BRICS TAX COOPERATION

SPECIAL FOCUS

International Tax Review provides taxpayers with in-depth analysis of developments in Brazil, Russia, India, China and South Africa (BRICS), along with the rest of the world.

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The BRICS countries’ (Brazil, Russia, India, China and South Africa) tax authorities have agreed to share information to strengthen their tax systems, including India helping South Africa to implement an advance pricing (APA) regime.

In a communiqué released last week, by Indian Finance Minister P Chidambaram, the BRICS committed to sharing their experience of best practice, capacity building, anti-avoidance and non-compliance practices and effective exchange of information.

The countries promised to share resources and knowledge and to also extend cooperation in tax administration in a way that will benefit people living in BRICS countries.

The five heads of revenue met in Delhi on January 17 and 18.

Information sharing with treaty partners

Chidambaram’s announcement of greater BRICS convergence on tax matters comes in the same week as India’s Central Board of Direct Taxes (CBDT) released an instruction which contains guidelines on the sharing of information among treaty partners (covering inbound and outbound requests).

Highlights of the new guidelines include a provision that requests for exchange of information should not be generic.

“The information should be sought in elaborative and specific manner,” says the manual, which also has a provisio allowing two or more countries to conduct a joint audit if related persons are engaged in border activities.

And Rafael Santiago Lima, from the Division of International Affairs of the Undersecretariat of Examination at the Brazilian Receita Federal, also this week confirmed that Brazil is altering the way it handles data received through information exchange agreements. He said such information should be constantly looked at and examined.

“Brazil is changing its system of dealing with the information and how it is used. Reforms are on the way,” he said.

South Africa and India

Among those in the meeting was South African Revenue Service’s (SARS) Commissioner, Oupa Magashula.

“BRICS cooperation must not be viewed in isolation,” said a spokesman for SARS. “It should be noted that South Africa has long established relations with Brazil and India bilaterally, through the IBSA (India, Brazil, South Africa) Heads of Revenue Administration Working Group and multilateral fora such as the UN, World Customs Organisation, [and the OECD] Global Forum on Transparency and Exchange of Information for Tax Purposes, the Task Force on Tax and Development and the Task Force on Tax Crimes and other Crimes.”

The revenue authority said though BRICS cooperation will not duplicate IBSA, the lessons learnt through IBSA cooperation will no doubt serve as a good foundation for taking forward BRICS cooperation.

SARS said it intends to send its officials for training with other BRICS partners and will receive their officials in return.

Explaining what SARS will bring to the table, the spokesman said: “SARS distinguishes
between technical (negotiating) skills, functional (implementation) skills and social skills (intra-organisational and wider cross-government and international cooperation) and South Africa has much experience in technical skills in the form of negotiating the Tax Information Exchange Agreement (TIEA) as a bridge into Africa.”

“South Africa is particularly interested in the APA regimes of fellow BRICS countries and there is consensus to focus efforts on addressing the practices resulting in the erosion of the tax base,” the spokesman added.

Bucking the trend

However, there are – in some aspects – vast differences between the BRICS’ tax systems. Brazil does not adhere to the OECD transfer pricing guidelines and has a stand-out regime when it comes to the rest of the world. Russia is gearing-up to join the OECD in the foreseeable future, though its decision is not at all definite. South Africa is also aligning itself far more closely with the OECD.

Because of this, TP Ostwal of TP Ostwal & Associates in India, who also drafted the India chapter in the UN’s practical manual for transfer pricing in developing countries, said: “I do not know the future of this alliance but when it comes I can certainly say India, China and Brazil will come closer in their cooperation.”

He added, however, that alliances like the BRICS are important if developed countries are to get their fair share of taxable profits.

“I don’t see any problem in such a move. This is inevitable if developing countries have to fight the developed countries’ forces and as such all these [BRICS] countries are not likely to join the OECD. And, if they do join the OECD they will have to change the rules of the game – those of source-based taxation principles.”

Thougt leader

India is emerging as a benchmark for many aspects of the other countries’ tax systems. Not only is it helping South Africa implement its APA regime, it is also a thought leader for China.

“In practice, Chinese tax authorities may have followed the Indian practices in some areas, for example, to increase their expectations on returns of contract R&D services,” said Annie Han, tax manager at Siemens in China.

This commitment to work together could be good news for people living in the BRICS. Improved, more efficient, tax systems will mean more revenue and an improved society but it is important the countries remain attractive investment locations.

“It is good for BRICS countries to find the best ways to deal with the unique issues they face but not addressed by OECD guidelines by sharing experiences. But taxpayers will not want to see that the tax authorities become more aggressive in their tax positions through an alliance,” Han added.

India will also hope to gain from the alliance, especially while it is introducing its general anti-avoidance rule (GAAR).

“India is on the brink of adopting or implementing a GAAR, controlled foreign company (CFC) rules, branch profits tax and so on,” said Amit Singhania, of Amarchand & Mangaldas. “This forum provides scope for greater deliberation, consensus building, cooperation and exchange of ideas and experiences between the developing countries on key aspects of international taxation.”

Singhania believes the establishment of a formal, coordinated group for the BRICS to discuss tax policy and administration signals a levelling of the playing field between developed and developing countries.

“Traditionally, developed and developing countries have had different perspectives on issues relating to international tax policy. Most authoritative texts on international taxation have emanated from the developed world. This initiative provides developing nations the opportunity to build consensus for their positions on pertinent issues of international tax policy, such as source-based taxation, transfer pricing and so on,” said Singhania.

Trouble ahead?

However, some advisers have voiced concerns about the BRICS nations pushing ahead with policies independently of the rest of the world.

Guillermo Teijeiro, of Teijeiro & Ballone Abogados, said he fears the BRICS being “too proactive” by themselves.

Elina Castro, tax director at Alstom in Argentina, commented, via LinkedIn, that if the rest of the BRICS follow Brazil’s transfer pricing policy and interpretation of double tax treaties, “we will have a lot of problems trying to harmonise international taxation with their view”.

Teijeiro agreed, adding that Brazilian CFC rules, the retrospective application of tax law in India and the taxability of indirect share transfers in China, could also be added to Castro’s list.

The impact of the initiative, said Singhania, “will largely depend on the seriousness with which it is pursued”.

“It will be interesting to see whether the BRICS countries release a model convention or policy papers for proposing a united front on behalf of the developing world on international tax issues. In any case, the initiative should have a positive bearing on the countries’ concerns relating to effective exchange of information and enforcement of taxation laws,” said Singhania.

Among BRICS countries, some of the highlights of cooperation in both customs and tax include:

2008

Brazil hosted an IBSA risk management seminar in October 2008.

India hosted IBSA seminars on customs valuation as well as transfer pricing in November 2008.

2011

South Africa hosted an IBSA tax evasion and avoidance seminar in August 2011.

South Africa hosted an IBSA meeting of customs technical experts on exchange of information in September 2011.

SARS hosted two five-day training programmes for cadets from the India National Academy of Direct Taxes (NADT) in March and September 2011.

2012

India hosted South Africa for a two-week study visit focussing on transfer pricing in January 2012.

China hosted South Africa for a training seminar on border management and security in November 2012.

2013

SARS and South Africa will host a further NADT training group in 2013 and SARS plans to visit India to benchmark their advanced pricing agreement (APAs) regime.
On October 10 2012, the Brazilian government published Provisional Measure (PM) 584, providing for tax measures applicable to operations involving the organisation or realisation of events directly related to the 2016 Olympic and Paralympic Games to be held in Rio de Janeiro.

The PM provides for the exemption of federal taxes due on import of goods or services used exclusively in activities directly related to the organisation or realisation of both events, such as: trophies, medals, plaques, statuettes, pins and badges, flags and other commemorative objects; promotional material, flyers and the like; and other similar non-durable material (up to one year). Taxes included in this exemption are the II (import tax); IPI (excise duty) over imports due on customs clearance; PIS/COFINS-Import; among other charges and duties.

Non-resident individuals entering Brazil with a temporary visa, employed or contracted by the above organisations to carry out activities related to the events’ organisation, are exempt of individual income tax (IRPF).

Furthermore, the International Olympic Committee (IOC) and RIO 2016 (Organising Committee) are exempt from a number of federal taxes, such as the IRPJ (corporate income tax), the IRRF (withholding income tax), the IOF (tax on financial transactions), the IPI (excise tax), the social contribution on net profits (CSLL), the PIS/COFINS-Import and the contribution for the intervention in the economic domain (CIDE). With regards to RIO 2016, the IRRF exemption applies to income paid, credited, delivered, used or remitted by or for this entity, regarding the supply of goods or services.

The PM also provides for the exemption of IPI and PIS/COFINS in the acquisition of goods and services in the local market used in the organisation or realisation of the events.

To enjoy these benefits, the IOC and associated companies, the Court of Arbitration for Sport (CAS), the World Anti-Doping Agency (WADA), National Olympic Committees, International Sporting Federations, media companies and accredited transmitters, sponsors, IOC and RIO 2016 service providers must be established in Brazil if they commercialise products or services in Brazil or employ individuals with or without a formal employment relationship, even if only for organising or realising the games.

The IOC and RIO 2016 shall provide a list to the Brazilian Revenue Service including the individuals and legal entities that shall be entitled to the tax benefits mentioned above. Further regulation is expected in due course.

As a general rule, a PM is issued by the Executive Branch of the Federal Government and has the effect of law while it is analysed by the Brazilian Congress, that can approve (with amendments or not) or reject it. This process should take place within a 60-day period, a term that may be extended for an additional 60-day period. If Congress does not act within this 120-day period, the PM expires and loses effectiveness. If approved without amendments, the abovementioned measures shall apply to taxable events occurring from January 1 2013 to December 31 2017.

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Russia’s Ministry of Finance has clarified how taxpayers should calculate the threshold for controlled transactions, but its interpretation leaves companies with a choice of non-compliance or dedicating more resources to transfer pricing.

Since Russia’s new transfer pricing rules were released last year, there has been much debate over how they should be applied.

The threshold value for domestic related party transactions to qualify as controlled is RUB3 billion ($103 million).

Taxpayers can determine whether a transaction exceeds the threshold by considering the aggregate income of all transactions between pairs of related companies.

Or, as the ministry stated in a recent letter, taxpayers can make calculations based on the sum of all transactions performed with all related parties in a year.

Under the ministry’s interpretation, if a Russian parent company provides services, loans, or sells goods to a subsidiary, and the total income received is below the threshold, those transactions could still be classed as controlled if income from transactions with all other subsidiaries in the group takes the total above the threshold.

A transfer pricing director for a Russian oil company, who wished to remain anonymous, said if the principle of calculating the overall income of all transactions with all related parties is enforced, the number of controlled transactions may radically increase.

“The more controlled transactions we have, the more money we spend on transfer pricing staff and other supplementary services,” said the director.

“The chance of not filing the notification on time will also increase and that may lead to a transfer pricing audit,” the director added.

Evgenia Veter, of Ernst & Young, said taxpayers must now decide to what extent they want to follow the ministry’s recommendations and what risk there will be if they do not.

“Companies will need to assess the risk of not documenting some transactions against the cost of being completely compliant,” said Veter. “To be fully compliant taxpayers will need to spend a lot of time and money on people and management services to prepare transfer pricing documentation for even very small transactions.”

“Taxpayers will still want to prepare documentation for more sensitive transactions but may be willing to accept some risk to avoid the cost of documenting every transaction,” she added.

It is questionable whether the tax authorities will actually have the resources to audit such a greatly increased number of controlled transactions.

However, the possibility of disputes arising if taxpayers do not follow the guidance will be high.

Vetern said the tax authorities seem to be trying to find the safest answer from a legislative or technical perspective but this is not always practical.

“In the medium term, the ministry’s opinion must be taken into account by those taxpayers who are planning their intra-group arrangements, for example, considering setting up a shared services centre, and providing uniform transactions by one group member to other members,” said Svetlana Stroykova, of PwC.
Indian Finance Minister, P Chidambaram, confirmed today that the major recommendations of the expert general anti-avoidance rule (GAAR) committee will be accepted and that GAAR implementation will be deferred by two years until 2016.

Foreign investors are cheering the news, which sees the legislative change pushed back from its original implementation date of April 1 2014.

Most of the other recommendations made by the Parthasarathi Shome-led expert committee were also accepted, including requirements regarding the make-up of the GAAR Approving Panel, the transaction value threshold for GAAR to be invoked, and a softening of the GAAR application criteria so that obtaining a tax benefit must be the main purpose for an arrangement, rather than “the main purpose or one of the main purposes” as previously worded.

“The modifications we have done are fair, non-discriminatory, just and strike a balance between interest of revenue and interest of investors,” said Chidambaram.

“The decisions [contained in today’s announcement regarding GAAR modifications] have by and large addressed the concerns that were expressed by investors,” he added. “Most of the apprehensions I think have been removed now.”
The State Administration for Taxation (SAT) is intending to incorporate the China chapter, an appendix in the UN's transfer pricing manual, into tax circulars in an attempt to increase the amount of corporate tax it collects.

The intention was made clear in recent meetings, according to Glenn de Souza of Baker & McKenzie. However, the SAT is believed to be hesitant about issuing specific circulars related to this area.

“We also hear that the GAAR rules may contain reference to the UN concepts,” said de Souza.

Ideas such as location specific advantages (LSA) feature heavily in the China chapter of the UN’s practical manual for transfer pricing in developing countries. There have been reports of audit cases where LSAs have been used aggressively to make a contract R&D subsidiary of a foreign company raise its mark-up rate to 15% (from 10%).

“A client pointed out that their Indian R&D centre had even lower costs than China, but the tax bureau said that India was not a relevant comparison because China was unique, in that it manufactured the entire spectrum of products and R&D centres had to be co-located where the manufacturing was taking place,” said de Souza.

China is effectively saying that R&D centres have to be located with manufacturing but this is not in keeping with the realities of business.

In general, however, it seems taxpayers and their advisers agree with the concepts set out in the China chapter, predominantly China’s standing in terms of location savings and market premiums and why these issues make China different to other countries when companies put together their transfer pricing documentation.

“It raises a lot of relevant points,” said Henrik Hansen of Ernst & Young. “What would be welcome are clear definitions of what SAT sees as a market premium and a location saving, including how they will approach these concepts. Taxpayers need these concepts in order to comply.”
In relation to the Taxation Laws Amendment Bill 2012, to avoid the re-characterisation of dividends as income in the hands of the shareholder it is important:

- that there is no obligation on the issuer of the shares to redeem the shares within three years; and
- that there is no option of the shareholder to redeem the shares within three years.

It is also necessary to ensure that the shares are not secured by a financial instrument and are also not subject to an arrangement in terms of which a financial instrument may not be disposed of by the issuer. It should therefore be ensured that there is no negative pledge in relation to any financial instrument held by the issuer.

Even if the relevant triggers are met, the dividends will still not be re-characterised as taxable income provided the shares are issued by the issuer for the purpose of acquiring equity shares in an operating company.

In terms of the new section 8EA, any dividend received by or accrued to a person during any year of assessment in respect of a share must be deemed in relation to that person to be an amount of income (and not a tax exempt dividend) if that share constitutes a “third-party backed share” at any time during that year of assessment.

A “third-party backed share” is defined in section 8EA(1) as any share in respect of which an enforcement right is exercisable or an enforcement obligation is enforceable as a result of any amount of any specified dividend or return of capital attributable to that share not being received by or accruing to the person holding the share.

An “enforcement obligation” is defined in section 8EA(1) as, in relation to a share, any obligation, whether fixed or contingent, of any person other than the issuer of the share to:

i) acquire the share from the holder of that share;
ii) make any payment in respect of that share in terms of a guarantee, indemnity or similar arrangement; or
iii) procure, facilitate or assist with any acquisition or the making of any payment contemplated in (i) or (ii) above.

An “enforcement right” has similar wording to the concept of an “enforcement obligation”.

In terms of the proviso to the definition of a “third-party backed share”, where the purpose of the issuer in issuing the preference shares is to acquire equity shares in an operating company, then the re-characterisation of dividends as taxable income does not take place. This is provided that the enforcement right or enforcement obligation may be exercised against any company that forms part of the same group of companies as the issuer and operating company respectively.

It can therefore be seen that there are fairly complex rules relating to the re-characterisation of tax exempt dividend income to taxable income in respect of certain shares. These rules apply in respect of existing shares and therefore it should be ensured that, at the relevant effective dates, the above-mentioned triggers are not in place in respect of all such shares.

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How BRICS can impact your transfer pricing

By Sophie Ashley

The BRICS are steadily earning their place in international transfer pricing policy. With strong economies, investment in and out of the BRICS is constantly growing.

The BRICS often need careful handling, however. They represent almost three billion people, with a combined nominal GDP of $13.7 trillion. The tax administrations are aggressive in protecting the countries’ revenues but their staff can lack in experience.

None of the BRICS are OECD-member countries (though they are all involved in tax policy discussions to differing extents) but their strong economies and attractive investment opportunities mean they have a relatively strong presence in OECD discussions.

Antoine Glaize, the global head of transfer pricing for Taxand, based in Paris, said, because of the BRICS’ separation from the OECD, the biggest concerns for taxpayers include “limitation of certain intangible payments, application of withholding tax on services, normative rules for local returns and difficulties [for authorities] to explain transfer pricing policies changes even [those] well documented.”

Double taxation is a constant threat and represents the biggest headache for taxpayers.

“Brazil effectively ignores arm’s-length principles and instead mandates arbitrary results according to the taxpayer’s functional profile,” said Michael Leonowitz, global transfer pricing leader and head of Americas taxes at SABIC, a manufacturing company.

“Comparability, reliability and industry dynamics are not properly taken into account. China, too, seeks to justify local profits, no matter what, by asserting vague notions of location savings and market premium, asserting such value drivers automatically accrue to China itself,” he added.

Despite the BRICS’ non-membership at the OECD, the organisation is still considered the biggest influencing factor in their tax policy. “This single organisation has been extremely proactive in publishing needed guidance – non-binding – to taxpayers and tax authorities and is providing thought leadership on emerging issues,” said Leonowitz.

Because these countries are in a stage of relatively new advanced economic development, there are other, stronger, factors at play in terms of driving transfer pricing development but the BRICS do play a part.

“While BRICS may have viewed transfer pricing as a potential threat for them and symmetrically have adopted very aggressive positions, they tend to soften their approach and to converge towards international standard rules even though field practice may remain far from MNEs expectations,” said Glaize.

Leonowitz said the China and India are particularly aggressive by challenging the application of traditional transfer pricing methodologies and positing creative arguments not previously addressed such as China’s location savings.

“Such debates are healthy, I think, to the extent the tax authorities remain open minded in tackling these interesting, thorny questions. The other countries do not yet exert much influence. The transfer pricing environment in Russia and South Africa is simply too new; Brazil is too arbitrary.”

Complying with each of the BRICS in turn requires a balance between local country law and reconciling against the other party to such transactions, which typically accept the arm’s-length principle and OECD guidelines.
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