Dear Sir/Madam

SUBMISSION: DRAFT DISCUSSIONS ON BEPS ACTION 7 AND BEPS ACTIONS 8 to 10

1. We herewith present the South African Institute of Chartered Accountants (SAICA) written submissions on the Draft Discussions on BEPS ACTION 7 relating to Additional Guidance on the Attribution of Profits to Permanent Establishments and BEPS ACTIONS 8 to 10 relating to the Revised Guidance on Profit Splits on behalf of the SAICA Transfer Pricing Subcommittee (a subcommittee of the SAICA National Tax Committee).

2. Our submissions include comments on the questions specifically raised in the discussion papers, as well as further input to simplify and clarify examples. We have deliberately tried to keep the discussion of our submissions as concise as possible, which does mean that you might require further clarification. In this respect, you are more than welcome to contact us in this regard.

BEPS ACTION 7

Question 1:

3. We are of the view that the result will be the same irrespective of the order that article 7 and article 9 of the Model Tax Convention (MTC) are applied.

4. The guidance should suffice, provided that the entity operating in its own capacity and creating the Dependent Agent Permanent Establishment (DAPE) for the offshore entity is rewarded with an arm’s length return for the undertaking of its activities.
Questions 2 and 3:

5. In principle yes. However, the functional analysis is simplistic. It may occur that the selling DAPE also takes some risk associated with logistics, depending on the nature of the product sold.

Question 4:

6. The key difference is that under the old interpretation of Article 7, cognisance of the overall profit situations is considered.

7. For example, a commission rate which provides for a reasonable allocation of a portion of the profit to SellCo may differ from an amount determined in pricing a notional transaction.

Question 5:

8. Not necessarily. The people function is not the only factor that needs to be considered when performing the functional and factual analyses.

9. Consideration should also be provided to the level of risk, and furthermore how and where such risk is managed.

Question 6:

10. It is submitted that if SellCo bears credit and stock risk, it may be more likely be classified as a buy/sell entity. In such instance a commission based approach may not always be the most appropriate.

Question 7:

11. Please refer to paragraph 6 and 7 above for an answer to the question raised.

Question 8:

12. The consequences in the example and the question to which party inventory and credit risk should be allocated depend on how the term “financial capacity” is determined.

Question 9:

13. We concur with the conclusion reached in example 2.
**Question 10:**

14. The construction of the profits or losses of the DAPE in Example 3 is dependent on whether the employee remains employed by Prima or is seconded to SellCo.

15. Furthermore, an analysis of the customer relationships should be undertaken to determine whether the employee has marketing intangibles as a result of these relationships.

**Question 12 and 13:**

16. We agree with the construction of the profits/losses of the DAPE in Example 4, as well as the conclusion reached regarding the difference that arises due to the allocation of risk between different enterprises and attribution of risk within the same enterprise.

**Question 14 to 20:**

17. While we agree with the conclusions, the various scenarios of the Example are simplistic. For example, the outcome can be impacted if the goods are stored in bond and the answer to the question regarding which entity is responsible for raising this may change the outcome.

18. The nature of the example suggests that some people need to be in the warehouse location, but these need not necessarily result in a significant people function (SPF).

19. For example, these people in the warehouse may be operating under the guidance of the offshore entity.

20. It should be considered if a cost plus method is not appropriate for this Example.

**BEPS ACTIONS 8 TO 10**

**Question 1 to 3:**

21. The distinction between transactional profits splits of anticipated profits and actual profits seems to be clear.

22. Practical examples and guidance on how entities would share risks would also be useful.

23. It is furthermore our understanding that often one entity typically takes certain risks associated with a transaction, while the other entity takes different risks. Where the parties to a transaction arguably share risks (for example the market risk) one may be able to separate these based on how the risks are managed. For example reputational risk and brand related risk versus customer relationship risk.
**Question 4 and 5:**

24. Yes, strengths and weaknesses appear to be captured clearly. One of the key strengths of the transactional profit-split-method (PSM) is that it aligns more to business practicalities than some of the other methods.

25. Accordingly, if a business operates in a way which makes the PSM a natural fit, then this would support the application of this method.

26. For instance in a retailing environment where there is a gradual shift from heavy support to a more autonomous operation over a period. A retailer may therefore have a number of markets in different stages of maturity.

27. As retailers operate internally in a similar manner to franchise arrangements, providing a combination of know-how, the brand, support services, centralised purchasing etc., a PSM often makes sense.

**Question 6:**

28. It is submitted that the sharing of economically significant risks does exist. It may be useful to clarify how the relevant risk is managed and by which entity it is managed.

**Question 7:**

29. No examples showing the application of a transactional profit split of anticipated profits have been observed.

**Question 8 and 9:**

30. The distinction between parallel and sequential integration of business operations is a useful refinement, but it should be noted that there may be instances where lines are close and difficult to differentiate. More detailed guidance would be appreciated.

**Questions 10 and 11:**

31. No responses.

**Question 12:**

32. The question to be put forward in this regard is how the group synergies came about. It may be argued that if one entity incurred costs in development, it should be rewarded over and above the marginal sharing.

**Question 13:**

33. The undertaking of a value chain analysis is effectively a more detailed functional analysis. However, a value chain analysis involves an in-depth assessment of value
drivers in an industry or organisation along the chain of primary and support activities of a multinational group that lead to the delivery of a product or service to end customers. Thus, the value chain analysis relies on more than just a functional analysis, it uses a value focused, end-to-end, functional analysis.

34. The more detailed analysis may however give rise to instances where the level of contribution is misunderstood as being more valuable than it really is, leading to a greater risk of default to a PSM. Thus, clear guidance is required.

Questions 14 and 15:

35. No responses.

Questions 16 to 18:

36. It is submitted that in reality profit splitting is mostly subjective, and a quantifiable basis for profit splitting can result in distorted outcomes.

37. Guidance regarding the application of the profit split method should therefore only point into a direction, but it should not be exhaustive, as there will need to be a degree of subjectivity.

38. The key area where additional guidance would be helpful is around the different measures for allocating and splitting profits between functions, risks and assets.

We would like to thank the OECD for the opportunity to participate in the development of the Base Erosion and Profit Shifting regime.

Yours sincerely

Pieter Faber
SENIOR EXECUTIVE: TAX LEGISLATION AND PRACTITIONERS
The South African Institute of Chartered Accountants