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Transfer pricing... a matter of urgency

There are winds of change blowing in the Northern parts of the country and they herald changes at the South African Revenue Service (SARS) as far as transfer pricing is concerned.

Transfer pricing rules were introduced into the Income Tax Act in 1995 as specific anti-avoidance measures to ensure that taxpayers don't shift profits from one country to another, in particular through artificial prices charged between connected parties in different countries. Transfer pricing is aimed at transactions between a non-resident and a resident taxpayer who are connected persons, and who are providing goods or services at prices which, in the Commissioner's opinion, would not have been charged at arm's length.

The Commissioner can, for tax purposes, adjust the pricing to conform to arm's length prices. The amount found by SARS to be either excessive or insufficient is deemed to be a dividend subject to the current Secondary Tax on Companies (STC).

However, since 1995 not much has happened on the transfer pricing front. We have seen no major queries from SARS, nor have we seen an energetic and focused drive by SARS to follow up on what must be thousands of transactions between related non-resident and resident taxpayers. It is understood that at some point in the early 1990's, SARS appointed an expert to spearhead a drive to investigate transfer pricing in South Africa. We have, nonetheless, not seen much activity from the transfer pricing group in the last 15 years. We have seen more queries from the South African Reserve Bank with regard to related party transactions than from SARS.

I think things are about to change, and that we are about to see a new era of transfer pricing investigations, reviews and audits, unparalleled to anything we've seen coming out of SARS for a long time.

There have been an increasing number of statements made by senior SARS officials about a renewed interest in transfer pricing, and real threats from SARS that transfer pricing will be taken seriously. Transfer pricing is being made a priority in the drive to collect more taxes in South Africa.

We have also seen recent draft amendments to the section in the Act dealing with transfer pricing, which will

enhance SARS's capacity to bring the transfer pricing provisions to bear.

There is a renewed debate about the removal of exchange controls. The Reserve Bank has always maintained that a properly functioning transfer pricing unit within SARS is a prerequisite for the removal of the remaining exchange controls. This is backed up by renewed pressures on South Africa from the Organisation for Economic Cooperation and Development (OECD) to free up the economy by scrapping the remaining exchange control regulations.

In addition to all this, SARS has the benefit of international guidelines, tax cases and international rulings on the application, evaluation and management of transfer pricing in an international context.

There are many overseas companies which have so-called marketing offices in South Africa which do not trade in the full sense, but which are set up to support and assist with the sales function. In these circumstances, SARS has an opportunity to impose a profit margin on the representative office by virtue of its supporting role. There are many other instances of a failure, on the part of SARS, to apply the transfer pricing provisions rigorously. Those days are close to an end.

We are about to enter an era of aggressive transfer pricing reviews by SARS. Taxpayers are urged to consult their advisors to ensure that proper transfer pricing policy documents are in place and that they are up to date, ready for use in response to the transfer pricing assault about to be mounted by SARS.



JOHAN TROSKIE

National Tax Director

johan.troskie@mazars.co.za

Mazars makes business dreams come true

When you think Mazars, think beyond audit, accounting and tax.

Do you have a great business idea — if only you had someone to help you develop it? Do you need to meet the right people, obtain finance, draw up a business plan, or have help pulling it all together? We can provide the assistance and expertise you need.

Having a great business idea is the first step but it's not always easy to transfer that idea into something concrete that becomes a successful reality. Mazars has the experience and access to business networks to get your idea off the ground.

We have been involved in some exciting business development projects in the last few months, which shows that having the right people to pull the project together results in success. Some examples of these projects are:

- Mazars has been instrumental in the development of a training centre for a correctional services facility in South Africa. This training centre is being set up to provide young offenders with skills and training that will ensure they are successfully rehabilitated and reintegrated into the community. The scope of the project has included the bringing together of key players, compiling the business plan, negotiating funding, completion and submission of documentation, overall business development facilitation and negotiations with government. The potential size of the project is R650m.
- the development and establishment of a petroleum distribution network on a national basis. The project involves consultation with oil companies, logistics and transport, development of infrastructure, stakeholder negotiation, recruitment and appointment of skilled individuals.
- creating an international joint venture knowledge management system for open and long-distance learning through the development of a software platform. Mazars has been instrumental in bringing together key players in Pakistan, Botswana and South Africa to facilitate this project, create infrastructure, project manage timely delivery, draft the business proposal and compile a costing model. The potential size of this project is US\$18m.

- facilitating the roll-out and construction of a fibre optic cable from Cape Town to Durban which involves project facilitation, the raising of capital and proposals on stakeholder structure.

These projects are vastly different, and for widely varying industries and areas of expertise, yet Mazars employs its knowledge in the business world, networks and contacts, and project facilitation skills to bring about the realisation of these business ideas. Through our international network, cross-border ventures are within our capacity and have been effectively implemented.

Whatever the idea, concept or dream, we can help turn it into a reality – even apparently crazy ideas can sometimes be turned into highly profitable ventures.



WILS RAUBENHEIMER

Partner

wils.raubenheimer@mazars.co.za



Strict criteria for B-BBEE Employee Share Trusts

If you establish an employee share ownership scheme for the benefit of black employees, it must comply with rigid criteria before your company will qualify for any points on the B-BBEE 'ownership scorecard'.

The criteria in question are set out in Annex 100B to Statement 100, which is part of B-BBEE Code Series 100, covering criteria pertaining to the ownership element of the generic B-BBEE scorecard.

In terms of Annex 100B, all of the following requirements must be met if any ownership points are to be awarded:

- the constitution of the scheme (the trust deed) must define the participants and their proportionate entitlement to distributions
- the participants may be identified either by name, or by virtue of membership of a defined class
- proportionate entitlements may be determined either by way of fixed percentages, or by the use of a formula
- the fiduciaries (trustees) of the scheme are to have no discretion in regard to (a) the identification of the beneficiaries or (b) their proportionate entitlements
- the black participants in the scheme must participate in the appointment of at least 50% of the fiduciaries (trustees) of the scheme
- the black participants must 'participate in managing the scheme at a level similar to the management role of shareholders in a company'
- the constitution (trust deed) must be available to participants at their request, in an official language with which they are familiar
- all accumulated 'economic interest' must be payable to participants at the earlier of a date or event specified in the constitution, or upon termination of the scheme
- the fiduciaries must present the financial reports of the scheme to participants at an annual general meeting.

It should be clear that a trust deed will not comply with the criteria in Annex 100B if any benefits are to be allocated at the discretion of the trustees.

If the trust deed were, for example, to provide that the trustees might, on an application by an employee, pay children's school fees or other study expenses, this would introduce a prohibited element of discretion into the powers of the trustees.

It would also offend against Annex 100B if the trust deed were to provide for the income of the trust to be applied towards the training of black employees. This is partly because it would be difficult, if not impossible, to spend funds in such a way that each employee derives a proportionate benefit, as required by Annex 100B.

If the trust deed is to comply with Annex 100B, it will in practice be necessary to limit the purposes of the trust to the distribution of cash amongst employees, either by reference to fixed entitlements, or a formula.

We generally recommend that the black beneficiaries of the trust be limited to black employees of the company during the currency of their employment. This approach obviates any need to fund the 'exit' of beneficiaries. We also generally recommend that beneficiaries' entitlements be established by reference to a simple formula, turning upon length of service, and accordingly rewarding stable and loyal employees.

It is advisable to have the draft trust deed presented for review prior to execution, in order to ensure compliance with Annex 100B. Existing trust deeds may also have to be reviewed for compliance, particularly where the trusts were established prior to promulgation of the B-BBEE Codes.



WOUTER SCHOLTZ

Director

wouter.scholtz@mazars.co.za

Absenteeism in the workplace

A problem that dogs every type of organisation is absenteeism. Some companies have HR management software that can track and record absenteeism and produce relevant management data. Others simply have an overriding sense that absenteeism is having a profound impact on their business, but can't put hard facts to it.

Managers can usually remember, however, that staff members were absent on critical days – that important deadline day when that vital report was meant to be delivered or when client feedback was scheduled. Often absenteeism goes hand in hand with poor performance; employees who are chronically absent are also not performing to standard.

Absenteeism involves sick leave that is not related to genuine illness. Every employer is able to understand and cater for genuine illness. It's the 'duvet days' that staff take, and being absent on crucial days particularly by staff that are already poor performers that organisations find so irksome.

“... absenteeism goes hand in hand with poor performance; employees who are chronically absent are also not performing to standard.”

For the most part, businesses have themselves to blame as very few companies actually manage absence. Simply recording absence is not managing it. The word management implies actually grappling with the issue, tackling it head-on and doing something about it. Good absenteeism management goes hand-in-hand with incapacity or poor performance management.

The first problem is that employees believe they're entitled to sick leave. This is not correct. They're only entitled to be paid when they're genuinely ill. Trying to uncover the genuineness of the illness goes a long way towards managing the problem.

There are a few simple tactics that can make a marked difference on managing the problem. The first is to have a 'return-to-work interview' with the staff member. At the

interview, managers should ask the employee about his or her absenteeism and produce a sick leave record. Seeing in black and white how many days have actually been taken and how many are left is often a wake-up call for the employee. Taking sick leave that isn't genuine is like borrowing money one doesn't have in the bank. Employees who do this are short-sighted – they may well find themselves having to take unpaid leave when things really go wrong. Simply educating employees about this fact goes a long way to addressing sick leave.

Another tactic is to try to uncover the real underlying reason for the absence. This is best approached on a well-being basis. Managers who are genuinely concerned for the staff member are more likely to get an honest response. An open, frank discussion about the problem goes a long way to building trust. When an employee feels genuine concern, they're more likely to share the real problem for staying away than if a punitive, high-handed approach is adopted. In a society with such a large incidence of social ills, this is a prudent way of approaching the issue.



MARLEEN POTGIETER

Equity Works

marleen@equityworks.co.za

Marleen consults to Mazars on issues relating to employment equity

CIPRO clamps down

In recent months the Companies & Intellectual Property Registration Office (CIPRO) has hardened its stance and is clamping down on infringements of its rules and procedures.

They've recently made good on their earlier warnings that companies and close corporations that fail to lodge their annual returns timeously will be deregistered. The law states that annual returns have to be lodged within a month after the day on which a company or close corporation was initially registered. If this doesn't occur, CIPRO assumes the business is no longer operational and starts the deregistration process. Warning letters have recently been sent out to all non-compliant entities; those that remained in default have now been deregistered.

The legal consequences of deregistration are dire and leave members and directors personally liable for the company/close corporation debts at the time of deregistration. At the same time, the company or close corporation's immovable assets, if applicable, are forfeited to the state. In addition, harsh penalties may apply.

To restore a registration, written application has to be made to the Registrar. Supporting documents must also be included some of which can be onerous to obtain. For example, if immovable property or other assets are involved, a letter from National Treasury and Public Works stating that they don't object to the restoration of the entity is required.

There is also the challenge CIPRO is facing in dealing

with fraudulent changes to company directorates and close corporation memberships.

To address this, they've implemented additional measures including the need for certified copies of identity documents to be lodged for all directors, members and shareholders whose details are being changed or lodged. This measure, however, doesn't prevent fraudulent changes made via electronic lodgement.

Should CIPRO decide to suspend electronic lodgements as it did some time back, this will again result in vast delays in the registration of documents, which in turn will have a huge impact on companies needing to do business with third parties, including financial institutions.



MICHAEL BERMAN

Company Secretarial Manager

michael.berman@mazars.co.za

Pending changes...

The new Companies Act, 2008, which is expected to be implemented towards the end of 2010, will bring about many changes, amongst them being:

- while existing close corporations will be able to continue trading, no new close corporations will be registered
- members will still be able to convert a close corporation to a company, but companies will no longer be allowed to convert to close corporations
- the capital maintenance concept will be abolished and the solvency and liquidity test will be introduced for inter alia, reductions of share capital, financial assistance for share purchases in itself (share buy backs) and dividends
- the concept of par value shares will also be abolished and all shares under the new Act will be No Par value shares (transitional provisions would allow for the continuance of existing par value shares for so long as they are in existence).

All new company registrations will have to comply with all the provisions of the New Act and CIPRO will no doubt take a jaundiced view of any registrations that don't.

New Bill proposes further amendments

In the latest move to revise corporate law in South Africa, the Department of Trade and Industry (DTI) has released a draft Bill that proposes additional amendments to the Companies Act, 2008. The Act itself is yet to become effective, and the Companies Amendment Bill, released on 28 July 2010, attempts to rectify certain errors and anomalies in the Act.

The Bill represents the third instalment in an ever increasing list of rectification and draft regulation that accompanies the Act. Government considers the new Act a vast improvement on the existing Companies Act, and they remain optimistic that the Act, together with the amendments and regulation, will be implemented in the 4th quarter of 2010.

Some of the key amendments proposed by the Bill include:

- reducing the list of activities that would trigger the requirement for foreign companies to register as an external company (for example, opening a bank account in South Africa won't trigger the requirement)
- limiting the ability of a business rescue practitioner to cancel or suspend existing agreements to which a company that has entered business rescue is party
- specifying shareholder and time limits and court procedures for the review of fundamental transactions eg a merger or amalgamation or scheme of arrangement
- extending the "two year grace period" that applies to the implementation of a company's Memorandum of Incorporation to also cover existing shareholders' agreements
- requiring that a special resolution is required, in certain instances, for the repurchase of shares
- expanding the provision in the Companies Act, 2008, that allows for a company to ratify fraudulent and grossly negligent actions of the directors that are outside of the scope and authority of their powers to include directors' actions that are undertaken knowingly, wilfully or intentionally
- proposing that for a special resolution, a higher percentage than the usual 75% may be stipulated in the Memorandum of Incorporation of a company.

The amendments do not address any new aspects of the requirements for the audit and independent review of the annual financial statements of companies. Those requirements were addressed in the draft Regulation earlier in the year. The amendments do, however, make it clear that an independent review of a company's annual financial statements does not constitute an audit within the meaning of the Auditing Profession Act.

"Government considers the new Act a vast improvement on the existing Companies Act and they remain optimistic that the Act will be implemented in the 4th quarter of 2010."

Substantial comment was received by government of the earlier draft Regulations and the DTI has indicated there are substantial changes to be made. Accordingly, the revised draft Regulations are expected to be re-released for some public consultation.

The Companies Amendment Bill will be subject to a due process through Parliament, including a 30-day public comment period by means of hearings.



KEVIN FROHBUS

Partner

kevin.frohbus@mazars.co.za

What's new at Mazars...

- Mazars Cape Town appointed **Yaseen Ismail** as Audit Partner effective 1 August 2010. Yaseen was one of the founding partners of Datay Mohamed Ismail Inc Chartered Accountants and serves on the Public Sector Committee of the SA Institute of Chartered Accountants (Southern Region) as well as on the Education Committee of the Independent Regulatory Board for Auditors (IRBA).
- **Judy Robison** joined Mazars in July as the National Learning and Development Manager. Her role will be to establish a national division that will formulate and implement a Learning and Development strategy. The goal is to drive a learning organisation culture, one that facilitates personal mastery, shared vision and continual learning opportunities.
- Mazars has extended its international footprint into **the Philippines**. A correspondence agreement has been signed with Reyes Tacandong and Company (RT&Co.) based in Makati, one of Manila's main business centres.
- Mazars South Africa has been accredited with USAID to carry out audit work on their behalf in **Kenya, Madagascar and nationally**.
- Mazars **Mauritius** held their official launch on 3 September 2010. Their honorary guest was **Pravind Kumar Jugnauth**, Vice Prime Minister of Finance.
- Mazars South Africa is in the process of finalising **BEE scorecards** for all its offices which should be completed in the next six months. To date, we have the following accredited scorecards:
Mazars Port Elizabeth – level 3 contributor
Mazars Johannesburg – level 3 contributor
Mazars Durban – level 2 contributor.

Please send your comments/ideas to the editor
noleen.hepburn@mazars.co.za

Get to know us better at www.mazars.co.za

New offices for Mazars Durban



Mazars Durban moved into their new offices at 197 North Ridge Road, Morningside on 1 June 2010. We look forward to your visit.



level: evil



BLOEMFONTEIN T. +27 51 403 4100 bfm@mazars.co.za CAPE TOWN T. +27 21 818 5000 cpt@mazars.co.za DURBAN T. +27 31 818 9000 dbn@mazars.co.za GEORGE T. +27 44 874 5022 grg@mazars.co.za JOHANNESBURG T. +27 11 547 4000 jhb@mazars.co.za PAARL T. +27 21 871 1474 prl@mazars.co.za PLETTENBERG BAY T. +27 44 533 0510 plt@mazars.co.za PORT ELIZABETH T. +27 41 501 9700 plz@mazars.co.za PRETORIA T. +27 12 346 4111 pta@mazars.co.za