Tax Avoidance
Anti-Avoidance Legislation

► Provisions relating to persons carrying on business which extends beyond Zimbabwe – S 19
► Provisions relating to over/under pricing and to exports without sale of goods by non-resident person– S 23
► Transfer pricing v. arms length pricing – S24
  - Unusual conditions of trade between related parties may be set aside.
► Tax avoidance generally - S 98
  - transaction, operation or scheme has effect of avoiding or postponing tax
  - Was entered into by abnormal means or manner
  - Created abnormal rights or obligations
  - Commissioner believes avoidance/postponement was sole or main purpose
  - transaction, operation or scheme may be set aside
Anti-Avoidance Legislation

► Thin capitalisation rules – S 16(1)(q)

- no deduction shall be made in respect of any expenditure incurred by a company, in servicing any debt or debts contracted in connection with the production of income to the extent that such debt or debts cause the person to exceed a debt to equity ratio of three to one

- Normal definition of equity applies which includes ordinary share capital, share premium, capital and revenue reserves and retained earnings but excludes preference shares with fixed or restricted rights

- Debt includes only interest bearing borrowings. Interest free borrowings from both group companies and third parties are excluded from both debt and equity.

- Revalue assets
Anti-Avoidance Legislation

General admin. and management expenditure in favour of related company – S 16(1)(r)

- the quantum of general administration and management fees which is tax deductible is limited to 1% of the total allowable expenses – excess disallowed
- Allowable expenses = A – (B + C)
- Recoveries should be specific in nature e.g. internal audit fees, training fees, marketing fees, research and development fees etc
- Applies only i.r.o. holding company and its subsidiary or foreign company and its local branch.
Current Legislation contd

► Income Tax Act Chapter 23:06 Second Schedule paragraph 4 and paragraph 12

- Where trading stock or farm trading stock is disposed of or donated in pursuance of a scheme, transaction or operation the sole or main purpose which is to avoid, postpone or reduce tax liability, the Commissioner is empowered to determine the amount such stock would have realised had it been disposed of by sale in the ordinary course of trade.
Section 14 of the Capital Gains Tax Act

Determination of fair market price of specified assets

Where a person purchases a specified asset from any other person at a price in excess of the fair market price or where he sells a specified asset to any other person at a price less than the fair market price the Commissioner may, for the purpose of determining the capital gain or assessed capital loss, as the case may be, of such first-mentioned person, determine the fair market price at which such purchase or sale shall be taken into his accounts or returns for assessment.
Section 77 of the VAT Act

- Schemes for obtaining undue tax benefits

► whenever the Commissioner is satisfied that any scheme,

(a) has been entered into or carried out which has the effect of granting a tax benefit to any person; and

(b) having regard to the substance of the scheme—

► (i) was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit; or

► (ii) has created rights or obligations which would not normally be created between persons dealing at arm’s length; and

► (c) was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit;

he shall determine the liability for any tax imposed by this Act, and the amount thereof, as if the scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such tax benefit.
Overview of Transfer Pricing
Introduction to Transfer Pricing

INTERCOMPANY TRANSACTIONS

Entity A  
Country A

Entity B  
Country B

Tangibles
Intangibles
Services
Loans
Rent

REGULATIONS

Appropriate Allocation of Deductions and Income

OBJECTIVE OF TAX AUTHORITIES

Maximize tax payments in their jurisdictions

OBJECTIVE OF THE TAXPAYER

Optimize effective tax rate
Transfer Pricing
Why is it important in Africa

“Estimated capital flight from 33 African countries was US$735bn between 1970-2008

Most escaped offshore and stayed offshore

Compare to external debt for these countries amounting to US$177bn in 2008”
(Africa’s Odious Debts)
OECD Guidelines

- Govern the key practical guidance for transfer pricing administration
- Not intended to influence or dictate legislation
- Governed by OECD member countries and observer countries e.g. SA
- Key changes between 2005 and 2010 editions
UN Developments in Transfer Pricing

- Looking at tax treatment of services
- Focus on capacity building
- Attraction of Foreign Direct Investment
- Simplification of legislation
- UN providing benchmarking based on generic sources
ATAF on Transfer Pricing

- Transfer pricing and thin capitalisation identified risk areas
- Establishment of TP committee
- Benchmarking – and the challenge of obtaining data on such independent enterprise transactions in the African market place.
- Capacity building and training – TP highly specialised area, low level of skills currently in most countries.
- Identification of transfer pricing risk in order to
  - Address potential tax loss
  - Maximise the use of scarce transfer pricing resource
  - Keep taxpayers compliance costs to a minimum
Transfer Pricing issues identified for the Committee

► Use of the arm’s length principle in their transfer pricing legislation and how to legislate this.

► Application of relevant legislation in practice in member countries including guidance for taxpayers and administrators.

► Technical events held including:
  ► TP Event held in February 2010 in Egypt
  ► Share and implement best practices
  ► Enhance professionalism
  ► Develop capacity
  ► Seminar on taxation of natural resources

► Resulted in establishment of a TP project
Transfer Pricing project

► Will source information from member countries to produce appropriate products to assist in building ATAF transfer pricing capability

► Specifically obtain information on
  ► Legislation
  ► Implementation of the legislation
  ► The organisational structure for dealing with transfer pricing risk
  ► Obtaining transfer pricing documentation

► Viewed as a 3-year Project plan

► Produce a manual or handbook providing guidance on the *practicalities* of transfer pricing audits

► Set up a Knowledge sharing facility (e-Resource)
Transfer pricing trend in Africa

► Specific transfer pricing legislation is becoming more common across the region
► Even where anti avoidance legislation is in force it generally falls back to OECD principles
► More African countries are embarking on transfer pricing audits
► ATAF is ensuring greater cooperation leading to multi jurisdictional audits
What does it all mean

► Penalties – e.g. up to 100%
► Tax and TP risk management elevated to C suite – board issue
► Increased move to good compliance ratings with Revenue Authorities
► Multi jurisdictional audits becoming common
Importance of understanding your business and the transactions
Intra-group transactions

Overview of transaction types:

► Understand what qualifies as an intercompany transaction and gain introductory exposure regarding how to structure intercompany transactions within a global business

► Gain exposure as to how and when corporate transfer pricing policy and implementation may trigger regulatory scrutiny

Per the OECD Guidelines:

► Focus on cross-border transactions vs. domestic

► A tax administration should recognise actual transactions undertaken
Intra-group transactions

- Transfer prices are prices / remuneration for interactions between commonly controlled parties involving:
  - The sale or transfer of tangible goods and products;
  - The provision of services;
  - The use of intangible property; and
  - The provision of financing.

<table>
<thead>
<tr>
<th>Tangible Goods</th>
<th>Intangible Assets</th>
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<tbody>
<tr>
<td>► Intercompany transactions relating to physical goods&lt;br ► <strong>Examples:</strong> raw materials, intermediate goods, finished goods, products, equipment</td>
<td>► Intercompany transactions related to intangible property&lt;br ► <strong>Examples:</strong> marketing intangible assets such as trademarks, trade names; technology and process intangible assets</td>
</tr>
</tbody>
</table>

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<tr>
<th>Services</th>
<th>Financing</th>
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</thead>
<tbody>
<tr>
<td>► Intercompany transactions relating to the provision of service, whether centralized or not&lt;br ► <strong>Examples:</strong> management services such as treasury, finance, accounting, HR; other services such as research and development, IT, manufacturing (on a contract or toll basis)</td>
<td>► Intercompany transactions relating to financing activity&lt;br ► <strong>Examples:</strong> intercompany loans, intercompany current accounts, extension of trade credits, loan guarantees (explicit or implicit)</td>
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## Determination of arms – length price

<table>
<thead>
<tr>
<th>Traditional transactional methods</th>
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<tr>
<td>• Comparable Uncontrolled Price Method</td>
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<tr>
<td>• Resale Price Method</td>
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<td>• Cost Plus Method</td>
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<tr>
<th>Profit based methods</th>
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<tbody>
<tr>
<td>• Transactional Net Margin Method</td>
</tr>
<tr>
<td>• Profit Split Method</td>
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</tbody>
</table>
Audit strategy and controversy planning
Controversy phases

Controversy can be distinguished in four phases. In each of these phases, different tools and practices can be used/apply

► Prevention
► Preparedness
► Treatment
► Aftercare
Prevention phase

► At the planning and implementation phase of tax structures it is already advisable to consider what defense items can be employed and implemented to mitigate tax controversy exposure down the line
  ► Considering how to reflect items from a compliance and reporting perspective
  ► Considering using robust documentation
  ► Consider language (wording) used
  ► Consider obtaining a ruling or an opinion
Preparedness (diagnostic) phase

► When the taxpayer or the auditor note that something is amiss, but the authorities are not yet aware of the issue, controversy preparedness is highly advisable. This may range from the discovery of an anomaly when preparing the year-end figures, when deadlines for reporting have expired to when a tax inspector has announced they will be auditing the company.

► What is the burden of proof allocation?

► What remedial actions exist (amended return, apply voluntary disclose or play the audit lottery?)

► Collecting the relevant facts and weighing their importance is of key importance during this phase.

► Deciding how to manage the (possible) dispute process.
Treatment phase

► When an adjustment is proposed, or discussions on the adjustment are perhaps still ongoing, there are several issues to consider:
  ► How can you narrow the scope of the matter in dispute?
  ► What remedies are available?
  ► What are the consequences of the dispute resolution/dispute management tools that are available?
  ► What option is most desirable considering relevant stakeholders and recurring consequences of that route and resolution option?
  ► How to prepare an objection or appeal?
  ► Are there any alternative dispute resolution options (mediation/arbitration), how to avoid double taxation?
  ► Consider aggressive or conciliatory approaches
After-care phase

What is the best way to implement the dispute outcome, what are the consequences of the dispute outcome for tax reporting requirements and what other taxes may or may not be triggered

- Was the issue in dispute a one-time issue or recurring? If recurring, is remedial action taken as regards later years?
- Can internal procedures be amended/improved to help avoid having the issue resurface?
- Can a closing agreement be entered into on later open years with the same issue or perhaps an Advance Pricing Agreement?
- How is double tax relief obtained after settlement of the issue or after having received a court judgment on the issue?
- Can the issue be finalized/ agreement implemented without triggering indirect tax consequences?
Planning for an audit

- Indicators of pending audit
  - General tax audit
  - Audit in customs values
  - Questionnaire from RA
  - Possible audit in another location
## Typical TP enquiry from Revenue Authority (RA)

<table>
<thead>
<tr>
<th>Initial Risk assessment</th>
<th>Review of filings, review of accounts possible initial queries.</th>
</tr>
</thead>
<tbody>
<tr>
<td>In office desk audit – documentation review</td>
<td>Review of documentation, responses and other information. Possible comparable Analysis to test results. Further queries</td>
</tr>
<tr>
<td>Field audit – interviews and site visit</td>
<td>Interviews with operational and financial People at client. Testing facts against Documentation.</td>
</tr>
<tr>
<td>Review and collation stage</td>
<td>Requests for more information, possible Additional meetings</td>
</tr>
<tr>
<td>Outcome</td>
<td>Letter of findings, letter of assessment</td>
</tr>
</tbody>
</table>
Planning for an audit

► Responding to RA
  ► Consider position, well defended or at risk – impacts the strategy
  ► If at risk may wish to consider opening discussions with a view to voluntary disclosure
  ► If strong position need to strategise around controversy and ensure all documentation and evidence to hand
Managing the audit

► Information to collate
  ► Copies of all agreements relating to transactions
  ► Evidence of pricing – calculations, spreadsheets
  ► Supporting TP documentation including robust economic analysis to support arm’s length
  ► Invoices for transactions
Managing the audit

► Being prepared
  ► Ensure agreements, invoices and documentation aligns
  ► Ensure both align to operations
  ► Ensure you have a robust position
  ► Test if the policies have been correctly implemented

**IF A PROBLEM IS IDENTIFIED – RETHINK STRATEGY**
Managing the audit

► The Desk Audit
  ► Queries and correspondence from the RA
  ► Respond comprehensively but only to what is requested
  ► Keep a copy file of all information and note the source
  ► Interpret the line of questioning and try to get ahead

*IF A PROBLEM IS IDENTIFIED – RETHINK STRATEGY*
Managing the audit

► The Field audit
► Prepare your staff for the visit ensure they understand context
► Provide information packs
► Offer factory/facility tours
► Ensure you manage the flow of information and do not allow RA “loose”
► Keep a copy file of all information provided and note source
► Minute all meetings and have RA sign off as a true copy
Assessment and controversy phase

► Once audit complete – outcome likely position paper and assessment
► Consider the following:
  ► Statute of limitations – and that of counter parties
  ► Existence of DTA
  ► Domestic procedures
  ► Opportunity of ADR
  ► Timing
Example of a process

- **Litigation**
  - Establishes precedent
  - Confirms view
  - Gives certainty
  - Lengthy process

- **Mutual Agreement Procedure**
  - No precedent
  - Confirms view
  - Gives some certainty
  - Lengthy process

- **Alternate Dispute Resolution (ADR)**
  - No precedent
  - View not confirmed
  - No certainty
  - Quick process
Payment and penalties

What is the impact:
► Does the Tax Administration have a “pay now fight later” approach? How will this impact your cash flow? Can you ask for postponement?
► What is the risk of penalties and how extensive?
► When will interest run from?

These are often the hidden costs and can often exceed the tax costs in an adjustment
Statute of limitations
Prescription

► Know the statute of limitations on issuing an additional assessment following an adjustment

► Know when the Tax Administration can extend this or when it is void e.g. Typically where:
  ► There is fraud, misrepresentation or non-disclosure of material facts
Typical outcomes

- Majority of TP cases are typically settled through an ADR process – comes down to a number - most SA cases and GSK are good examples
- There is an increased amount of litigation globally suggesting RA’s and taxpayers alike are gaining an appetite for this
- Majority of cases not settled are resolved through MAP – can be time consuming and no guarantee of resolution
Questions?
Thank you for attending!
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