the arm's length principle weren't required, as a strengthening of the respective guidelines was sufficient. This guidance strengthening resulted in an amendment to the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (The Guidelines), with the most fundamental changes being made to the guidance on risk and intangibles[248].

A key assertion of this revised approach is that value is created from both the control of an intangible's risks[249] and from its initial or continuous development, enhancement, maintenance, protection and exploitation (DEMPE). As such, persons involved in this "value chain" should receive compensation to reflect the value they created from risks assumed and/or DEMPE functions performed. Therefore, the mere contractual[250] (instead of functional) assumption of ownership (instead of value creation) shouldn't entitle the legal owner to the sole right of generating returns. Instead, the legal owner should provide arm's length compensation to the provider(s) of DEMPE functions, as well as those persons assuming a significant portion of the intangible's economic risks. Essentially, in an MNE structure, the entity responsible for making the decisions regarding an intangible's ability to generate income should be the entity yielding the related rewards, rather than the entity located in a tax haven with minimal operational activity and that happens to be the legal owner[251].

[247] Deloitte.com, 2017a
[248] KPMG.us, 2019
[249] KPMG.us, 2019 – "*Control over risk involves the following two elements of risk management: (i) The capability to make decisions to take on, lay off, or decline a risk-bearing opportunity, together with the actual performance of that decision-making function; and (ii) the capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of that decision-making function*."
[250] KPMG.us, 2019 – This includes the contractual rights (inter-group) funders may assign to themselves in the development of IP, with limited operational involvement.
[251] KPMG.us, 2019

Although the use of The Guidelines' arm's length principle in a South African TP context hasn't been enacted in the ITA, Practice Note 7 ("PN7"), which is used by taxpayers as a guide to interpret and apply Section 31, makes specific reference to the fact that all arm's length price interpretations are to be drawn directly from The Guidelines[252]. SARS notes in PN7 it draws on this interpretation because of The Guidelines' acceptance as the arm's length standard by many other countries, as well as its ability to promote tax equality and to counter harmful tax regimes[253]. South Africa's adoption of The Guidelines through PN7 as the means to determine an arm's length price implies that South Africa follows the recently amended Guidelines which include the abovementioned modifications to the arm's length principle.

The expansion of the arm's length principle to consider the eligibility of an MNE entity deriving its income from an asset it may legally own, whilst not truly sharing in the risks and rewards of ownership nor having a say in the asset's strategic use within the group, pierces the veil of legal ownership to evaluate a transaction by its substance instead of its form. The principle considers value to be created by those who created or continue to maintain the asset, those who are exposed to both the upside and downside of an asset's returns and/or those who are responsible for the asset's strategic deployment. Although this approach may appear to be revolutionary in prescribing what is considered to be a fair arm's length transaction (and thus its price) for TP purposes, this concept is embodied within existing CFC rules. The South African CFC rules apply the same principle by viewing the *modus operandi* of a CFC as a mere extension of its shareholders' will by disregarding the legal separation between the CFC and its shareholders. Where shareholders attempt to shift their valuable assets to offshore locations with the intention of deferring or avoiding local tax, their actions are remedied by the CFC rules, such that they (as the derivers of value) ultimately bear the tax they were trying to avoid. The expansion of the scope of the arm's length concept to align value creation with TP outcomes thus directly overlaps with the CFC principle of identifying the true creator of the entity's value and amending the tax consequences to directly align these with the value-creation reality.

4.3.1. Broadening of the arm's length scope

The amendments to the arm's length principle significantly broaden the scope beyond traditional transaction considerations. Instead of only looking at transactions, operations, schemes, agreements or understandings (as depicted in Section 31) to determine whether a

[252] OECD.org, 2018
[253] SARS, 1999:6

third-party price point was used, the new approach considers the roles of transaction parties by way of their risks assumed and rewards garnered.

This new approach starts to encroach on traditional CFC territory. For example, consider a South African shareholder ("A") and its CFC subsidiary ("B") located in a jurisdiction that has a corporate tax rate lower than South Africa's. Imagine A develops valuable IP in South Africa, which it then sells to B (at a fair market price). B, as the legal owner of the IP, then provides third-party customers with a right to use the IP for a market-related consideration. B has an operational agreement with A, whereby A continues to develop and maintain the IP. The agreement can be justified as being at arm's length, but it's structured in such a way that A's income received from B closely approximates its expenditure, resulting in minimal profits being earned by A. In addition, B takes instruction from A with regards to the strategic use and deployment of the IP. From a CFC perspective, B is considered to act as an FBE, thus resulting in a nil inclusion of the CFC's income in A's tax return. From a TP perspective, however, the old rules would consider whether the agreement between A and B was merely at arm's length (i.e., whether the price charged by A for its work performed as per the scope of the agreement was a justifiable market-related price). Under the new arm's length principle consideration is given to the DEMPE performed by A, as well as the risks and control it assumes over B's IP – these elements (which wouldn't have been included in the existing operational agreement) would be factored in to increase the transaction price between A and B. This adjustment helps to restore compensation to the jurisdiction in which value is truly created.

In addition to its broadened scope, the values within the revised arm's length principle appear to be embedded within Action 3's building blocks – most notably those that deal with the determination and allocation of income of a CFC (as outlined in Section 2.3.2). The way in which the CFC rules aim to identify instances of artificial profit shifting by adopting a risk-based approach appears to have a similar objective to the new arm's length principle. For instance, in the categorical analysis of income, the building blocks consider the legal classification of income and the treatment of related-party transactions – this aspect is a key component of the new arm's length principle. Furthermore, in the substance analysis of income, the source and substance analysis consider the activities of the CFC and thus the ability of the entity to earn its income on its own – these elements are also considered part of the new arm's length principle. Even the excess profits analysis proposed in the building blocks adopts a similar realignment purpose. The building blocks' considerations thus effectively reassign value to the underlying activities that created it – a principle that directly overlaps with the revised arm's length provisions.

4.4. CHAPTER CONCLUSION

When considering the efficiency and effectiveness of targeting profit-shifting transactions, it is important to bear in mind that the MNEs with the largest profits are the culprits in shifting the most profits[254]. Given the tendency for avoidance behaviour to be concentrated amongst a few MNEs (10% of foreign-owned MNEs) that are responsible for nearly all (98% of) profit shifting into tax havens[255], it follows that anti-shifting policies should be targeted at this group to yield the most effective anti-avoidance results[256].

The enhanced TP compliance requirements are a key part of solving the profit-shifting puzzle, as the detailed information provided by MNE groups by way of master files, local files and CbC reports can be used by SARS to paint a holistic picture of an MNE group's operations. By disclosing similar information but on a high-level basis, the information provided in the IT10B schedule for the purpose of CFC reporting overlaps with the TP reporting requirements. In addition to these South African reporting requirements, the surplus layer of CRS information received about South African taxpayers' offshore activities also helps to add colour to the MNE's structural picture. By having access to this data, SARS is in a better position to determine whether South Africa is receiving its fair share of tax on these group profits.

Furthermore, the revolution of the TP arm's length principle, which ensures that entities within an MNE group are appropriately compensated for the value-adding functions they perform, has drastic implications for MNEs that shift their high-value intangibles to low-tax jurisdictions. The result of these amendments will see these profit-shifting entities ultimately bear the tax they were initially trying to avoid.

In light of the above, there is a clear overlap between TP and CFC rules – not just in their purpose, but also in their reporting requirements, as well as in the way the TP arm's length principle aligns TP outcomes with value creation. Considering that the bulk of profit shifting in South Africa has been performed by a small number of MNEs, the anti-avoidance method with the widest scope to address such inter-group transactions will be the most effective prevention mechanism. South Africa should earnestly consider the appropriateness of the existing CFC and TP anti-avoidance mechanisms and how these could be better deployed to deter profit shifting.

[254] Reynolds & Wier, 2018:1
[255] Reynolds & Wier, 2018:2
[256] Reynolds & Wier, 2018:1

CHAPTER 5: AN OVERVIEW OF CFC AND OTHER ANTI-AVOIDANCE REGULATIONS IN INDIA AND BRAZIL

5.1. ELECTION OF BRICS COUNTRIES FOR COMPARISON

The term "BRIC" was first used in 2001 by Goldman Sachs' then Chairman of Asset Management, when he noted that Brazil, Russia, India and China's ("BRIC") forecasted growth was likely to exceed the forecasted growth of seven of the largest developed economies in the coming years. The term was extended to BRICS to include South Africa in 2010. Although the BRICS economies have not necessarily formed a political alliance nor a formal trading association, they have the potential to form a powerful economic bloc. By 2050, China and India are predicted to become the world's dominant suppliers of services and manufactured goods, while Brazil and Russia are predicted to become just as dominant in the supply of raw materials. This growth trend shows that, in the future, the largest global economic powers will no longer be the richest on an income-per-capita basis[257]. The South African economy tends to be the outlier compared to the other BRICS economies, with its gross domestic product (GDP) being 4.6, 5.8, 7.7 and 38.0 times smaller than the GDPs of Russia, Brazil, India and China respectively. South Africa does, however, have a role to play among these emerging market leaders considering its status as one of the largest economies in Africa[258].

The research question aims to determine whether South Africa's CFC rules appropriately achieve their purpose. To assess whether other developing countries have similar deliberations regarding their legislation, the Indian and Brazilian CFC (or CFC-equivalent) rules have been considered. India and Brazil have been chosen instead of other African economies because of their active involvement in the BEPS project[259][260]. In addition, since South Africa's CFC legislation is considered to be one of the most advanced among the G20, it would be better to assess other G20 nations' approaches to the legislation, of which the BRICS countries' interpretation would be most relevant considering the bloc's stance on acting in one another's economic interest[261].

[257] Chen, 2019
[258] BusinessTech.co.za, 2018
[259] Deloitte.com, 2017b:4
[260] Valadão, 2016
[261] Chen, 2019

5.2. THE (LACK OF) CFC RULES IN INDIA

India committed to the BEPS outcome through its involvement in the BEPS project. It has been actively implementing the BEPS actions by amending provisions in its domestic legislation, as well as its DTAs[262]. Despite this commitment, India has not yet implemented any CFC legislation in its domestic law[263], even though such rules were introduced for implementation in the Indian Direct Tax Code (IDTC) in 2010[264].

5.2.1. Non-implementation of CFC legislation in India

The IDTC was drafted by the Indian government to help simplify the existing Indian Income Tax Act of 1961 (IITA). The idea was for this new bill to replace the IITA altogether. An initial draft was compiled in 2009, and was further amended in 2010 and 2012, with a final revised version released in 2014[265]. These efforts were put on hold until 2017, when the Indian government instructed a newly formed committee to draft a revised IDTC that would reform India's income-tax laws to bring them in line with international best practice, whilst addressing the country's economic needs. The committee report was finalised in August 2019. Whilst it is yet to be made public, a few high-level proposals were made available for public comment[266]. Despite the Indian government's efforts, critics point out that the replacement of the IITA with the IDTC is unlikely, given that the enactment of a new tax law could jeopardise precedence set by case law, and make life for both tax officials and taxpayers unduly burdensome and administratively intensive during the change-over process. It has been suggested that the existing IITA should rather be amended for changes proposed in the IDTC[267] – something which has already been taking place in recent years.

Many important proposals that were initially introduced in each iteration of the IDTC have been subsequently enacted in the IITA. These include general anti-avoidance rules, the PoEM concept, taxation of the indirect transfer of assets, and advanced pricing provisions[268]. CFC rules, however, are yet to be enacted in the IITA despite appearing in the IDTC, and being recommended for implementation, since 2010[269].

[262] Deloitte.com, 2017c:4
[263] Deloitte.com, 2017b:45
[264] Jain, 2012:149
[265] Business-Standard.com, 2019
[266] Kariva & Verma, 2019
[267] Sanghvi, 2019
[268] Kariva & Verma, 2019
[269] Jain, 2012:149

Critics argue that the CFC framework isn't suited to India's economic station, as India, unlike other developed countries that have enacted these rules, is a developing country and a net capital importer, while the rules are designed for countries that are net capital exporters[270]. Concerns based on the rules presented in the various iterations of the IDTC[271] have also been raised, namely the risks of double taxation (as the draft rules have the power to override existing Indian DTAs[272]) and the adverse impact the rules could have on the competitiveness of Indian-controlled offshore entities. The draft rules' active-income requirement, whereby entities are deemed to be CFCs if 50% of their income is from passive rather than active sources, has been condemned for being anti-competitive by not accommodating newly established foreign entities that may fail to generate significant active income in their first year(s) of operation[273]. Critics have also highlighted that Indian MNEs making use of offshore treasury companies to finance their offshore merger and acquisition activities could be placed at a competitive disadvantage if such treasury companies were to be subjected to additional CFC taxation[274]. Administrative burdens and associated costs have also been highlighted as issues to consider[275].

5.2.2. Indian PoEM rules

Although CFC legislation hasn't been enacted in India, other similar anti-avoidance mechanisms have been incorporated into the IITA. The Indian government has adopted an expanded version of the concept of PoEM to determine the residency of a foreign company. This ensures that entities incorporated in foreign jurisdictions that are effectively controlled by Indian residents do not escape Indian taxation. Although these regulations are not seen as an anti-abuse tool *per se*, India's PoEM rules are viewed as the closest piece of legislation that the country has to a CFC regime. Despite this, PoEM criteria are criticised for being subjective and the view is that the implementation of CFC legislation may assist in clarifying the law's ambiguities, by specifically targeting passive income[276].

Section 6(3) of the IITA (the section of the act harbouring the PoEM provisions) was amended in 2015 before becoming effective on 1 April 2017. The reason for implementing this change was to prevent taxpayers from engaging in avoidance behaviour by manipulating the old PoEM

[270] Jain, 2012:145, 153
[271] As the 2019 report has not yet been made available, only commentary on previous versions of the code can be considered
[272] Jain, 2012:150
[273] Jain, 2012:151
[274] Jain, 2012:154
[275] Jain, 2012:146
[276] Deloitte, 2017b:45

rules to avoid being taxed as an Indian resident[277]. In terms of the recently amended legislation, a foreign company conducting active business outside India may be deemed to be an Indian tax resident, and thus subject to Indian taxation on its worldwide income, if it is found that its PoEM has been established in India. PoEM is defined as the place where key management operates and where commercial decisions are made to facilitate the conduct of an offshore company's operations, and no regard is given to the foreign entity's location (nor the reason for its (elected) jurisdiction)[278]. The rules also consider the foreign company to have its PoEM in India if more than half of the number of persons employed, and the related salary bill incurred by the entity, relates to Indian personnel[279]. As one would expect, these rules have been criticised for threatening foreign investment with such broad residency rules, as large MNEs may think twice before deploying capital for international projects through India[280].

PoEM has been highlighted as comparative to CFC regulations, however these two sets of rules have unconnected focus areas. PoEM assesses control by considering the impact an entity's resident board members and key local management have on the foreign firm's decision-making processes[281], while the CFC rules look through to the control exerted by a foreign entity's resident shareholders. The CFC regulations target the shifting of profits into low tax jurisdictions, and the corresponding deferral of a resident's tax liability, while the PoEM rules subject all applicable offshore income earned to Indian taxation, i.e., income earned by both active businesses (an active business earns less than half of its total income from passive sources and related-party transactions)[282] and non-active businesses[283]. It is evident from the above that PoEM's stance on anti-avoidance drastically differs from the CFC outlook. Thus it is irrelevant to draw further comparisons between these two rules given their misaligned purposes.

Although India doesn't have CFC legislation in place at present, it has focussed on implementing other aspects of the BEPS Action Plan into its legislation to counter profit shifting, of which the main offenders happen to be MNEs.

[277] Butani & Kotha, 2018
[278] Nangia, 2017
[279] Butani & Kotha, 2018
[280] Nangia, 2017
[281] India, Central Board of Taxes [Central Board of Taxes], 2017:2-3
[282] Butani & Kotha, 2018
[283] Central Board of Taxes, 2017:4

5.2.3. Other anti-avoidance provisions adopted in India: TP regulations

India has acknowledged that BEPS continues to remain a concern for its economy, with most profit shifting taking place as a result of aggressive TP policies adopted by MNEs[284]. The Indian revenue authorities have indicated that excessive related-party payments (such as the payment of management fees, royalties and interest by local entities to foreign affiliates) have been a major contributor to the country's BEPS challenges[285]. These avoidance methods have been further exacerbated by the lack of transparent reporting by MNEs to the Indian government[286]. To counter this, India has highlighted TP as a high-risk area[287] and has, in response, enhanced its TP regulations and overhauled its tax audit system over the last decade[288].

The Indian TP regime is perceived to be one of the most aggressive in the world[289]. With effect from the beginning of the 2016 tax year, India adopted the three-tier TP documentation system (master file, local file and CbC reporting) as outlined in BEPS Action 13[290], such that its adoption of these recommendations has closely followed Action 13's recommendations[291]. These reports help to provide MNE group and transactional information to the Indian revenue authorities, thereby improving transparency between MNEs and the Indian government[292].

There are, however, aspects of Indian legislation that don't strictly adopt the proposed BEPS standards, as the need to accommodate local circumstances has seen the Indian government alter elements of these recommendations[293]. Although Indian TP regulations (ITPR) broadly follow the OECD's five-method standard[294] (encompassed in Actions 8, 9, 10 and 13) to determine the arm's length price in related-party transactions[295], a so-called sixth method has also been adopted. This method takes any other method into account by considering the price that was or would have been charged or paid for the same or similar uncontrolled transaction under similar circumstances[296]. The assumption that the data required to perform price

[284] United Nations, 2014a:1-2, 5
[285] Deloitte.com, 2017b:36
[286] United Nations, 2014a:1-2, 5
[287] Deloitte.com, 2017b:36
[288] United Nations, 2014a:3
[289] RSM India, 2016
[290] InternationalTaxReview.com, 2018
[291] PWC.com, 2019a
[292] Deloitte.com, 2017c:4
[293] Shelepov, 2017:120
[294] EY.com, 2019 – These methods (in no hierarchical order, as no such order applies) include the comparable uncontrolled price method (i.e., prices based on the taxpayer's interactions with third parties), the resale price method, the cost plus method, the profit split method, and the transactional net margin method (i.e., profit margin analysis).
[295] PWC.com, 2019a
[296] RSM India, 2016:77

comparisons in any one of the OECD's five methods readily exists (as one may expect in developed nations) has been widely criticised for not necessarily being applicable to developing countries[297]. To accommodate such a scenario, India's inclusion of this additional method allows taxpayers the flexibility to use other data sources to justify the use of an elected price (for example, by using tender documents, third-party quotations, valuation reports, and negotiation documents), although taxpayers must still justify why the other methods were not considered appropriate[298]. Adopting the sixth method thus demonstrates how India has taken BEPS recommendations and tailored them to suit its developing nation status.

The enhanced ITPR showcases India's commitment to combatting avoidance behaviour by mitigating its biggest BEPS risk – the shifting of profits by MNEs operating in India[299]. For now, India's management of this risk doesn't include the enactment of CFC legislation (despite recommendations for its implementation existing since 2010). Many critics argue that it should not be a priority to justify the enactment of the legislation given India's net capital importing status, as well as the fact that there is little data showing that residents are deferring profits offshore[300]. This may be as a result of India prioritising other avoidance risks, combined with the government's response to CFC criticism as it attempts to balance its support for business growth whilst combating BEPS[301]. Despite PoEM being noted as potentially comparable to CFC rules, it doesn't target profit shifting and tax deferral in the same manner. Thus, for now, India doesn't appear to have any regulations in place to solely target such Action 3 BEPS risks.

5.3. THE CFC RULES IN BRAZIL

Brazil's CFC regulations were enacted in 2001, followed by a reform in 2014 which became law on 1 January 2015. Although Brazil was actively involved in the creation of the BEPS Action Plan[302], Brazil's CFC rules, like India's PoEM rules, have been criticised for being used as a tax collection tool rather than an anti-avoidance measure, as well as for inadequately handling the risks of double taxation[303].

[297] RSM India, 2003:2-5
[298] RSM India, 2016:77-78
[299] Deloitte.com, 2017b:42
[300] Jain, 2012:153
[301] Shelepov, 2017:120
[302] Valadão, 2016
[303] Teijeiro, 2015

5.3.1. An overview of Brazil's CFC legislation

Brazil's current CFC legislation (which was amended in 2014[304]) subjects the profits of directly and indirectly controlled entities located offshore to Brazilian taxation, in which such profits are calculated according to the applicable accounting rules of the CFC's jurisdiction[305]. In attributing this income, the rules incorporate the usual CFC elements of establishing the definition of a CFC with reference to residents'[306] control, as well as the use of foreign tax credits to reduce the Brazilian tax imposed on such imputed income. The rules, however, deviate from international (Action 3) standards in certain instances, by applying the full-income inclusion method without distinguishing between the active and passive nature of such income, and by not incorporating any imputed-income exemptions.

In determining whether a foreign entity is subject to the Brazilian CFC rules, one would consider not only a shareholder's voting rights, but also their power over the entity's decision-making processes and the resultant impact on electing the majority of persons to the company's governing authority (such as the board of directors)[307]. Both foreign-controlled companies (FCCs) – entities that control the abovementioned decision-making processes – and foreign affiliates (FAs) – entities that influence the abovementioned decision-making processes – can have their income imputed for CFC purposes. A foreign entity is presumed to be controlled if a shareholder or related-party shareholders hold more than 50% of the foreign entity's voting rights. Foreign entities whose Brazilian shareholders hold in excess of 20% of such voting rights are considered to be affiliated entities[308].

All profits of FCCs accrue to Brazilian shareholders in proportion to their shareholdings for tax-calculation purposes, although they exclude profits attributable to other FCCs that are directly or indirectly controlled by the same shareholders (inter-group profits are effectively eliminated to avoid double counting and thus double taxation). However, in the instance where FCCs derive their income from services directly related to the pre-operational phases of Brazilian oil and gas industries (i.e., prospecting and exploration), such profits are not imputed. For FAs, profits will only be included in a shareholder's tax calculation when they're declared as a dividend, provided that the FA isn't located in a low-tax jurisdiction (such as a tax haven and/or

[304] Bianco & Santos, 2017
[305] *Ibid*
[306] Violin, 2014b – Brazil's CFC regime only applies to juristic, and not natural, persons.
[307] *Ibid*
[308] Violin, 2014a

a sub-taxation regime[309])[310]. Should the FA not meet these criteria, its income will accrue to the shareholder as if it were an FCC[311].

The all-inclusive nature of these rules counter Action 3's anti-avoidance purpose by ignoring an FCC/FA's jurisdiction of incorporation and level of tax paid in the foreign jurisdiction and by disregarding the nature of the income earned by these entities, such that both active and passive incomes are imputed[312]. A further illustration of how these rules deviate from the Action 3 recommendations is that they don't incorporate exemptions for a taxpayer's imputed income (apart from the abovementioned oil industry exemption)[313]. This so-called anti-avoidance measure thus results in the imputation of all offshore income regardless of whether there was an intention to avoid or defer tax, and/or tax savings were realised.

Concerns have also been raised regarding the conflict between the CFC full-income inclusion method and Article 7 of Brazil's DTAs. In the 2014 case *National Treasury v. Companhia Vale do Rio Doce* (the Vale case), the compatibility of Brazil's pre-2014 CFC legislation with Article 7 in Brazil's treaties with Belgium, Luxembourg and Denmark was challenged in the Brazilian courts, after the Brazilian revenue authorities sought to tax profits earned by taxpayers' CFCs located in those jurisdictions. The court found that Article 7, which doesn't allow a contracting state to tax the business profits earned by a resident of another contracting state (unless a fixed place of business exists in that first contracting state), protects the profits of an entity not located in such a contracting state – as such, Brazil's CFC rules could not apply to the profits earned in those jurisdictions[314].

In another (earlier) case, *Eagle Distribuidora de Bebidas S/A v. National Treasury* (the Eagle case), the taxpayer contested the revenue authority's inclusion of profits from a Spanish subsidiary (in terms of the pre-2014 CFC rules) using the same rationale as the Vale case (i.e., that Article 7 of the Brazilian-Spanish DTA applied instead of Brazil's CFC rules). The outcome of this ruling differed from the Vale case – the court held that the disputed income from the Spanish subsidiary (which was equity-accounted income from that entity's Argentinian and Uruguayan subsidiaries) arose as a result of the Spanish entity's passive earnings, thus the income wasn't "business profits" within the scope of Article 7. The revenue

[309] PWC.com, 2019b – A sub-taxation regime is a country whose corporate income tax rate is less than 20%.
[310] Violin, 2014b
[311] Violin, 2014a
[312] Teijeiro, 2015
[313] Lessa, 2017:26
[314] Bianco & Santos, 2017

authority's inclusion of this income under the then-CFC provisions was found to be valid by the court. Despite this ruling, the court's views have been criticised for its erroneous interpretation of international tax law and treaty provisions[315].

The rulings that applied to the Vale and Eagle cases highlight the interpretative conflict that exists with regards to the interaction of CFC rules with DTA provisions. Although these rulings only apply to the pre-2014 CFC regime, it remains to be seen whether these interpretations will continue to have jurisprudence as disputes between taxpayers and the revenue authority arise over the interpretation and application of the new CFC regulations.

Despite the onerous income-inclusion requirements, the Brazilian revenue authorities have offered some relief to taxpayers. Where offshore income has been deemed to accrue to a Brazilian shareholder, the Brazilian revenue authorities provided taxpayers with the option to defer their imposed tax obligation, such that 12.5% of the offshore imputed income would be deemed to be distributed (and thus subject to tax) in the first year, with the balance deemed to be distributed up to, and including, the eighth subsequent year (during which time the tax obligation falls due)[316]. Such a deferral isn't interest-free, however – in deferring these taxes, the outstanding tax obligation will attract interest at LIBOR[317] until all taxes have been paid[318]. In addition to this payment deferral, authorities granted Brazilian shareholders the ability to consolidate profits/losses from all FCCs until 2022, provided that the FCC's country has an exchange of information agreement with Brazil, at least 80% of the entity's income is active in nature and the FCC isn't located in a tax haven or sub-taxation regime. The consolidation of these jurisdictions' income would allow loss-making FCCs to be offset against profitable ones, thereby reducing the calculated Brazilian tax[319].

One of the Action 3 recommendations that Brazil has complied with allows the offset of foreign tax credits against the local tax imposed from the inclusion of an FCC/FA's profits. For FCCs, a Brazilian shareholder may deduct the foreign corporate taxes paid, as well as dividends withholding taxes paid, from the Brazilian taxes due (in proportion to the shareholder's participation in such an FCC, but limited to the Brazilian tax imposed on the inclusion). For FAs, only the dividends withholding taxes paid can be credited against the tax raised on the FA's imputed income. It should be noted that these foreign tax credits will only be granted in

[315] Maito da Silveira & Freitas de Moraes e Castro, 2010
[316] Violin, 2014b
[317] The London Inter-bank Offered Rate (LIBOR) is a benchmark interest rate at which global banks provide short-term funding to one another.
[318] Teijeiro, 2015
[319] Violin, 2014b

the year in which such foreign tax is imposed and paid[320]. The rules also incorporate a 9% presumed tax credit (available until 2022) for Brazilian shareholders whose FCCs are involved in the construction industry or the production of food or beverage products[321].

5.3.2. Brazil versus BEPS

The Brazilian CFC rules don't appear to have incorporated the BEPS Action 3 building blocks (as outlined in Section 2.3.) into the domestic legislation – the rules don't factor in exemptions for the generation of active income (building block 2) nor have any computation and attribution rules (building blocks 4 and 5) been considered. Disregarding whether passive or active income has been earned by an FCC or FA by adopting a full-income inclusion method is also not in line with the CFC purpose of tackling the deferral of taxation on offshore passive income. For these reasons, critics argue that the Brazilian government has ignored the long-term impact these rules could have on the competitiveness of Brazilian MNEs and economic growth, by instead favouring a short-term policy that may over-tax residents and boost tax revenues[322].

The Brazilian revenue authorities have also been criticised for failing to appropriately reform the legislation as an effective anti-avoidance mechanism by only incorporating beneficial provisions for certain categories of taxpayers that exert political influence. Examples of this influence can be seen in the addition of the 9% tax credit for taxpayers operating in the construction, food and beverage industries, as well as the outright exclusion of the application of the rules to individuals[323].

Although Brazil's CFC rules have faced much criticism, it doesn't appear that the implementation of Action 3 recommendations into the domestic legislation will be prioritised at this stage. Like their Indian counterparts, the Brazilian authorities have highlighted that TP remains one of the key BEPS risks as the use of inter-group cross-border transactions has been identified as one of the most common BEPS techniques exploited by MNEs. As such, Brazil has identified Actions 8, 9, 10 and 13 (as well as 4 and 12[324]) as the most important Actions from the BEPS Action Plan that it will be focusing on to counter BEPS[325].

[320] Violin, 2014a
[321] Violin, 2014b
[322] Bianco & Santos, 2017
[323] Violin, 2014b
[324] OECD.org, 2019a – Action 4 limits interest deductions on cross-border loans between entities within an MNE group, while Action 12 recommends legislation that requires taxpayers and advisors to disclose aggressive tax-planning arrangements.
[325] Valadão, 2016

As the purpose of Brazil's current CFC legislation doesn't necessarily prevent profit shifting or deferral to low-tax jurisdictions, alternative aspects of Brazil's legislation (namely its TP rules) are considered for comparative purposes.

5.3.3. Other anti-avoidance provisions adopted in Brazil: TP regulations

As one of Brazil's key concerns has been the lack of exchange of information disclosure to determine taxpayer compliance[326], the country has prioritised the enactment of this aspect of Action 13 in its legislation. Brazil's required disclosure (effective from 2016) is similar to Action 13's CbC report, in which taxpayers are required to disclose profits earned by foreign-controlled subsidiaries on a per-country basis, and to provide the details of import and export transactions. Brazil's report, however, isn't considered to be as detailed as the CbC reporting requirements outlined in Action 13. In addition, not all elements of the Action recommendations have been adopted by Brazil – Action 13 recommends incorporating the three-tier documentation system, but Brazil is yet to incorporate these requirements into its legislation[327].

Brazil's TP rules may struggle to adapt to the detailed three-tier Action 13 recommendations considering that the current legislation doesn't require detailed submissions from taxpayers in the form of master and local files. This is largely as a result of the simplified arm's length pricing techniques that have been adopted in Brazil. Brazil's TP rules seek to adopt elements of the OECD's arm's-length principle by only permitting three transaction methods out of the five-method standard to determine an arm's length price, namely the comparable uncontrolled price (CUP), the cost plus (CPM) and the resale price (RSP) methods. In addition, the sixth method has been adopted for import and export transactions involving commodities which require the use of the CUP method, such that quotations instead of comparative transactions may be used to determine an arm's length price. An additional simplification method is the fixing of mark-ups and margins according to a taxpayer's industry for the CPM and RSP methods respectively[328]. It should be noted, however, that transactions involving royalty payments, administration and scientific fees, technical assistance, etc. are not subject to Brazil's TP regulations.

The creation of pricing certainty and the simplification of calculations by using other available information instead of having to select comparable transactions, the setting of predetermined

[326] Valadão, 2016
[327] *Ibid*
[328] Valadão, 2016 – For example, taxpayers in the pharmaceutical and paper sectors are considered to act at arm's length if their gross profit margins on import transactions are no more that 40% and 30% respectively, while all taxpayers are considered to act at arm's length if their mark-up is no more than 20% on imports and 15% on exports.

margins across various industries, and omitting the complications of setting an arm's length price involving the use of intangibles, reduces compliance costs which benefits both taxpayers and the revenue authorities. Taxpayers are merely required to submit their methods used, together with the applicable method's calculations, in their annual tax returns which the revenue authorities then monitor accordingly[329]. These simplified rules have also helped to reduce litigation between taxpayers and the state, as the uncertainty that comes with adopting a price based on a comparable transaction is eliminated[330]. Although this simplification has helped to reduce the costs and complexities of TP compliance, the rules have been criticised for exposing taxpayers to double-taxation risks and for hampering Brazil's integration into global value chains, largely because of the conflict between international TP regulations adopted by MNEs and Brazil's dissimilar TP legislation that these MNEs are required to adhere to[331].

In light of this criticism, Brazil's recent announcement of its intention to join the OECD launched a 15-month long project to explore how Brazil's TP laws could be aligned with the OECD's Guidelines. In July 2019, the outcomes of the project were announced: 30 Brazilian rules with key differences were identified, of which 27 increased the risk of double taxation[332]. The OECD concluded that these discrepancies have an adverse effect on MNEs' ability to do business, as well as on tax collections earned, finding that Brazil's acceptance into the organisation would be dependent on the country's full alignment with the OECD's TP guidelines[333]. The Brazilian revenue authorities have acknowledged that the current rules create additional complexities despite their simple and practical application and have resultantly expressed their desire to align Brazilian TP legislation with the Guidelines, pending governmental evaluation[334].

Brazil's tax legislation is known for being incompatible with the OECD principles, as the country has a history of incorporating only aspects of recommended international standards into its domestic legislation that suit its domestic purposes[335]. Although there is some merit in Brazil's deviation, in that the simplicity of Brazilian anti-avoidance rules reduce costs associated with administration and enforceability, commentators still criticise this legislation for focussing on revenue collection objectives instead of protecting the local tax base[336].

[329] Gomes de Oliveira & Lisboa Moreira, 2017
[330] Valadão, 2016
[331] Tomazela, 2019
[332] Amano, 2019
[333] Tomazela, 2019
[334] Amano, 2019
[335] KPMG.com, 2017:12
[336] Bianco & Santos, 2017

Brazil's recent commitment to amending its TP regulations showcases the revenue authorities' desire to transform its international tax legislation, not just to allow Brazil to join the OECD, but to also enact the desired TP changes needed to combat MNE BEPS behaviour. It remains to be seen whether Brazil will enact legislation that effectively deters BEPS.[337]

5.4. CHAPTER CONCLUSION

Both India and Brazil have identified the damaging impact MNEs can have on their economies when they apply profit-shifting techniques. To combat these BEPS behaviours, both countries appear to be prioritising the strengthening of their TP legislation rather than their CFC (or CFC-equivalent) rules.

Despite India's commitment to the enactment of the BEPS Action Plan, as well as its continued support for the enactment of CFC legislation (as noted in the comments to the IDTC), these rules have not yet found their way into India's legislation. This may be as a result of Action 3 not forming part of the priority BEPS actions for India's implementation plan[338], although it is possible that public criticism against the implementation of CFC legislation may also be delaying its enactment. This approach is not surprising given India's comments that the implementation of the BEPS actions should be done with caution by developing countries, as the rules are largely skewed to developed nations with different economic needs to their developing counterparts[339]. India's adoption of a sixth method in addition to the OECD's five-method approach for determining an arm's length price for TP assessment purposes[340] is an example of the country's consideration and adaptation of OECD recommendations to its economic station.

Brazil is another example of a BRICS country that hasn't incorporated all of the OECD recommendations into its domestic legislation. The criticism against Brazil's piecemeal adoption of the BEPS actions doesn't seem to have inspired reforms of the country's CFC regulations, even while these rules are condemned for being used as a tax collection tool instead of as an anti-avoidance measure. One of the few benefits of Brazil's CFC legislation, however, is that the administrative burden on Brazilian authorities and taxpayers is relatively low, as the attribution rules are simple to comply with (for instance, a CFC's accounting profits are easily imputed without the need to separately calculate passive and active income[341]). The

[337] For a direct comparison between the Action 3 building blocks and the South African CFC legislation, see Appendix II.
[338] United Nations, 2014a:6
[339] United Nations, 2014a:8
[340] Action Aid, 2015
[341] Lessa, 2017:27-28

prioritisation of simplicity is also a theme in Brazil's TP legislation, as utilising predetermined margin methodologies is suited to the country's limited technical knowledge of TP issues[342]. Despite its inaction on CFCs, Brazil's consideration in recent months of reform to its TP rules will help to align its tax laws with the BEPS project, even though the impetus for these changes may have been borne from Brazil's desire to join the OECD. Such reforms will help Brazil to enact some of the BEPS Actions it considers to be most important (namely, Actions 8, 9, 10 and 13) in countering BEPS manoeuvres committed by MNEs[343]. However, the implementation of the OECD's recommendations will be dependent on the Brazilian government's desire to make these changes.

It is evident from the above that India and Brazil have directed their focus to strengthen their TP rather than CFC regulations to combat BEPS. India has criticised proposed CFC legislation for being anti-competitive as well as burdensome from a compliance perspective, while Brazil hasn't yet prioritised the incorporation of key Action 3 requirements into its regime (which may complicate its over-simplified approach to taxpayer compliance and resultant monitoring by the revenue authority). Both countries appear to have side-lined CFC regulations in favour of TP, given that these rules are seen to be more effective in countering profit-shifting tactics employed by MNEs.

[342] Valadão, 2016
[343] United Nations, 2014b:2-3

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

6.1. INTRODUCTION

The objective of this dissertation was to conduct extensive research and analysis to answer the primary research question:
"Can the purpose of curbing tax avoidance embedded within South Africa's CFC rules be more simply achieved?"

To answer this question, the following aspects were interrogated:

i. Chapter 2 explored a brief history of the rules and examined the existing application of the rules within the ITA;
ii. Chapter 3 considered the impact of complex international laws on South Africa's domestic tax legislation and the result these effects have on the application of the country's CFC rules. It also explored the outlook that developed nations, such as the UK and the US, have regarding the proposed strengthening of CFC legislation advocated in the BEPS Action Plan;
iii. Chapter 4 assessed the reporting overlap and principle application of the TP and CFC rules; and
iv. Chapter 5 reviewed the standpoint that fellow BRICS nations India and Brazil have taken up with regards to CFC and TP legislation.

A brief summary of these respective chapter findings is laid out below, together with the final recommendations that were derived from the answering of the above question.

6.2. CFC BACKGROUND SUMMARY

The initial introduction of CFC rules in South Africa was an understandably defensive tactic, given the government's need to protect its tax base and prevent capital shifting in the wake of the relaxation of exchange control regulations. The purpose of the legislation was to deter taxpayers, who had the intention of reducing or deferring their South African tax obligations, from shifting their profits offshore by using artificial structuring techniques. South Africa's CFC regime has developed over the years to become one the strongest set of such rules amongst the G20 nations.

CFC rules came under the spotlight on a global scale soon after the global financial crisis, as profit-shifting manoeuvres adopted by MNEs to take advantage of cross-border tax-rate arbitrage was exposed. G20 politicians responded to the resultant public outrage by appointing

the OECD to develop anti-avoidance guidelines, culminating in the BEPS Action Plan. Part of this plan included the strengthening of CFC rules as depicted in Action 3. South Africa's CFC rules, harboured within Section 9D of the ITA, appear to be closely aligned with the Action 3 recommendations.

6.3. SOUTH AFRICA'S NEED TO REMAIN COMPETITIVE

South Africa's ITA is considered to be a body of "patchwork"[344] that has been created largely from the transplanted pieces of international legislation slotted into domestic regulations. This methodology was applied in the development of Section 9D, as aspects of foreign CFC rules or accounting standards were assimilated into the section without due consideration of the impact these components could have on domestic interpretation. This created legal and effective complexities within South Africa's CFC rules, despite the regime's close alignment with the Action 3 recommendations. Notwithstanding its perceived sophistication in comparison to other G20 regimes, the legislation's complexities could hinder the competitiveness of South African businesses operating abroad. Furthermore, the "patchwork" methodology creates a risk of misinterpretations occurring when these transplanted components are applied in a domestic (and international) context. These complexities could adversely impact the competitiveness of South African MNEs, as well as dampen South Africa's appeal in attracting foreign investment. Considering South Africa's reliance on corporate taxes for revenue collection purposes, it would be in the country's interest to stimulate corporate growth that would in turn grow the tax base, and thus tax collections.

6.4. NON-ADOPTION OF ACTION 3'S RECOMMENDATIONS

Regardless of the strength and sophistication of South Africa's CFC regime, its domestic enforcement may not necessarily have the desired impact in deterring cross-border tax-avoidance behaviour. The OECD recommended that a global strengthening of CFC rules would create an ideal outcome in deterring this behaviour. However, it didn't anticipate the impact that a series of "prisoner's dilemma" choices made by various countries would have on the implementation of Action 3's recommendations. Two of the world's largest developed countries, the US and the UK, appear to have snubbed these recommendations by adopting tax policies to suit the growth strategies of their MNEs – a move which risks starting a race to the corporate-tax bottom. This trend of non-adoption (not only in the US and the UK, but in fellow BRICS nations Brazil and India as well) may inhibit the effectiveness of South Africa's CFC rules in achieving its purpose of deterring tax avoidance.

[344] Li & Pidduck, 2019

6.5. THE INDIAN AND BRAZILIAN OUTLOOK

Despite the initial drafting of CFC rules in India by 2010, the regime is yet to be enacted into India's IITA. These draft rules have been criticised for being ill-suited to India's economic standing given its status as a developing country, as well as the fact that the legislation is primarily designed to meet the needs of net capital exporters rather than net capital importers. India's focus has instead been on enhancing its TP rules to counter MNE tax avoidance, to the extent that the country's TP rules have been developed to become one of the most aggressive regimes in the world. Although India incorporated the BEPS standards into its TP legislation, it has acknowledged that not all aspects of these recommendations are necessarily suited to its economic needs. As such, India has taken the liberty of tailoring certain elements of these standards (such as the adoption of a sixth method to determine an arm's length price) to better suit its developing nation status.

Brazil is another example of a developing country that incorporated selected components of international tax principles into its legislation that best suit its domestic purposes. Brazil's CFC regime fails to tackle the deferral of taxation on offshore passive income by overlooking a key anti-avoidance aspect – whether there was an intention to avoid tax. As such, the rules have been criticised for being used as a tax collection tool when their purpose is instead to act as a tax-avoidance deterrent. Despite this, no plans appear to be on the horizon to reform these rules to align with the Action 3 recommendations. Brazil has instead focussed its attention on amending its TP legislation, not only for the purpose of countering the BEPS risks that have been identified through MNEs' cross-border TP manipulation, but also for the purpose of aligning its tax principles with those of the OECD's as a result of its desire to join the organisation.

India and Brazil have therefore not placed reliance on CFC rules for the purpose of combating MNE profit shifting. They have instead matched their anti-avoidance approach (focussing on TP) to the elements identified as posing key BEPS risks – the manipulation of cross-border pricing by MNEs.

6.6. THE TP AND CFC OVERLAP

As MNE cross-border transactions have become more complex, taxpayer reporting has evolved to accommodate SARS' need to effectively monitor BEPS and TP risks. The required submission of taxpayer operational and economic information incorporated in the CbC, master file and local file reports, has given SARS unprecedented access to MNE information on a global scale. Even if taxpayer submission isn't required, MNEs would still perform this

reporting function given that SARS may request this information at any time. It was also found that the high-level information reported from a TP perspective happens to overlap with the information required for submission for CFC reporting purposes. In addition to these local reporting requirements, SARS also receives CRS information on South African taxpayers from third-party institutions from around the world. The access to such a broad range of taxpayer data gives SARS unprecedented insight into taxpayer affairs, allowing the revenue authority to cross-reference locally submitted information with foreign submissions received. Access to, and the interpretation of, this data will become a crucial means by which SARS monitors and assesses profit-shifting risks.

In addition to reporting, an overlap in principle between TP and CFC rules was also established. The adoption of the arm's length principle is an integral part of the ITA's TP legislation, such that Section 31's title makes deliberate reference to it – "*Tax payable in respect of international transactions to be based on arm's length principle*". To interpret what constitutes an arm's length price or transaction in a South African context, common practice is to draw on the interpretations laid out in The Guidelines. The release of Actions 8, 9 and 10 prompted the OECD to revise The Guidelines to amend the arm's length principle to align TP outcomes with the underlying value creation. Since SARS and South African taxpayers use The Guidelines, it follows that these amendments have a direct impact on local arm's length interpretations. Although this alignment of compensation and value was revolutionary from a TP perspective, these principles were already embodied within South Africa's existing CFC legislation. Preventing the creation of value mismatches simulated by controlling shareholders with the ability to control the financial and economic actions of an MNE is a principle that both TP arm's length interpretations and CFC rules now share. Furthermore, the TP rules apply to a broader scope of transactions as they're not limited to only considering the value shift that may occur between a shareholder and their controlled offshore entity.

6.7. RECOMMENDATION

In answering the primary research question, there appears to be a simpler way to achieve the anti-avoidance purpose embodied within South Africa's existing CFC legislation. Although the South African CFC regime has been identified as one of the most complex amongst the G20, deterring tax avoidance doesn't necessarily require complexity, but rather efficiency. Bearing this in mind, MNEs have been identified as the main profit-shifting culprits in South Africa – it thus follows that attention must be given to the appropriate legislation that targets these entities, thereby enhancing the coverage of BEPS risks and yielding better anti-avoidance results. In order for CFC rules to achieve their best results in curbing global profit shifting, all

countries should be strengthening their regimes – if there is limited global adoption, the impact of strong domestic legislation on achieving this purpose may be somewhat diminished. From this dissertation's assessment of four other countries' (the UK, the US, India and Brazil') approach to the OECD's call for the global strengthening of CFC rules, actioning these amendments doesn't appear to be a priority for these countries. Such global non-adoption could have an adverse impact on the success of South Africa's CFC rules achieving their purpose, such that it could render them ineffective. South Africa's existing TP legislation, however, whose reporting and (recently amended) arm's length principles have been shown to directly overlap with the CFC regime, has been shown to better target the pricing manipulations committed by these MNEs.

As the other side of the tax complexity coin is tax simplification (which can be achieved by simplifying the existing legal and effective complexities), it is recommended that, in order to more simply and effectively target profit shifting, sole reliance should be placed on South Africa's TP legislation. Simplicity would be achieved by only having to rely on Section 31 of the ITA (and not Section 9D as well) and by also removing the CFC reporting requirements. As TP legislation effectively covers all aspects of the purpose which CFC rules aim to achieve, and considering that TP legislation eliminates the need for these rules' existence, it is therefore recommended that South Africa's CFC regime is repealed. It is further recommended that additional research is performed to assess the economic impact the removal of CFC legislation would have in a South African context.

APPENDIX I: COMPARATIVE TABLE OF SOUTH AFRICAN, US, UK AND BRAZILIAN CFC REGIMES

	South Africa[345]	United Kingdom[346]	United States of America[347]	Brazil[348]
BEPS Action 3 building blocks 1 & 2: Control over a CFC (definition and threshold/ exemption requirements)	Definition: A CFC is defined as a foreign entity in which South African residents hold >50% participation rights in a foreign entity, or where a foreign entity is consolidated into a resident entity's financial statements in terms of IFRS 10.	Definition: A CFC is defined as a foreign entity in which UK shareholders control an entity operating in a low-tax jurisdiction. An entity is "controlled" when UK residents own >50% interest or when UK residents own >40% interest and a non-resident owns at least a 55% interest.	Definition: A CFC is defined as a foreign entity in which US shareholders own >50% of an entity by vote or by value.	Definition: A CFC is an FCC (>50% shareholding) or FA (>20% shareholding), where control is considered by determining shareholder control over an entity's decision-making processes and the impact this has on the election of persons to the board.
	Exemption: Shareholders owning <10% aren't considered when aggregating ownership to determine the 50% requirement.	Exemption: A CFC isn't considered to be in a low-tax jurisdiction if the foreign taxes payable are at least 75% of UK tax that would've been payable had the entity been a UK resident.	Exemption: Shareholders owning <10% aren't considered when aggregating ownership to determine the 50% requirement.	
			Exemption: An entity isn't considered to be a CFC where there is an equal partnership between foreigners and US persons	
Building blocks 3, 4 & 5: Income of a CFC (definition, calculation and attribution of income)	CFC income: Defined as "net income" which determines the entity's taxable income as if it had been a resident.	CFC income: Profits of the CFC (excluding capital gains) are taxable in the UK.	CFC income: Undistributed passive income (including the CFC's earnings derived from investments in US property) and GILTI income are taxable in the hands of the US shareholder.	CFC income: All income of an FCC or FA is considered to be CFC income.

[345] Section 9D
[346] Smith, 2013:127-131 (refer Section 3.2.3)
[347] Choi & Rienstra, 2020 (refer Section 3.2.2)
[348] Bianco & Santos, 2017; Violin, 2014a; Violin, 2014b (refer Section 5.3.1)

	South Africa	United Kingdom	United States of America	Brazil
		Income exemption: *De minimis* rule – income that has met the requirements of the CFC charge gateway test (see below) is exempt where this is less than 5% of the CFC's total income.	Income exemption: *De minimis* rule – where the total of foreign base company and insurance income is less than 5% of the CFC's total income, or $1 million, this income is exempt.	
	Income exemption: Net income is deemed to be nil if the foreign taxes payable are at least 75% of tax that would've been payable had the entity been a resident.	Income exemption: If the foreign taxes payable are at least 75% of the corresponding UK tax, then the income is exempt.	Income exemption: If the foreign taxes payable are at least 90% of the US tax rate, then the income is exempt.	Income exemption: Profits attributable to other FCCs are excluded from CFC income.
	Income exemption: Income attributable to an FBE is deemed to be nil in the definition of net income.	Income exemption: Income is exempt if the CFC generates *bona fide* trading income.	Income exemption: GILTI exemptions – 50% deduction of GILTI income until 2025, 37.5% thereafter.	Income exemption: Income relating to the pre-operational phases in the oil and gas industries are excluded.
		Income exemption: Low profits – where a CFC's accounting profits are less than £50 000, don't exceed £500 000 (and non-trading income is less than £50 000) or are less than 10% of operational expenditure, the income is exempt.	Income exemption: If the sum of GILTI and FDII exceeds a US shareholder's taxable income, the GILTI exemption may be limited.	
		Income exemption: Group finance exemption – CFCs have the option to elect that either 0% or 25% of their total financing income earned could be subjected to taxation.		
		Income exemption: Income from CFCs located in specified jurisdictions is exempt.		
		Income exemption: Where a CFC becomes UK-controlled, all income is exempted for the first 12 months.		
	Included income: FBE income attributable to diversionary transactions between related parties is included to determine net income.	Included income: CFC charge gateway test – profits that "pass through the gateway" are subject to UK tax.	Included income: Where insurance income and foreign base company income exceeds 70% of the CFC's total income, all income is imputed.	

	South Africa	United Kingdom	United States of America	Brazil
	Attribution: Income is attributed to shareholders in proportion to their shareholding, or according to the percentage outlined by IFRS 10 in the financial results.	Attribution: Income is attributed to shareholders in proportion to their shareholding	Attribution: Income is attributed to shareholders in proportion to their shareholding.	Attribution: Income is attributed in proportion to a shareholder's shareholding. This is attributed in December each year. In the case of an FA that's not located in a low-tax jurisdiction, however, this income is attributed upon the distribution of a dividend.
				Payment deferral: Taxpayers have 8 years in which to settle their CFC income-tax obligations (outstanding tax liabilities do, however, attract interest at LIBOR).
				Consolidation of CFC income: Shareholders have the ability to consolidate the profits and losses of their CFC income in their tax returns in determining the tax owed on net CFC income.
Building block 6: Prevention of double taxation	Foreign tax credits: The South African tax payable on net income is determined after deducting the foreign taxes paid.		Foreign tax credits: Foreign taxes are deemed to be "paid" on taxable distributions from CFCs – this reduces the US tax payable on CFC income.	Foreign tax credits: The Brazilian tax payable is determined after deducting the foreign taxes paid (corporate tax and withholding taxes). FAs may only have withholding taxes deducted.
	Income subject to withholding tax: Income on which withholding taxes are paid (e.g., interest, dividends and royalties) is not considered to be net income		Foreign tax credits: Where a shareholder has imputed GILTI, 80% of foreign taxes paid may be claimed as a foreign tax credit.	

APPENDIX II: CBC REPORTING TEMPLATES

The below extracts illustrate the layout of the CbC report recommended in the OECD's BEPS Action 13[349]:

Transfer pricing documentation – Country-by-Country Report

A. Model template for the Country-by-Country Report

Table 1. **Overview of allocation of income, taxes and business activities by tax jurisdiction**

Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) before Income Tax	Income Tax Paid (on Cash Basis)	Income Tax Accrued – Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

[349] OECD, 2015b:29

Table 2. **List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction**

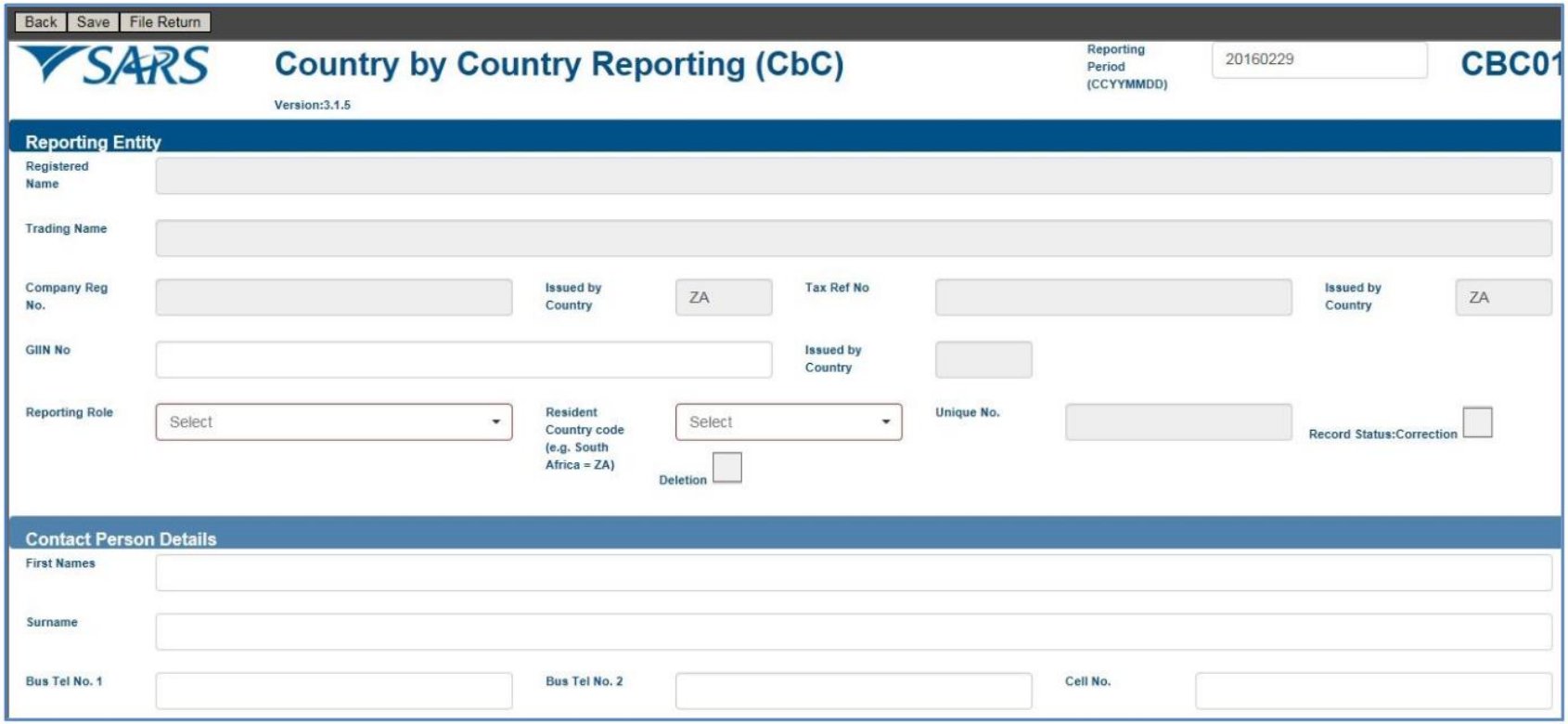
Name of the MNE group: Fiscal year concerned:														
Tax Jurisdiction	Constituent Entities Resident in the Tax Jurisdiction	Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence	Main Business Activity(ies)											
			Research and Development	Holding or Managing Intellectual Property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to Unrelated Parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding Shares or Other Equity instruments	Dormant	Other[1]
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														

1. Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

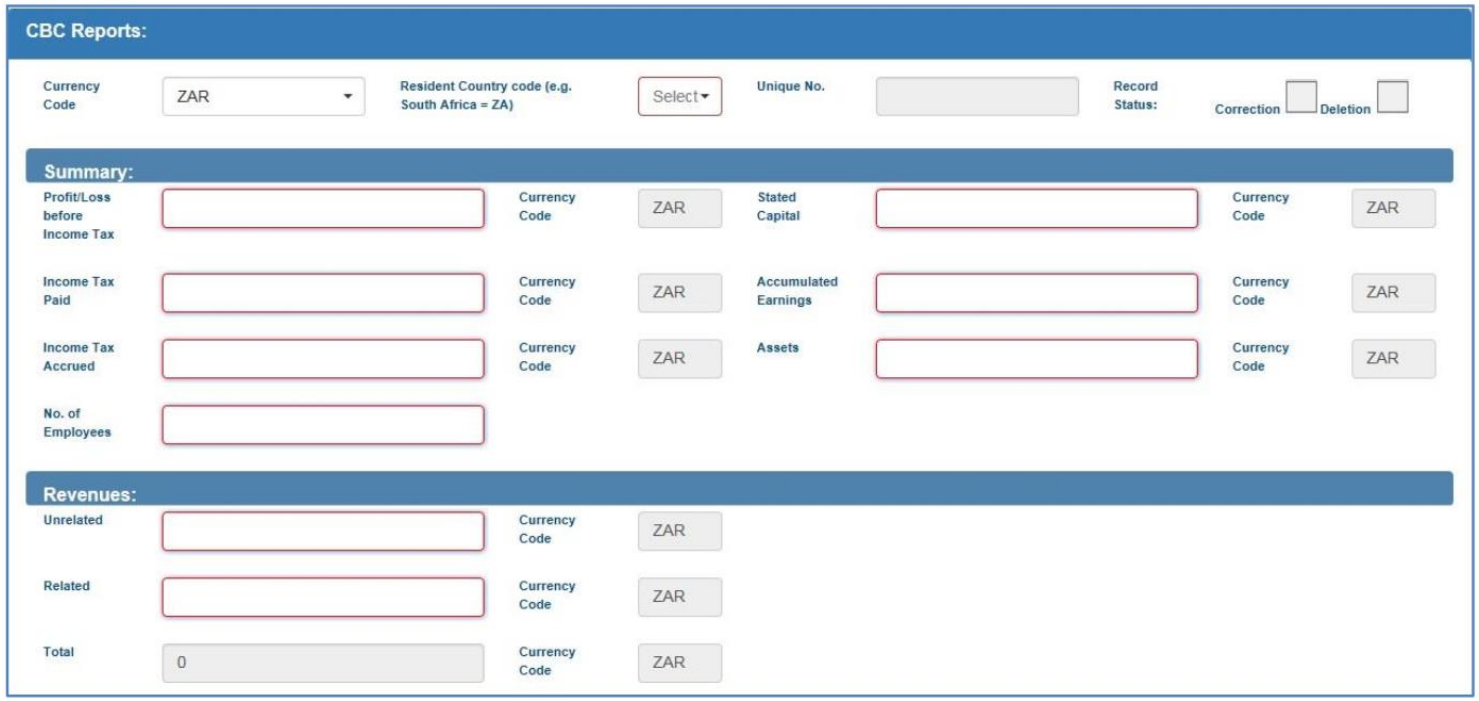
Table 3. **Additional Information**

Name of the MNE group: Fiscal year concerned:
Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the Country-by-Country Report.

The below extracts illustrate the layout of the CBC01 form required by SARS for MNE groups' CbC reporting[350]:



[350] SARS, 2019:11-19


CBC Reports:
Currency Code
ZAR
Resident Country code (e.g. South Africa = ZA)
Select
Unique No.
Record Status:
Correction
Deletion
Summary:
Profit/Loss before Income Tax
Currency Code
ZAR
Stated Capital
Currency Code
ZAR
Income Tax Paid
Currency Code
ZAR
Accumulated Earnings
Currency Code
ZAR
Income Tax Accrued
Currency Code
ZAR
Assets
Currency Code
ZAR
No. of Employees
Revenues:
Unrelated
Currency Code
ZAR
Related
Currency Code
ZAR
Total
0
Currency Code
ZAR

Selection for Constituent Entities

Number of Constituent Entities in this Tax Jurisdiction: 0

Constituent Entity:

Registered Name

Trading Name

Company Reg No.

Issued by Country: Select

Tax Ref No

Issued by Country: Select

Resident Country code (e.g. South Africa = ZA): Select

Incorp Country code(e.g. South Africa = ZA): Select

Address

Address type: Select

Country Code: Select

Business Activities

Main Business Activities: Select + −

Other Business Activity Information

APPENDIX III: CFC REPORTING

The below extract illustrates the layout of the IT10B schedule required by SARS for CFC reporting[351]:

INCOME TAX - Controlled Foreign Company (CFC) - 2012 onwards — IT10B

(This return and the annual financial statements of the CFC must be attached to the annual tax return)

CFC No	Registered Name of CFC	Registered Business Address of CFC	Physical Business Address of CFC	Contact Email of CFC	Contact Phone No of CFC	Foreign Tax Reference No of CFC	CFC Financial Year End {dd/mm/yyyy}	Country of Effective Management of CFC {select from dropdown list}	Country of Incorporation of CFC {select from dropdown list}	Primary Activity of CFC {select Standard Industry Division (SIC7) from dropdown list}	Number of Employees of CFC	CFC Net Profit or (Loss) before Tax {Rands only - enter losses as a negative amount}	Is the CFC a Protected Cell Company as defined in s9D? {Y}es/{N}o	Is the CFC taxable as part of a group taxation in a foreign country? {Y}es/{N}o	Imputed Net Income of CFC {Rands only}	Foreign Tax Credit claimed by CFC i.r.o. s6*quat* {Rands only}	Portion of Imputed Net Income of CFC attributable to Foreign Business Establishment (s9D(9A)(a)) {Rands only}	Does the CFC qualify for the Foreign Business Establishment Exemption i.r.o. s9D(1) & s9D(9)(b)? {Y}es/{N}o	Has the CFC utilised the High Tax Exemption i.t.o. par. (i) of further proviso to s9D(2A)? {Y}es/{N}o	Are the participation rights excluded i.t.o. par. C of proviso to s9D(2)? {Y}es/{N}o	Did the CFC receive income i.r.o. the following paragraphs to s9D(9A)(a)? {Select X if applicable}							Does the CFC qualify for an exemption i.t.o. the following paragraphs to s9D(9)? {Select X if applicable}				
																						(i)	(iA)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(c)	(e)	(f)	(fA)	(fB)

[351] SARS.gov.za, 2019c

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