SOUTH AFRICA

AFRICA SPOTLIGHT: 15 BY 2015?

The OECD's 15 step action plan is no longer new to conversation, yet African countries are still evaluating its feasibility in lieu of local tax landscapes and the capacity of African tax authorities to fall in line with the OECD's ambitious goals. Meanwhile, projections for further growth in Africa continue to draw multinational corporations (MNCs) to the continent and strengthen tax revenues from increased investment. This revenue flow and international presence is vital to strengthening the infrastructure in Africa and securing further foreign investment in the region.

In a more recent context, where the global financial crisis has reduced the emphasis on official development assistance, developing countries are beginning to realise that the achievement of economic goals (i.e. market reforms, promotion of private sector investment, and industrialisation, etc.) will depend heavily on tax revenues. Consequently, creating robust and equitable tax policies and implementing fair and effective tax systems has become critical.

BEPS and the African tax landscape

Though composed of over 50 sovereign countries, tax authorities throughout the African continent have garnered attention due to common obstacles and apprehensions as more developed tax authorities implement the proposed BEPS action plan[1]. The action plan has set out to minimise the artificial segregation of taxable income from the activities that generate it by eliminating the gaps in the interaction of different tax systems, and to ensure that income from cross-border activities is not untaxed or unduly lowly taxed.

As Africa is largely categorised as low income and developing countries, the regional tax landscape presents a number of domestic factors which muddy the waters for local revenue authorities to apply comprehensive transfer pricing regimes as suggested by the BEPS action plan. Hot topics for transfer pricing discussion in Africa can be summarised in four broad areas:

- Capacity constraints
- Legislative barriers
- Comparable data, and
- Raw materials.

Capacity constraints

Despite the development of international and domestic guidance, even the world's most sophisticated tax administrations sometimes have difficulties assessing whether the prices at which MNCs carry out cross-border transactions are manipulated, especially for complex financial transactions and those involving significant unique intangibles. For developing countries, the problem of assessing appropriate transfer prices is exacerbated by a lack of the requisite skills and experience required to analyse complex transfer pricing issues.

Many African nations' anti-avoidance principles are largely based on the OECD guidelines, but due to the lack of local resources, comprehensive transfer pricing regimes still present high cost thresholds to the tax administrations of developing countries and have yet to be implemented[2]. Judge Dennis Davis of South Africa heads the country's tax review committee, and explains that the South African Revenue Service (SARS) currently lacks the capacity to deal effectively with local transfer pricing matters, which potentially affect the economy by billions of Rand. Citing discrepancies with the size and power of units within authorities like the HMRC, Davis is calling for SARS to bolster its staff to match this fiscal challenge, and to invest heavily in the future of transfer pricing in South Africa.

In addition, African Economic Outlook, a product of collaborative work by the African Development Bank, the OECD Development Centre and the United Nations Development Programme, has determined that African tax authorities may not be able to recognise profit shifting where this occurs and that they often lack the means and technical capacity to deal with the complexities of the practice. Despite the current deficiencies in capacity, much of Africa is focused on capacity-building in order to provide clear taxation policies which foster foreign direct investment (FDI). These efforts aim to align Africa with international norms and taxation objectives set by regional organisations such as the African Tax Administration Forum (ATAF).

ATAF, currently composed of 36 African member countries, is a platform for mutual cooperation, whereby African countries can share views on tax matters and best practices with the aim of making a substantial contribution towards levelling the playing field in the area of transfer pricing.

Legislative barriers

Although organisations like ATAF are increasing the response to transfer pricing concerns in the region, no African country is yet a member of the OECD (despite South Africa being one of its five key partners) and only 14 countries in Africa have established specific transfer pricing legislation or documentation requirements.

Each country, listed below by date of transfer pricing regulation implementation, has established local legislation in varying degrees (most notably Kenya, Egypt and South Africa) to meet fiscal needs without creating burdensome compliance regulations that deter good governance in tax matters. As an example, countries like South Africa and Kenya have cultivated well-established regimes that tend to serve as models for the region, while other countries, such as Angola and Tanzania, are only beginning to implement transfer pricing specific legislation.

[1] *OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing.*

[2] *UN meeting: 'Transfer Pricing and Capacity Development in Tax Matters' held on 14 March 2012.*

Countries with Transfer Pricing legislation/rules

1995 – 2000	2001 – 2005	2006 – 2010	2011 - 2015
1. South Africa	1. Namibia	1. Algeria	1. Algeria
2. Zambia	2. South Africa	2. Egypt	2. Angola
	3. Zambia	3. Kenya	3. Egypt
		4. Malawi	4. Cameroon
		5. Namibia	5. Ghana
		6. South Africa	6. Kenya
		7. Zambia	7. Malawi
			8. Nigeria
			9. Namibia
			10. Senegal
			11. South Africa
			12. Tanzania
			13. Uganda
			14. Zambia

In the absence of transfer pricing legislation, both tax administrations and MNCs have only limited guidance to which they can refer when determining TP in related-party transactions.

Generally, African countries that have yet to develop transfer pricing legislation follow practical guidance regarding the implementation of the broad-spectrum anti-avoidance provisions based on the arm's length principle as well as the OECD Guidelines and the UN Practical Manual. Nevertheless, an MNC cannot assume that the prices established for intra-group transactions under a typical worldwide transfer pricing policy based on the OECD Guidelines would definitely be accepted by the African authority concerned.

Lack of comparable data

Although both the OECD and the UN endorse the use of arm's length pricing regimes to dictate cross-border transactions, African countries frequently express concerns about the availability and quality of financial data for transactions between unrelated parties to be used for comparisons. A lack of local comparable data often forces MNCs and revenue authorities to use non-domestic comparable data (often sourced from North American or European databases) which does not reflect local market conditions. This lack of data creates significant challenges for both taxpayers and tax administrations in the continent and often results in increasingly difficult tax audits.

The raw material rush

Many African countries are rich with raw material and natural resources, and their national welfare depends on an appropriate share of profit from the exploitation of their natural resources. Taxation of these natural resources is unique, as it essentially requires a splitting of the profits from the use of the natural resources between the country where they were harvested, and the company (usually a MNC) that has the capacity to extract the mineral from the ground, refine it and sell it.

If the tax regime does not split these profits appropriately, there may be a significant loss of revenue for the country. Intrinsically, there is widespread concern for the mining sector in sub-Saharan Africa, where there are several race-to-the-bottom investment incentives and inconsistencies in the granting of tax incentives.

In an attempt to prevent BEPS for mineral and commodity products in controlled transactions, a number of resource-rich countries have developed methods which require pricing of commodity transactions in accordance with publicly available data from commodity exchanges. This has the effect of preventing the shifting of commodity product related income outside of the country of extraction, but comes with significant burdens to the tax-payer and the local revenue authorities to agree upon an established extraction price which considers refinement and transport costs incurred.

Africa in the future

With increased FDI, Africa's infrastructure in the socio-political sphere will continue to launch new initiatives and align domestic economic and legal foundations with the region's aspirations. As more African countries adopt transfer pricing regimes and local legislation, the continent will naturally harmonise with the global economy to some degree.

Where transfer pricing is a long-term goal, and for countries on the continent which already employ comprehensive transfer pricing regimes, moving forward in the future will include increasing their institutional capacity to meet their current capacity constraints, and clarifying compliance regulations. Although many countries have begun to build transfer pricing regimes based on the OECD Guidelines and the UN Practical Manual, protection of both revenues from raw materials and the domestic tax base are likely to dictate Africa's priorities in the future.

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