

THIN CAPITALISATION: AN ANALYSIS OF THE APPLICATION OF THE AMENDED SECTION 31(3) OF THE INCOME TAX ACT NO. 58 OF 1962

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DECLARATION

I, Thothobela Rachel Khumalo declare that *Thin capitalisation: An analysis of the application of the amended section 31(3) of the Income Tax Act No. 58 of 1962* is my own work and that all the sources I have used or quoted have been indicated and acknowledged by means of complete references.

Signature: _____

Date: _____

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SUMMARY

Key words: Arm's length; Multinational enterprises; Profit shifting; Thin capitalisation; Connected person; Excessive interest deduction

The current Income Tax legislation, in relation to thin capitalisation, requires South African-based entities to transact at an arm's length basis. This is in accordance with the Draft Interpretation Note issued by the South African Revenue Service in April 2012. The amendment of section 31 of the Income Tax Act No. 58 of 1962, seeks to combine the thin capitalisation rules with that of the transfer pricing provisions, in terms of the Draft Interpretation Note.

The thin capitalisation guidelines contained in the Draft Interpretation Note has become a difficult concept for the South African entities to apply, for they are required to demonstrate to the tax authorities that transactions, arrangements, schemes and operations entered into between connected persons meet the arm's length principle.

Practice Note 7, Draft Interpretation Note, and the Organisation for Economic Co-operation and Development document, outlines guidelines that entities can use to apply the arm's length principle. Uncertainty exists for these South African entities, on how they can measure the arm's length basis of transaction entered between connected persons. This study aim to develop a measuring instrument that entities can apply to determine the arm's length debt, in terms of section 31 of the Income Tax Act No. 58 of 1962.

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LIST OF ACRONYMS

AJCA	American Jobs Creation Act of 2004
APA	Advance Pricing Agreement
ATCA	Advance Thin Capitalisation Agreement
Canadian ITA	Canadian Income Tax Act of 1985
CFC	Controlled Foreign Company
CRA	Canadian Revenue Agency
CSARS	Commissioner of the South African Revenue Service
EBITDA	Earnings, Before Interest, Tax, Depreciation and Amortisation
ECJ	European Court of Justice
HMRC	Her Majesty's Revenue & Customs
IFRS	International Financial Reporting Standards
INTM	International Manual
IRC	Internal Revenue Code
IRS	Internal Revenue Service
JIBAR	Johannesburg Interbank Agreed Rate
JSE	Johannesburg Stock Exchange
MNEs	Multinational Enterprises
OECD	Organisation for Economic Co-operation and Development
REIT	Real Estate Investment Trust
SARB	South African Reserve Bank
The Act	Income Tax Act No. 58 of 1962
TIOPA	Taxation International and Other Provisions
UN Model	United Nations Model
WWDC	Worldwide Debt Cap

CHAPTER 1

INTRODUCTION TO THE STUDY

1.1 BACKGROUND

Transfer pricing is a term used to describe “the pricing of goods and services that are exchanged between divisions within a firm” (Hirshleifer, 1965:172). According to Gupta (2012:30), transfer pricing refers to “the pricing at which an enterprise transfers physical goods and intangible property or provides services to an associate enterprise”. Holtzman and Nagel (2014:57) define transfer pricing as “inter-company pricing arrangements relating to transactions between related parties”. In agreement with this, Terzioglu and Steen (2014:27) explain that transfer pricing is the “transfer of services or goods and that prices are charged internally within an organisation”. It can be concluded that transfer pricing refers to the intercompany pricing of goods or services exchanged between associate enterprises. These associate enterprises would enter into transactions such as intra-group loan agreements, that are not always within arm’s length in order to sometimes gain a tax advantage (Buettner *et al.*, 2008:03 & Martini *et al.*, 2012:1062). Sikka and Willmott (2010:346) are of the opinion that, an increase in global trade and corporate power, transfer pricing mechanisms could be used as strategies for avoiding taxes. This argument is supported by Malevu (2011:13) who stated that transfer prices are affected with the principal aim of easing the tax burden of the multinational group as a whole. Before the amendment of section 31 of the Income Tax Act No. 58 of 1962 (the Act), on 1 April 2012, the Commissioner of the South African Revenue Service had to adjust the price between related parties for goods and services supplied to reflect an arm’s length price. Currently section 31 of the Act allows the taxpayer to determine the arm’s length debt.

Transfer pricing and its related tax implications and considerations are stipulated in section 31 of the Act. Section 31 of the Act was introduced on 19 July 1995, in response to cross-border intra-group transactions between multinationals enterprises (MNEs) (Practice Note 7 of the Act). Practice Note 7 of the Act, which previously dealt with section 31 (measures to counter transfer pricing), issued by the South African Revenue Service, provided taxpayers with guidelines in respect of transfer pricing and which also addressed issues concerning thin capitalisation.

Thin capitalisation refers to a situation where an enterprise is funded through a high level of debt, compared to equity (UN Model, 2011:67). According to Gajewski (2013:78) thin capitalisation is a process of selecting a method for financing companies and shareholders directly or indirectly. Thin capitalisation is associated with high debt funding relative to equity funding, as interest expense is tax deductible and the deduction will minimise tax payments (Mintz & Smart, 2004:1165; Overesch & Wamser, 2010:563). Overesch and Wamser (2010:563) state that:

“Borrowing from affiliates located in low-tax countries and lending to entities in high-tax countries will allow the latter to reduce taxable income by deducting interest payments”.

Previously, the provisions of thin capitalisation were based on a safe harbour of debt-to-equity ratio of 3:1 as was contained in Practice Note 2 of the Act; this was introduced on 14 May 1996 (Practice Note 2 of the Act). The debt-to-equity ratio was determined by the Commissioner of the South African Revenue Service. On 1 April 2012, Practice Note 2 of the Act was replaced by a Draft Interpretation Note which moves the burden of prove on the taxpayer to determine arm’s length debt (SARS, 2012:04).

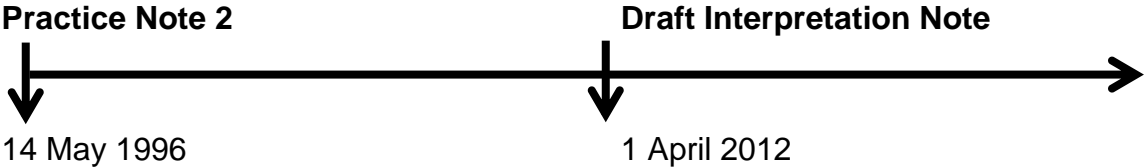


Figure 1.1: Thin capitalisation timeline

Source: Own Research

Thin capitalisation is complex and engrosses multiple international transactions and comparisons. It is important for South African taxpayers to understand the practical implications and application of the current legislation, which include the Draft Interpretation Note, in order to avoid penalties and interest payments as set out in Chapter 15 (Administrative Non-compliance Penalties) or Chapter 16 (Understatement Penalty) of the Tax Administration Act 28 of 2011. The problem statement to this study is discussed next.

1.2 PROBLEM STATEMENT

According to Ernst and Young (2013:02), the new Draft Interpretation Note does not provide the level of guidance hoped for in order to determine whether or not a South African entity is thinly capitalised. A report issued by Deloitte (2014:01) states that the new Draft Interpretation Note has limited guidance regarding the appropriate indicators of the arm's length debt and there is a lack of transactional period for companies to restructure their debt levels to ensure compliance with the new legislation. BDO (2013:01) is of the opinion that the new Draft Interpretation Note requires voluminous documentation to prove to tax authorities that the loan obtained is within arm's length and could be costly for South African taxpayers. In agreement with this, KPMG (2012:48) pointed out that the guidance provided by the South African Revenue Service in the Draft Interpretation Note is vague and does not provide taxpayers with the much-needed certainty to comply with the legislation. As discussed in the introduction of this chapter, at times associate enterprises enter into non-arm's length transactions such as intra-group loans to derive a tax benefit. It is thus necessary that South African taxpayers should have a measurable benchmark that determines the arm's length debt, in order to comply with section 31 of the Act. A debt-to-equity ratio of 3:1 was previously used as a measuring tool, prior to 1 April 2012, by the Commissioner of the South African Revenue Service to identify thinly capitalised entities (SARS, 2012:04). The gap in the literature is that section 31(2) and section 31(3) of the Act does not provide a practical measure that South African taxpayers can use to determine the arm's length debt, leaving these enterprises in the doubtful position of not knowing whether the requirements of the legislation, such as section 31 of the Act, have been complied with. Enterprises are therefore compelled to meet the requirements of the legislation, as laid out by the Minister of Finance, Pravin Gordhan, in his 2010 Budget Speech (National Treasury, 2010:15).

“Steps will be taken against several sophisticated tax avoidance arrangements and the use of transfer pricing mismatches.”

Therefore it can be perceived that thin capitalisation leads to tax avoidance because entities have the option of choosing finance that involves less tax liability (Gajewski, 2013:79). There still remains a problem in providing South African entities with a clear guide on how to determine the arm's length debt in order to avoid being thinly capitalised.

1.3 RESEARCH OBJECTIVES OF THE STUDY

1.3.1 Primary research objective

In addressing the problem statement above, the primary objective of this study is to explore the financial ratios per sector of companies listed on the Johannesburg Stock Exchange, as a practical benchmark for South African entities to measure their thin capitalisation positions. This was done with the intention of providing a practical benchmark that South African entities can apply regarding the correct treatment of thin capitalisation.

1.3.2 Secondary research objectives

The primary research objective will be achieved by the following secondary research objectives:

- To determine the characteristics of the arm's length principle that will be applied by South African entities to establish the arm's length debt by gathering an understanding of key concepts concerning thin capitalisation rules and the effectiveness of these rules);
- To evaluate South Africa's taxpayers' approach to thin capitalisation by investigating the current treatment of transactions affecting thin capitalisation in the legislation and its application, and comparing it to methods adopted by other countries. This is done with the intention of exploring the different methods that are used by other countries in combating thin capitalisation); and
- To identify financial ratios in the financial statement that are used to determine the arm's length debt

1.4 PURPOSE OF THIS STUDY

The purpose of this study is to provide a practical benchmark that South African taxpayers can use to determine the arm's length debt.

1.5 RESEARCH METHODOLOGY

To achieve the research objectives a literature review, together with an empirical study, will be conducted.

1.5.1 Literature review

The literature review scrutinise the arm's length principle, as contained in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, Practice Note 7 of the Act, Practice Note 2 of the Act, the Draft Interpretation Note and the amended terms of section 31 of the Act. This will bring a thorough understanding of the current treatment on transactions affecting thin capitalisation in terms of section 31 of the Act. In addition to this, a comprehensive review of academic literature, both nationally and internationally, is used to understand the key concepts concerning thin capitalisation rules and the effectiveness of the anti-avoidance rule.

1.5.2 Empirical study

The empirical study is performed by selecting non-financial industry sectors listed on the Johannesburg Stock Exchange (JSE). A sample of all non-financial JSE listed industry sectors are selected per JSE listed sector. The reason for excluding the financial industry is that their financial ratios substantially differ from those of other companies (Ohlson, 1980:144 & Mossman *et al.*, 1998:40). All the chosen JSE listed companies are international companies.

Financial statements for the periods 2009 to 2013 are used to calculate the financial ratios. The periods selected explain the recent changes to the amended section 31 of the Act. The financial statements, which are secondary data, will be collected from McGregor BFA (version number 2.7.360.0) for each JSE listed industry sector. No selection was carried out for the 2014 year of assessment, as most companies have not yet finalised their audits, as it is required per the JSE listing requirements.

The companies are divided according to sectors as presented by the McGregor BFA database system. The results are interpreted in Chapter 5 of this study, with the aim of providing a measure that South African entities can use to determine the arm's length debt.

1.6 LAYOUT OF THE STUDY

This study is made up of the following chapters:

Chapter 1: Introduction to the study

This chapter provides the background to the study, introduce the problem statement and presents the research objectives and research methodology that is used in the study.

Chapter 2: Research methodology

This chapter discusses the research methodology and design adopted in the study.

Chapter 3: Thin capitalisation concepts

Chapter 3 of the study contains a literature review of key concepts concerning thin capitalisation and how effective these rules are. The chapter discusses characteristics of the arm's length principle, as recommended by the OECD, as well as Practice Note 7 of the Act and other publications.

Chapter 4: Comparison of thin capitalisation methods adopted by Canada, the United Kingdom and the United States of America with South Africa

Chapter 4 of the study provides a comparison of the methods adopted by Canada, the United Kingdom and the United States of America's thin capitalisation legislation with South Africa. Chapter 4 compares the current wording of the pre- and post-amendments of section 31 of the Act.

Chapter 5: Empirical research findings

Chapter 5 discusses the sampling method used and the results of the average financial ratios per sector.

Chapter 6: Conclusions and recommendations

Chapter 6 discusses the conclusions based on the results of the literature review and the empirical study. Recommendations and limitations from the study are provided in this chapter.

1.7 CHAPTER SUMMARY

Chapter 1 introduced the study, the problem statement and the primary and secondary research objectives. The chapter presented the research methodology that will be

followed in addressing the primary and secondary research objectives of the study. Chapter 2 will contain the research methodology and design that is adopted in the study.

CHAPTER 2

RESEARCH METHODOLOGY

2.1 INTRODUCTION

The purpose of this chapter is to discuss how the study was designed and to provide an understanding of the specific research methodology used to conduct this study. Included in this chapter is the research type, the type of method adopted for the collection and the method used to analyse the data.

2.2 RESEARCH DESIGN AND METHODOLOGY

Burns and Grove (2003:195) define a research design as a “blueprint for conducting a study with the maximum control over factors that may interfere with the validity of the findings”. According to Mouton (2001:55), a research design is a blueprint of how one intends to conduct the research. The point of departure is the formulation of a research question or problem (Mouton, 2001:55). Adams *et al.* (2007:81) agrees, stating that research design is “a master plan specifying the methods and procedures for collecting and analysing information”.

According to Welman *et al.* (2005: ix), research methodology explains “the nature and process of research conducted with the aim of finding answers to a specific research problem”. The methodology is the entire process of the study in an attempt to find answers to the research question. Kothari (1985:07) explains that a research methodology is a path of discovering answers to the research question.

The research design is therefore a plan with specific methods and procedures designed to answer the research question, the research methodology can be described as the process of finding answers to the research question.

2.3 RESEARCH METHODS

Research projects are conducted by three main methods: the quantitative method, qualitative method and mixed methods (Christensen *et al.*, 2010:361). According to Creswell (2014:04) the quantitative method is adopted with the aim of viewing reality in an objective manner and uses a measure in the form of an instrument or questionnaire. Adams *et al.* (2007:26) agree with Creswell, stating that the quantitative method is based

on quantitative measurement and is used in every sphere of life. Mouton and Marais (1990:155) explained that the qualitative methods applied in a research that are not strictly formalised, such as the ethnomethodology and phenomenology, employing methods that are not numerical. According to Strauss & Corbin (1996:10) qualitative method refers to a research that produces findings not arrived at by statistical procedures or other means of quantification. Adams *et al.* (2007:27) agrees, stating that qualitative method uses a number of methodological approaches based on diverse theoretical principles that are non-quantitative. The third method of research, which is the mixed method combines both the quantitative and qualitative research (Christensen *et al.*, 2010:361 & Clark and Creswell, 2008:xvi). Collin *et al.* (2006:67) explains that the mixed method research consists of both quantitative and qualitative methods. Clark and Creswell (2010:165) agree with Collin *et al.* stating that the mixed method involves the collection or analysis of both quantitative and qualitative data in a single study in which the data are collected concurrently or sequentially, are given a priority, and involve integration of the data at one or more stages in the process of research.

For this reason, the present study followed a mixed method research by collecting and analysing both quantitative (numeric) and qualitative (text) data. The aim of the present study is to explore the financial ratios per sector of companies listed on the JSE, as a practical benchmark for South African entities to measure their thin capitalisation positions. The analysis of qualitative data in chapter 3 and 4 will provide the baseline for exploring the thin capitalisation concept. Chapter 5 will present an analysis of quantitative data by extracting average ratios per sector of the JSE listed companies, to measure their thin capitalisation position. The next section will discuss the type of research adopted in this study.

2.4 THE RESEARCH TYPE

Berk (1981:205) differentiates between two types of research, namely basic research and applied research.

Berk (1981:205) explains that applied research is used in the social science discipline to support the empirical questions addressed. The aim of this type of research is:

- an interdisciplinary approach;

- the use of multiple methods;
- the emphasis on mutable variables;
- a clear distinction between statistical and substantive significance; and
- the emphasis on quantitative trade-offs.

According to Adams *et al.* (2007:27), applied research is aimed at making decisions about real-life problems and it is more concerned with the knowledge of action. This present study can be seen as an applied research, because multiple methods are used to address the primary research objective, which is to explore financial ratios per sector of companies listed on the JSE, as a practical benchmark for South African entities to measure their thin capitalisation positions. The next section will discuss the purpose of research.

2.5 THE PURPOSE OF RESEARCH

According to Babbie (2013:42), there are three main purposes of social science research namely, explanatory, exploratory, and descriptive. According to Singleton *et al.* (1999:93), explanatory research is aimed at testing relationships to find answers to a problem or hypothesis. The purpose of exploratory social science research is to observe groups, events and histories of persons (Singleton *et al.*, 1999:91). Welman *et al.* (2005:14) states that exploratory research is used to find a problem or a hypothesis to be tested. Singleton *et al.* (1999:93) adds that the purpose of descriptive studies is to describe a specific phenomenon, focusing on relatively few dimensions and measuring these dimensions systematically, usually in a detailed numerical manner. Mouton and Marais (1990:44) explain that the purpose of a descriptive study is a study that emphasise the in-depth description of a specific individual, situation, group, organisation, tribe, sub-culture, interaction, or social object. According to Welman *et al.* (2005:23), the purpose of descriptive studies is to understand the phenomenon by using experimental methods indicating how variables are related to one another.

The present study is aimed at exploring the financial ratios per sector of companies listed on the JSE and to describe the causes and consequences of thin capitalisation. A descriptive study will be conducted in chapter 3 and 4 of the present study, to describe the causes and consequences of thin capitalisation. In addition, chapter 5 of this study will explore the average sector ratios of JSE listed companies, as a practical benchmark

for South African entities to measure their thin capitalisation position. Paragraph 2.6 will analyse how data was collected in conducting the present study.

2.6 DATA COLLECTION AND ANALYSIS

The data collected in this study consists of the literature review (refer to paragraph 2.6.1) and secondary data (refer to paragraph 2.6.2).

2.6.1 Literature review

The literature review was conducted in establishing the background to the study and a review of national and international existing literature concerning thin capitalisation. The aim of the literature review is to:

- Determine the characteristics of the arm's length principle that will be applied by South African entities to establish the arm's length debt by gathering an understanding of key concepts concerning thin capitalisation rules and the effectiveness of these rules (refer to chapter 3); and
- Evaluate South Africa's taxpayers approach to thin capitalisation by investigating the current treatment of transactions affecting thin capitalisation in the legislation and its application, and compare it to methods adopted by other countries, this is done with the intention of exploring the different methods that are used by other countries in combating thin capitalisation (refer to chapter 4).

Mouton (2001:87) explains that a literature review is not a collection of texts, but rather the investigation of how other scholars have theorised and conceptualised on the issues that is relevant to one's area of interest. Mouton (2001:87) adds that there are a number of reasons why a review of the existing scholarship is important and provides the following reasons:

- "To ensure that one does not merely duplicate a previous study;
- To discover what the most recent and authoritative theorising about the subject is;
- To identify the available instrumentation that has proven validity and reliability;
- To ascertain what the most widely accepted empirical findings in the field of study are;
- and

- To ascertain what the most widely accepted definitions of key concepts in the field are”.

According to Kothari (1985:41), the literature review assists the researcher in understanding the relationship between the research problem and the body of knowledge in the area. This will help the researcher to select a methodology that is capable of providing a valid answer to the research question.

According to Onwuegbuzie *et al.* (2012:05) there are two forms of analysing the literature, namely between-study literature analysis and within-study literature. Onwuegbuzie *et al.* (2012:05) explains that a between-study literature analysis involves comparing and contrasting information from two or more literature sources. In contrast a within-study literature analysis involves analysing the contents of a specific work (Onwuegbuzie *et al.*, 2012:05). It involves analysing every component of work, including title, conceptual framework/theoretical framework, results section, discussion section and procedures used, which can be in a form of a case study (Onwuegbuzie *et al.*, 2012:05). Eisenhardt (1989:533) agrees, stating that a within-case analysis is a preliminary theory generation and gaining familiarity with data, which involves detailed case study write-ups.

Therefore, a between-study literature will be conducted in chapter 3, to analyse thin capitalisation concepts. Furthermore, a within-study literature will be presented in chapter 4 of the present study, by selecting and comparing different countries’ treatment on thin capitalisation in a form of a case study. The within-study literature analysis is conducted by: title (background to the legislation), conceptual framework (application to the legislation), results section (calculations to test thin capitalisation) and discussion section (conclusion).

2.6.1.1 The case study

Swanborn (2010:03) explains that a case study is an appropriate way of answering a broad research question by providing a thorough understanding of how the process develops in a case. Rowley (2002:17) agrees, stating that a case study serves as an advantage for contemporary events, when the relevant behaviour cannot be manipulated.

According to Rowley (2002:21) there are two types of case studies, the single case study and multiple case studies. The single case study refers to the design of a single experiment (Rowley, 2002:21). Single case studies are appropriate for testing a well-

established theory and are used as a preliminary or a pilot in multiple case studies (Rowley, 2002:21). According to Rowley (2002:21), multiple case studies are preferred, as they used to establish or refute a theory. For this reason, a multiple case study was adopted and the approach is illustrated in chapter 4 of the present study, where the thin capitalisation regime is analysed in different countries and compared to South Africa.

Yin (1994:90) states that there are three principles that the researcher should follow when establishing the reliability and validity of a case study. The validity of a case study is achieved by using multiple sources evidence and the reliability of a case study is to create a case study database that contains a chain of evidence similar to the criminology investigation (Yin, 1994:93-98).

The principles are as follows (Yin, 1994:92):

- **The use of multiple sources**

Making use of multiple sources can include using measurements, emphasising verbal information, historic events and interviews.

- **Create a case study database**

The case study database ranges from the researcher's interviews, observations or document analysis.

- **Maintain a chain of evidence**

According to Yin (1994:98), to maintain a chain of evidence is to increase reliability of the information in the case study. The aim is to allow the reader of the case study to follow the derivation of any evidence from the initial research question.

The principles were followed in chapter 4 of this study, because multiple forms of evidence were used as a means of creating a database that analysed the background history of the thin capitalisation legislation of different countries and academic researchers' empirical evidence in the approach of the thin capitalisation rules. Evidence of how to implement the thin capitalisation regime was maintained by using the legislature of different countries to establish calculation examples of how to determine thinly capitalised entities.

2.6.2 Secondary data collection

According to Sapsford and Jupp (2006:142), there are two types of methods for the collection of data in a research study: primary data and secondary data collection. Primary data collection refers to the original data at a time contemporary or near contemporary with the periods investigated (Sapsford & Jupp, 2006:142). Welman *et al.* (2005:149) describes primary data as the original data collected for research purposes.

Secondary data are sources copied and interpreted from the primary data material (Sapsford & Jupp, 2006:142). According to Welman *et al.* (2005:149), secondary data is information that is collected by agencies and institutions.

Adams *et al.* (2007:117) states that secondary data collection is used to validate the selected sample in a study. Furthermore, Adams *et al.* (2007:118), outline the following as advantages of using secondary data collection:

- 1) Large samples of resources are available;
- 2) Support for information usage and explanation of methodology, sampling strategy and data codes are given; and
- 3) Data is easily analysed and interpreted.

Therefore, an empirical study will be conducted by collecting secondary data from McGregor BFA in order to achieve the final research objective of the study. The final research objective is to identify financial ratios in the financial statement that are used by the South African taxpayers to measure their thin capitalisation position (refer to chapter 5).

2.7 SAMPLE COLLECTION

Welman *et al.* (2005:52) defined a population as the full set of cases from which a sample is taken. According to Dane (2011:107), sampling refers to a process of selecting participants for a research project. Welman *et al.* (2005:55) stated that a sample must be a representative of the generalised population from which it was drawn and it is a miniature image of the population.

Sampling can be distinguished between probability sampling and non-probability sampling. Probability sampling is where any element or member of the population will be included in the sample, whereas non-probability sampling conveys the opposite, where some elements have no chance of being included in the sample (Welman *et al.*, 2005:56).

In the present study, non-probability sampling will be conducted, as some elements will have no chance of being included in the population. According to Welman *et al.* (2005:56), non-probability sampling is divided into four categories: quota sampling, purposive sampling, snowball sampling and self-selection sampling. The purposive sampling is considered as the most important type of non-probability sampling, because the unit of analysis in a sample is a representative of the relevant population (Welman *et al.*, 2005:56). It can therefore be concluded that, a purposive sampling will be conducted in this study, because only the relevant population will be selected.

The population in this study can be defined as companies listed on the JSE. The sample to be selected from the population is all sectors in the JSE, except the financial sector. The reason for excluding the financial sector is that their financial ratios substantially differ from those of other companies (Ohlson, 1980:144 & Mossman *et al.*, 1998:40). Furthermore, a cross-sectional time horizon will be used to examine different JSE industries within the 2009-2013 periods. According to Welman *et al.*, (2005:95) a cross-sectional time horizon is a non-experimental design that involves measurement at a single time which comprises of different age groups, universities and organisations known as cohorts. Table 2.1 shows the different industries and the number of companies per sector that will be examined in 2009-2013 period using McGregor BFA. Certain industries such as health care, oil and gas, technology, telecommunications and utilities do not have sectors as reported by McGregor BFA. Table 2.2 shows the final sample of JSE listed sectors that will be used in chapter 5 of this study to address the third secondary research objective.

Table 2.1: Sample of JSE listed industries per sector:

INDUSTRY	NUMBER OF COMPANIES PER INDUSTRY
Basic Resources	
Forestry and Paper	4
Industrial Metals	10
Mining	55
Chemicals	6
Consumer Goods	
Automobiles and Parts	1
Food and Beverages	19
Personal and Households	10
Consumer Services	
Media	6
Retail	27
Travel and Leisure	11
Financials	
Banks	7
Financial Services	26
Insurance	10
Investment Instrument	13
Real Estates	4
Health care	10
Industrials	
Construction and Material	26
Industrial Goods and Services	58
Oil and Gas	5
Technology	21

INDUSTRY	NUMBER OF COMPANIES PER INDUSTRY
Telecommunication	5
Utilities	1
TOTAL NUMBER OF COMPANIES	383

Source: McGregor BFA

Below is Table 2.2, which presents the final sample from the population size used in this study.

Table 2.2: Final sample of JSE listed industries per sector:

Population (Industries)	Number of sectors per industry
Basic Resources	4
Consumer Goods	3
Consumer Services	3
Health Care	1
Industrials	2
Oil and Gas	1
Technology	1
Telecommunication	1
Utilities	1
Final sample	17

Source: Own research

The above sample is selected to address the final secondary research objective, which is to identify financial ratios in the financial statements that are used to determine the arm's length debt.

Figure 2.1 illustrates the manner in which the present study was carried out.

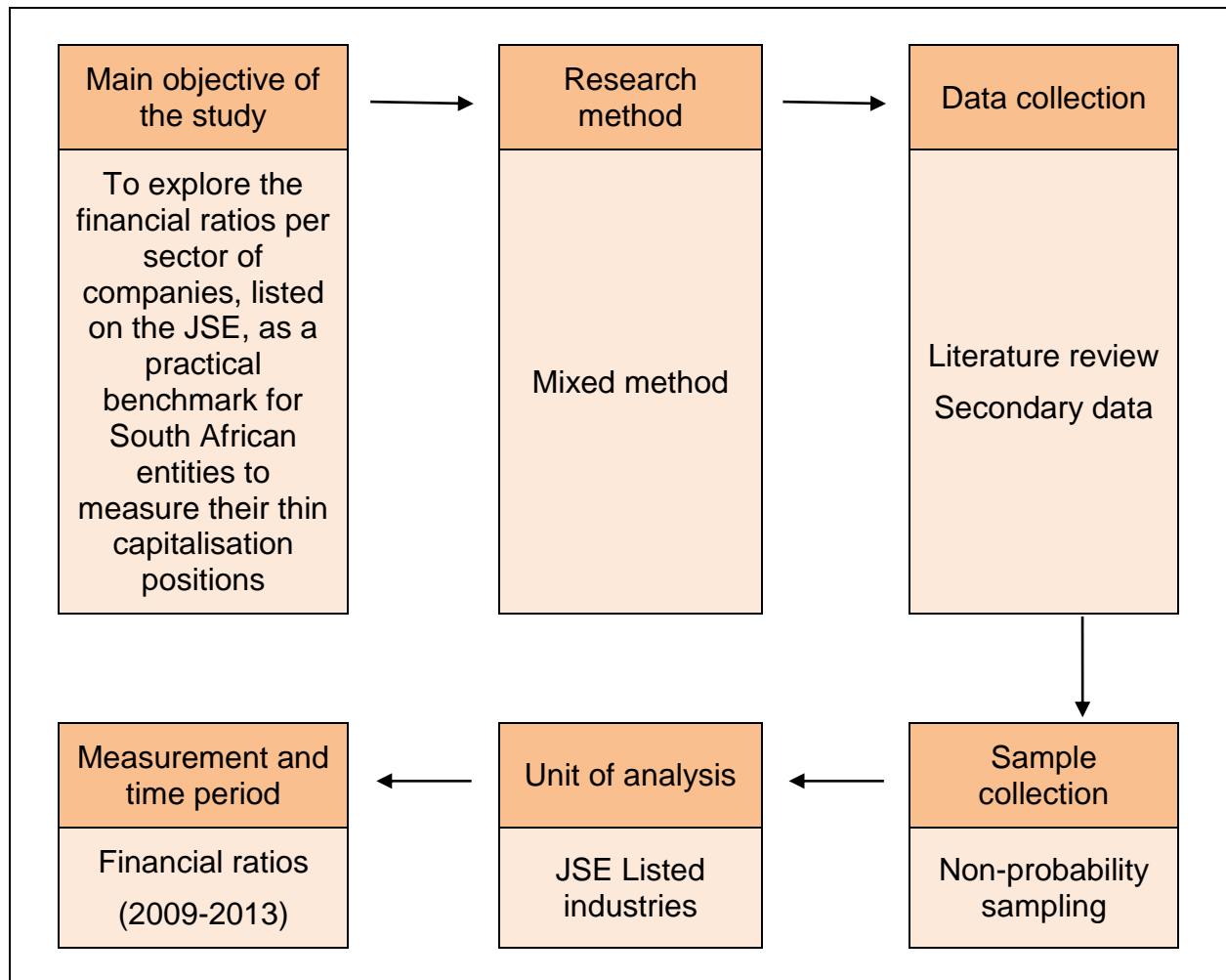


Figure 2.1: Research methodology

Source: Own research

2.8 VALIDITY, REALIBILITY AND OBJECTIVITY

Kothari (1985:02) explains that a research study is “the process undertaken within a framework of set philosophies and uses procedures, methods and techniques that have been tested for their validity and reliability”.

According to Rowley (2001:20), reliability is the demonstration that the operations applied on a study, such as the data collection produced, can be repeated and the same results will be obtained. Reliability is the accurate measurement of the data collected.

Kothari (1985:02) states that objectivity is the steps taken by the researcher, in an unbiased manner, to draw conclusions without introducing vested interest. Kothari (1985:02) explains that validity is the correct procedure applied on a study to find an

answer to the research question. Therefore, validity refers to the technique that the researcher uses for gathering data to answer the research problem.

In the present study, the financial ratios of the JSE industries are investigated as part of the secondary research objective set out in Chapter 1. McGregor BFA will be used as a data warehouse to collect the required ratios. McGregor BFA collects data from the financial reports of the companies and this data is available to the public. It is a legislative requirement, under International Financial Reporting Standards (IFRS), that all JSE-listed companies make available their financial statements to the public. It can therefore be said that the data collected in this study is valid and reliable.

2.9 ETHICAL CONSIDERATIONS

Sapsford and Jupp (2006:293) state that research ethics need to be addressed throughout the research project. Research ethics play an important role in the research project, such as honesty and respect for the rights of individuals (Welman *et al.*, 2005:181). In recent years research ethics have become an area of concern and research participants should be protected from undue intrusion, distress, physical discomfort or other harm (Sapsford & Jupp, 2006:293). It is thus, necessary for the researcher to adhere to research ethics by ensuring that the research project is not harmful to the subjects involved (Sapsford & Jupp, 2006:294). Singleton *et al.* (1999:474) state that the researchers are expected to be completely honest in observations, analysing and reporting the findings during the process of conducting research. Therefore, no group of individuals were harmed in any way during the conduct of this research project.

2.10 CHAPTER SUMMARY

In this chapter, the research methodology which applied to the research study was discussed. Literature ranging from journal articles, court cases, policy documents, books and income tax legislation were used.

The population and sample size of JSE-listed sectors applicable to the study were given. The next chapter will determine the characteristics of the arm's length principle that will be applied by South African entities to establish the arm's length debt.

CHAPTER 3

THIN CAPITALISATION CONCEPTS

3.1 INTRODUCTION

South African entities have uncertainty regarding the practical application of thin capitalisation rules, as per the amended section 31 of the Act (KPMG, 2012:48 & Deloitte 2014:01). This study aims to develop a benchmark that can be used by South African entities to measure their thin capitalisation positions, in order to comply with the current legislation, section 31 of the Act.

The purpose of chapter 3 is to address the first secondary research objective (Chapter 1, paragraph 1.3.2) of the study, by discussing thin capitalisation rules and the effectiveness of these rules. This chapter will determine the characteristics of the arm's length principle, as contained in the OECD Model Tax Convention. This chapter identifies practical considerations that taxpayers should consider when applying the arm's length principle in terms of Practice Note 7 of the Act and other relevant publications. Other issues considered in this chapter relate to previous studies concerning thin capitalisation and the impact of corporate taxes on internal borrowings.

3.2 THIN CAPITALISATION RULES

The increase in global trade between MNEs has become a challenge for tax authorities to collect corporate taxes, as these MNEs use internal debt to save tax payments by deducting interest on the taxable income through debt finance (Sikka & Willmott, 2010:10). Financing through debt has rewarding tax benefits for corporates; because interest expenses are tax deductible, whilst dividends are not tax deductible. MNEs can reduce their overall tax liability by deducting excessive interest payments (Mintz & Smart, 2004:1149 & Huizinga *et al.*, 2008:81). Shareholders who have chosen debt as a method of financing allow the company to deduct interest paid and this deduction causes the income of the company that is subject to tax to decrease (Gajewski, 2013:78). Such deductions could cause the government to lose its share of income. There is thus a need for governments across the globe to tighten their tax legislation to limit possible tax base erosion by MNEs.

In an attempt to minimise excessive interest deductions by corporates, policy-makers around the world have introduced what is said to be “thin capitalisation rules”. The term refers to capitalisation arrangements of connected corporations whereby the owners seek to decrease tax liability by using high levels of debt relative to equity (Lore, 1959:437). Thin capitalisation rules apply where a subsidiary is owned or controlled by a foreign company (Farrar & Mawani, 2008:03).

The general pattern observed in the literature of thin capitalisation is that MNEs use intercompany loans as a tax minimisation tool, by borrowing from subsidiaries located in low-tax countries and lending to affiliates in high tax countries. This will allow the latter to deduct interest payments at high-tax rates and this will reduce the overall tax liability (Buettner & Wamser, 2013:63; Haufler & Runkel, 2012:1087; Fuest, Hebous & Riedel, 2011:138 & Webber, 2010:684). For this reason, thin capitalisation is used as an anti-avoidance rule by tax authorities to restrict MNEs from deducting excessive interest. Gajewski (2013:79) states that debt financing is a preferred method of financing as compared to equity finance by companies; this indicates that there are tax-related benefits associated with this type of finance.

Thin capitalisation is an important issue for both governments and MNEs. Governments introduce the rules to limit excessive interest deductions to increase tax revenue, whereas MNEs can plan their tax activities by structuring their capital structure in accordance with differences in international tax rules in order to minimise the tax liability of the group (Overesch & Wamser, 2010:563). This suggests that quantitative and qualitative forms of restrictions on interest deductions play a major role in the crafting of thin capitalisation rules and this will affect the tax planning activities by MNEs. However, empirical evidence concerning whether tax authorities have been successful in structuring thin capitalisation rules to restrict MNEs from shifting profits to low-tax jurisdictions is still rare.

According to Farrar and Mawani (2008:04), the thin capitalisation regime can be classified as subjective or objective rules. The objective rules are quantitative measures, such as the debt-to-equity ratio and debt-to-EBITDA (earnings before interest, tax, depreciation and amortization) ratio to limit interest deductions (Farrar & Mawani, 2008:04). For example, objective rules would limit interest deduction if the debt-to-EBITDA ratio exceeds 3:1. Subjective rules are qualitative and require the corporation to limit the

interest deductions in terms of given facts and circumstances (Farrar & Mawani, 2008:04). The subjective rules would limit interest deductions if the amount of the loan from a related party, the repayments terms and interest offered were not similar to what the bank or a third party would offer.

It is possible that the policy-makers accommodate industries that are similar in nature, but differ with respect to target markets. For example, in the motor industry, there are manufacturers that produce expensive vehicles that require an enormous amount of capital, compared to other manufacturers within the same industry that require less capital to produce less expensive vehicles.

A study by Blouin *et al.* (2014:08) identified two main differentials used for curbing excessive interest deductions namely: the automatic disallowance and discretionary application. The automatic disallowance implies that interest deductions are restricted if the related party debt or total debt reaches a certain threshold (Blouin *et al.*, 2014:08). Other countries have a discretionary application, which entails considering the actual leverage on an arm's length basis, by comparing the foreign subsidiary's leverage to the leverage of similar resident corporates (Blouin *et al.*, 2014:08). This means that the taxpayer should demonstrate to the tax authorities that the debt borrowed could have been borrowed, if it was borrowed from an independent party. In the present study the discretionary application is used by both the United Kingdom and South Africa. Further details about the different approach used will be discussed in Chapter 4 of the study.

Ting (2004:128) is of the opinion that any MNE receiving internal loans will likely fail the arm's length debt principle, as this principle is based on the assumption that the loan would have been obtained if it was from an independent party. According to Mardan (2013:01), most countries have adopted the debt-to-equity ratio safe haven, to limit interest deduction.

Ruf and Schindler (2012:03) describe the discretionary application as the arm's length principle. Ruf and Schindler (2012:03) mentioned that, under the arm's length principle, the deductibility of interest on internal debt may be denied if it is found that the terms and conditions of the internal financing differ materially, compared to those of third party lenders. Consequently, Ruf and Schindler (2012:16) reported in their study that there are three ways in which to determine the arm's length principle:

- “Whether the interest rate paid on internal debt is a market related interest,
- Whether the loan could have been obtained under the same terms and conditions from an unrelated party, and
- Whether the ratio approach would have been selected if external debt financing had been available”.

They warned that the last two issues are impractical and costly, for both the tax authorities and the taxpayer, to prove that the financial structure is at an arm’s length (Ruf & Schindler, 2012:17). They concluded that the arm’s length principle is not a proper alternative to thin capitalisation rules (Ruf & Schindler, 2012:17).

It is clear that the design of thin capitalisation rules is not easy, even though guidelines are given by the OECD to simplify the process. For this reason it is important for policy-makers to introduce the best suitable method that can be applied by the taxpayers and effective enough to curb excessive interest deductions. The next section of the study will discuss how effective the thin capitalisation rules are, the definition of the arm’s length principle and the guidelines recommended by the OECD on how taxpayers should transact at arm’s length.

3.3 THE EFFECTIVENESS OF THIN CAPITALISATION RULES

According to Ting (2004:98), the policy objective of the thin capitalisation regime is to prevent MNEs from allocating excessive amounts of debt to their foreign counterparts. For this reason it is necessary that the South African tax authorities formulate a legislative framework that is not only effective but can be applied by taxpayers. Smith (1996:1528) contends that to draft effective thin capitalisation rules is difficult, because the rules are easily circumvented.

In accordance with the above, Buettner *et al.* (2012) analysed the effectiveness of thin capitalisation rules over a period of nine years of all foreign subsidiaries of German multinationals. The empirical evidence shows that the thin capitalisation rules have extensive effects on the tax-sensitivity of the capital structure and that, when a country imposes thin capitalisation rules, the motivation to use internal debt is reduced by half (Buettner *et al.*, 2012:936). The study by Buettner *et al.* (2012) further reports that the

tax-sensitivity of internal debt to thin capitalisation rules is mainly driven by the parent company debt. One limitation to the study is that the model favours countries that define debt-to-equity ratio as their safe haven, whereas currently here in South Africa the arm's length principle is used in curbing excessive interest deductions (Buettner, 2012:936).

A study by Chu (2012:123) established that strict thin capitalisation rules have two opposing forces on the social welfare of high-tax countries. On one hand, the rules increase tax revenue which, in turn, improves the social welfare of a country (Chu, 2012:124). On the other hand, reducing the tax haven utilisation restricts MNEs from engaging in international tax planning activities and, as a result, the cost of capital increases and that increase depresses the incentive to invest, and is therefore harmful to economic growth (Chu, 2012:124). He concludes that the thin capitalisation rules have uncertain effects on social welfare and that lenient rules could be favourable (Chu, 2012:131).

Ting (2004:127) suggests that the use of an arm's length debt principle is based on a notional debt, that an independent commercial lending institution is expected to lend to borrow other corporations. In terms of the Australian legislation, the notional amount is determined under the assumption that the entity has no foreign operation or investment and no credit support from the group members (Ting, 2004:127). It ignores the credit rating and financial strength of any associate of the company and simply looks at the Australian operation in isolation (Ting, 2004:127). According to Ting (2004:128), the arm's length principles' objective is to test that some funding arrangements may be commercially viable, notwithstanding that they exceeded the prescribed limits. Ting (2004:128) concluded that the arm's length test is framed in such a way that it will be difficult, or even impossible, to satisfy in many cases, even when the debt effectively comes from independent parties.

A research article by Fuest, Hebous and Riedel (2011) explores whether international profit-shifting through debt financing differs between developing and developed countries. Their results found that the influence of tax rate on the amount of debt financing provided to a foreign affiliate is twice as large in developing countries compared to developed countries (Fuest *et al.*, 2011:135). According to the authors (Fuest *et al.*, 2011:137), this supports the view that developing countries are disposed to MNEs tax planning activities

and further suggest that an increase in the corporate tax rate in a developing country encourages corporates to use more debt than in developed countries. They explained that developed countries have more effective policies and capacity than developing countries that limit the deductibility of interest paid (Fuest *et al.*, 2011:137). This suggests that South Africa as a developing country is predisposed to MNEs tax planning and that an increase in corporate tax rate will cause MNEs to use more debt.

The fundamental characteristic of assessing the taxpayer's thin capitalisation position is to establish that transactions between connected persons are conducted at arm's length (Practice Note 7 of the Act & SARS, 2012:07). The next section will focus on the definition of the arm's length principle, the OECD recommendations on how to approach the arm's length principle and the practical consideration that should be taken into account when applying the principle in terms of Practice Note 7 of the Act.

3.4 THE ARM'S LENGTH PRINCIPLE

3.4.1 Definition of the arm's length principle

According to Practice Note 7 of the Act, the arm's length principle means that transactions between MNEs should contain commercial characteristics that are comparable to transaction between independent parties. Black's Law dictionary (1990:109) defines an arm's length transaction as:

"A transaction in good faith in the ordinary course of business by parties with independent interests commonly applied in areas of taxation when there are dealings between related corporations, e.g. parent and subsidiary".

According to the OECD guidelines (2010:10), the arm's length principle is applied by comparing the terms and conditions of MNEs transaction with the terms and conditions of transaction between independent parties. Richardson (2000:03) described the arm's length principle as the transfer of price between MNEs that should be the same as those prices between independent parties acting in an open market. According to Datta (2012:535) the arm's length principle is the condition that both the parties to a transaction are independent and are on equal footing. It can be said that the arm's length principle is the process of determining the comparable market price that independent parties are willing to exchange goods and services.

In terms of Practice Note 7 of the Act the arm's length principle should have substantive financial characteristics of a transaction between independent parties, where each party will strive to get the utmost benefit from the transaction. The OECD guidelines identified issues that tax authorities should take into account when determining the arm's length principle. Comparability analysis, recognition of actual transaction undertaken, losses, the effect of government policies, and the use of customs valuations

The above issues identified by the OECD guidelines will be discussed next.

3.4.1.1 Comparability analysis

The arm's length principle is based on comparing the situations in a controlled transaction with the conditions of transactions between independent parties (uncontrolled transaction) (OECD guidelines, 2010:10). According to the OECD guidelines (2010:11), the comparison test can only be useful if the economical characteristics of the situation being compared are sufficiently similar. The process of comparison entails that the conditions of MNEs transactions should be benchmarked against transactions undertaken by independent parties to establish the material differences or similarities thereof (OECD guidelines, 2010:11). The OECD has identified five factors that can be used to successfully implement the comparability analysis:

- a. Characteristics of property or service;
- b. Functional analysis;
- c. Contractual terms;
- d. Economic circumstances; and
- e. Business strategies.

a. Characteristics of property or service

The OECD guideline (2010:12) states that it is important, when comparing transactions between MNEs and independent parties, to take into account the value in an open market. Characteristics of property and service include:

- the physical features of the property;
- quality and reliability;

- the availability and volume of supply;
- the provision of services; and
- the nature and extent of the services.

The above characteristics should be considered when applying the comparability analysis (OECD guidelines, 2010:12).

b. Functional analysis

In performing the functional analysis it is important to compare and identify the economic activities and responsibilities undertaken by each party to the transaction (OECD guidelines, 2010:13). It will also be relevant to understand the arrangement and organisation of the MNE and how the structure can impact the decisions of the taxpayer (OECD guidelines, 2010:13).

The OECD guidelines (2010:13) identified functions such as the design, manufacturing, assembling, research and development, servicing, purchasing, distribution, marketing, advertising, transportation, financing and management that the taxpayer and the tax authorities should compare. The guidelines suggest that it is important to adjust any material differences identified, taking into account the economic significance of those functions (OECD guidelines, 2010:13). The OECD guidelines (2010:13) recommend that the functional analysis should take into account the type of assets used, the nature of the assets, the use of valuable intangibles, financial assets, market value and location. The OECD guidelines (2010:13) state that, in order to compare uncontrolled and controlled transactions, it is necessary to consider the risks assumed by each party, since the allocation of risk will be an influential factor of transactions between associate enterprises. The types of risks to consider include:

- market risk;
- risks or loss associated with the investment;
- risks of the success and failure of investment in research and development and
- financial and credit risk.

The OECD guidelines (2010:14) acknowledge that the functional analysis may not be accurate due to the size of the sample of third party data, but this should not affect the quality of data to produce a reliable analysis.

c. Contractual terms

In terms of the OECD guidelines (2010:14), the contractual terms of the transaction should form part of the functional analysis; as this will ensure that the conduct of each party involved conforms to the terms of the contract. In cases where associate enterprises do not follow the terms of the contract, further analysis should be obtained to determine the true terms of the transactions between MNEs (OECD guidelines, 2010:14).

d. Economic circumstances

To perform a comparability test of transactions between independent parties and associate enterprises, it is required by the OECD guidelines (2010:15) that the market price and adjustment should not differ materially. It is essential to identify the economic circumstances to establish comparability which are:

- the geographical area;
- the size of the market;
- the extent of competition in the markets;
- the relative competitive positions of the buyers and sellers;
- the availability (risk thereof) of substitute goods and services;
- the levels of supply and demand in the market as a whole and in particular regions;
- consumer purchasing power;
- the nature and extent of government regulation of the market;
- costs of production, including the costs of land, labour, capital, and transport costs;
- the level of the market (e.g. retail or wholesale) and
- the date and time of transactions.

e. Business strategies

The OECD guidelines (2010:16) recommend that business strategies must also be taken into account when determining the comparability of the connected party transactions undertaken by MNEs and transactions between independent enterprises. When determining the business strategy of the MNEs, it is crucial to evaluate whether or not the taxpayer followed a strategy that caused profits to decrease in return for long-run profits (OECD guidelines, 2010:16).

In summary, the comparability analysis is an important tool that can be used by MNEs to justify their arm's length position. It is required, therefore, that transactions between MNEs be accounted at market value. To be able to substantiate the comparability analysis it is necessary to identify and compare functions undertaken by independent parties in an uncontrolled transaction to functions undertaken by MNEs in a controlled transaction and adjust any material differences. In addition, the contractual terms and conditions of transactions between MNEs should be analysed to ensure that terms and conditions are adhered to. The comparability test should consider the economic circumstances and business strategies undertaken by independent parties and MNEs and adjust for any material differences. The next section will discuss the recognition of the actual transaction undertaken by MNEs in a controlled transaction.

3.4.1.2 Recognition of actual transaction undertaken

The OECD guidelines (2010:17) outline that the tax authorities should examine transactions between MNEs in the manner that has been structured by them, using the methods applied by the MNEs. In terms of the OECD guidelines (2010:17), there are two instances where the tax authorities can disregard methods adopted by the MNEs when entering into a controlled transaction.

Firstly, the tax authorities should establish whether or not the economic substance of a transaction differs from its form (OECD guidelines, 2010:17). For example, MNEs may enter into a loan arrangement by lending to an affiliate that does not necessarily need a loan or, in many instances; the affiliate does not qualify for the loan. In such cases the tax authority is empowered to structure the controlled transactions according to the economic substance (OECD guidelines, 2010:17).

Secondly, the MNEs can enter into a controlled transaction where the economic substance and form are the same, but the arrangement made in relation to the transaction differs from those entered into by independent enterprises (OECD guidelines, 2010:17). For example, the MNEs can enter into a loan agreement and the borrowing affiliate does qualify for the loan, but the terms and conditions of the loan are structured in a manner that are not commercially viable, such as the interest rate being too high. In this case the tax authorities are encouraged to adjust the terms and conditions of the loan in a manner that is commercially viable (OECD guidelines, 2010:17).

It can therefore be concluded that tax authorities should take into account methods adopted by MNEs when evaluating a controlled transaction. An exception to this is in cases where the economic substance of a controlled transaction differs from its form, or when an arrangement in relation to a controlled transaction differs to that of an independent party in an uncontrolled transaction. The next section will discuss “losses” as another issue that tax authorities should consider when determining the arm’s length principle.

3.4.1.3 Losses

The OECD guidelines (2010:18) mention that it is necessary for tax authorities to examine entities within the MNEs that continuously realise losses. The guidelines do, however, consider that the loss may be due to heavy start-up costs, unfavourable economic conditions, inefficiencies, or other genuine business reasons. In these instances the tax authorities should consider the business strategy of the MNE group, such as the history, economy and culture of the MNE group (OECD guidelines, 2010:18). The OECD guidelines (2010:19) further mention that tax authorities should acknowledge cases whereby enterprises realise recurring losses to enter into a new market. For example, an affiliate can borrow funds from the MNE group and incur high losses due to interest payments made to the MNEs as a result of entering a new market.

Thus there may be genuine business reasons for the continuous losses incurred by MNEs. Tax authorities should therefore consider the reasons that caused an affiliate of a MNE to realise losses continuously in determining the arm’s length principle.

The next paragraph will discuss the effect of government policies that should be considered by tax authorities when determining the arm's length principle.

3.4.1.4 The effect of government policies

The OECD guidelines (2010:19) recommend that taxpayers should consider the government policies, such as price controls, interest rates, payments for service and management fees and the payment of royalties and subsidies, when determining the arm's length price. OECD guidelines suggest that government policies should be treated as conditions of the market in that particular country (OECD, 2010:19). Even though independent parties may not engage in transactions that are subject to government policies, it might be a challenge to apply the arm's length principle (OECD guidelines, 2010:19).

In summary, tax authorities should consider the effect of government policies such as changes in interest rates, because this will affect the determination of a controlled transaction, such as interest payments (may be too high due to government policies). Government policies should be treated as conditions that affect the economy of a particular country and not an international policy. The use of customs valuations will be discussed next, as part of the arm's length principle issue that tax authorities should take into account.

3.4.1.5 Use of customs valuations

Valuation methods used by the taxpayer may differ compared to the transfer pricing methods suggested by the OECD in applying the arm's length principle (OECD, 2010:20). It is recommended by the OECD guidelines (2010:20), that customs administrators and tax authorities exchange information that relates to the taxpayer's customs duty and income tax.

Accordingly, the way path of determining the arm's length principle does not only consider the comparison between uncontrolled transactions and controlled transactions, but includes consultation with other parties such as MNEs, independent parties and customs administrators.

It may be worthwhile for MNEs to establish a mutual agreement with the tax authorities prior to entering into transactions that might not meet the required standard of the arm's

length principle, as recommended by the OECD. This will assist MNEs to avoid litigation with the tax authorities for failing to comply with the arm's length principle. Researchers (Keuschnigg & Devereux, 2013; Yao, 2013; Miesel *et al.*, 2003; Pendse 2012) have criticised the practical application of the arm's length principle as contained in the OECD guidelines. They found that the policy may be harmful to the social welfare of a country, as it discourages investment and will most likely create disputes between MNEs and tax authorities (Keuschnigg & Devereux, 2013; Yao, 2013; Miesel *et al.*, 2003; Pendse 2012).

According to Pendse (2012:342), the OECD guidelines are subjective and could result in disputes between MNEs and tax authorities. Keuschnigg and Devereux (2013:438) established that the arm's length principle introduces an inconsistent benchmark in the taxation of MNEs. Moreover, imposing the arm's length principle, as contained in the OECD guidelines will have two contradictory effects (Keuschnigg and Devereux, 2013:438). On one hand, the tightening of the arm's length principle will raise world tax revenue and increase welfare; on the other, the arm's length principle will discourage profit shifting activities by MNEs from high-to-low tax countries (Keuschnigg and Devereux, 2013:437). Enforcing the arm's length principle will discourage investment and employment, because the policy forces MNEs to set prices lower than market value (Keuschnigg and Devereux 2013:437).

Miesel *et al.* (2003:02) identified two obstacles that MNEs and tax authorities will be faced with when implementing the arm's length principle. The first is that the arm's length principle is based on the assumption that the MNEs are separate entities, whilst in reality the MNEs are integrated enterprises. According to Miesel *et al.* (2003:02), the measure of integration cannot be duplicated in the context of the arm's length principle, even though the MNEs sell similar products within the same industry. Another obstacle is that MNEs could enter into transactions that independent parties would not undertake, making it difficult for the MNEs to achieve the comparability analysis suggested by the OECD guidelines (Miesel *et al.*, 2003:02).

Yao (2013) concurs with the above studies, stating that the arm's length principle is aimed at increasing tax revenues in a perfect market. Yao (2013:03) revealed that the arm's length principle restricts MNEs from engaging in pricing strategies and could thus be harmful to their net earnings and, in turn, decrease the tax revenue expected by the tax

authorities. Roy and Pyne (2012:523) state that the arm's length principle is justified by the fact that it contributes tax equality and neutrality between the associate's enterprises and an independent enterprise

In conclusion, the issues identified by the OECD guidelines for tax authorities to take into account when determining the arm's length principle appear to be subjective. Firstly, the comparability analysis considers that conditions of a controlled transaction should be benchmarked against the conditions an uncontrolled transaction undertaken by independent parties to establish differences/similarities. This can cause the transaction not to be comparable. Secondly, the economic substance of the actual transaction undertaken by MNEs could differ in all material respect to the economic substance of the transaction between independent parties. Lastly, to consider the government policies in determining the arm's length principle, it may be necessary to acquire an expert in matters that relates to interest rates, price controls and subsidies of that particular country. Consistent with the above OECD guidelines, South African Revenue Services has identified issues that should be considered when applying the arm's length principle. This is important for this study, because the determination of the arm's length debt is based on the arm's length principle (SARS, 2012:06 & Section 31 of the Act).

3.4.2 South African Revenue Service approach to the arm's length principle

Onsando (2007:49) revealed that the South African Revenue Service has issued guides of how South African taxpayers can apply the legislation. These guides include practice notes, interpretation notes and brochures. Two of the guides issued by the South African Revenue Services relevant to this study include the Practice Note 7 of the Act and the Draft Interpretation Note (the determination of the taxable income of certain persons from international transactions: thin capitalisation of section 31 of the Act). The guides are aimed at providing taxpayers with guidelines to be followed in establishing the arm's length price (Practice Note 7 of the Act). The objective of the Draft Interpretation Note is to provide guidance to South African taxpayers on how to apply the arm's length basis to avoid being thinly capitalised (SARS, 2012:03). The process of how South African taxpayers can apply the arm's length basis in order to avoid being thinly capitalised will be discussed in Chapter 3 paragraph 3.6.

Although not an OECD member country, South Africa has followed the OECD guidelines in determining the arm's length principle (Practice Note 7 of the Act & section 31 of the Act). The Commissioner of the South African Revenue Service is of the opinion that the application of the arm's length principle will minimise the potential for double taxation (Practice Note 7 of the Act).

According to Practice Note 7 of the Act the determination of the arm's length principle is not an exact science, but requires that both the taxpayer and the tax authority approach each case in an objective manner. According to Manyaka (2010:30), the arm's length principle is based on the theory that transactions of independent parties are subject to the full play of market forces. Hence, these transactions of independent parties provide a benchmark that tax authorities can apply to evaluate MNEs.

Practice Note 7 of the Act has identified a number of practical considerations with regards to the application of the arm's length principle, as recommended by the OECD guidelines. The practical considerations relevant to the study will be discussed next, because this will affect how MNEs will determine the arm's length debt in terms of the current section 31 of the Act.

3.4.2.1 The availability of information

Practice Note 7 of the Act provides that, in instances where the South African tax authority fails to find comparable transactions, it is acceptable that the Commissioner use other foreign countries' comparable transactions, taking into account geographical differences. The Draft Interpretation Note (SARS, 2012:08) suggests that a relevant comparable transaction may be financial ratios obtained from third party databases, but the Draft Interpretation Note does not indicate whether the ratio should be obtained from a foreign country.

3.4.2.2 Independent parties to be evaluated in a controlled transaction

In terms of Practice Note 7 of the Act, a controlled transaction refers to "a transaction in terms of which the ownership or control relationship is able to influence the transfer price set". Practice Note 7 of the Act requires the Commissioner to seek a reasonable approach in the determination of transactions that will be used to establish the taxpayer's arm's length basis. It should also be noted that the Commissioner would prefer using South

African entities to evaluate the taxpayer's arm's length position (Practice Note 7 of the Act). According to the Draft Interpretation Note (SARS, 2012:07) the taxpayer is required to find a reasonable approach in establishing the arm's length principle, by evaluating the controlled transaction from the lender and the borrower's perspective.

3.4.2.3 Use of multiple year data

Practice Note 7 of the Act requires that all relevant facts and circumstances should be taken into consideration when examining data of a controlled transaction. Practice Note 7 of the Act requires that multiple year data should be used of both the tested party and the independent party, to establish the economic effects of the product or service. In accordance with this, the Draft Interpretation Note (SARS, 2012:08) suggests that terms and conditions of the funding arrangement of a controlled transaction should be obtained for the years (periods) of funding.

3.4.2.4 Materiality in a practical assessment of comparability

Practice Note 7 of the Act provides that immaterial differences should not be considered when performing the arm's length basis. In terms of Practice Note 7 of the Act, the purpose of performing a functional analysis is to understand the qualitative functions of the tested party, such as the risks and assets used in the business, in order to determine a proper comparison of the functions undertaken by independent parties with similar assets and risk. The Draft Interpretation Note (SARS, 2012:08) states that taxpayers should consider qualitative and quantitative factors that third party lenders take into account when making lending decisions to obtain comparable data.

3.4.2.5 Interest free loans to non-residents

According to Practice Note 7 of the Act, South African taxpayers granting loans to their foreign affiliates often charge no interest and have no repayment terms of the arranged loans. For this reason the Commissioner will adjust the amount of income of the non-resident taxed in South Africa in terms of section 9D of the Act. Section 9D of the Act applies when a resident receives income from a foreign company in which the resident owns shares or voting rights (Stiglingh *et al.*, 2012:584). The South African Revenue Service are investigating the availability and use of a third party database that consists of

credit ratings and score card models that can assist in the assessment of arm's length interest (SARS, 2012:09).

3.4.2.6 Recognition of actual transactions undertaken

Practice Note 7 of the Act states that the economic substance of a controlled transaction between the MNEs will be used as a basis of comparison with the structure of the transaction undertaken by independent parties. This is to ascertain a commercial viability of controlled transactions among MNEs (Practice Note 7 of the Act). Therefore, in order to ensure that the economic substance of a controlled transaction, such as debt, meets the required standards of the arm's length principle, it is important that taxpayers should consider the following functional analysis factors, in determining the arm's length debt (Practice Note 7 of the Act).

- “The funding structure which has been or is in the process of being put in place, including the dates of transactions, the source of the funds (immediate and ultimate), reasons for obtaining the funds, how the funds were or will be applied (the purpose of the funding) and the repayment terms;
- The business (a high level understanding covering the relevant industry, the business itself, details regarding the management team and external market conditions) and the plans of the principal trading operations (including the business strategy);
- The financial strategy of the business, including how capital is allocated, the relationship between capital and cash flows from operations and any changes relating to the funding transactions; and details regarding the principal cash flows and the sources of repayment of debt;
- The taxpayer's current and projected financial position for an appropriate period of time, including the assumptions underlying the projections and cash flows (for example, the appropriateness of the intended repayment through sale of the asset, if applicable, or increased profits)” (SARS, 2012:07-08).

To recognise the actual transaction demands voluminous documentation from the taxpayer to explain the economic substance and to ascertain the commercial viability of a controlled transaction (debt).

3.4.2.7 Arrangements common between group companies

According to Practice Note 7 of the Act, it is necessary to test arrangements between MNEs with similar arrangements entered into by independent parties in similar circumstances. The fact that the arrangement is between the MNEs is an appropriate reason for the Commissioner to test the arm's length principle (Practice Note 7 of the Act).

3.4.2.8 "Safe harbours"

In terms of Practice Note 7 of the Act, the disadvantage of using safe harbours is that misleading results can be produced that are not consistent with the arm's length principle. However, with the current Draft Interpretation Note, the South African Revenue Service will determine which taxpayers are at risk of being thinly capitalised cases by considering the debt-to-EBITDA ratio of 3:1 when testing the arm's length debt and an interest rate that exceeds the weighted average of the South African Johannesburg Interbank Agreed Rate (JIBAR), plus two per cent (SARS, 2012:12). The South African Revenue Service acknowledges that this is not a safe harbour but an indicator that will be used to select thinly capitalised cases (SARS, 2012:12). However, a report issued by the National Treasury (2013:06) on 29 April 2013 suggests that a potential safe harbour of 3:1 debt-to-EBITDA ratio can be considered in restricting the deductibility of excessive interest payments by MNEs.

From the above practical considerations identified by Practice Note 7 of the Act it appears that the Commissioner and the South African taxpayer can reach common ground in establishing the arm's length basis of a controlled transaction. However, the concern is that Practice Notes cannot override the provisions set out in the Income Tax Act (ITC 1675 SATC 219). It is important that the Income Tax Act provides practical guidelines in matters concerning the application of the arm's length principle.

Matsui (2011:578) states that the imposition of the arm's length principle on MNEs generates a co-ordination failure amongst countries, as this principle induces MNEs to set transfer prices equal to marginal costs. The result of this is that the economic welfare of both countries will decrease, compared to a situation where the principle is not imposed. Contrary to this, Choe and Matsushima (2013:128) state that the arm's length

principle makes tacit collusion between corporates more stable, because the arm's length principle requires corporates not to price-discriminate between its own associates.

The arm's length principle may be seen as a principle that is difficult to apply, due to the fact that entities may have a similar structure, target market and industry, but differ in the credit ratings determined by independent lenders such as banks. The next section will discuss the impact of taxes on debt, as well as the use of financial ratios used by the lending institutions to grant loans.

3.5 THE IMPACT OF TAXES ON TOTAL DEBT

Thin capitalisation rules can be an essential determinant of a company's capital structure. According to Buettner *et al.* (2009:09), the term capital structure of a company refers to a mix of long-term debt, short-term debt, issue of convertibles and preference shares, lease finance and equity.

De Mooij (2012:497) is of the opinion that the option for the use of intercompany loans creates opportunities for MNEs to exploit cross-country tax arbitrage by adjusting their capital structure. MNEs can easily shift profits by increasing transfer prices of interest charged on an intercompany loan (De Mooij, 2012:502). According to De Mooij (2012:502), tax authorities can impose an interest rate limitation at which deductions are granted as a measure of restricting excessive interest deductions, although he admits that the application of this method may be complex to apply. Consequently, MNEs should consider the difference in corporate tax rates between countries in their financing strategies in order to minimise their total tax base (Goritzer, 2010:01). Arena and Roper (2010:638) found that corporate tax rates are not the only motivation that MNEs use to shift debt into a high tax country, but MNEs also consider inter-country withholding taxes on dividends.

It can be said that debt is a preferred source of finance because it reduces the tax obligation due to a government and increases shareholders' returns, although it is not the only means of finance that MNEs consider. The next section of the study will discuss components that motivate MNEs to consider debt over equity as a means of financing.

3.5.1 Debt versus equity finance

The study by Modigliani and Miller (1963) is the foundation of corporate finance and taxes. Modigliani and Miller (1963:442) identified that debt financing increases firm value, therefore, corporates should fully utilise the tax saving benefits over the use of debt. According to Graham *et al.* (1998:131), corporates that finance their operations through debt reduce taxable income and also the corporate tax rate payable to the tax authority.

Chowhry and Coval (1998:88) suggest that it would be beneficial for the parent within the MNEs to finance their subsidiary with both equity and debt. They argue that the choice of financing activities is largely influenced by corporates' taxes (Chowhry & Coval, 1998:88). It is found that the corporate tax rate of the subsidiary country exceeds the corporate tax rate of the parent country, then it is advantageous for the MNE to transfer funds in the form of interest payments to the parent country, since interest payments are tax deductible (Chowhry & Coval, 1998:88). Sekar and Bhushan (2012:528) agree, stating that the decision of financing would be beneficial if both equity and debt are mixed as a means of finance.

In addition, if the parent's corporate tax rate is higher than that of the subsidiary, it will be profitable for the MNEs to transfer funds in the form of dividends to the subsidiary's country (Chowhry & Coval, 1998:89). The consequence of this is that dividends received will be taxed in the subsidiary country and this dividend income will attract an additional tax rate of the difference in the tax rates of the subsidiary and the parent (Chowhry & Coval, 1998:89).

In agreement with Chowhry and Coval, Huizinga *et al.* (2008) showed empirical evidence that the capital structure of MNEs are dependent on the national tax rates and international tax rates difference. According to Huizinga *et al.* (2008:114), the source of where income is taxed appears to be an important determinant of how MNEs structure their financing activities. Thus, MNEs can change the source of where income will be taxed by using debt as a financing tool to foreign subsidiaries located in a high tax country.

The Draft Interpretation Note (SARS, 2012:08) indicated that taxpayers should consider the use of appropriate financial ratios and indicators of creditworthiness from independent

rating agencies in order to determine the arm's length debt. The next section of this study will consider the use of financial ratios as a lending tool.

3.5.2 Use of financial ratios as a lending tool

According to Beaver (1966:71), the use of financial ratios by credit lenders, credit-rating agencies, investors and management is to predict failure. Failure can be defined as "the inability of entities to meet their financial obligation" (Beaver, 1966:71). Ratio analysis will enable lending institutions to determine which entities can be classified as failed or non-failed if there is a benchmark set for the entities (Beaver, 1966:81). According to Jooste (2007:01), the income statement and balance sheet ratios are not enough to determine the liquidity position of an entity. Jooste (2007:01) suggests that, cash flow ratios are a preferred measure of the financial strengths and weaknesses of an entity. Steyn and Smith (2002:42) define liquidity as "the availability of cash in the near future after taking into account financial commitments over a period".

Financial ratios can be divided into four categories:

- Liquidity ratios;
- Profitability ratios;
- Long-term solvency ratios; and
- Turnover ratios (Delen *et al.*, 2013:3970).

The study will focus on the long-term solvency ratios, because this is the type of financial ratios used by the Commissioner of the South African Revenue Service to determine taxpayers that are at risk of being thinly capitalised (SARS, 2012:08). Long-term solvency ratios measure the level of financial risk that could be faced by creditors (Delen *et al.*, 2013:3970). Long-term solvency ratio has two ratios that are important to the study and they are analysed as follows:

- (i) The debt-to-equity ratio:
 - Which measures the total liabilities to the total equity (Correia *et al.*, 2011:17), and
- (ii) The debt-to-EBITDA ratio:

- This measures the repayments of loans over earning capacity (Maricica & Georgeta, 2012:730).

3.6 CHAPTER SUMMARY

In chapter 3, key concepts concerning thin capitalisation rules, and how effective these rules are, were discussed. The characteristics of the arm's length principle and the definitions of the arm's length principle were identified. This chapter considered the practical application of the arm's length principle as contained in Practice Note 7 of the Act. The chapter identified the impact that debt has on the capital structure of the MNEs.

It was found that the thin capitalisation regime is associated with international debt shifting behaviour by MNEs and that tax authorities have formulated different approaches to minimise the tax base erosion activity by MNEs. Two structures were identified that tax authorities use to curb excessive interest deductions, namely: the automatic disallowance (objective rules) and the discretionary application (subjective rules). Researchers established that the latter is difficult to satisfy, because it assumes that MNEs are separate entities, discourages investments and employment in countries where it is imposed (Farrar & Mawani, 2008:04 & Blouin *et al.*, 2014:08). In addition, it was found that the practical application of the arm's length principle was, to a certain extent, inadequate and complex (Ting, 2004:128). This was identified by the South African Revenue Service under Practice Note 7 of the Act. The shortcomings acknowledged by South African Revenue Service can nullify the accurate basis of the arm's length principle. Therefore, it is necessary for the South African entities to acquire a practical benchmark that can be used to measure transaction that are within arm's length. Hence, the main objective of this study is to determine benchmark that can be used to measure the thin capitalisation position of entities. This will eliminate the uncertainty of how to apply the current legislation.

The next chapter of this study will determine methods adopted by other countries, including South Africa, to curb excessive interest deduction by showing examples of the practical application of thin capitalisation. .

CHAPTER 4

COMPARISON OF THIN CAPITALISATION METHODS ADOPTED BY CANADA, THE UNITED KINGDOM AND THE UNITED STATES OF AMERICA WITH SOUTH AFRICA

4.1 INTRODUCTION

The aim of this chapter is to address the second research objective of the study, which is to compare the methods adopted by other international countries in combating thin capitalisation. This is achieved by observing the enforcement legislation of three countries, namely Canada, the United Kingdom and the United States of America, and comparing these to South Africa. Reasons for selecting these countries will be explained later in this chapter.

In the previous chapter it was established that thin capitalisation rules are intended to prevent MNEs from shifting profits from high tax jurisdictions to low tax jurisdictions. For this reason, a combination of international countries with high and low corporate tax rates, compared to South Africa, was selected to determine the different methods applied to combat thin capitalisation.

This chapter will analyse the repealed Practice Note 2 of the Act to provide the background of the wording of the previous legislation, and the Draft Interpretation Note will be analysed taking into account updates and changes within section 31 of the Act. Examples of how to determine the arm's length debt and interest are presented in this chapter. Chapter 4 provides an analysis of tax court cases relating to thin capitalisation of the selected international countries and South Africa. The chapter will commence by introducing the different methods adopted by each of the selected countries, in order to compare the different approaches that are used to combat excessive interest deductions.

4.2 THIN CAPITALISATION APPROACH

Countries' thin capitalisation regimes differ among several key definitions and application. Firstly, thin capitalisation rules differ in the ratio benchmark and the approach to which they apply. Secondly, they vary in the definition of maximum debt ratio, beyond which interest is no longer deductible.

For instance, the United Kingdom and Canadian thin capitalisation legislation emphasis on related party debt to determine the excessive interest, while the United States of America focus on total debt to curb the deductibility of interest (section 147 of the TIOPA, section 18(4) of the Canadian Income Tax Act, & section 163(j) of the Internal Revenue Code). South Africa currently limits excessive interest deduction on total debt, as per the amended section 31 of the Act.

The selected countries in this study, including South Africa, have adopted the OECD Tax Convention to limit excessive interest deductions by MNEs (refer to Table 4.1 of the study). The countries followed the arm's length principle contained in Article 9, read together with Article 11 of the OECD Convention. Article 9 of the OECD Convention focuses on associated enterprises. Paragraph 1 of Article 9 provides that:

“[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly” (OECD, 2010:12).

This means that where there is a financial or commercial agreement between connected persons of the same group, and either of the enterprises made a profit because of the conditions of the agreement, and such conditions differ from those between independent parties, then such profit should be taxable.

Paragraph 6 of Article 11 of the OECD Convention provides that:

“Where, by reason of a special relationship between the payer and the beneficial owner, or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention” (OECD, 2003:14).

Article 11(6) of the OECD Convention applies where the payer of the interest and the beneficial owner of the interest are related to each other and the amount of interest paid between them exceeds an arm's length amount. The excessive interest that is not within arm's length shall be taxable under the laws of the respective states.

An analysis should be made of whether or not the terms and conditions of related party transactions are comparable to the terms and conditions of transactions carried out between independent enterprises. Choe and Matsushima (2013:120) show, in their empirical study, that the arm's length principle compels corporates not to price-discriminate between its own affiliates and independent parties. Manyaka (2010:58) reasons that there is inadequate guidance on how one should apply the arm's length principle. For this reason, the OECD has issued a report (2011), the United Nations Model Double Tax Convention, that illustrates the methods that countries can adopt to apply the arm's length principle of debt.

According to the United Nations Model Double Tax Convention report (2011:67), there are two approaches that tax authorities can adopt in order to combat excessive interest deductions, namely the arm's length approach or the fixed ratio approach. The arm's length approach requires that each case be determined on its own merits, by establishing the facts and circumstances of whether financial assistance received constitutes debt or equity (UN Model, 2011:67). In terms of the United Nations Model Double Tax Convention report (2011:67), the arm's length approach considers the borrowing capacity of debt that a corporation would be able to obtain from third party lenders and considers the amount of debt that a borrower would have borrowed if the lender had been an independent party. According to the United Nations Double Tax Convention Model report (2011:67), the arm's length approach may be implemented through specific legislative rules or the application of transfer pricing legislation based on the arm's length principle.

The fixed ratio approach, on the other hand, is described as a "predetermined ratio" on which interest may not be deducted if the ratio is exceeded (UN Model, 2011:67). Most countries prefer the fixed ratio approach and use the debt-to-equity ratio to determine the limitation on which interest may not be deducted. Table 4.1 shows the different approaches used by the selected OECD member countries and South Africa as a non-

member. The respective corporate tax rates of these countries are also disclosed in the table.

Table 4.1: Different approaches per selected countries:

Country	Corporate tax	Approach	Safe haven	Related party/total debt
Canada	26.1% ¹	Fixed ratio approach	1.5:1	Related party debt.
South Africa	28%	Arm’s length approach	N/A ²	Total debt
United Kingdom	23%	Arm’s length approach	N/A	Related party debt
United States of America	39.1%	Combined approach	1.5:1	Total debt

Source: Adjusted Buettner *et al.* (2012:932)

According to Mardan (2013:02), it is better for tax authorities to use the “earning stripping” method (hereby referred to as the arm’s length approach), instead of the fixed ratio, as this method takes the productivity of the firm into account. With the earning stripping approach, the excessive interest is calculated as a percentage of the EBITDA (earnings before interest, taxes, depreciation and amortization (SARS, 2012:02)). Countries such as Germany, Italy and Denmark use the earning stripping approach (Edgar *et al.*, 2008:811). The United States of America, as indicated, applies both the arm’s length approach using the debt-to-EBITDA ratio, and the fixed ratio approach using the debt-to-equity ratio benchmark (Fuest & Hemmelgarn, 2005:513). The EBITDA ratio is based on

1 Corporate tax rates were obtained from the OECD Tax Database (www.oecd.org/tax/tax-policy/tax-database.htm#C_CorporateCap)

2 According to Draft Interpretation Note the safe haven is no longer in use, but the South African Revenue Service will use ratios such as the debt-to-equity ratio and the debt-to-EBITDA ratio of 3:1 to identify taxpayers that are at risk of being thinly capitalised

IFRS (International Financial Reporting Standard), which is an accounting standard of how public companies prepare and disclose financial statements (SARS, 2013:09).

The study will present the advantages and disadvantages of both the approaches adopted by different countries in Table 4.2 of this chapter. The purpose of Table 4.2 of the study is to determine a suitable and practical approach that countries can adopt to deal with thin capitalisation.

Table 4.2: Advantages and disadvantages of thin capitalisation different approaches:

Arm’s length approach	Fixed Ratio Approach
Advantages	Advantages
Provides for a much closer approximation of the debt the corporation could borrow.	Provides a great deal of certainty and reduces compliance costs to companies and taxing authorities.
The arm’s length analysis is designed to the facts and circumstances of each case and allows a more tailored approach to the determination of deductible debt interest.	The fixed ratio approach is easy to understand and to calculate because it is a method provided by the tax authorities, e.g. the debt-to equity ratio.
Disadvantages	Disadvantages
The tax authorities need to understand the processes third party lenders use to determine the maximum amount of debt they would lend to a specific taxpayer, such as the industry of the taxpayer, the quality of management, the free cash flows of the corporate and the ability of the group and its subsidiary to repay loans and interest.	The fixed ratio approach treats firms equally, irrespective of the industry specifics.
The system may be costly, due to lack of experts in the field that should determine the characteristics of lending to a corporate that has a foreign affiliate.	The fixed ratio approach can be misleading, as it is not a key factor that third party lenders use to grant debt.

Source: Adjusted OECD thin capitalisation legislation draft (2012:09-12).

Table 4.2 shows that:

- The arm's length principle is a closer approximation of debt that could have been borrowed, but requires experts that have knowledge in instituting the lending process.
- The fixed approach is easy to understand and implement, but misleading because it is not a key factor that the lending institutions consider when granting a loan.

According to Buettner *et al.* (2012:930) and Blouin *et al.* (2014:07), Canada was the first OECD member to enact the thin capitalisation rules in 1971. For this reason Canada's thin capitalisation rules will be discussed in the next section of this chapter. An analysis of the background of thin capitalisation legislation in Canada will be provided, together with the application of the legislature, documentation procedures and tax court cases under the Canadian tax system.

4.3 CANADA

4.3.1 Background to the legislation

Like many other OECD member countries, Canada has adopted the "safe harbour" approach to prevent Canadian MNEs from stripping the government of its fair share of income tax. The debt-to-equity ratio threshold of 3:1 was adopted at the inception of thin capitalisation rules and in the year 2000 the debt-to-equity ratio was reduced to 2:1 (Farrar & Mawani, 2008:05). Moreover, the Canadian tax authorities' reduced the 2:1 debt-to-equity ratio in March 2013 to 1.5:1 (SARS, 2013:11). This was in accordance with the recommendations given by the Advisory Panel in 2008. The Advisory Panel (Canadian Income Tax, 2008:65) further suggested that the rules should apply to trusts, partnerships and Canadian affiliates of non-resident corporations.

Section 18(4) to section 18(8) of the Canadian Income Tax Act (ITA) was amended with the above recommendations of the Advisory Panel and seeks to limit interest expense deductions by the Canadian entities. Section 18(4) to section 18(8) of the Canadian ITA is discussed below.

4.3.2 Section 18(4) to section 18(8) of the Canadian ITA

The aim of section 18(4) of the Canadian ITA is to ensure that taxpayers understand that an interest deduction for debt offered by non-resident is limited to a threshold of 1.5:1 debt-to-equity ratio. Section 18(4) of the Canadian ITA provides that: In computing the taxable income of a trust, corporation or property business, there shall be no deduction of any amount of interest paid or payable by the Canadian resident to the specified non-resident only if that the following conditions are met:

- (a) “the amount, if any, by which
 - i. the average of all amounts each of which is, in respect of a calendar month that ends in the year, the greatest total amount at any time in the month of the outstanding debts to specified non-residents of the corporation or trust, exceeds
 - ii. 1.5 times the equity amount of the corporation or trust for the year, is of
- (b) The amount determined under subparagraph (a) (i) in respect of the corporation or trust for the year”.

It is emphasised in section 18(4) of the Canadian ITA that, the banking businesses will be excluded from the 1.5:1 debt-to-equity threshold and that the rules of the Canadian ITA will only apply to Canadian non-resident.

In accordance with this section 18(5) of the Canadian ITA was amended in March 2013 to ensure that the taxpayers understand the meaning of what constitutes an equity amount that will be used to measure thinly capitalised entities. Section 18(5) of the Canadian ITA defines the equity amount of a corporation or trust as, the total amount of retained earnings, the average of the contributed surplus and the average of all paid-up capital which is owned by a non-resident shareholder.

Furthermore, section 18(5) of the Canadian ITA provides that the thin capitalisation rules will only apply to Canadian resident entities who own 25% or more fair market value shares or 25% or more voting rights.

Section 18(6) of the Canadian ITA deals with back-to-back loans, this is an anti-avoidance rule designed to restrict a non-resident corporation from depositing funds into a financial institution and, in turn, the institution lends the funds to the Canadian corporation. An exception to the back-to-back loan rule is provided for in paragraph 3 of the Interpretation Bulletin IT-59R3.30 which states that section 18(6) of the Canadian ITA will generally be applied in situations in which the application of the thin capitalisation rules is otherwise unfulfilled or avoided.

Section 18(7) of the Canadian ITA provides that, thin capitalisation rules will apply to partnerships by taking into account a partner's share of debt in determining the excessive debt-to-equity ratio.

Section 18(8) of the Canadian ITA states that interest paid or payable to a controlled foreign affiliate by a Canadian corporate would not otherwise be deductible if it was deducted under the provisions of section 18(4) of the Canadian ITA.

Canadian Finance Minister, Jim Flaherty, mentioned in his 2012 federal budget speech that the disallowed interest will be treated as dividend income and no longer interest income from the year beginning March 2013 (National Post, 2013). The effect of this is that the withholding tax (of 25%, unless a tax treaty between Canada and another country exist) rules will apply in terms of Part XIII of the Canadian ITA.

It is imperative that taxpayers understand the practical application of the words contained in section 18(4) to section 18(8) of the Canadian ITA, in order to comply with the legislation. The next section of this chapter discusses the application to the legislation.

4.3.3 Application to the legislation

Spearman (2013:02) and Robertson (2013:15) warn that it is necessary for taxpayers to understand the anti-avoidance rules, in order to ensure that all connected party transactions are justifiable.

Canadian-based corporations are required to file form T106 to report transactions with related non-residents in terms of section 233(1) of the Canadian ITA. Taxpayers are required to file a tax return with the Canada Revenue Agency (CRA) where a total market

value of reportable transactions with all related non-residents exceeds (CAD) 1 million, (which is approximately ZAR 9.5 million) (PWC, 2013:307).

In terms of the Program Report (2012-2013) issued by the CRA, the taxpayer should make a self-assessment of tax on transactions between related non-residents, to prove that transactions were entered at arm's length. This program is referred to as an Advance Pricing Agreement (APA). The APA provides that the taxpayer and the tax authority agree on the best transfer-pricing method to determine the arm's length price (Oguttu, 2006:400).

In summary, the Canadian thin capitalisation rules relate to partnerships, trust and non-resident that are related to Canadian corporates. The thin capitalisation rules apply to members of the Canadian corporates that own 25% or more of equity shares or voting rights as contained in section 18(4) to section 18(8) of the Canadian ITA. Taxpayers are only required to file form T106 where transactions between related non-residents exceed ZAR 9.5 million.

4.3.4 Case laws

The CRA has adopted an industry-based audit approach (to capture taxpayers that are thinly capitalised) by employing the tax service officers, who are experts in specific industries such as the automotive, pharmaceutical, banking, oil and gas industries (PWC, 2013: 317).

The debt-to-equity ratio test limitation adopted in Canada was evident in the *Speciality Manufacturing Ltd v The Queen* (1990) court case. The court denied an interest deduction of \$948 665 for the years of assessment 1984 to 1987 with respect to interest paid to two *Speciality Manufacturing Ltd* American affiliates. The taxpayer argued that paragraph 1 of Article IV of the 1942 Canada-United States of America Treaty superseded the application of the currently revised section 18(4) of the Canadian ITA. Article IV of the 1942 Canada-United States of America Treaty allows the Canadian enterprise, to include in its taxable income any amount that has been diverted to a United States enterprise subject to the applicable measures of the appeal. That is to state that the Canadian enterprise can deduct payments in respect of interest paid to the United States of America's affiliates on the grounds that the taxpayer notifies the CRA that interest

payments are on an arm's length basis. The court found that the interest charged on the loan to the United States of America's affiliates was at an arm's length rate, but argued that the capital structure of the taxpayer violated the limitation debt-to-equity ratio of 3:1 (currently it is 1.5:1).

From this court case it is deduced that taxpayers can transact on an arm's length basis, but fail to meet the required ratio limitation, as set out in the Canadian ITA. Perhaps the decision in this court case motivated the Advisory Panel to reduce the debt-to-equity ratio to 1.5:1, matching it with that of the United States of America.

In agreement with the recommendations set out by the Advisory Panel, the CRA extended the scope of the application of thin capitalisation rules to trusts and partnerships. In the *Wildenberg Holdings Ltd v Minister of Revenue* (1999) case, it was found that the non-resident member entered into what appears to be a partnership agreement to utilise the provisions of section 96(1) of the Canadian ITA, which permits the partnership to compute its taxable income as if it was a separate person. The highlights of the *Wildenberg Holdings Ltd v Minister of Revenue* case are as follows:

A German resident, who owned 50% shares, made a loan of a total amount \$ 1 200 000 to the taxpayer and another Canadian resident corporate. The taxpayer submitted that borrowing from a non-resident to finance the business operations of the partnership between *Wildenberg Holdings* and another Canadian resident corporation did not fall under the ambit of section 18(4) of the Canadian ITA limitations. The Minister of Revenue rejected the submission on the grounds that the debt offered was a debt to the taxpayer and other Canadian resident corporate and not debt to the partnership, considering that the German resident owned 50% shares in each corporate.

The next section will provide an illustrative example of how to calculate the arm's length debt and interest in order to understand how the Canadian tax authorities determine the arm's length position of a thinly capitalised entity.

4.3.5 Calculations

As stated in the section above the debt-to-equity ratio was 2:1, which was replaced by a 1.5:1 debt-to-equity ratio from years on or after March 2013. The following is an example

of how Canada determines thinly capitalised entities under the current (after March 2013) and the previous (before March 2013) legislation (Grant Thornton adjusted, 2012:03-04).

Canco is a Canadian-resident corporation, wholly-owned by USco, a US resident corporation. Canco has borrowed \$15 000 000 from USco, subject to interest at 5% per year, to help finance its manufacturing operations. Interest amount payable is \$750 000 (\$15 000 000). On 31 December 2013, Canco’s year-end, all of this debt was still outstanding. Canco has no other outstanding debts to specified non-residents. Example will be illustrated from the current and previous legislation.

Pre-March 2013

Canco’s equity, under the previous (2:1 debt-to-equity ratio) thin capitalisation rules is \$5 000 000 (\$15 000 000 × 1÷3). The disallowed amount would be \$250 000 as calculated below.

$$\frac{\$15\,000\,000 - (2 \times \$5\,000\,000)}{\$15\,000\,000} \times \$750\,000$$

Post-March 2013

Canco’s equity, under the current (1.5:1 debt-to-equity ratio) thin capitalisation rules is \$6 000 000 (\$15 000 000 × 1÷2.5). The disallowed amount would be \$375 000 as calculated below.

$$\frac{\$15\,000\,000 - (1.5 \times \$5\,000\,000)}{\$15\,000\,000} \times \$750\,000$$

Under the current rules, the disallowed interest would be treated as a dividend for withholding tax purposes, subject to a rate of 5% of the Canadian-US tax treaty.

4.3.6 Conclusion

The CRA has shown initiative in combatting debt shifting behaviour by MNEs. Perhaps the employment of stricter thin capitalisation rules, as recommended by the Advisory Panel, might bring the taxpayer and the authorities to common ground. Farrar and Mawani (2008:18) studied 3 715 firms in Canada, which has 64 industries. The result was

that only the real estate industry has a debt-to-equity ratio in excess of 2:1 (Farrar & Mawani, 2008:18).

The results prove that the Canadian taxpayers are cautious in using internal debt as a vehicle for shifting profits to lower tax jurisdiction. Thus, it can be concluded that a fairer ratio should be industry based, as this will enable the taxpayer to access their thin capitalisation position based on the comparable industry. If such a comparable industry does not exist, the taxpayer should be motivated to file an APA as prescribed by section 233(1) of the Canadian ITA.

The next section of this chapter discusses the enforcement of thin capitalisation legislation in the United Kingdom. The reason for selecting the United Kingdom is that, the United Kingdom applies the arm's length approach, which is a similar approach adopted by South Africa.

4.4 THE UNITED KINGDOM

4.4.1 Background to the legislation

The United Kingdom introduced thin capitalisation rules in 1990 and since inception the rules have been amended at least three times, between 1994 and 2004 (Von Brocke & Perez, 2009:29). In 2010 Her Majesty's Revenue & Customs ("HMRC"-the tax authority in the United Kingdom) replaced Schedule 28AA ICTA of 1988 (which dealt with interpreting transfer pricing transactions) with "Taxation International and Other Provisions Act) 2010 Part 4.

According to Webber (2010:695), the United Kingdom enforcement rules on thin capitalisation are inefficient, hence the numerous changes over the years. Van Saporoea (2009:03) agrees, stating that the frequent changes suggest that it has been difficult for the United Kingdom to craft these rules successfully. An interesting fact, though, is that the United Kingdom thin capitalisation rules apply to transactions among the United Kingdom enterprises and not only between the United Kingdom and non-United Kingdom enterprises ("TIOPA", Part 4).

The United Kingdom relies on the arm's length principle to regulate excessive interest deductions, according to the International Manual 541010 ("INTM"- An introduction to thin

capitalisation). The provisions contained in INTM 541010 state that “in tax terms a United Kingdom company (which may be part of a group) may be said to be thinly capitalised when it has excessive debt in relation to its arm’s length borrowing capacity, leading to the possibility of excessive interest deductions.” Therefore, it is required of the United Kingdom enterprise to ascertain that the amount of debt being borrowed could and would have been borrowed, had there been an independent relationship between the lender and the borrower (INTM 541020). The United Kingdom rules (INTM 541020) emphasise that, to follow the arm’s length principle, it is necessary to hypothesise that the borrower is a separate entity from the group. This is in accordance with Article 9 par 1.6 of the OECD guidelines.

In establishing the arm’s length borrowing capacity of the United Kingdom company (or a group of companies), section 147 of the TIOPA should be followed. Section 147 of the TIOPA states that, “if provisions made or imposed between related parties which differ from what would have been made between independent parties, and such parties incur a profit or a loss, the parties should calculate taxable income as if the transaction followed an arm’s length provision instead of the actual provision”. Section 152 of TIOPA requires that all factors should be taken into account when comparing the actual provision to the arm’s length provision. The required factors include (TIOPA):

- i. “the question whether the loan would have been made at all in the absence of the special relationship,
- ii. the amount which the loan would have been in the absence of the special relationship and
- iii. The rate of interest and other terms which would have been agreed in the absence of the special relationship”.

According to Webber (2010:694), there is insufficient guidance concerning how much debt violates the arm’s length principle and further reiterates that such uncertainty for taxpayers will lead to costly litigation. Mattson (2010:53), on the other hand, is of the opinion that United Kingdom arm’s length principle excludes characteristics of determining arm’s length interest.

To clear the uncertainty perceived to be faced by taxpayers, the HMRC has introduced what is said to be the “worldwide debt cap” (WWDC) legislation in 2010. The legislation targets larger business and excludes enterprises such as the small-and-medium sized corporations, as contained under Part 7 (Tax Treatment of financing costs and income) of TIOPA. Small-and-medium sized corporations are those groups, where at least one member has 250 or more employees, an annual turnover of £50 million or annual balance sheets of £43 million or more (Jervis *et al.*, 2010:20).

Part 7 of the TIOPA requires the taxpayer to perform what is called a “gateway test”. The gateway test is prepared by comparing the "United Kingdom net debt" (broadly financing liabilities minus financing assets of relevant group companies) and the "worldwide gross debt" (the external financing liabilities of the worldwide group). That is, a United Kingdom based corporate should compare its net debt to the multinational enterprise’s net debt. If it is found that the United Kingdom net debt exceeds 75% of the worldwide gross debt, the WWDC rules will apply. This will potentially lead to a disallowance of interest expenses (Part 7 of the TIOPA). If the WWDC applies (that is the United Kingdom net debt exceeds worldwide gross debt), its effect must be determined by calculating and comparing two key figures: the "test expense amount" and the "available amount":

- The test expense amount is the sum of the net internal and external financing expenses of the United Kingdom based companies, and
- The available amount is the net external finance expense of the worldwide group from consolidated accounts (Part 7 of TIOPA).

If the test amount exceeds the available amount, the difference is then disallowed in terms Part 7 of the TIOPA. It can be said that the gateway test applies by comparing the net debt of the United Kingdom companies to the total external net debt of the United Kingdom group. If it is found that the United Kingdom companies’ finance expenses exceeds the United Kingdom group external finance expense by at least 75%, then Part 7 TIOPA rules will disallow interest payments, based on the condition that the United Kingdom company has an annual turnover of £50 million or more. Accordingly, the “gateway test” will not apply if the finance expense amount is below the threshold of 75% and the turnover is less than £50 million.

4.4.2 Application to the legislation

HMRC introduced the advance thin capitalisation agreement (“ATCA”) in 2007 to provide certainty in relation to financing transactions by the United Kingdom companies (PWC, 2013:810). The ATCA guidance is contained in the Statement Practice 01/12, which was issued in February 2012. This guidance states that situations suitable for ATCAs include, but are not limited to, the following (Statement Practice 01/12):

- i. “Arrangements which have a significant commercial impact on an enterprise's results;
- ii. Where an arrangement would be unlikely to be regarded as "low risk" by HMRC;
- iii. Where the arm's length nature of a transaction is a matter of doubt”.

According to Baker and McKenzie (2012:02), the ATCA gives clarity of the deductibility on interest and the overall tax charge of the United Kingdom companies. Thus, the guidelines will assist the United Kingdom taxpayer to assess its thin capitalisation position and, if uncertainty arises, the taxpayer is encouraged to file an ATCA. As mentioned above, to the extent that the test amount exceeds the available amount, the United Kingdom members of the group are denied a deduction for the intra-group financing costs of the United Kingdom members of the group, given that the debt exceeds 75% of the interest of the worldwide group (Part 7 of the TIOPA). The group is encouraged to file a return that allocates the differences in the test amount and the available amount, in order to apply the arm’s length test.

4.4.3 Case laws

The United Kingdom thin capitalisation rules were challenged in the European Court of Justice (“ECJ”) in the Test Claimants in the thin cap Group Litigation v Commissioner of Inland Revenue (2007).

The case that was selected involved a United Kingdom resident company which was at least 75% owned by a non-resident parent company and has been granted a loan, either by that parent company or by another non-resident company. Details of the ECJ case 524/04, March 13, 2007, will be discussed.

The ECJ Test Claimants case, involves loans granted to a United Kingdom resident based company, by a company established in another country. The two companies belonged to the same group of companies and the parent company, which is the lender, is established in another country.

Some of the claimant companies converted part of those loans to equity. Due to the conversion, the claimant companies concluded an agreement with the HMRC as to how that legislation should be applied in such conditions, laying down the terms upon which the tax authorities would assess loans to be granted within the group of companies in future years. The claimants brought refunds for the consequential tax disadvantages which they claim to have suffered as a result of the application of the United Kingdom legislation, which include, in particular, the additional corporate tax paid following the decision of the HMRC to disallow interest paid as a deduction against their taxable profits, and the additional tax arising as a result of those companies having converted loans to equity.

The Advocate noted that the thin capitalisation legislation (prior to its amendment in 1998) applied to loans granted by a non-resident company to a resident subsidiary of which the former company owned 75% capita (ECJ case 524/04). Accordingly, the tax legislation targeted only relations within a group of companies, which primarily affects freedom of establishment and should be considered in terms of Article 43 EC Treaty (ECJ case 524/04).

Brocke and Perez (2009:31) agree in stating that “the United Kingdom owned enterprises had an advantage over internationally owned businesses”. As such the ECJ determined that the thin capitalisation rules contravened the freedom of establishment in terms of Article 43 of the EC Treaty (ECJ case 524/04).

4.4.4 Calculations

Part 7 of the TIOPA requires the United Kingdom corporate to determine the thin capitalisation position by computing a test expense amount and the available amount comparison. The following is an example of the calculation (Adopted WWDC, 2010:04):

Group United Kingdom has a corporation, Company A, which has the following finance expense from United Kingdom based corporations: Loan from group Company B £3 000,

loan from Company C £1 000 and finance lease payments of £2 000. The total interest expense is £6 000. Company A further has finance income of £2 000. Therefore the net test amount will be £4 000 (£6 000-£2 000). Members of Group United Kingdom include Company D located in France with an external finance expense of £2 500, and finance income of £150, and Company E, located in the United States of America, with an external finance expense of £3 000 and finance income of £1 000. The available amount is £4 350 (£2 500+£3 000-£150-£1 000). To the extent that the tested amount exceeds the available amount, it will be considered as the disallowed interest expense. In this case, the available amount is greater than the test amount; therefore no adjustment is required in terms of Part 7 of TIOPA.

4.4.5 Conclusion

The United Kingdom thin capitalisation regime has been changed numerous times and it may be challenging for the United Kingdom taxpayers and their foreign counterparts to keep up with the current rules. However, the current change, that introduced the gateway test, seems to be a more reliable and objective test that both the taxpayer and the HRMC can apply. Furthermore, a United Kingdom based corporation is encouraged to file an ATCA in situations where the arm's length nature of a transaction is in doubt. Thus, Part 7 of the TIOPA provides the taxpayer with proper guidance in determining the arm's length debt.

The next section will discuss the background legislation of the United States of America and the application of the thin capitalisation legislation. The reason for including the United States of America in the study is because it has a corporate tax rate of 39.1%, being the highest in the world (Buettner *et al.*, 2012:932 & Saez *et al.*, 2012:03).

4.5 THE UNITED STATES OF AMERICA

4.5.1 Background to the legislation

United States of America thin capitalisation rules were introduced as early as 1989, when section 163(j) (Interest) was enacted into the Internal Revenue Code of 1986 (IRC) (Webber, 2010:690). Thin capitalisation rules are known as the earning stripping limitation rules and apply to all corporations, excluding small corporations. A small corporation is a

domestic corporation, which has no more than 75% shareholders as individuals, estates, certain trusts and exempt organisations (Luttrell 2002:59).

Section 163(j)(2) of the IRC of 1986 applies when:

- (A) (ii) “the ratio of debt to equity of such corporation as of the close of such taxable year (or on any other day during the taxable year as the Secretary may by regulations prescribe) exceeds 1.5:1,
- (B) there is "excess interest expense", which means the excess (if any) of:
 - (i) the corporation's net interest expense,
 - (ii) over the sum of 50% of the adjusted taxable income of the corporation plus any excess limitation carry forward under the clause”.

Thus, when condition “A” of section 163(j) (2) is met and the interest is greater than 50% of the adjusted taxable income (EBITDA), then that interest portion above 50% will be disallowed. Accordingly, both condition “A” and “B” have to be met in order to limit the interest deduction. From the above it can be perceived that the ratio approach acts as a benchmark of interest limitation, followed by an arm’s length approach, which measures the level of the disallowed portion of interest.

For the purpose of section 163(j), the disallowed interest may be carried forward for a maximum period of three years (Department of Treasury, 2007:09). An exception to the above rule is that if a corporation’s debt-to-equity ratio does not exceed 1.5:1, then the corporation may deduct the “disqualified interest” in terms of section 163(j). A comprehensive example on how the disqualified interest works is stated below. For the purpose of section 163(j) of IRC, the disqualified interest is:

- “any interest paid or accrued by the taxpayer (directly or indirectly) to a related person if no tax is imposed by this subtitle with respect to such interest,
- any interest paid or accrued by the taxpayer with respect to any indebtedness to a person who is not a related person,
- any interest paid or accrued (directly or indirectly) by a taxable Real Estate Investment Trust (“REIT”) subsidiary (as defined in section 856)”.

Therefore, the interest that meets the definition of a disqualified interest may be deducted, on condition that the debt-to-equity ratio does not exceed the safe harbour of 1.5:1.

In 2004, Congress passed the American Jobs Creation Act of 2004 (“AJCA”), in response to a study conducted by the Secretary of Treasury in relation to the earnings stripping rules, and the effectiveness of these rules in preventing the shifting of income outside the United States of America (Department of Treasury, 2007:02). The study found that MNEs that have headquarters in the United States of America, shifts their headquarter corporations to countries with low tax rates, thereby entering into an inversion transaction (Department of Treasury, 2007:02).

According to the Department of Treasury (2007:03), an inversion is “a transaction through which the corporate structure of a United States-based multinational corporation is altered so that a new foreign corporation, typically located in a low-or-no tax country, replaces the existing United States parent corporation as the parent of the corporate group”. Consequently, when the transactions are completed, the foreign operations of the corporation are generally outside the United States of America taxation jurisdiction (Department of Treasury, 2007:03).

To address the corporate inversion, the United States of America tax authorities introduced in the IRC, section 7874, which primarily deals with these types of corporations. Section 7874 of IRC provides for certain tax consequences for inversion transactions. It provides that:

- i. “where there has been significant continuity of ownership before and after the transaction and if there is at least 60% continuity of ownership between the old United States parent corporation and the new foreign parent corporation, section 7874 of the IRC limits the ability to use tax attributes to offset any benefits resulting from the transaction,
- ii. If there is at least 80% continuity of ownership between the old United States parent corporation and the new foreign parent corporation, section 7874 of the IRC treats the new foreign parent corporation as a domestic corporation for income tax purposes”.

Section 7874 of the IRC only applies to transactions after 4 March 2003, and so corporations that inverted before that time are unaffected. Therefore, it can be said that,

if the former shareholders of the domestic corporation establish a corporation outside the United States and owns at least 60% shares, but not more than 80%, such corporation will be treated as a foreign enterprise. But if, the former shareholder formulates a corporate outside the United States of America and owns at least 80% of shares, such enterprise will be treated as a domestic corporation for tax purposes.

Shifting the headquarters of a corporation into a low-or-no tax jurisdiction can be seen as another method United States of America firms use to avoid high tax corporate charges. Seida and Wempe (2004:824) agree, stating that, by shifting corporate headquarters to lower tax jurisdiction, corporates reduce the effective tax rates.

4.5.2 Application to the legislation

In 2009 the Internal Revenue Service (IRS) released form 8926 (Disqualified Corporate Interest Expense under Section 163(j) and Related Information), which deals with the computation of a taxpayer's corporate tax and determination of the taxpayer debt-to-equity ratio and the adjusted taxable income (IRS Bulletin, 2007:50). Taxpayers could also use form 8926 to calculate the amount of interest that is disallowed in terms of section 163(j) (Department of Treasury, 2011:01).

A study by Desai, Foley and Hines (2004), which focused on 3,680 multinational enterprises in the United States of America, showed that firms increased debt in response to high tax rates. Desai, Foley and Hines (2004:2462) state that: "affiliates in high-tax countries generally make use of debt to finance their operations, as compared to affiliates located in low-tax countries".

Blouin *et al.* (2012:06) performed an extended analysis of the study of Desai, Foley and Hines (2004), to investigate the impact of taxation on the capital structure of United States of America multinational enterprises. Blouin *et al.* (2012:06) found that a 10% higher tax rate increases debt-to-asset ratio by 1.9%. Furthermore, their findings showed that, in the absence of thin capitalisation rules the debt-to-asset ratio will increase by 2.7%, while it is only 1.2% when thin capitalisation rules apply (Blouin *et al.*, 2012:06). It may be concluded that internal debt is used by MNEs with affiliates located in low tax countries as a vehicle to shift profits, although tax effects are minimal (Blouin *et al.*, 2012:07). The

United States of America thus stands a high chance of losing its share of revenue due to profit shifting by MNEs.

The study by Seida and Wempe (2004:816) analysed four firms and found that at least three out of the four firms had a debt-to-equity ratio of less than 1.5:1. They concluded that it is possible to strip all earnings from the United States of America as long as the debt-to-equity ratio does not exceed the benchmark (Seida & Wempe, 2004:816).

Therefore, it can be concluded that there is a direct relationship between high corporate taxes and debt in relation to the United States of America and that the higher the corporate taxes the bigger the possibility that MNEs will enter into inversion transactions. Thus, if MNEs seeks to reduce tax, it must first calculate how much debt it wants from a foreign affiliate and then calculate how much equity should be invested to meet the debt-to-equity limitations, as long as the ratio does not exceed the 1.5:1 safe harbour.

4.5.3 Case law

In the *Laidlaw Transportation Inc. v CIR TC Memo 1998-232*, the court found that the MNE structure was created solely to gain tax advantage through interest tax deductions under section 163 of the IRC. *Laidlaw Transportation Inc.*, a Canadian based corporation, gained entry to the United States of America market by forming a structural group which involved the creation of three subsidiaries, a Canadian-based subsidiary, a Netherlands-based subsidiary and a United States of America-based subsidiary.

The Canadian parent had 100% ownership in the subsidiary based in Canada and the Canadian subsidiary had 100% ownership of the Netherlands subsidiary. Furthermore, the Canadian parent wholly owned the United States of America -based corporate. In order to expand the business operations in the United States of America, the parent borrowed \$1 billion from a Canadian bank and on-lent the money to the Netherland subsidiary.

The Netherland subsidiary lent the money to the United States of America-based corporate, which meant that the United States of America corporate can deduct \$133 500 000 in interest payments in terms of section 163 of IRC. The loan agreement included fixed maturity dates, fixed interest rates and guarantees and also a balloon payment. The court found that the United States of America-based corporate never paid the principal

amount owing to the Netherlands-based corporation. The IRS challenged the loan from the Netherlands and disallowed \$133 500 000 million of the interest deduction. The court agreed with the IRS and proved that the debt-to-equity ratio of the United States of America-based corporate was higher (at 2.5:1) compared to those of competitors. According to the court, this suggests that the United States of America-based corporate was unable to secure a loan equal to the amount obtained from the Netherlands corporate. The court favoured the IRS decision for disallowing interest deduction in terms of section 163(j) of the IRC.

Therefore, in establishing whether or not the loan obtained from related parties is within arm's length, the courts will consider the debt-to-equity ratio of the taxpayer, comparing it to the debt-to-equity ratios of competitors. This will indicate whether or not debt received from a related party could have been granted by independent parties.

4.5.4 Calculations

The following is an example of the statutory rules of section 163(j) of the IRC. Source: The Joint Committee Report (2011:20-21)

Company X, a corporation established in country A, wholly owns Co.US, a corporation in the United States of America. Company X investment in Co.US equity amounts to \$6 500 000. In addition, Co.US has borrowed \$8 000 000 from Company X and \$5 000 000 from Bank, an unrelated bank.

In 2010, Co.US first year of operation, Co. US adjusted taxable income is \$1 000 000 (none of which is from interest income). It also pays \$400 000 of interest to Company X and \$300 000 of interest to the unrelated bank. Under the United States of America-income tax treaty, Country A owes no tax to the United States of America on the interest payments made by Co.US to Company X.

Co.US has a 2:1 debt-to-equity ratio (total borrowings of \$13 000 000 (\$8 000 000 + \$5 000 000) and total equity of \$6 500 000, accordingly, Co.US deduction interest paid of \$700 000 (\$400 000 + \$300 000) may be limited. Therefore, Co.US disqualified interest is \$400 000 (the amount of interest paid to a related party on which no Federal income tax is imposed). Co.US excessive interest expense is \$200 000 (\$700 000 - (\$1 000 000 x 50%)). Accordingly, Co.US may deduct only \$500 000 (\$700 000 - \$200 000) of the

interest expense in the 2010 year of assessment. The \$200 000 excessive interest expense may be carried forward and deducted in the subsequent tax year.

4.5.5 Conclusion

It has been over two decades since the United States of America has initiated thin capitalisation rules and the concern is whether the IRS has effectively archived their objectives in mitigating tactics used by multinationals from entering into transactions that are not within arm's length. Whilst the United States of America's debt-to-equity ratio is lower, compared to other countries, this does not necessarily demonstrate that the rules are effective in restricting corporates from shifting profits into a low tax jurisdiction.

United States of America applies the fixed ratio and the arm's length principle in preventing excessive interest deductions, contained in section 163(j) of the IRC. This study established that the provisions of section 163(j) of the IRC can only apply firstly, when the debt-to-equity ratio exceeds 1.5:1; secondly, the rules apply when the excessive interest payments from the total debt of related and non-related party exceeds 50% of the taxable income.

The next section will focus on South Africa's thin capitalisation legislation. The background to the legislation will be analysed, as well as the application of the legislation with reference to the Act.

4.6 SOUTH AFRICA

4.6.1 Background to the legislation

4.6.1.1 Thin capitalisation provisions before July 1995

Prior to 1995, transfer prices were regulated by the Exchange Controls Regulations of the South African Reserve Bank (SARB, 2001:01). The aim of the regulations was to prevent MNEs from transferring profits out of South Africa to lower tax jurisdictions (Practice Note 7 of the Act). The Exchange Controls Regulations were repealed after the democratic elections to attract foreign investment (Manyaka, 2010:15).

As part of the reformation into the Income Tax Act, the Minister of Finance, Trevor Manuel, appointed a Commission of Inquiry led by Professor Michael M. Katz (the Katz

Commission), to transform the South African tax system used by the previous government (Minister of Finance, 2002:03). The Katz Commission recommended in the first and second report into certain aspects of the Tax Structures of South Africa that the Income Tax Act should contain provisions of transfer pricing (Practice Note 2 of the Act). Accordingly, section 31 of the Act was introduced into the legislation in July 1995 as per the Katz Commission of Inquiry recommendations (Practice Note 2 of the Act).

4.6.1.2 Thin capitalisation provisions after July 1995 and before April 2012

Section 31 of the Act was then introduced with two sets of tax rules namely transfer pricing and thin capitalisation. Section 31 of the Act was divided into four subsections and the provisions of thin capitalisation were contained under section 31(3) of the Act. However, section 31(3) of the Act did not contain “thin capitalisation” wording reference. The main purpose of section 31(3) of the Act was to allow the Commissioner to limit the deductibility of excessive interest (Practice Note 2 of the Act). The previous section 31(3) of the Act reads as follows:

(3)(a) Where any person who is not a resident (investor) has granted financial assistance whether directly or indirectly, to—

- a) any connected person in relation to the investor who is a resident; or
- b) any other person which is a resident and that investor owns not less than 25% of the capital of the non- resident,

and the Commissioner is of the opinion that the value of the financial assistance granted by the investor is excessive in relation to the fixed capital of such a South African connected person, then, any interest payable in relation to the financial assistance shall be disallowed as a deduction.

According to section 31(3) of the Act, financial assistance granted indirectly, refers to, any financial assistance granted by any third person who is not a connected person in relation to the investor.

A transaction is subject to section 31(3) of the Act when it meets the following conditions:

- a) A non-resident should grant financial assistance to a resident directly/indirectly.

- b) The financial assistance granted should be between connected persons.
- c) The non-resident should own at least 25% of the voting rights of the receipt of the financial assistance.
- d) The Commissioner will, in relation to the capital structure of the resident, determine the acceptable amount of the financial assistance.
- e) Financial assistance includes indirect funding from third parties in relation to the connected person.

These conditions set out by section 31(3) of the Act, are now analysed.

a) A non-resident should grant financial assistance to a resident directly/indirectly

Transactions are subject to section 31(3) of the Act when there is financial assistance from a non-resident. It is important to note that the provisions of section 31(3) of the Act will not apply where the financial assistance is granted by a resident to another resident person. Therefore, for the purpose of section 31(3) of the Act, it is important to determine the meaning of the terms “financial assistance” and “non-resident”. The Act defines financial assistance as: “a loan, advance or debt and the provision of any security or guarantee”. Section 31(3) of the Act defines a non-resident as “a natural person not ordinarily resident in the Republic or a person other than a natural person managed or controlled outside the Republic”.

b) The financial assistance granted should be between connected persons

Section 31(3) of the Act is applicable when the financial assistance is granted between connected persons. Therefore, section 1 of the Act paragraph (d) defines connected persons in relation to a company as:

“(d) In relation to a company-

- (i) its holding company, as defined in section 1 of the Companies Act, 1973 (Act 61 of 1973);

its subsidiary as so defined;

(ii) any other company where both such companies are subsidiaries (as so defined) of the same holding company;

(iii) any person, other than a company as defined in section 1 of the Companies Act, 1973 (Act 61 of 1973), who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20 per cent of the company's equity share capital or voting rights;

(iv) any other company, if at least 20 per cent of the equity share capital of such company is held by such other company and no shareholder holds the majority voting rights of such company;

(v) (vA) any other company if such other company is managed or controlled by-

(aa) any person who or which is a connected person in relation to such company;
or

(bb) any person who or which is a connected person in relation to a person contemplated in item (aa); and

(vi) where such company is a close corporation-

(aa) any member;

(bb) any relative of such member or any trust which is a connected person in relation to such member; and

(cc) any other close corporation or company which is a connected person in relation to

(i) any member contemplated in item (aa); or

(ii) the relative or trust contemplated in item (bb)."

c) The non-resident should own at least 25% of the voting rights of the receipt of the financial assistance

Section 31(3) of the Act to apply the financial assistance received should be from a non-resident who is a connected person and owns at least 25% of the voting rights of the resident. Thus, in cases where the non-resident owns less than 25% voting rights of the residents, the provisions of section 31(3) of the Act will not apply.

d) The Commissioner will, in relation to the capital structure of the resident person determine the acceptable amount of financial assistance

The Commissioner was empowered in terms of section 31(3) of the Act to establish the amount that is considered to be an excessive interest amount. The Commissioner used Practice Note 2 of the Act (currently repealed) to calculate the arm's length price (interest) in the determination of an excessive amount of the financial assistance granted by the non-resident. According to Practice Note 2 of the Act, the Commissioner would apply section 31(3) of the Act where the debt-to-equity ratio of the financial assistance exceeded 3:1. Thus the first step that the Commissioner would undertake is to establish that the financial assistance offered by the non-resident connected person exceeds three times the fixed capital of the resident. The approach was adopted from the Exchange Control Regulations to ensure consistency in the application of legislation (Practice Note 2 of the Act). The second step undertaken by the Commissioner would be to apportion the interest of the financial assistance claimed as a deduction between an acceptable amount and an excessive amount (Practice Note 2 of the Act). The following is the formula in terms of Practice Note 2 of the Act, which the Commissioner used to determine the excessive interest:

$$\frac{A - B \times (C - D)}{C}$$

- (i) "A": represents the disallowable interest, limited to interest incurred during such year in respect of financial assistance granted on or after 19 July 1995;
- (ii) "B": represents the total interest incurred during such year in respect of all financial assistance, contemplated in subsection (3), in existence during such year (whether or not such financial assistance was granted before, on or after 19 July 1995);

(iii) "C": represents the weighted average of all interest-bearing financial assistance which was in existence during such year (whether or not such financial assistance was granted before, on or after 19 July 1995); and

(iv) "D": represents the greater of-

- a) three times the fixed capital of the resident or recipient as at the end of the relevant year of assessment; and
- b) the weighted average of all interest-bearing financial assistance granted prior to 19 July 1995, which existed during such year".

Paragraph 2.2 of Practice Note 2 of the Act considers an interest rate of South African prime rate, plus 2%, to be an acceptable annual interest rate. Therefore an interest rate that exceeds prime plus 2% will be disallowed in terms of section 31(3) of the Act.

e) Financial assistance includes indirect funding from third parties in relation to the connected person

In the application of section 31(3)(b) of the Act, the term "indirect funding" refers to back-to-back arrangements through independent parties or co-investors. This is in the case where a foreign parent company makes a loan to a South African bank or a foreign bank and the condition is that the bank lends the funds to the South African subsidiary. The arrangement will be treated as financial assistance in terms of section 31(3) of the Act.

Figure 4.1 is an illustration of how the previous section 31(3) of the Act applied.

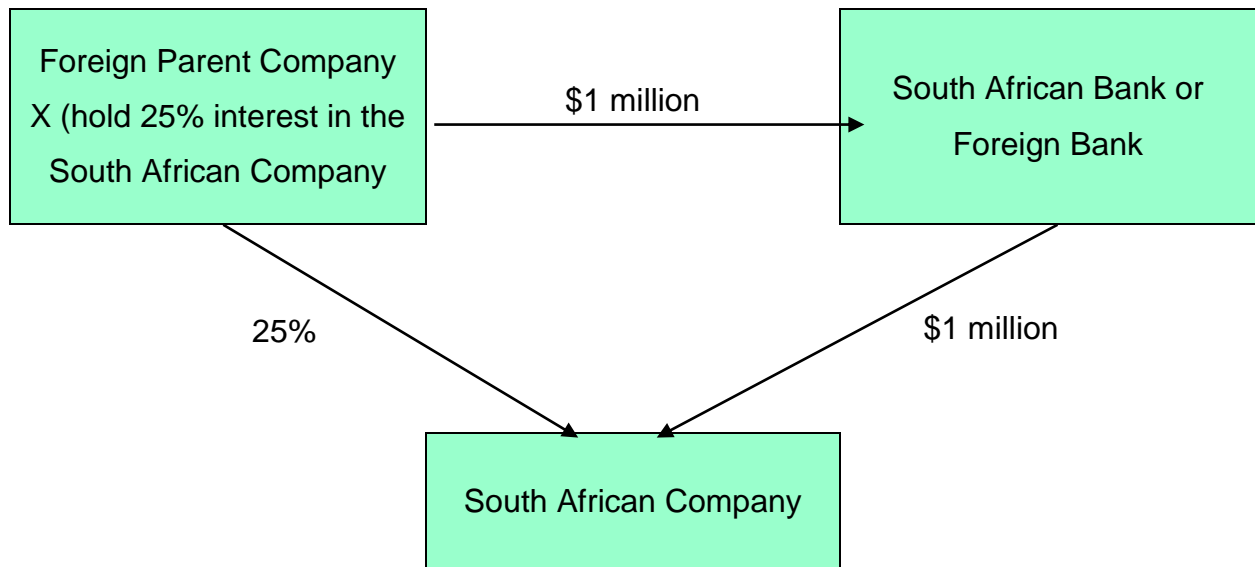


Figure 4.1: An illustration of the previous section 31(3) of the Act

Source: Own Research

From the analysis above it can be said that section 31(3) of the Act applies where a non-resident grants financial assistance to a resident in whom the non-resident owns at least 25% of the shares. Moreover, the financial assistance granted by the non-resident should exceed three times the fixed capital of the resident, in order for the provisions of section 31(3) of the Act to apply.

As from April 2012, the thin capitalisation rules will no longer be dealt with by a separate section 31(3) of the Act, but it is governed by the general transfer pricing provisions under section 31(2) of the Act, as contained in the Draft Interpretation Note issued by South African Revenue Service (Taxation Laws Amendment Act No.24 of 2011). The next section will analyse the relevant updates and changes to section 31(3) of the Act after April 2012.

4.6.1.3 Thin capitalisation provisions after April 2012

Section 31 of the Act was further amended, effective from 1 April 2012. The amendment constituted a restructuring of section 31 of the Act, with the primary aim of determining international transactions on an arm's length principle (Section 31(1) of the Act). A discussion of the arm's length principle was explained in Chapter 2 of this study.

Practice Note 2 of the Act is withdrawn effective from 1 April 2012 and replaced by a Draft Interpretation Note (SARS, 2012:04). The Draft Interpretation Note is used as a guide to

apply the current section 31 of the Act (SARS, 2012:04). Notwithstanding the change in the wording of the provisions of section 31 of the Act, the major change of section 31(3) of the Act is that the taxpayer must determine the acceptable amount of debt on an arm's length basis (SARS, 2012:04). The onus is thus shifted to the South African taxpayer to establish the arm's length debt and apportion the interest deduction between an acceptable amount and an excessive amount.

This part of the study will focus on discussing section 31(1) to section 31(3) of the Act in detail, because these subsections are more relevant to the study. This part of the study will further, highlight the important facts contained under section 31(4) to section 31(6) of the Act. Section 31(1) of the Act provides that:

“(1) for the purposes of this section—

“Affected transaction” means any transaction, operation, scheme, agreement or understanding where—

(a) That transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both—

(i) (aa) a person that is a resident; and

(bb) any other person that is not a resident;

(ii) (aa) a person that is not a resident; and

(bb) any other person that is not a resident that has a permanent establishment in the Republic to which the transaction, operation, scheme, agreement or understanding relates;

(iii) (aa) a person that is a resident; and

(bb) any other person that is a resident that has a permanent establishment outside the Republic to which the transaction, operation, scheme, agreement or understanding relates; or

(iv) (aa) a person that is not a resident; and

(bb) any other person that is a controlled foreign company in relation to any resident and those persons are connected persons in relation to one another; and

(b) any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length".

"Financial assistance" includes the provision of any—

(a) Debt; or

(b) Security or guarantee.

Section 31(1) of the Act applies when there is an affected transaction and there is financial assistance. The term financial assistance is similar to the previous section 31 of the Act and the term "affected transaction" has been inserted in section 31 of the Act. Section 31(1) of the Act and the term "affected transaction" will be analysed below.

(a) Section 31(1) of the Act

In order for section 31(1) of the Act to apply, there has to be a transaction, scheme, operation, or understanding between connected persons. With the current amended section 31 of the Act a connected person does not have to be a non-resident, it can be a resident person in terms of paragraph (a) (i) of section 31(1) of the Act. In terms of section 31(1) of the Act the affected transaction refers to the total amount of debt and not debt from a non-resident connected person, as it was previously in section 31 of the Act. The definition of a connected person has slightly changed effective from 1 November 2012. Connected person (section 1 of the Act) therefore means, in relation to a company-

(d) "(i) any other company that would be part of the same group of companies as that company if the expression "at least 70 per cent of the equity shares of" in paragraphs (a) and (b) of the definition of "group of companies" in this section were replaced by the expression "more than 50 per cent of the equity shares of or voting rights in; (ii & iii have been deleted).

(iv) any person, other than a company, as defined in section 1 of the Companies Act, 2008 (Act No. 71 of 2008), who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20 per cent of—

(aa) the equity shares in the company; or

(bb) the voting rights in the company”.

The current definition of connected person requires that at least more than 50% of equity shares should be owned by the company within the same group, in order to qualify as a “connected person”. A transaction is subject to section 31(1) of the Act, when the terms and conditions differ from those that independent parties would undertake in an arm’s length agreement. The concern with section 31(1) of the Act, is that it does not address the situation where there may not be independent persons dealing within the arm’s length basis of an affected transaction. For example the taxpayer cannot justify a transaction, operation or understanding between connected persons when there are no comparable markets.

Furthermore, the definition of an affected transaction is a mirror image of section 80L of the Act, which deals with impermissible tax avoidance arrangements. Section 80L of the Act defines the term arrangement as “any transaction, operation, scheme, agreement, or understanding, whether enforceable or not, including all steps herein or parts thereof, and includes any of the foregoing involving the alienation of property”.

It is clear from the definition of section 80L of the Act that the legislature crafted the thin capitalisation rules in a manner that covers any arrangement that will result in MNEs avoiding tax by shifting profits to low tax jurisdiction.

Section 31(1) (ii) (bb) of the Act speaks of a permanent establishment and section 31(1) (iv) (bb) of the Act mentions the words “controlled foreign company”. The term permanent establishment was adopted from Article 5 of the OECD Model Tax Convention. It refers to: “a fixed place of business through which the business of an enterprise is wholly partly carried on” (OECD Model Tax Convention, 2003:08). This means that a resident or non-resident in a MNE can grant financial assistance to a non-resident subsidiary of that MNE, with the sole intent that the funds should be transferred through to its South African permanent established subsidiary. Then such financial assistance is seen as an affected

transaction and the provisions of section 31 of the Act will apply. Accordingly, when applying the provisions set out in section 31 of the Act, the South African permanent established subsidiary will be treated as a separate enterprise (SARS, 2012:13).

The definition of controlled foreign company (CFC) is contained under section 9D of the Act. It refers to a foreign company where more than 50% of the participation rights or voting rights in the foreign company are directly or indirectly owned by South African residents. For instance, a financial assistance is granted by a non-resident company to a South African subsidiary, in which the South African resident/s owns at least 51% participation or voting rights, then such assistance will fall within the ambit of an affected transaction.

Section 31(2) of the Act provides that:

”(2)Where—

- a) any transaction, operation, scheme, agreement or understanding constitutes an affected transaction; and
- b) any term or condition of that transaction, operation, scheme, agreement or understanding—
 - (i) is a term or condition contemplated in paragraph (b) of the definition of ‘affected transaction’; and
 - (ii) results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding,

the taxable income or tax payable by any person contemplated in paragraph (b)(ii) that derives a tax benefit contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm’s length”.

The issue addressed in section 31(2) of the Act is that the affected transaction should be adjusted in terms and conditions that would have existed between independent parties transacting on an arm’s length basis. An analysis of section 31(2) of the Act follows next.

(b) Affected transaction adjusted in terms of the arm's length basis

Section 31(2) of the Act does not explicitly address the basis of the arm's length, but provides that the taxpayer entering into a transaction, scheme, or understanding should calculate the taxable income using the terms and conditions of an independent party as a guide concerning the arm's length basis. The concern is how the taxpayer could calculate the taxable income in cases where comparable independent party transaction does not exist, in other words, where the taxpayer does not have competitors in the market.

Section 31(3) of the Act provides that:

“To the extent that there is a difference between—

- a) any amount that is, after taking subsection (2) into account, applied in the calculation of the taxable income of any resident that is a party to an affected transaction; and
- b) any amount that would, but for subsection (2), have been applied in the calculation of the taxable income of the resident contemplated in paragraph (a), the amount of that difference must, for purposes of subsection (2), be deemed to be a loan that constitutes an affected transaction.”

Section 31(3) of the Act will be analysed next in the context of the deemed loan amount.

(c) Deemed loan of an affected transaction (before amendment from 1 January 2015)

Section 31(3) of the Act provides that, where there is a difference in an amount of any resident and the amount is applied as an arm's length amount, that difference must be deemed as a loan. Thus to state that, the amount applied by the connected persons should be adjusted in a manner that reflects the arm's length amount and any difference between the applied amount and the arm's length amount should be deemed as a loan when calculating the taxable income. That is, the Act expects the taxpayer to self-assess the thin capitalisation position.

This is in accordance with the provisions of section 102 of the Tax Administration Act 28 of 2011, which places the burden of proof on the taxpayer to prove that a receipt is capital or revenue in nature in order for the receipt to be taxable. Therefore, the taxpayer should consider whether the affected transaction derived a tax benefit and if that is the case, then the taxpayer should recalculate the taxable income by structuring that tax benefit as a loan to a resident/non-resident that granted the financial assistance. The recalculation of the tax benefit is known as a secondary tax adjustment and the disallowed interest is known as a primary transfer pricing adjustment in terms of the Draft Interpretation Note (SARS, 2012:10) and an example of how to compute the adjustment is provided later in the chapter.

Section 31(4) provides that the provisions of section 31(2) of the Act will apply with respect to the granting of any financial assistance. Thus, where there is any financial assistance received by a resident from any other person, the provisions set out in section 31(2) of the Act will apply.

Section 31(5) of the Act provides that: "the provisions of section 31 of the Act will not apply to so much of that financial assistance which is directly applied to any foreign company in which the headquarter company directly or indirectly holds at least 10% of the equity shares and voting rights, where the financial assistance is provided by a non-resident". This will apply in instances where a non-resident connected person lends money to a headquarter company and in return the headquarter company on-lends to the foreign company. The loan amount from the non-resident loan will be subject to the provisions of section 31(5) of the Act, but limited to 10% of the total amount contributed to the headquarter company.

Section 31(6) of the Act provides that:

"Section 31 will not apply to the calculation of taxable income or tax payable of a resident (other than a headquarter company) in respect of any amount received or accrued to a resident from any transaction, operation, scheme, agreement or understanding that comprises, amongst others, the granting of financial assistance to a CFC in relation to the resident, if:

- “the resident (alone or together with a company in the same group of companies) owns at least 10 per cent of the equity shares and voting rights in the controlled foreign company;
- that controlled foreign company has a foreign business establishment as defined in section 9D(1); and
- the aggregate amount of tax payable by the controlled foreign company to all spheres of government of a foreign country in respect of a particular tax year is at least 75 per cent of the amount of tax that would have been payable in respect of the CFC’s taxable”.

From the above analysis of the current section 31 of the Act it is understood that the taxpayer is required to validate that the debt, which meets the definition of an affected transaction, is at an arm’s length. Similar to the case in the United Kingdom, the Commissioner places the onus on the taxpayer to self-assess the arm’s length debt from both the lender’s perspective and the borrower’s perspective

Table 4.3 illustrates the change in the amendment, formulation and comparison of thin capitalisation regime in South Africa (before 1 January 2015):

Table 4.3: Thin capitalisation regime:

14 May 1996	1 April 2012
Implementation of Practice Note 2 of the Act	Replacement of Practice Note 2 of the Act with the Draft Interpretation Note
Amendment of the thin capitalisation regime:	
Commissioner determines the arm’s length debt	Taxpayer determines the arm’s length debt
The formulation of thin capitalisation rules:	
<ul style="list-style-type: none"> • Automatic disallowance • Objective rules 	<ul style="list-style-type: none"> • Discretionary application • Subjective rules

Comparison of the wording of the previous and current section 31 of the Act	
<ul style="list-style-type: none"> Financial assistance should be granted by a non-resident connected person 	<ul style="list-style-type: none"> Financial assistance should be granted by a non-resident or a resident connected person

Source: Own Research

Table 4.3 shows the differences in the amendment, formulation and comparison of the thin capitalisation regime.

According to Joubert (2014:01), the application of section 31 of the Act requires the taxpayer to establish the leverage position in relation to the industry before obtaining an intercompany loan.

The next section of the study will focus on the amendment of section 31(3) after 01 January 2015.

Section 31(3) was amended from 1 January 2015 by replacing section 31(3)(b) with the following:

b) “any amount that would, but for subsection (2), have been applied in the calculation of the taxable income of the resident contemplated in paragraph (a),

the amount of that difference must, if that person is a resident and the other person to the affected transaction is a person as contemplated in paragraph (a) (i) (bb) or (a) (iii) (bb) of the definition of “affected transaction”-

i) if that resident is a company, be deemed to be a dividend consisting of a distribution of an asset in specie declared and paid by that resident to that other person; or

ii) if that resident is a person other than a company, be deemed, for purposes of Part V, to be donation made by that resident to that other person,

on the last day of the period of six months following the end of the year of assessment in respect of which that adjustment is made:

Provided that where the amount of that difference was prior to 1 January 2015 deemed to be a loan that constitutes an affected transaction, so much of that loan as has not been repaid before 1 January 2015 must –

- a) if that resident is a company, be deemed to be a dividend consisting of a distribution of an asset in specie that was declared and paid by that resident to that other person; or
- b) if that resident is a person other than a company, be deemed, for purpose of Part V, to be a donation made by that resident to that other person, on 1 January 2015.

Thus to state that the deemed loan in section 31(3)(c) (prior to 1 January 2015) will now be treated as a dividend in specie and will be subject to dividend tax in the case of companies. Therefore South African companies will be subject to dividend withholding tax at a rate of 15% in terms of section 64EA of the ITA. According to BDO (2014:01) the move from a deemed loan to a dividend is more practical and easy to administer, as a deemed loan is never repaid in practice and there are no contractual obligations in place to make the repayments. The South African Institute of Tax Professional (2015:03) disagrees stating that, the amendment of section 31 precedes the year-end normal tax calculation for companies. The South African Institute of Tax Professional (2015:03) added that companies may have issues with compliance, because normal tax returns associated with the differentials (deemed loan now deemed dividend) is only due 12 months after year end, whilst the new rule arises 6 months after year.

4.6.2 Application of the legislation (From 1 April 2012 to before 1 January 2015)

In order to comply with the legislation, the taxpayer should demonstrate that the debt borrowed could have been borrowed from a commercial point of view, if it was borrowed from an independent lender. Spearman (2013:02) and Robertson (2013:15) warn that it is necessary for the taxpayer to understand the anti-avoidance rules in order to ensure that all connected party transactions are justifiable.

To determine whether or not the interest and the debt are within an arm's length range the taxpayer is requested to perform a functional and comparability analysis, as set out in the Draft Interpretation Note (SARS, 2012:07). The functional analysis and comparability analysis were discussed in chapter 3 of the present study in relation to the

arm's length principle; a few points relating to the application of the arm's length debt and interest, as contained in the Draft Interpretation Note, will be highlighted in this section.

(a) Determining the arm's length debt

The South African taxpayer is required to perform a functional analysis to demonstrate to the Commissioner that the debt from an affected transaction is within arm's length (SARS, 2012:07). The taxpayer is encouraged to use the financial ratios of comparable industries to support the appropriateness of the arm's length debt (SARS, 2012:07 & National Treasury, 2013:06). According to the Draft Interpretation Note of the Act (SARS, 2012:09), the appropriate financial ratios that the taxpayer can use are the debt-to-equity ratio, debt-to-EBITDA ratio and the interest cover ratio.

(b) Determining the arm's length interest

In terms of the Draft Interpretation Note (SARS, 2012:09), the taxpayers credit rating or scorecard model from third party lenders may be used by the taxpayer to justify the arm's length interest rate. The South African Revenue Service does not currently have a third-party database to assist in analysing the appropriateness of comparable data and the arm's length amount of debt (SARS, 2012:08). Without this database it may be challenging for the taxpayer and tax authorities to prove that the amount of debt could and would have been borrowed at an arm's length rate.

Badenhorst (2013:08) explains that the practical application of the arm's length principle to financial assistance is likely to be difficult, as third party financial providers consider many issues before offering financial assistance. Badenhorst (2013:08) states that the analysis of the arm's length amount is a subjective matter rather than an objective one. Wellsted (2013:41) agrees stressing that the revenue authorities may attempt to second-guess genuine business decisions made by taxpayers in assessing what constitutes an arm's length debt.

While it is clear that the Interpretation Note is only a draft, there seems to be uncertainty surrounding the practical application of the arm's length amount from the revenue authorities' side. However, the draft is an indication of how section 31 of the Act will be interpreted. In addition to this, the Draft Interpretation Note (SARS, 2012:11) denotes that the South African Revenue Service will use a risk-based approach in selecting enterprises

that are thinly capitalised, by considering the debt-to-EBITDA ratio and debt-to-equity ratio of an enterprise that is greater than 3:1. The ratio is merely used as an indicator by the revenue authorities to scrutinise taxpayers that may be thinly capitalised. The South African Revenue Service (SARS, 2012:12) will consider a debt denominated in rand to be a higher risk, if the interest rate of an inbound loan is:

- Exceeding the weighted average of the South African Johannesburg Interbank Agreed Rate, plus 2%.
- Exceeding the weighted average of the base rate of the country of denomination, plus 2%.

The South African Revenue Service will use the debt-to-EBITDA ratio and the debt-to-equity ratio in excess of 3:1, and interest on an inbound loan that exceeds the weighted average base rate plus 2%, to test entities that are thinly capitalised, because the South African Revenue Service do not have a database that will assist in establishing the arm's length debt. This is supported by the issuing of the new ITR14 form that requests the taxpayer to provide the debt-to-equity ratio, debt-to-EBITDA ratio and the interest cover ratio.

The South African Revenue Service has issued a new return form, ITR14 that companies should file, replacing the former IT14 form, effective from 1 May 2013. The form is electronically generated and displays questions relevant to pre- and post-section 31 of the Act. In the "Information to create this income tax return", the ITR14 return displays two questions:

- 1) Did the company enter into an affected transaction, as set out in section 31, where the company incurred foreign expenditure?
- 2) Did the company enter into an affected transaction, as defined in section 31 where the company received/earned foreign income?

If "yes" is answered then the company should answer the following supporting questions:

- "Does the company have transfer pricing documentation that supports the pricing policy applied to each transaction between the company and the foreign connected person during the year of assessment as being at arm's length?"

- Did the company conduct any outbound transaction, operation, scheme, agreement for no consideration with a connected person that is taxed outside South Africa?
- Did the company transact with a connected person that is a tax resident in a tax haven/low tax jurisdiction?
- Did the company make a year-end adjustment to achieve a guaranteed profit margin?"

The ITR14 form requests the taxpayer to calculate the fixed capital ratio (debt-to-equity ratio), in terms of Practice Note 2 of the Act, for the years of assessment before 1 April 2012. And for years after 1 April 2012, the companies are requested to calculate the debt-to-EBITDA ratio and the interest cover ratio.

The calculation of ratios may be a challenging tool that a taxpayer can use to prove to the revenue authority that debt borrowed from a related party is within arm's length, given that the ratio will differ in all aspects for every company within the same industry. Perhaps, in the event of an audit, the taxpayer will be able to justify transactions between related parties by performing both the functional and comparability analysis, as stated in the Draft Interpretation Note.

Therefore, it can be said that a test that a taxpayer can provide to the tax authority, to prove that a transaction meeting the definition of an affected transaction was within an arm's length, is the debt-to-equity ratio and the debt-to-EBITDA ratio. In relation to the calculation of the interest cover ratio, the repealed Practice Note 2 and the Draft Interpretation Note suggest that an arm's length interest should not be higher than the weighted average base rate, plus 2% of the JIBAR rate for South Africa inbound loans and should not exceed the weighted average base rate plus 2% of the foreign country inbound loans.

As from 01 January 2015 all deemed loans and interest under section 31(3) will now have transitional adjustments and become deemed dividends (Taxation Law Amendment Act 2014:93).

4.6.3 Case law

There are no current tax cases in South Africa on the subject of thin capitalisation. The reason seems to be that South African entities are cautious about changes within the tax

legislature, to avoid litigation that will lead to high penalties and interest payments. Another reason may be that the Commissioner is reluctant to pursue entities that appear to be thinly capitalised, because of costs involved in pursuing internationally based parent corporates with a subsidiary located in South Africa.

Even though there is no tax court cases in South Africa dealing with thin capitalisation, it is necessary to analyse the available tax cases dealing with excessive interest deductions, under the provisions of section 11(a) of the Act, and the general anti-avoidance tax case under the repealed section 103 of the Act (replaced by section 80A to section 80L of Part IIA of the Act).

4.6.3.1 Tax court case under section 11(a) of the Act

In the ITC 1530 54 SATC 261 the Commissioner for Inland Revenue disallowed a portion of interest payments by the taxpayer to its holding company. The issue in this case was that interest expense paid was considered excessive and not in the production of income. The holding company charged the subsidiary an interest of 29,25% interest rate per annum. The court held that:

- a) “[T]he Commissioner for Inland Revenue is entitled to disallow expenditure to the extent to which it is excessive on the ground that the expenditure was not actually incurred in the production of the income as required by s 11(a) of the Income Tax Act 58 of 1962 or was not wholly or exclusively laid out or expended for the purposes of trade as required by s 23(g) of the Act, but was inspired by some other motive – the principle having been applied in relation to interest paid on loans that was considered to be excessive and not in the production of income.
- b) That it is clear that the question of excessive expenditure is to be considered in the context of the particular circumstances of the case and not *in vacuo* – factors to be considered in determining whether the interest paid was excessive include, for example, the relationship between the lender and the borrower, the terms of the loan and whether there was an ulterior motive in the levying of interest or a higher rate of interest.

- c) That in all the circumstances of the case the interest rate of 29,25 per cent paid by the appellant to its holding company in the year of assessment in question was an excessive rate of interest.
- d) That the acceptance of 21 to 22 per cent as a reasonable rate of interest by the Commissioner for Inland Revenue was possibly generous in its allowance of a premium to the appellant and its holding company – but it is not possible for the court to accurately determine a reasonable rate and to do so in fractions of a per cent.
- e) That, therefore, a deduction of interest at the rate of 22 per cent on the loan in question from the appellant’s holding company is allowed”.

It became evident in this tax case that the determination of an appropriate interest rate was a challenge for the Commissioner and that the Commissioner considered the relationship of the borrower and the lender before reaching a judgement. In the context of the current section 31 of the Act, this is a functional analysis because the terms and conditions of the contract (interest rate) between connected persons were used to determine the arm’s length interest.

In ITC 1762 66 SATC 41, the court found that the taxpayer entered into a so-called management buyout agreement. The arrangement bore indications of fraudulent conduct. The Commissioner of Inland Services disallowed an interest deduction of the R53 million debts that the taxpayer claimed was debt used to purchase the business of M. The court found that the taxpayer was dishonest and created the false impression that the purchase price was paid, but all that was paid was an interest of R80 million. The court dismissed the appeal on the basis that the purchase price of the business was not a genuine purchase price and therefore the interest could not be deducted in terms of section 11(a) read together with section 23(g) of the Act.

4.6.3.2 Tax court case under section 103 of the Act

In the recent tax court case of CSARS v NWK Ltd (October 2010), the Commissioner argued that the taxpayer entered into what seemed to be simulation contracts and that the taxpayer is not entitled to claim interest deductions on the amount that was not actually borrowed.

NWK Ltd claimed deductions from income tax in respect of interest paid on a loan to it by Slab Trading Company (Pty) Ltd (“Slab”), a subsidiary of First National Bank (“FNB”), for the sum of R96 415 776. NWK is a public company which formerly operated as a co-operative society trading in maize. In terms of the contract between Slab and NWK the capital amount would be repaid by delivering maize to Slab at the end of the five periods. The interest, as per the contract, was 15.41% per annum. Slab sold its rights to take delivery of maize at the end of the 5 year period to First Derivatives.

New assessments were issued disallowing the interest that was previously deducted. The Commissioner imposed additional tax and interest of R47 360 583. According to the Commissioner, the loan was not a genuine contract, but a series of transactions entered into between NWK and FNB and its subsidiaries, all designed to disguise the true nature of the transaction between NWK and FNB, with the intention of NWK avoiding or reducing its liability for tax.

In response, NWK contended that the contracts concluded between the parties were performed in accordance with their terms. The following reasons were given:

- 1) “NWK received the amount of R96 million in terms of the loan agreement and delivered the promissory notes to Slab;
- 2) NWK paid the price of the maize to First Derivatives in terms of the forward sale agreement;
- 3) NWK was not party to the agreements between Slab and FNB; and
- 4) There was no unexpressed agreement on the part of NWK that was not recorded in the contracts to which it was party”.

The Tax Court found in favour of NWK on the basis that it was clear that NWK and FNB at all times intended to fulfil all the contractual terms agreed upon.

4.6.4 Calculations

The Draft Interpretation Note (SARS, 2012:09) gives guidance on how to compute an arm’s length debt and interest, by stating that if a company has entered into an affected transaction, and the actual terms and conditions of the debt are not those that would have

been agreed to, then the taxpayer is requested to calculate both the primary and the secondary pricing adjustment. According to the Draft Interpretation Note (SARS, 2012:16) the excessive interest on an affected transaction must be disallowed in computing the taxable income, thereby effecting a primary adjustment. The disallowed interest portion shall be a deemed loan and this will require the taxpayer to calculate a secondary adjustment. to account for interest income at an arm's length amount.

The following serves as an example to indicate the arm's length principle on an affected transaction (SARS, 2012:11 adjusted):

Company A, a corporation from Country X, lends its South African subsidiary R1 million on 31 December. Interest is payable at 10% per year. The subsidiary has a 30 June financial year end. The South African affiliate determines that an arm's length amount of debt is R800 000 and an arm's length interest rate is 10% per year.

4.6.5 Results

The South African affiliate must compute a primary adjustment in its tax return, by not claiming an interest deduction of R9 918 ($R200\,000 \times 10\% \times 181/365$). This will increase the taxable income by R9 918.

The excessive interest will constitute a deemed loan by the South African subsidiary to its foreign affiliate in terms of section 31(3). The South African taxpayer is required to calculate the interest income on the deemed loan at a rate of 10% and include it in its taxable income. The secondary adjustment calculation will take into consideration that the primary adjustment arose over a 6 month period (loan was granted on 31 December and subsidiary has a 30 June year-end) during the year of assessment. Interest will be capitalised annually in calculating the outstanding balance of the deemed loan. The deemed loan will be regarded as being repaid if the taxpayer can validate receipt of interest income.

The next section will look at the results of the above example, applied as from 01 January 2015.

The South African affiliate must compute a primary adjustment in its tax return, by not claiming an interest deduction of R9 918 ($R200\,000 \times 10\% \times 181/365$). This will increase

the taxable income by R9 918. Therefore, it is assumed that $R9\ 918 \times 15\% = R1\ 488$ will be the dividend that is payable to the South African Revenue Service in terms of section 64K of the ITA.

The excessive interest will constitute a deemed dividend deemed loan distributed by the South African subsidiary to its foreign affiliate in terms of section 31(3) of ITA. The South African taxpayer is required to calculate the interest income on the deemed loan at a rate of 10% and include it in its taxable income. The secondary adjustment calculation will take into consideration that the primary adjustment arose over a 6 month period (loan was granted on 31 December and subsidiary has a 30 June year-end) during the year of assessment. Interest will be capitalised annually in calculating the outstanding balance of the deemed loan. The deemed loan will be regarded as being repaid if the taxpayer can validate receipt of interest income.

4.7 CHAPTER SUMMARY

The purpose of this chapter was to address the second research objective of the study, by comparing the different approaches that other international countries have adopted in combatting thin capitalisation. Furthermore, the chapter analysed section 31 of the Act, Practice Note 2, and the Draft Interpretation Note, taking into consideration the updates and changes of section 31 of the Act.

It was established in this chapter that there are two approaches that countries can use to apply the thin capitalisation regime, namely the fixed ratio and the arm's length principle, as contained in the United Nations Double Tax Convention. South Africa has adopted the arm's length approach, effective from 1 April 2012. Furthermore, it was found that the use of the arm's length principle has deficiencies such as the implementation of the approach may be costly because it requires experts in the field to determine the characteristics of borrowing to MNEs. In addition, it was found that the selected countries taxpayers, except for Canada, find it challenging to implement or rather apply the thin capitalisation rules, as set out by the legislation.

An analysis of section 31 of the Act was performed in this chapter, specifically focusing on the wording contained in section 31 of the Act, before and after the amendments. It was established that thin capitalisation rules will no longer apply to financial assistance

granted by non-residents, but will apply where financial assistance is obtained from the resident or non-resident. This means that the arm's length approach will be based on the total debt, rather than debt only from non-residents. Thus, it was established in this chapter that the thin capitalisation position of South African entities will be based on the total debt.

The next chapter will focus on identifying the financial ratios in the financial statements that are used to determine the arm's length debt. The financial ratios will be determined per sector from McGregor BFA.

CHAPTER 5

EMPIRICAL RESEARCH FINDINGS

5.1 INTRODUCTION

The purpose of this is to present the empirical research findings. An analysis of how data was collected and the interpretation of data will be discussed in this chapter. The main aim of this study is to explore the financial ratios per sector of companies listed on the JSE, as a practical benchmark for South African entities to measure their thin capitalisation positions. The primary objective was achieved by addressing the following secondary research objectives:

- To determine the characteristics of the arm's length principle that will be applied by South African entities to establish the arm's length debt, by gathering an understanding of key concepts concerning thin capitalisation rules and the effectiveness of these rules (refer to chapter 3);
- To evaluate South Africa's taxpayers' approach to thin capitalisation by investigating the current treatment of transactions affecting thin capitalisation in the legislation and its application, and comparing it to methods adopted by other countries. This is done with the intention of exploring the different methods that are used by other countries in combating thin capitalisation (refer to chapter 4); and
- To identify financial ratios in the financial statement that are used to determine the arm's length debt (refer to chapter 5).

A discussion of how the financial ratios relevant to the study were analysed is explained in the next section.

5.2 FINANCIAL RATIOS

The findings of this study will be reported for each JSE industry sector. The average of debt-to-equity ratio from 2009 to 2012 will be reported and analysed and the debt-to-EBITDA ratio for 2013 will be presented and analysed for each category of the selected sectors of the JSE. The graphs presented in this study will report the average debt-to-equity ratio per sector, from 2009 to 2012. The average debt-to-EBITDA ratio per sector will be presented separately and not in graphs, because this is a new ratio that entities

can use to demonstrate the arm's length debt (SARS, 2013:08). The following paragraph provides a reason for using the debt-to-equity ratio as a measure of the arm's length debt:

- According to Practice Note 2 of the Act, the Commissioner was empowered to calculate the debt-to-equity ratio of a South African taxpayer. In terms of the Practice Note 2 of the Act, the taxpayer was required to maintain a 3:1 debt-to-equity ratio and, in cases where the 3:1 debt-to-equity ratio is exceeded, the taxpayer should justify the ratio to the Commissioner and the Commissioner would suggest that the ratio should be restored.

Taxpayers were given the opportunity to justify their thin capitalisation position in the cases where the debt-to-equity ratio was exceeded. The next paragraph will provide a reason for using the debt-to-EBITDA ratio:

- On 1 April 2012, Practice Note 2 of the Act was replaced by a Draft Interpretation Note. The Draft Interpretation Note (SARS, 2012:08) indicates that appropriate financial ratios such as the debt-to-equity ratio and the debt-to-EBITDA ratios can be used to determine the arm's length debt. The National Treasury (2013:06), has issued a report indicating that safe harbour of 3:1 of the debt-to-EBITDA ratio is a reasonable ratio to restrict excessive interest deductions.

Therefore, this study will use average debt-to-equity ratio from 2009-2012 and analyse the ratio using a graph. Furthermore, this study will present average debt-to-EBITDA ratio for 2013 period. The study will use average ratios, because this is a comparable industry norm ratio that the Draft Interpretation Note (SARS, 2012:08) suggests that taxpayers should use from third party databases. The study used McGregor BFA as a reliable third party database to compute these ratios.

An illustration of how data will be analysed is presented in Figure 5.1.

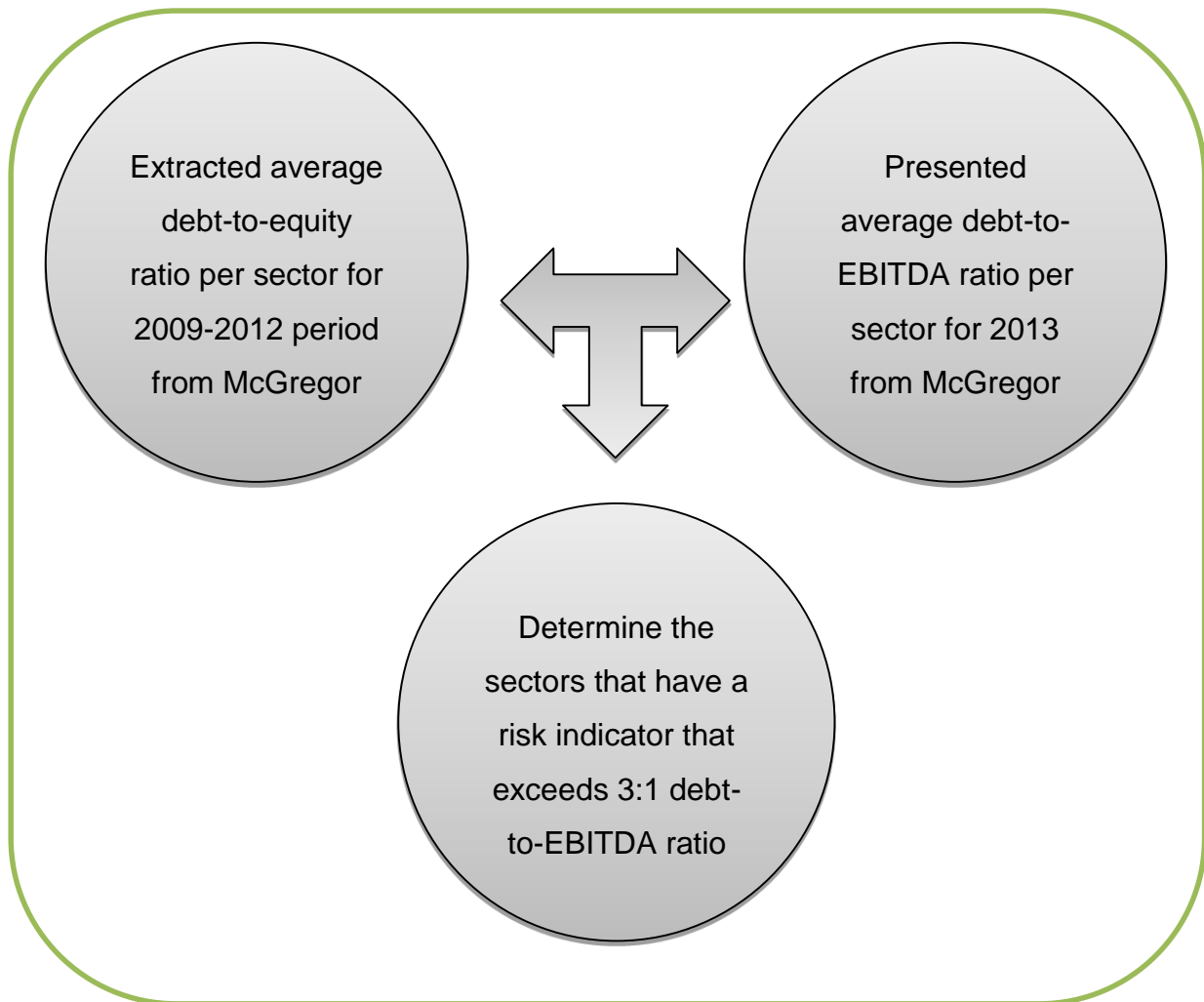


Figure 5.1: Steps in analysing average ratios per sector

Source: Own Research

5.2.1 Debt-to-equity ratio

The Commissioner of the South African Revenue Service was empowered to apply the provisions contained in the previous section 31(3) of the Act, where the debt-to-equity ratio exceeds 3:1 (Practice Note 2 of the Act). The onus was therefore on the Commissioner to establish whether the taxpayer's debt and interest was within an arm's length. It appears that the Commissioner selected such a policy because MNEs would prefer to utilise internal financing over external finance, so that they can structure their business operations in a manner that would benefit the entire MNE. A study by Gaud *et al.* (2007:203) agrees with this, stating that profitable companies prefer to increase dividends rather than decrease the level of debt and this will attract investors to the

company. According to McGregor BFA equity is calculated by adding: ordinary share capital, share premium, non-distributable reserves and distributable reserves. In addition debt is computed by adding convertible debentures, directors' and shareholders' loans, long-term non-interest bearing loans, long-term interest bearing loans and current liabilities.

5.2.2 Debt-to-EBITDA ratio

Currently, with the amended section 31 of the Act, the onus is on the taxpayer to prove their arm's length position. South African Revenue Service indicated that taxpayers with an excessive 3:1 debt-to-EBITDA ratio are at risk of being audited by the authorities. This is not a benchmark, but an indicator of taxpayers that are at risk of being audited. It appears that the tax authorities considered that the debt-to-EBITDA ratio is a performance pricing mechanism that third party lenders use to grant loans (Asquit *et al.*, 2005:107 and Demirogluand & James, 2011:778). This means that if the debt-to-EBITDA ratio of a company is considered high by third party lenders, then the interest attached to the loan will be high and, as a consequence, a high interest amount will decrease the tax liability due to the South African Revenue Service. Perhaps this logic encouraged the tax authority to amend the current section 31 of the Act, considering that MNEs will not borrow from third parties, but will use internal debt to transport profits out of South Africa into lower tax jurisdictions.

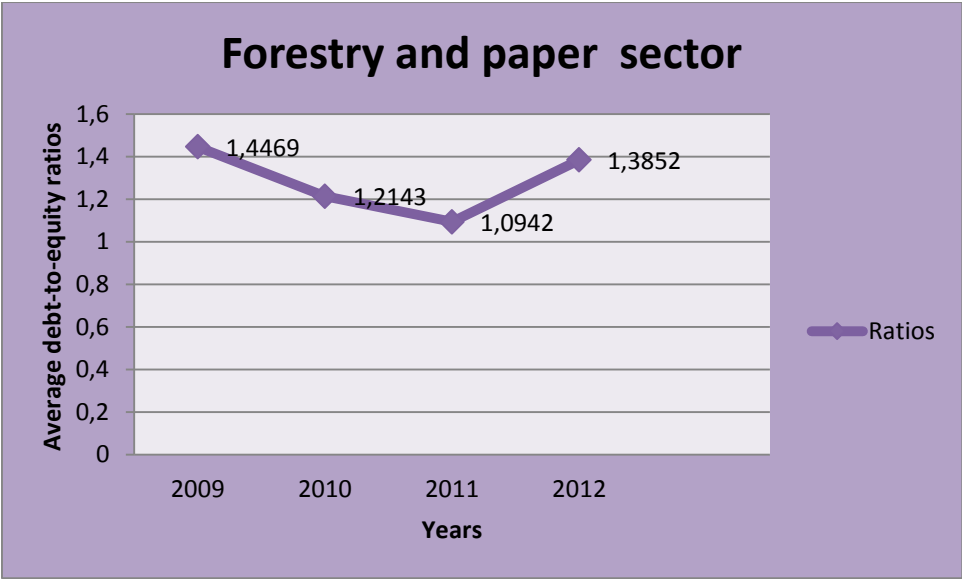
The next section will focus on the interpretation of the selected financial ratios from the sectors of the JSE as per the selected sample in chapter 2, table 2.2 of the present study.

5.3 INTERPRETATION RESULTS

5.3.1 Forestry and paper sector (Basic resources)

The forestry and paper sector maintained a good average debt-to-equity across the sector ratio from 2009-2012. The results show that the sector average debt-to-EBITDA ratio (3.9:1) is just above 3:1 risk indicator (McGregor BFA). Graph 5.1 illustrates the forestry and paper sector's average debt-to-equity.

Graph 5.1: Forestry and paper sector

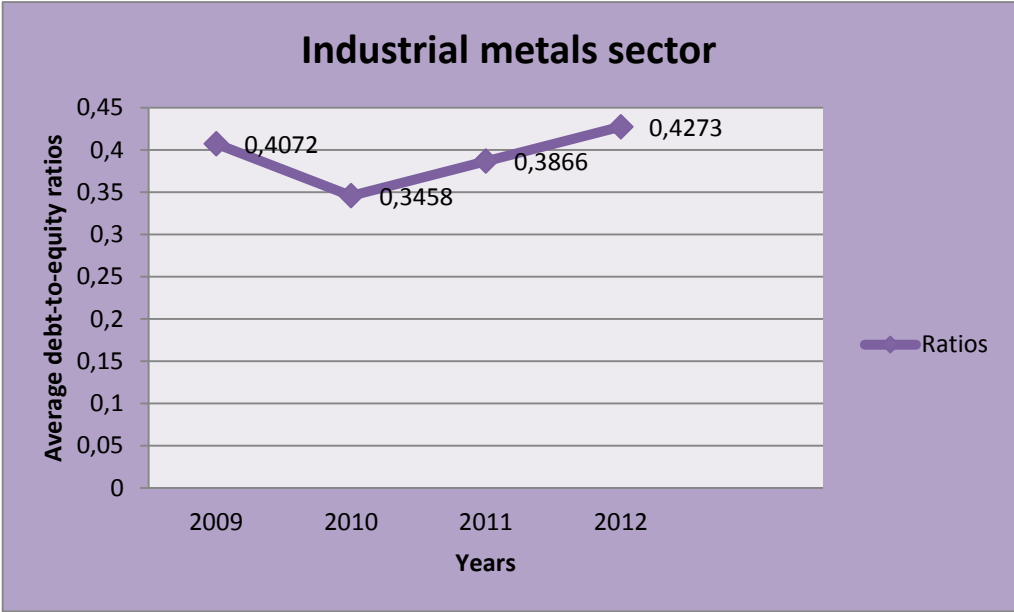


Source: Own Research

5.3.2 Industrial metals sector (Basic resources)

The industrial metals sector has maintained an average debt-to-equity ratio and debt-to-EBITDA ratio (0.7:1) of below 1:1 from 2009-2013 (McGregor BFA). Taxpayers within the industrial metals sector managed to keep the debt-EBITDA ratio below the risk indicator of 3:1. Graph 5.2 shows the average debt-to-equity ratio from 2009-2012 periods.

Graph 5.2: Industrial metals sector

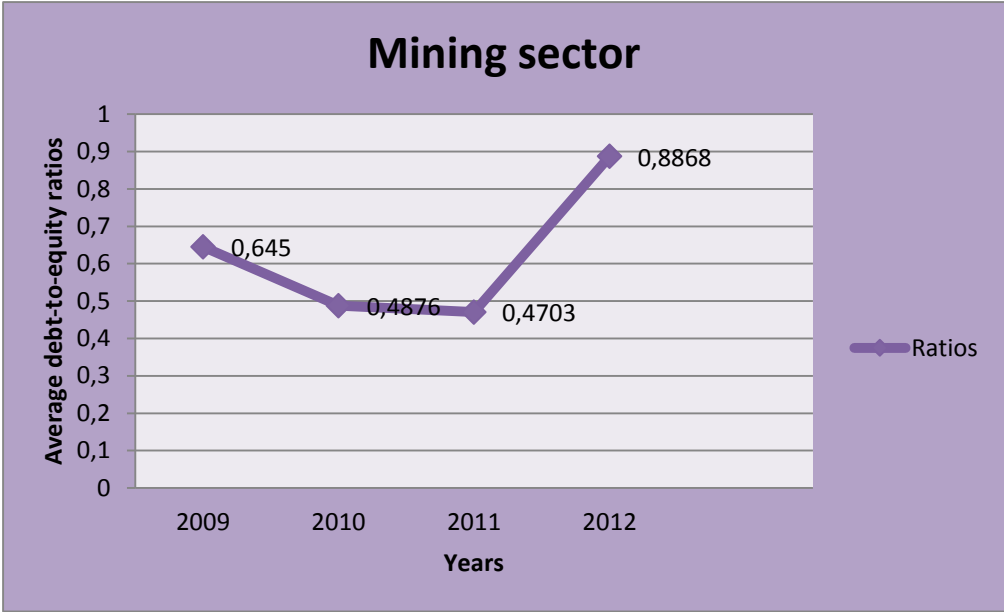


Source: Own Research

5.3.3 Mining sector (Basic resources)

Despite the lengthy strikes within the sector, the mining industry has managed to keep its average debt-to-equity ratio below 3:1 (McGregor BFA). A report issued by Standard and Poor (2012:30) revealed that the Impala Platinum debt-to-EBITDA ratio increased by 0.5 times more in 2012 compared to the previous year (2011). The report indicated that the mining sector is a capital-intensive sector; this means that the increase in the level of debt was due to purchases of mining equipment and assets. The average debt-to-EBITDA ratio is at 5.9:1, which indicated that the mining sector has more debt relative to its earnings before interest, tax, depreciation and amortisation. Graph 5.3 shows the average debt-to-equity ratio from 2009-2012 periods.

Graph 5.3: Mining sector

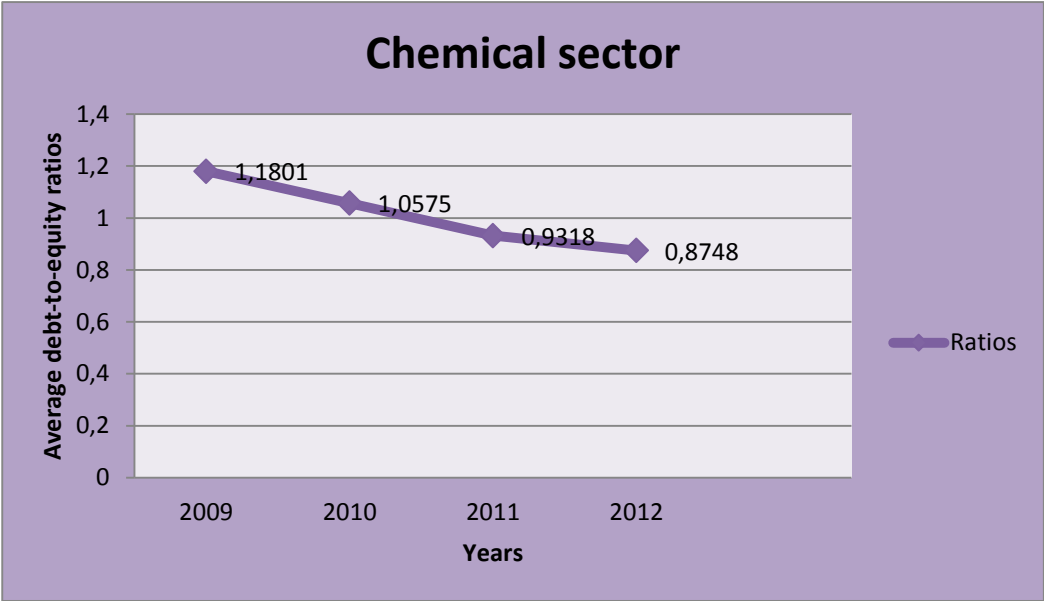


Source: Own Research

5.3.4 Chemical sector (Basic resources)

The chemical sector average debt-to-EBITDA ratio (2.9:1) for 2013 remained below the 3:1 risk indicator (McGregor BFA). This indicates that the sector has been profitable enough to cover its debt. This is confirmed by Dr Mike Booth (Engineering News, 2012:01); the information officer of the Chemical and Allied Industry Association, who stated that the sector is expected to increase by at least 4% per annum from 2012. The debt-equity ratio has also been below the 3:1 benchmark, indicating that the average capital structure is within the limitations of the previous section 31(3) of the Act. Graph 5.4 shows the average debt-to-equity ratio results of the sector.

Graph 5.4: Chemical sector



Source: Own Research

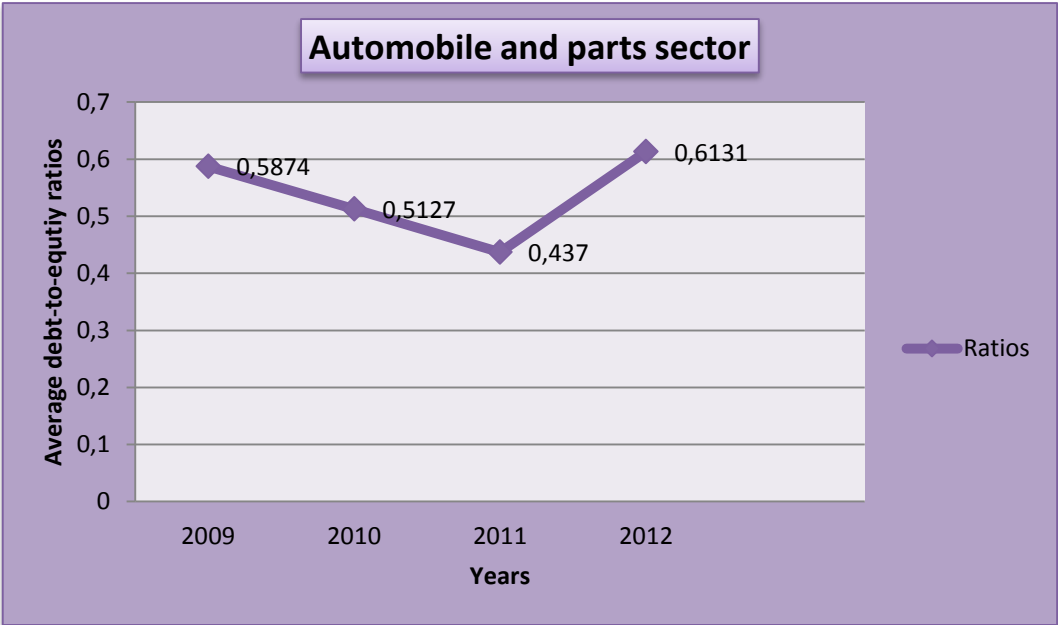
5.3.5 Automobile and parts sector (Consumer goods)

The automobile and parts sector indicates that the average debt-to-equity ratio remained stable for over the past 4 year (2009-2012) period and that the ratio was below the 3:1 benchmark (refer to graph 5.5 of the study).

However, in 2013, the results showed an average of 5:1 debt-to-EBITDA ratio (McGregor BFA). The reason is that the average industry employment figures rose by 441 jobs in the third quarter of 2013 and exports sales to Europe dropped by 12.7% (National Association of Automobile Manufactures, 2013:01). Naude and Bandenhorst-Weiss (2012:49) explained that the automobile industry is not a competitive industry, because South Africa experiences high labour costs, poor infrastructure and dated technology within the industry.

An increase in labour costs and a decrease in export sales will decrease the earnings before interest, tax, depreciation and amortisation (EBITDA). This will result in an increase in the debt-to-EBITDA ratio. Graph 5.5 shows the results of the automobile and parts sector.

Graph 5.5: Automobile and parts sector

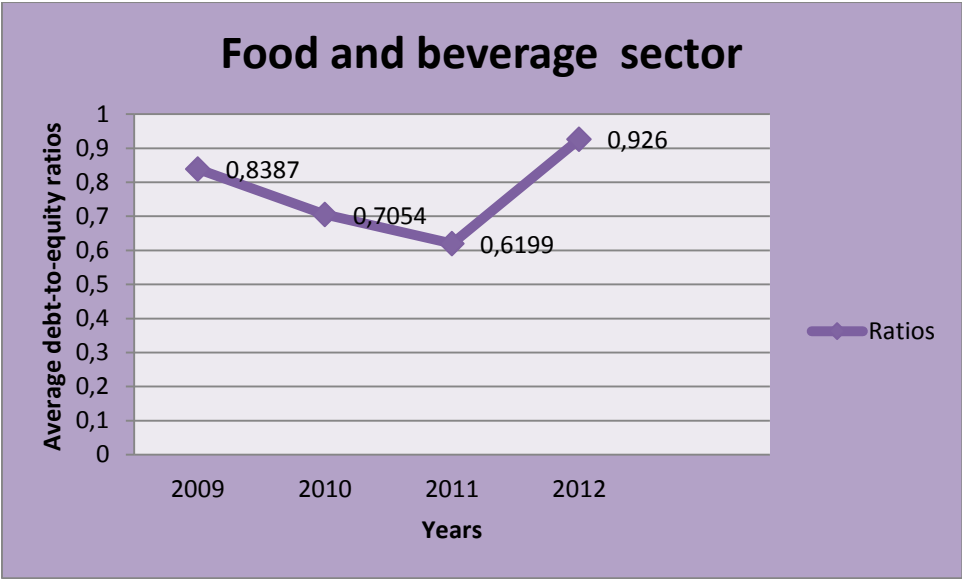


Source: Own Research

5.3.6 Food and beverage sector (Consumer goods)

The food and beverage sector maintained a healthy average debt-to-equity across the sector ratio from 2009-2012. The results show that the sector average debt-to-EBITDA ratio (3.4:1) is just above the 3:1 risk indicator (McGregor BFA). The sector contributes R41.8 billion in revenue, which is 6.7% of total government revenue (ARA, 2013:13). The Annual DTI report (2012), issued by the Industry Association for Responsible Alcohol Use, showed that the sector spans the primary, secondary and tertiary sector of the South African economy. This indicates that the primary sector provides agricultural products, such as grapes, to the secondary sector, where wine is produced and the tertiary sector markets and distributes the products nationally and internationally. Food and beverage are mainly sold on a cash to cash basis, which could be the reason why the sector has maintained a healthy average debt-to-EBITDA ratio. Graph 5.6 illustrates the average debt-to-equity of the food and beverage sector.

Graph 5.6: Food and beverage sector

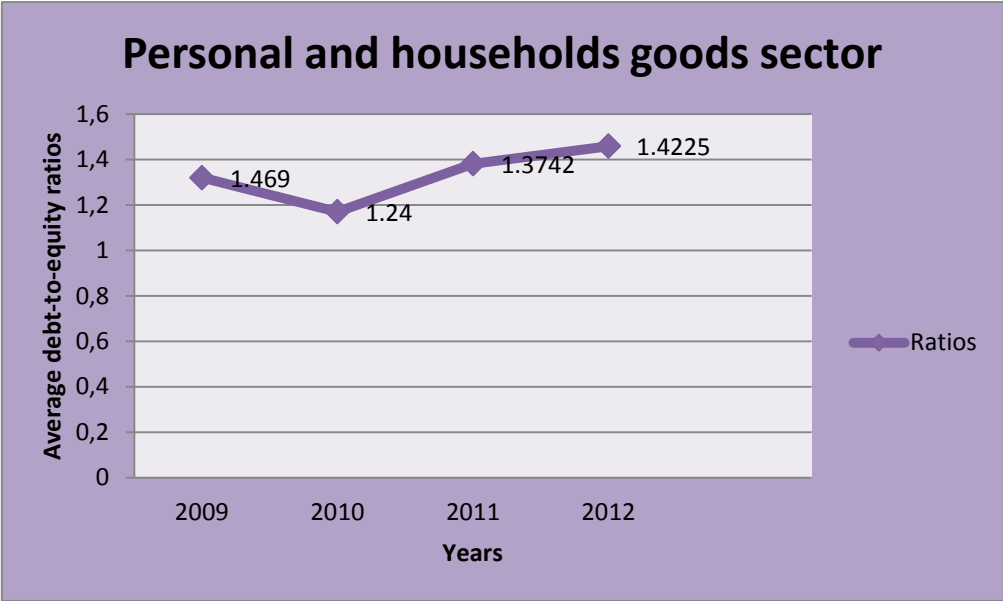


Source: Own Research

5.3.7 Personal and household goods (Consumer goods)

The average debt-to-equity ratio has been maintained for the past 4 years. The results from the McGregor BFA show the ratio is below the 3:1 benchmark set by the Commissioner of the South African Revenue Service. The average debt-to-EBITDA ratio in 2013 is at an average of 4:1, mainly because of the 0.1% increase in employment across the sector in June 2013 (Statistics S.A., 2014:13). The earnings before interest, taxation, depreciation and amortisation would decrease as a result of an increase in employment costs and this will cause the debt-to-EBITDA ratio will to be high. Graph 5.7 shows of the average debt-to-equity ratio for 2009-2012 periods.

Graph 5.7: Personal and households goods sector



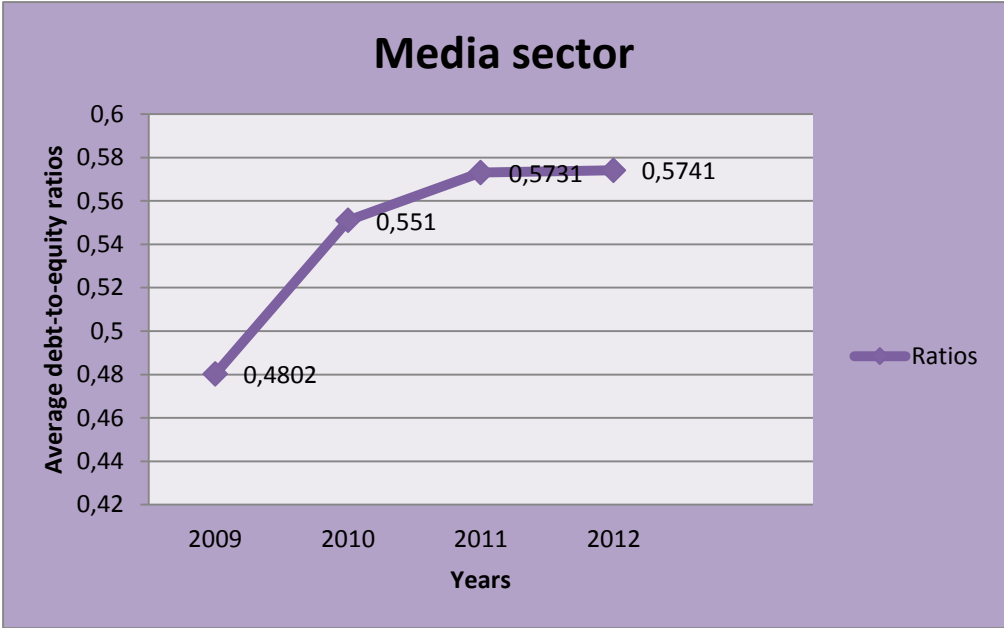
Source: Own Research

5.3.8 Media sector (Consumer service)

The debt-to-equity ratio for the 2009-2012 year was maintained under the 3:1 ratio (McGregor BFA). The issue came in 2013, where the average earnings, before interest, tax, depreciation and amortisation were lower compared to the loans within the sector. According to McGregor BFA, the total average debt of the five companies within the sector in 2013 was R31 093 419 and the bulk of that amount is from long-term interest-bearing borrowings. The average EBITDA is equal to R1 860 175.

This indicates that the media sector is not profitable and is unable to pay its long-term debt. According to McGregor BFA, the average debt-to-EBITDA ratio of is 8.3:1, which is more than the risk indicator of 3:1. The taxpayers within this sector will therefore have to prove that their long-term loans obtained from third parties, residents, resident connected persons and non-resident connected persons are within the arm’s length, if audited by the tax authorities. Graph 5.8 illustrates the average debt-to-equity ratio from 2009-2012 years.

Graph 5.8: Media sector



Source: Own Research

5.3.9 Retail sector (Consumer service)

The average debt-to-equity ratio has been maintained for the past 4 years. The results from McGregor BFA show the ratio is below the 3:1 benchmark set by the Commissioner. The debt-to-EBITDA ratio (3.2:1) in 2013 shows that the ratio is within the 3:1 risk indicator, showing that the entities within the sector are cautious not to use too much debt to finance their trade operations. Graph 5.9 shows the average debt-equity from 2009-2012 periods.

Graph 5.9: Retail sector

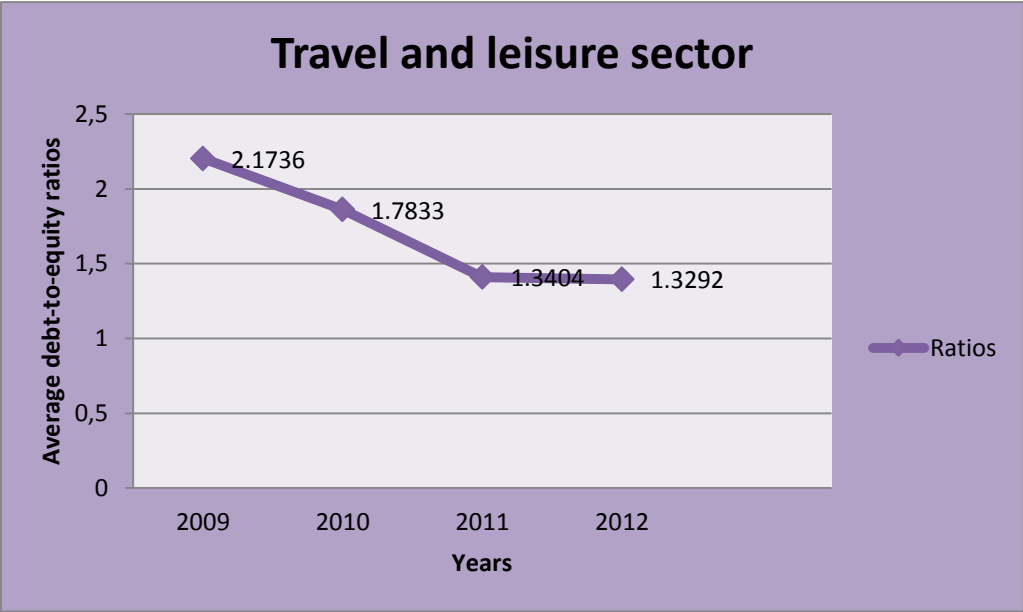


Source: Own Research

5.3.10 Travel and leisure sector (Consumer service)

The average debt-to-equity ratio from 2009-2012 and debt-to-EBITDA ratio (2.2:1) for 2013 are under 3:1 (McGregor BFA). The sector attracts tourists from outside the country who buy goods and services on a cash basis. Perhaps this is the reason that the average debt-to-EBITDA ratio and debt-to-equity ratio is below 3:1. According to the National Department of Tourism (2013:01), the sector grew since the 2010 World Cup and generated around R50 billion worth of revenue in 2012. Graph 5.10 shows the average debt-to-equity ratio for 2009-2012 of the travel and leisure sector.

Graph 5.10: Travel and leisure sector

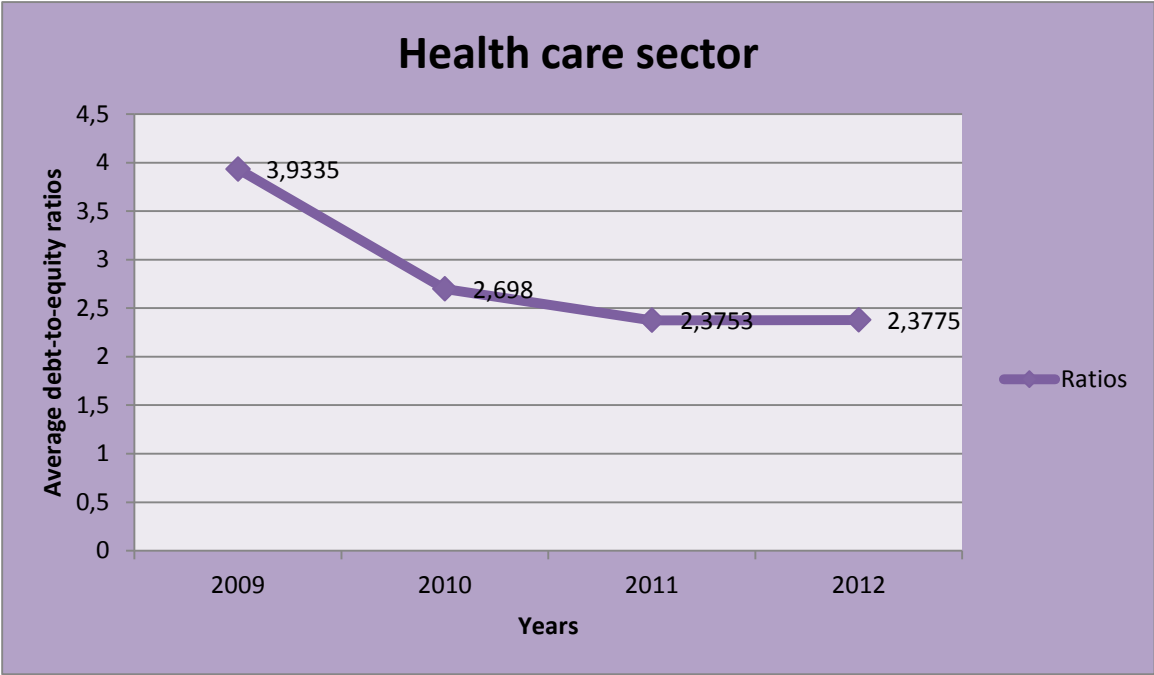


Source: Own research

5.3.11 Health care sector

The health care sector’s average debt-to-equity ratio has remained under 3:1 and the debt-to-EBITDA ratio (3.0:1) stayed under the 3:1 risk indicator in 2013 (McGregor BFA). A report by Econex (2013:42) has shown that the private health care sector has contributed over R1 billion worth of tax revenue. Econex is a consultancy firm which deals with trade analysis and general applied economics in the health care sector. The report also indicated that the medical schemes had a net surplus of approximately R3.7 billion during the 2012 year (Econex, 2013:42). The health sector seems to be able to cover its financial obligations for the 2009-2013 periods. Graph 5.11 illustrates the average debt-to-equity ratio.

Graph 5.11: Health care sector



Source: Own Research

5.3.12 Construction and material sector (Industrials)

The construction and material sector indicates that the average debt-to-equity ratio remained stable over the past 4 year (2009-2012) period and that the ratio was below the 3:1 benchmark (McGregor BFA). In 2013, the results showed an average of 5.6:1 debt-to-EBITDA ratio (McGregor BFA).

According to a report issued by PWC (2013:06), the construction and material sector has shown a 1% growth in 2013, compared to a 6% growth in 2012. The report by PWC (2013:03) showed that the labour unrest in the country had a negative impact on the sector, which resulted in cancellation and delaying of foreign direct investment. Skills shortages in the sector also resulted in an increase in labour costs of up to 9.5% for the 2013 period. An increase in labour costs will decrease the earnings before interest, tax, depreciation and amortisation (EBITDA). This will result in an increase in the in debt-to-EBITDA ratio. The debt-to-equity ratio results of the construction and material sector are shown in Graph 5.12.

Graph 5.12: Construction and material sector

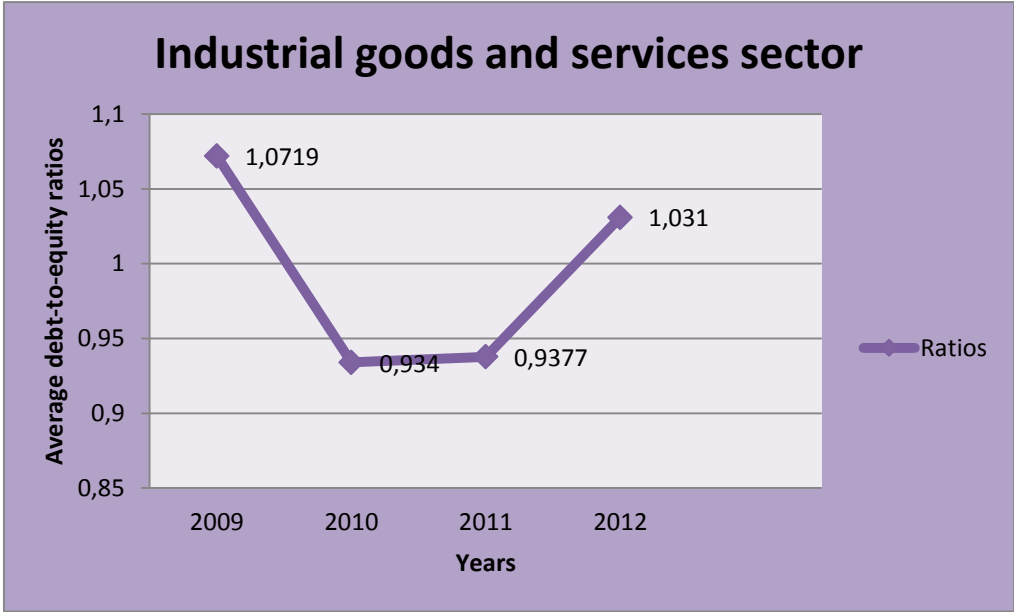


Source: Own Research

5.3.13 Industrial goods and services (Industrials)

The industrial goods and services comprises of companies that supply industrial machinery, tools, cement, metal fabrication and transportation. The debt-to-equity ratio for this sector has remained under 1:1 for the years 2009-2012 (McGregor BFA). The debt-to-EBITDA ratio is above the risk indicator, standing at an average of 4:1 (McGregor BFA). Graph 5.13 shows the average debt-to-equity ratio for 2009-2012 periods.

Graph 5.13: Industrial goods and services sector

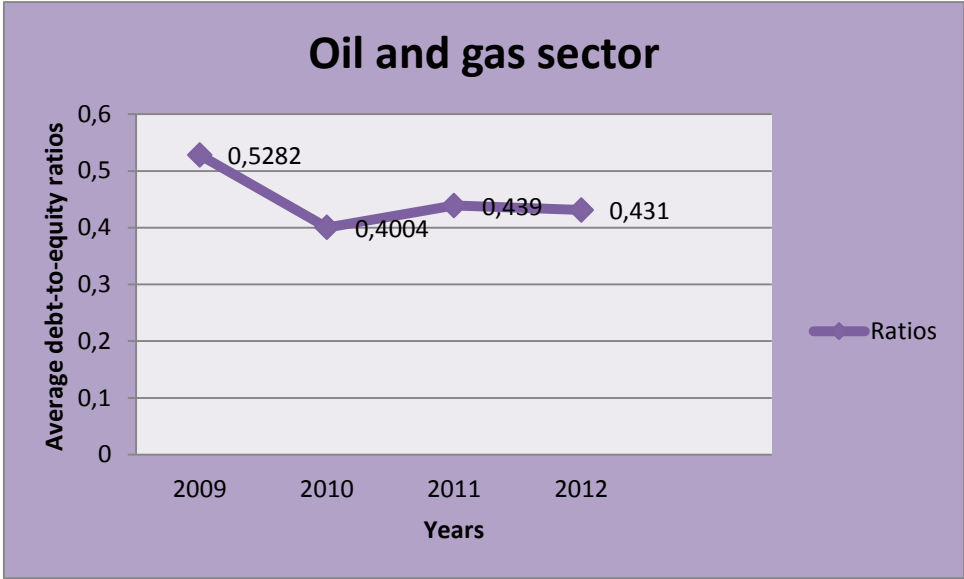


Source: Own Research

5.3.14 Oil and gas sector

The oil and gas sector had an average debt-to-equity ratio of below 1:1 during 2009-2011(McGregor BFA). Although the ratio was still within the benchmark of 3:1, in 2012 oil prices increased due to the increase in production costs and refining capacity has decreased, which could turn the country into a net importer instead of the net exporter of refined fuels and South Africa has limited hydrocarbon reserves (Wesgro, 2013:04). All these factors will cause the debt relative to equity to increase. The average debt-to-EBITDA ratio (0.9:1) is well maintained for the oil and gas sector in 2013. Graph 5.14 shows the average debt-to equity ratio for 2009-2012 periods.

Graph 5.14: Oil and gas sector

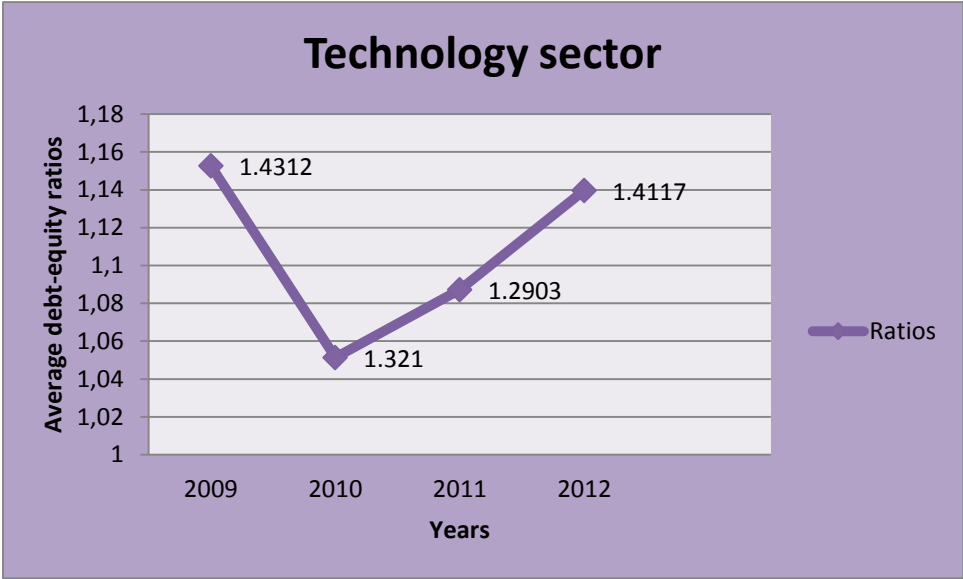


Source: Own Research

5.3.15 Technology

The average debt-to-equity ratio in the technology sector has been maintained for the past 4 years, according to McGregor BFA. In 2013, the debt-to-EBITDA ratio increased to approximately 4.8:1 in terms of McGregor BFA. According to the report by the South African Electro Technical Export Council (2013:05), the technology sector has increased in revenue up to R468,4 billion in 2013.. Graph 5.15 illustrates the average debt-to-equity ratio for 2009-2012 periods.

Graph 5.15: Technology sector

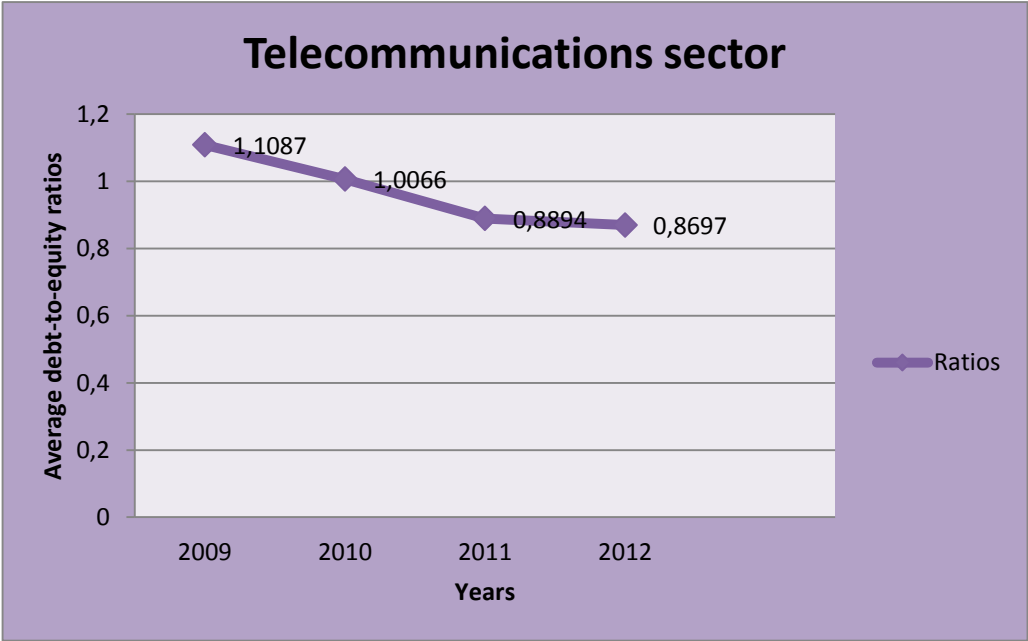


Source: Own Research

5.3.16 Telecommunications sector

The telecommunications sector is doing well, given that the majority of its customers use the service on a cash to cash basis, meaning the sector recognises revenue immediately and is able to meet its financial obligations timeously. Graph 5.16 shows the telecommunication average debt-to-equity for 2009-2012 periods. The average debt-to-EBITDA ratio is 1.7:1 for the 2013 period (McGregor BFA).

Graph 5.16: Telecommunications sector

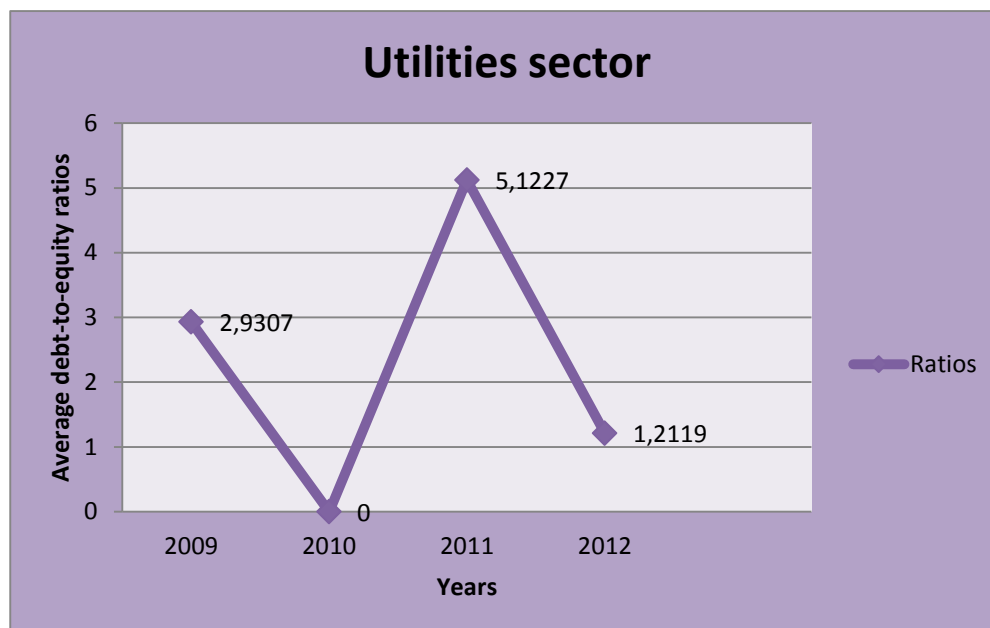


Source: Own Research

5.3.17 Utilities

IPSA Group Plc. was the only company under the utilities' sector. The company is incorporated in England, with a subsidiary located in Newcastle South Africa (McGregor BFA). The company owns and manages power generation plants in Southern Africa and has been listed on the JSE since October 2006 (IPSA financial statements, 2012:03). The results of the debt-to-equity ratio and debt-to-EBITDA ratio were unexpected, given that this is a JSE listed company. The financial statements were obtained from McGregor BFA to analyse the debt, equity and EBITDA for the years under review. Graph 5.17 shows the average debt-to-equity for 2009-2012 periods of the utility sector.

Graph 5.17: Utilities sector



Source: Own Research

This study will investigate each component of the debt-to-equity ratio and the debt-to-EBITDA ratio of the utility sector, because this is the only sector that had a negative debt-to-EBITDA (-21:1) ratio in 2013 period. The first component to be discussed is equity.

Equity

According to McGregor BFA equity is calculated by adding: ordinary share capital, share premium, non-distributable reserves and distributable reserves. The statement of financial position reveals that the ordinary share capital remained the same from the 2009 and 2011 to 2013 at R2 150 000, there was no data reported for the 2010 period (McGregor BFA). The share premium also remained the same from 2009 and 2011-2013 at R2 676 700, there was no data reported for 2010 period (McGregor BFA). Non-distributable reserves were reported as:

- -R1 562 000 in the 2009 period,
- -R2 054 000 in the 2011 period,
- -R3, 034 000 in the 2012 period, and
- -R4, 011 000 in the 2013 period.

Distributable reserves were reported as follows:

- -R1 379 400 in the 2009 period,
- -R1 903 200 in the 2011 period,
- -R1 339 000 in the 2012 period, and
- -R1 526 600 in the 2013 period.

For the 2010 year there was no data reported on the face of the financial statements, hence the zero debt-to-equity ratio. It is very strange that a listed company reported no data in 2010; moreover, a higher debt-to-equity ratio of 5:1 was reported in the subsequent year. The non-distributable and distributable reserves are increasing at a negative amount each year, showing that the company has been operating at a loss from 2009-2013.

Debt

According to McGregor BFA, debt is computed by adding convertible debentures, directors' and shareholders' loans, long-term non-interest bearing loans, long-term interest bearing loans and current liabilities. Debt was reported as follows:

- R3 684 200 in the 2009 period,
- R4 011 600 in the 2011 period,
- R1 541 400 in the 2012 period, and
- R1 513 000 in the 2013 period.

The debt-equity ratio for 2012 was way below 3:1 risk indicator; this could probably be because that the company managed to pay off outstanding debt.

EBITDA

The earnings before interest, tax, depreciation and amortisation were reported as follows:

- -R3 152 000 in the 2009 period,
- -R8 080 000 in the 2011 period,
- -R7 667 000 in the 2012 period, and

- -R7 160 000 in the 2013 period.

The average debt-to-EBITDA ratio for 2013 had gone down to a negative ratio of -21:1. This means that the company is over leveraged and that the debt amount is too high. The debt-to-EBITDA ratio indicates that the financial health of this company is declining and the question that arises is whether the IPSA Group will be able to meet its financial obligations. Since IPSA is the only listed company for this market, it might be difficult for the company to justify their arm's length position, if selected for an audit.

5.4 CHAPTER SUMMARY

The aim of this chapter was to determine the average debt-to-equity ratio and the average debt-to-EBITDA ratio of the non-financial JSE-listed sectors. It was found that all sectors except the utility sector managed to structure the debt-equity ratio below 3:1 during the years 2009-2012. Furthermore, the results show that out of the 17 sectors, 8 of these sectors were found to be at risk of being thinly capitalised. This is 47% of the selected population size.

The utility sector was found to be at a higher risk, compared to the other sectors, in the year 2013. The sector has a negative debt-to-EBITDA ratio which is not a good sign for either the taxpayer or the tax authority. If selected for an audit, the taxpayer has to prove beyond reasonable doubt that the debt obtained from third parties, non-resident connected persons or connected persons is within the arm's length, as per the current section 31 of the Act. Other sectors, such as the chemical sector, food and beverages sector and the forestry and paper sector, maintained a healthy average debt-to-EBITDA ratio for the 2013 period.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

Chapter 6 of this study draws conclusions and makes recommendations based on the research findings. This chapter provides, the research results based on the empirical evidence presented in chapter 5 of the study. Limitations to the study, as well as future research, will be discussed. The primary objective of the study is to explore the financial ratios per sector of companies listed on the Johannesburg Stock Exchange (JSE), as a practical benchmark for South African entities to measure their thin capitalisation positions. The primary research objective of the study was achieved by addressing following secondary research objectives:

- To determine the characteristics of the arm's length principle that will be applied by South African entities to establish the arm's length debt by gathering an understanding of key concepts concerning thin capitalisation rules and the effectiveness of these rules (refer to chapter 3);
- To evaluate South African taxpayers' approach to thin capitalisation, by investigating the current treatment of transactions affecting thin capitalisation in the legislation and its application and comparing it to methods adopted by other countries. This is done with the intention of exploring the different methods that are used by other countries in combating thin capitalisation (refer to chapter 4); and
- To identify financial ratios in the financial statement that are used to determine the arm's length debt (refer to chapter 5);

The next section will discuss how the secondary research objectives were used to achieve the primary research objective.

6.2 SECONDARY RESEARCH OBJECTIVES

The secondary research objective of the study will be discussed for each of the objectives.

6.2.1 To determine the characteristics of the arm's length

In chapter 3 of this study it was found that global trade between MNEs has become a challenge for tax authorities to collect corporate taxes, as MNEs engage in tax planning activities that erode the tax base. One of the activities of MNEs is to minimise the tax liability by entering into transactions that are not within the arm's length principle. The present study established that the arm's length principle is violated in instances whereby MNEs borrow funds from affiliates located in low tax jurisdictions to affiliates located in high tax jurisdictions, to allow the latter to benefit from interest deductions in order to reduce the overall tax liability.

6.2.2 To evaluate the South African taxpayers' approach to thin capitalisation

In chapter 4 of this study, it was established that thin capitalisation rules differ in both definition and application. There are two methods that were described by the United Nations Model Report that countries can use to combat excessive interest deductions, namely the fixed ratio approach and the arm's length approach. The former is a predetermined ratio that limits the interest deductions when it is exceeded. The latter considers that a "test" should be undertaken to justify that the amount of debt obtained could and would have been obtained if the lender and the borrower were independent parties.

This study found that there is no superiority between the different approaches because:

- The fixed ratio approach is straight-forward and easy to calculate, but treats entities equally, irrespective of the difference in the industry.
- The arm's length approach bases facts and circumstances of each case on its own merits, but requires expert knowledge in determining the characteristics of the borrowing entity that has foreign affiliates.

The study found that the primary aim of section 31(3) of the Act is to allow the Commissioner to limit excessive interest deductions. Since 1995, section 31(3) of the Act was utilised as an anti-avoidance rule against excessive interest deduction and was only revised in April 2012.

6.2.3 To determine the average debt-to-equity ratio and the debt-to-EBITDA ratio of South African listed sectors

The primary aim of this study is to explore the financial ratios per sector of companies listed on the JSE, as a practical benchmark for South African entities to measure their thin capitalisation positions. The findings of the study show that the arm's length debt follows the principle of the OECD guidelines enacted in Practice Note 7 of the Act and Draft Interpretation Note. Furthermore, the study found that the arm's length principle adopted in South Africa has flawed benchmarks. Firstly, the arm's length debt may not be reliably proven in instances where the entity does not have a comparable transaction. This was established in chapter 5 of this study where the utility sector had only one entity that is listed on the JSE. The entity had a negative debt-to-EBITDA ratio for the year 2013. Secondly, the arm's length principle is based on a notional amount that assumes that independent lenders would and could have granted the financial assistance to an entity on the condition that it is a separate entity.

In chapter 5, the present study showed that a reliable arm's length debt instrument that entities can use should be sector based. This is supported by the fact that entities of a similar sector share the same market and the comparable issue would be resolved. Entities should thus use the average debt-to-EBITDA ratio per sector to justify the arm's length debt. But in cases where the sector does not have a comparable sector it is necessary to consider the international average debt-to-EBITDA ratio norm of that specific sector.

6.3 RECOMMENDATIONS

This study has established that there is no practical benchmark which South African taxpayers can use to measure the application of the arm's length debt in terms of section 31 of the Act. It is therefore recommended that the practical benchmark should be based on the average debt-to-EBITDA ratio per sector, since the Act requires taxpayers to transact on an arm's length basis. Furthermore, it is recommended that the Interpretation Note should not be treated as a draft but should be enacted into the Act, similarly to Canada, the United States of America and the United Kingdom.

6.4 LIMITATIONS OF THE STUDY

The empirical evidence of this study was based only on the JSE-listed industries and these are not the only entities that tax authorities will be observing in determining thinly capitalised entities. South Africa Revenue Service explained that the debt-to-EBITDA ratio, interest cover ratio and the debt-to-equity can be used as one of the measures to prove that transactions are within the arm's length debt. The study only focused on the debt-to-EBITDA ratio and the debt-to-equity ratio, to determine a test that entities can utilise. Another limitation is that the study could not obtain the exact information that third party lenders use in granting MNEs loans.

6.5 AREAS FOR FURTHER RESEARCH

Some areas for further research:

- Replicate the study by choosing a different research design, such as questionnaires, to identify how entities determine the arm's length debt of an affected transaction.
- Determine the arm's length debt based on the characteristics used by third party lenders.
- Investigate whether or not the guidelines in the Draft Interpretation Note can be used as prescriptive legislation in instances where taxpayers failed the arm's length principle.
- To investigate whether or not South African entities understand the new Draft Interpretation Note in order comply with the requirements of the

6.6 CONCLUSION

The Act does not provide a practical benchmark that South African taxpayers can use to determine the arm's length debt in terms of section 31(3) of the Income Tax Act. Chapter 5 of this study complied with its primary research objective by providing a practical benchmark for South African entities to measure their thin capitalisation position.

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ANNEXURES

Automobile and parts

MTA:XJSE:EQU

Metair Investments Ltd

Financial Year	2012	2011	2010	2009
General				
Accounts Receivable / Turnover	7.4585	8.2716	9.4457	7.8042
Assets / Capital Employed	1.3954	1.3528	1.3968	1.3918
Book Value / Share (c)	1356.089	1118.83	890.4203	776.0687
Cash Flow / Share (c)	439.0799	378.2419	283.0758	156.1989
Cash Flow Dividend Cover	5.4375	5.2534	2.2646	10.4133
Cash Flow Interest Cover	23.6894	68.0869	33.9426	7.259
Current Ratio	1.9743	2.4708	2.1597	2.1186
Debt / Assets	0.3644	0.2812	0.3123	0.324
Debt / Equity	0.6131	0.437	0.5127	0.5874
Directors Remuneration % Profit Before Tax	5.8547	2.3437	1.9086	4.3585
Dividend / Share (c)	80.75	72	125	15
Dividend Cover	3.839	3.6111	1.512	4.4667
Dividend Yield %	2.1909	3.5175	6.1199	0
Earnings / Share (c)	310	260	189	67
Earnings Yield %	9.6966	14.0998	15.4286	12.594
Inflation Adjusted Profit / Share (c)	291.9339	278.6557	187.1052	26.8828
Inflation Adjusted Return On Assets %	19.7356	22.7623	19.038	6.271
Inflation Adjusted Return On Average Equity %	22.4772	26.2447	21.2817	3.3486
Inflation Adjusted Return On Average Total Assets %	21.7462	23.9853	18.666	6.0559
Inflation Adjusted Return On Equity %	20.2092	23.5008	19.8963	3.2642
Interest Cover	24.7926	73.3295	34.2527	4.7077
Leverage Factor	1.1088	1.1013	1.1312	0.667
Long Term Loans % Total Debt	15.1991	3.9706	4.9554	8.489
NAV / Share (c)	1450.121	1249.819	1005.147	951.1488
Net Profit Margin %	8.3541	9.5098	7.3985	1.5622
Operating Profit / Employee	103184.9	96827.93	72577.27	26581.2
Operating Profit Margin %	12.6756	13.4188	10.736	4.2464
Price / Book Value	2.3575	1.6482	1.3758	0.6855
Price / Cash	10.3995	6.1857	5.6548	2.641
Price / Cash Flow	7.2811	4.8752	4.3275	3.4059

Financial Year	2012	2011	2010	2009
Price / Earnings	10.3129	7.0923	6.4815	7.9403
Price / EBIT	6.9572	4.5266	4.2883	5.2518
Price / EBITDA	5.8448	3.9136	3.4271	2.8572
Price / Inflation Adjusted Profit	10.9511	6.6175	6.5471	19.7896
Price / NAV	2.2046	1.4754	1.2187	0.5593
Price / Share (c)	3197	1844	1225	532
Quick Ratio	1.1259	1.4263	1.1687	1.2322
Retention Rate %	76.8731	77.5324	61.9172	100
Return On Assets %	20.1416	23.4293	19.5433	7.1995
Return On Average Assets %	23.1368	25.4896	19.9824	6.9835
Return On Average Equity %	24.7832	28.7722	23.7005	4.9551
Return On Average External Investments %	45.8269	36.276	69.5548	43.7279
Return On Capital Employed %	18.5241	22.4616	18.8116	3.6865
Return On Equity %	22.3333	25.8035	22.1083	4.802
Return On External Investments %	44.4869	32.0668	55.243	65.7319
Total Assets Turnover	1.589	1.746	1.8203	1.6954
Total Debt / Cash Flow	1.8934	1.2925	1.6128	2.9186
Turnover / Employee	814042.9	721584.9	676015.1	625969.8
Cash Flow				
Adequacy Ratio	101.7783	117.7919	176.8209	337.886
Cash Flow (Cata Less Pref. Dividend) / Share				
Cash Flow (Cata) To Current Liabilities	57.1703	51.0487	62.2889	58.0318
Cash Flow (Cata) To Net Earnings After Tax	119.0098	75.1502	124.6554	481.7071
Cash Flow (Cata) To Total Debt				
Cash Flow (Cata) To Turnover (Margin)	11.1178	7.8944	10.1581	10.1486
Cash Flow (Ncta) To All Investments	77.0689	199.4748	122.4696	283.2093
Cash Flow (Ncta) To Capital Investments	149.4025	203.8567	220.6406	351.6785
Cash Flow (Ncta) To Financial Investments	99.6665			
Cash Flow Less Interest Paid To Income Before Tax	108.1755	75.0058	111.6948	321.928
Cash Flow Return On Total Net Assets	33.3347	26.0691	34.0357	32.3558
Cash Flow Return On Total Net Operating Assets	35.7603	35.6601	33.5477	19.9535
Cash Flow To Capital Redemption	353.8482	-15059.9	-392.323	-1491.78
Cash Flow To Total Shareholders' Equity	27.9278	19.9246	27.8306	26.9392

Financial Year	2012	2011	2010	2009
Change In Working Capital To Operating Cash Flow	-10.1735	-26.9524	0.6172	59.3336
Dividend Coverage	0.2467	0.3838	0.2984	0.0249
Interest Coverage	2196.432	4232.12	3199.745	1205.092
Price / Share To Cash Flow / Share	793.1972	769.4312	453.2284	219.747
Reinvestment Rate	19.028	11.8542	18.6353	24.6595
Growth				
Attributable Earnings	7.8797	47.0621	431.856	-499.159
Dividend / Share	12.1528	-42.4	733.3333	
Earnings / Share	19.2308	37.5661	182.0896	-9.4595
Growth In Cash From Operating Activities	44.61	-4.3609	34.4144	57.2564
Internal Growth Rate (After Tax) %	48.7598	69.1497	19.0151	
Net Turnover	22.8035	14.412	12.3033	-20.0542
Sustainable Growth (After Tax)	108.1801	165.4681	33.621	
Total Assets	34.9377	19.2828	4.5975	-5.8259
Total Shareholders' Interest	24.6421	26.002	15.5217	6.5853
Enterprise Value				
Enterprise Value	5398496	2870663	2062902	1176783
Enterprise Value / Cash	12.0724	6.8077	6.751	4.17
Enterprise Value / EBIT	8.0764	4.9819	5.1195	8.2921
Enterprise Value / EBITDA	6.7851	4.3071	4.0914	4.5112
Enterprise Value / PAT	10.9584	6.3638	6.7449	16.7133
Enterprise Value / Share	37.113	20.2944	14.6245	8.3998

Chemicals

AFE:XJSE:EQU

Aeci Limited

AFX:XJSE:EQU|AFE:XJSE:EQU|OMN:XJSE:EQU|RLF:X
JSE:EQU|DTA:XJSE:EQU|SPA:XJSE:EQU

African Oxygen Limited, Aeci Limited, Omnia Holdings
Ltd, Rolfes Technology Hldgs, Delta Emd Ltd,
Spanjaard Limited

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	5.596	5.1574	5.9525	5.9126
Assets / Capital Employed	1.4631	1.4279	1.3885	1.3979
Book Value / Share (c)	2067.762	1847.575	1542.449	1542.319
Cash Flow / Share (c)	464.9765	460.5251	444.6289	490.1133
Cash Flow Dividend Cover	0.8161	1.3426	0.7148	0.6028
Cash Flow Interest Cover	5.8581	5.1292	4.2214	4.597
Current Ratio	1.3608	1.4288	1.3885	1.4738
Debt / Assets	0.4633	0.4753	0.5098	0.5433
Debt / Equity	0.8748	0.9318	1.0575	1.1801
Directors Remuneration % Profit Before Tax	3.7728	3.5227	6.1426	3.1814
Dividend / Share (c)	569.75	343	622	813
Dividend Cover	3.0227	5.0513	1.4548	2.3812
Dividend Yield %	0.4084	0.2796	0.4731	0.7544
Earnings / Share (c)	1722.2	1732.6	904.9	1935.9
Earnings Yield %	8.4108	9.3296	5.1608	13.9655
Inflation Adjusted Profit / Share (c)	229.7439	211.6388	120.747	195.3142
Inflation Adjusted Return On Assets %	9.6368	9.4996	7.3844	10.7501
Inflation Adjusted Return On Average Equity %	10.7391	11.2866	6.9963	11.4617
Inflation Adjusted Return On Average Total Assets %	9.9208	10.1982	7.2254	10.584
Inflation Adjusted Return On Equity %	10.3357	10.2926	6.908	11.4244
Interest Cover	5.1478	4.2914	2.5911	3.7095
Leverage Factor	1.1414	1.1873	1.0945	1.1743
Long Term Loans % Total Debt	14.1861	20.3378	27.8023	31.5577
NAV / Share (c)	2095.271	1900.417	1568.085	1530.219
Net Profit Margin %	4.8834	5.1852	3.4581	4.7367
Operating Profit / Employee	189717	179959.1	131618.2	193361.9
Operating Profit Margin %	8.0778	8.5613	6.5531	8.7622
Price / Book Value	9.9025	10.0516	11.3676	8.9878

Financial Year	2012	2011	2010	2009
Price / Cash	72.9983	60.829	62.5529	51.7176
Price / Cash Flow	44.0366	40.3257	39.4351	28.2833
Price / Earnings	11.8894	10.7186	19.3767	7.1605
Price / EBIT	50.1135	48.1983	64.2465	35.0494
Price / EBITDA	36.0594	35.7172	43.3441	26.9679
Price / Inflation Adjusted Profit	89.1253	87.7485	145.2127	70.9728
Price / NAV	9.7725	9.7721	11.1818	9.0588
Price / Share (c)	20476	18571	17534	13862
Quick Ratio	0.7664	0.8652	0.8357	0.8284
Retention Rate %	66.2554	78.0734	42.4018	51.0883
Return On Assets %	10.4658	10.638	8.5309	11.805
Return On Average Assets %	10.8592	11.463	8.3487	11.8162
Return On Average Equity %	12.619	13.9633	9.3533	14.3581
Return On Average External Investments %	74.9312	83.8342	120.0267	44.7566
Return On Capital Employed %	9.2571	9.1996	6.2509	8.9207
Return On Equity %	11.946	12.6307	9.337	13.8621
Return On External Investments %	73.9048	83.8342	106.8335	52.9815
Total Assets Turnover	1.2956	1.2426	1.3018	1.3473
Total Debt / Cash Flow	3.8901	3.7383	3.6684	3.7135
Turnover / Employee	2348633	2102018	2008482	2206773
Adequacy Ratio	121.5651	56.3418	176.4475	83.0205
Cash Flow (Cata) To Current Liabilities	23.7271	13.8842	36.0329	32.3734
Cash Flow (Cata) To Net Earnings After Tax	146.7299	77.6624	277.9084	190.364
Cash Flow (Cata) To Turnover (Margin)	7.281	4.2309	10.1885	8.9343
Cash Flow (Ncta) To All Investments	69.6125	51.2595	121.627	206.2666
Cash Flow (Ncta) To Capital Investments	89.0297	51.5151	184.1731	124.2171
Cash Flow (Ncta) To Financial Investments	1317.754	744.3682	1739.293	9691.612
Cash Flow Less Interest Paid To Income Before Tax	113.6023	75.0331	221.9502	170.7237
Cash Flow Return On Total Net Assets	20.0598	14.8082	28.4489	29.3905
Cash Flow Return On Total Net Operating Assets	24.5325	23.992	21.8446	21.8224
Cash Flow To Capital Redemption	-550.862	1123.42	-556.963	410.5695
Cash Flow To Total Shareholders' Equity	17.6676	10.0895	26.9928	25.7411

Financial Year	2012	2011	2010	2009
Change In Working Capital To Operating Cash Flow	-19.7294	-43.1064	34.9856	32.0778
Dividend Coverage	0.2343	0.2839	0.1893	0.2621
Interest Coverage	530.9341	281.5773	486.4964	479.6921
Price / Share To Cash Flow / Share	5564.465	9768.978	4135.387	3440.159
Reinvestment Rate	11.4878	5.92	16.5761	13.7639
Attributable Earnings	5.8718	67.1871	-32.4079	7.3991
Dividend / Share	66.1079	-44.8553	-23.4932	33.7171
Earnings / Share	-0.6003	91.4687	-53.2569	26.6784
Growth In Cash From Operating Activities	62.798	-45.2912	-25.6892	259.188
Internal Growth Rate (After Tax) %	12.9344	28.0645	4.1845	7.5184
Net Turnover	12.414	11.5003	-7.4166	-1.2642
Sustainable Growth (After Tax)	19.5676	44.9786	5.0547	11.2784
Total Assets	7.8098	16.8165	-4.1842	0.1894
Total Shareholders' Interest	11.9403	23.5903	0.3501	7.4206
Enterprise Value	1.41E+08	1.28E+08	1.18E+08	95542270
Enterprise Value / Cash	78.3156	65.3812	67.2854	57.3907
Enterprise Value / EBIT	53.7638	51.8052	69.1071	38.8941
Enterprise Value / EBITDA	38.686	38.3902	46.6233	29.9261
Enterprise Value / PAT	87.5207	81.4127	123.5272	72.6139
Enterprise Value / Share	219.675	199.6078	188.6055	153.8258

Construction and materials

ACE:XJSE:EQU

PPC:XJSE:EQU|AFT:XJSE:EQU|DAW:XJSE:EQU|MZR:
XJSE:EQU|WEA:XJSE:EQU|CSP:XJSE:EQU|ACE:XJSE:
EQU|MAS:XJSE:EQU|BIK:XJSE:EQU|KDV:XJSE:EQU|W
TL:XJSE:EQU|SEP:XJSE:EQU|CSP:XJSE:EQU|WBO:X
JSE:EQU|MUR:XJSE:EQU|RBX:XJSE:EQU|AEG:XJSE:E
QU|GRF:XJSE:EQU|BSR:XJSE:EQU|SSK:XJSE:EQU|C
GR:XJSE:EQU|PKH:XJSE:EQU|ESR:XJSE:EQU|SAN:XJ
SE:EQU|SKY:XJSE:EQU|ERB:XJSE:EQU|AEGCB:XJSE:
IBI

Accentuate Limited

Ppc Limited, Afrimat Limited, Distr And Warehousing,
Mazor Group Ltd, Wg Wearne Ltd, Chemical
Specialities Ld, Accentuate Limited, Masonite Africa
Ltd, Brikor Ltd, Kaydav Group Ltd, William Tell
Holdings Lt, Sephaku Holdings Ltd, Chemical Spec Ltd
Pref, Wilson Bayly Hlm-Ovc Ltd, Murray & Roberts
Hldgs, Raubex Group Ltd, Aveng Group Limited, Group
Five Ltd, Basil Read Holdings Ltd, Stefanuti Stck Hldgs
Ltd, Calgro M3 Hldgs Ltd, Protech Khuthele Hldgs, Esor
Limited, Sanyati Holdings Ltd, Sea Kay Holdings Ltd,
Erbacon Inv Hldgs Ltd, Aveng Group Limited Conv

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	3.929	4.1066	4.2539	4.3897
Assets / Capital Employed	1.898	1.7906	1.8308	1.9985
Book Value / Share (c)	635.8407	582.6299	624.4272	582.0238
Cash Flow / Share (c)	106.4401	108.3281	184.3128	234.1574
Cash Flow Dividend Cover	0.1384	0.1252	0.1561	0.1622
Cash Flow Interest Cover	4.6728	5.2039	7.4952	8.3873
Current Ratio	1.1785	1.2093	1.2611	1.1709
Debt / Assets	0.6041	0.591	0.6094	0.6482
Debt / Equity	1.5364	1.4343	1.5026	1.791
Directors Remuneration % Profit Before Tax	7.5596	9.7923	3.9364	3.4435
Dividend / Share (c)	768.85	865.2	1181	1444
Dividend Cover	2.6627	2.7603	3.7185	3.6035
Dividend Yield %	0.0975	0.1223	0.1612	0.1745
Earnings / Share (c)	2047.2	2388.2	4391.6	5203.5
Earnings Yield %	6.6879	7.2962	13.6297	14.455
Inflation Adjusted Profit / Share (c)	19.5748	17.4681	106.1683	140.9977
Inflation Adjusted Return On Assets %	4.6117	5.0623	10.5723	12.309
Inflation Adjusted Return On Average Equity %	3.0235	2.8001	16.8729	24.1614
Inflation Adjusted Return On Average Total Assets %	4.5699	4.8961	10.4566	13.0325

Financial Year	2012	2011	2010	2009
Inflation Adjusted Return On Equity %	2.9694	2.8317	16.157	22.5452
Interest Cover	3.3002	3.7382	6.9361	7.4551
Leverage Factor	0.7833	0.7105	1.611	1.9677
Long Term Loans % Total Debt	11.1215	12.1515	13.4317	11.7492
NAV / Share (c)	640.1092	578.2373	601.5164	565.7318
Net Profit Margin %	0.9648	1.1125	5.0284	6.3958
Operating Profit / Employee	33433.4	35481.38	74195.93	94032.22
Operating Profit Margin %	3.1298	3.7835	7.6924	8.9799
Price / Book Value	48.1457	56.1815	51.4151	61.8497
Price / Cash	103.0275	117.3639	83.3101	84.7323
Price / Cash Flow	287.6077	302.1655	174.1876	153.7342
Price / Earnings	14.9536	13.7061	7.3105	6.918
Price / EBIT	407.2251	420.6362	188.2275	172.9568
Price / EBITDA	208.5234	224.9917	135.8654	133.5183
Price / Inflation Adjusted Profit	1563.901	1873.875	302.3973	255.3091
Price / NAV	47.8247	56.6082	53.3734	63.6309
Price / Share (c)	30613	32733	32105	35998
Quick Ratio	1.0531	1.0752	1.1202	1.0366
Retention Rate %	-22.7653	-74.9094	54.8728	57.6325
Return On Assets %	4.6489	5.5037	11.077	12.9426
Return On Average Assets %	4.8912	5.3815	11.0539	13.9033
Return On Average Equity %	3.7491	3.8714	18.8327	27.4973
Return On Average External Investments %	21.3075	34.5119	67.9141	109.5244
Return On Capital Employed %	2.7363	2.9402	13.2815	18.4225
Return On Equity %	3.6444	3.9272	17.8556	25.4696
Return On External Investments %	19.5492	29.5708	59.9245	104.5183
Total Assets Turnover	1.4854	1.4546	1.44	1.4413
Total Debt / Cash Flow	9.1781	7.7145	5.0908	4.4517
Turnover / Employee	1068229	937783	964541.4	1047136
Adequacy Ratio	37.6855	33.9406	115.381	80.2521
Cash Flow (Cata) To Current Liabilities	6.699	5.5422	16.864	24.339
Cash Flow (Cata) To Net Earnings After Tax	149.2677	106.1743	117.4108	144.0493
Cash Flow (Cata) To Turnover (Margin)	2.4216	1.9782	6.1777	9.6602
Cash Flow (Ncta) To All Investments	39.4975	-1.0769	83.2002	100.6439
Cash Flow (Ncta) To Capital Investments	29.4712	-1.3158	115.2429	103.5089

Financial Year	2012	2011	2010	2009
Cash Flow (Ncta) To Financial Investments	-488.329	-10.3864	991.6634	417.9533
Cash Flow Less Interest Paid To Income Before Tax	121.4785	92.6417	101.1004	122.8969
Cash Flow Return On Total Net Assets	16.3397	13.9886	27.0774	42.3142
Cash Flow Return On Total Net Operating Assets	23.2666	23.7744	34.9607	41.7333
Cash Flow To Capital Redemption	328.7528	-704.139	-703.883	661.5505
Cash Flow To Total Shareholders' Equity	8.7569	6.6975	21.1025	36.8367
Change In Working Capital To Operating Cash Flow	-33.4971	-48.022	-25.8278	0.6582
Dividend Coverage	0.5367	1.0196	0.3912	0.2862
Interest Coverage	299.0213	216.7876	551.1682	779.4235
Price / Share To Cash Flow / Share	52631.32	80450.06	23437.78	16077.77
Reinvestment Rate	4.0738	-0.1241	11.3551	22.8757
Attributable Earnings	-1.7098	-78.6216	-21.7775	2.0888
Dividend / Share	-11.1362	-26.7401	-18.2133	16.961
Earnings / Share	-14.2785	-45.6189	-15.603	-3.3112
Growth In Cash From Operating Activities	48.3171	-61.9403	-35.0401	-11.6751
Internal Growth Rate (After Tax) %	-0.3505	-0.9179	7.8922	11.6454
Net Turnover	13.3396	-3.3701	-0.5053	27.3483
Sustainable Growth (After Tax)	-0.449	-1.1634	17.3416	32.0173
Total Assets	10.9932	-4.3418	-0.4174	16.0358
Total Shareholders' Interest	5.9164	-2.7988	11.5778	17.3002
Enterprise Value	1.86E+09	2.04E+09	1.92E+09	2.07E+09
Enterprise Value / Cash	105.2765	119.314	84.7082	86.1313
Enterprise Value / EBIT	416.1148	427.6255	191.3863	175.8125
Enterprise Value / EBITDA	213.0754	228.7302	138.1454	135.7228
Enterprise Value / PAT	802.7652	868.3658	279.8028	235.423
Enterprise Value / Share	312.8127	332.769	326.4377	365.9236

Food and beverages

AHL:XJSE:EQU

SAB:XJSE:EQU|AWT:XJSE:EQU|DST:XJSE:EQU|CVH:XJSE:EQU|ARL:XJSE:EQU|OCE:XJSE:EQU|RCL:XJSE:EQU|SOV:XJSE:EQU|CBH:XJSE:EQU|CKS:XJSE:EQU|QFH:XJSE:EQU|TBS:XJSE:EQU|AVI:XJSE:EQU|PFG:XJSE:EQU|ILV:XJSE:EQU|TON:XJSE:EQU|CLR:XJSE:EQU|AHL:XJSE:EQU|BIO:XJSE:EQU|UBU:XJSE:EQU|RFG:XJSE:EQU

Ah-Vest Limited

Submiller Plc, Awethu Breweries Ltd, Distell Group Ltd, Capevin Holdings Ltd, Astral Foods Ltd, Oceana Group Ltd, Rcl Foods Limited, Sovereign Food Inv Ltd, Country Bird Hldgs Ltd, Crookes Brothers Ltd, Quantum Foods Hldgs Ltd, Tiger Brands Ltd, Avi Ltd, Pioneer Foods Group Ltd, Illovo Sugar Ltd, Tongaat Hulett Ltd, Clover Industries Ltd, Ah-Vest Limited, Bioscience Brands Ltd, Ububele Holdings Ltd, Rhodes Food Grp Hldg Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	7.5798	8.5643	8.442	8.6893
Assets / Capital Employed	0.6413	0.8129	0.8017	0.8056
Book Value / Share (c)	3271.679	2780.97	1200.048	3084.894
Cash Flow / Share (c)	726.0086	564.9009	237.7095	671.064
Cash Flow Dividend Cover	0.2083	0.1669	0.0909	0.2791
Cash Flow Interest Cover	5.5809	6.061	4.6931	3.9275
Current Ratio	0.9872	0.9986	0.9799	0.9127
Debt / Assets	0.7931	0.5201	0.5735	0.6296
Debt / Equity	0.926	0.6199	0.7054	0.8387
Directors Remuneration % Profit Before Tax	0.9638	0.961	1.5381	0.7514
Dividend / Share (c)	3485.995	3384.636	2614.331	2404.156
Dividend Cover	2.0949	1.978	2.2883	2.2271
Dividend Yield %	0.1636	0.164	0.0709	0.2701
Earnings / Share (c)	7302.701	6694.698	5982.37	5354.206
Earnings Yield %	6.4676	7.0477	7.018	7.5029
Inflation Adjusted Profit / Share (c)	520.4609	346.7365	144.3142	392.2233
Inflation Adjusted Return On Assets %	19.9655	17.027	16.5938	17.1236
Inflation Adjusted Return On Average Equity %	16.9705	12.1443	11.7158	12.1981
Inflation Adjusted Return On Average Total Assets %	18.4379	13.9452	13.3034	16.9081
Inflation Adjusted Return On Equity %	15.2792	11.8398	11.5015	11.9704
Interest Cover	5.2245	5.3185	4.2331	3.967
Leverage Factor	0.9246	0.8762	0.8682	0.8219

Financial Year	2012	2011	2010	2009
Long Term Loans % Total Debt	64.6548	45.5605	49.7373	53.6867
NAV / Share (c)	790.3342	1591.037	629.6165	1522.196
Net Profit Margin %	14.1264	10.2265	9.5503	9.3858
Operating Profit / Employee	247727.9	206774.1	209999.2	266539.7
Operating Profit Margin %	17.8374	13.9126	13.53	15.2107
Price / Book Value	34.5122	34.2751	72.9954	23.1376
Price / Cash	780.03	550.1073	1208.33	547.3023
Price / Cash Flow	155.5257	168.734	368.5086	106.3639
Price / Earnings	15.4618	14.2378	14.6427	13.331
Price / EBIT	166.1342	192.2899	408.5533	105.3033
Price / EBITDA	135.6888	147.6987	308.2837	78.2947
Price / Inflation Adjusted Profit	216.9481	274.9004	606.9951	181.9805
Price / NAV	142.8674	59.9093	139.1291	46.8908
Price / Share (c)	112913	95318	87598	71377
Quick Ratio	0.6546	0.6464	0.6287	0.5632
Retention Rate %	65.6716	57.3935	61.4648	50.9156
Return On Assets %	17.7919	14.9532	14.5247	16.4943
Return On Average Assets %	19.6793	15.0495	14.3309	18.3733
Return On Average Equity %	18.3654	13.3923	12.9456	13.7145
Return On Average External Investments %	5.8313	3.4605	3.9887	6.0426
Return On Capital Employed %	9.3599	9.2212	8.2548	8.2243
Return On Equity %	16.4518	13.102	12.6115	13.5581
Return On External Investments %	4.971	3.4643	4.3388	3.8453
Total Assets Turnover	0.9975	1.0748	1.0735	1.0844
Total Debt / Cash Flow	4.173	3.0518	3.5613	3.8554
Turnover / Employee	1388812	1486235	1552106	1752319
Adequacy Ratio	45.3524	197.19	170.7918	69.1997
Cash Flow (Cata) To Current Liabilities	57.7785	57.7899	63.6708	46.3134
Cash Flow (Cata) To Net Earnings After Tax	108.3326	141.2782	166.1107	119.1314
Cash Flow (Cata) To Turnover (Margin)	16.2381	15.2225	17.0961	12.4532
Cash Flow (Ncta) To All Investments	96.2903	98.7559	111.0027	98.8451
Cash Flow (Ncta) To Capital Investments	191.9845	179.2435	175.5439	80.6345
Cash Flow (Ncta) To Financial Investments	36.7557	621.5205	590.5233	408.9757

Financial Year	2012	2011	2010	2009
Cash Flow Less Interest Paid To Income Before Tax	92.1899	122.2449	136.3448	106.2361
Cash Flow Return On Total Net Assets	17.5405	24.8522	26.071	23.5295
Cash Flow Return On Total Net Operating Assets	15.5072	21.7491	20.8221	23.2449
Cash Flow To Capital Redemption	67.488	-493.404	-848.251	360.4026
Cash Flow To Total Shareholders' Equity	18.1202	18.7992	21.7372	17.1938
Change In Working Capital To Operating Cash Flow	-1.9904	-0.545	11.0456	-10.3026
Dividend Coverage	0.3268	0.3094	0.2717	0.4134
Interest Coverage	518.9326	667.8353	613.0423	399.916
Price / Share To Cash Flow / Share	18258.39	17584.33	32333.18	12862.01
Reinvestment Rate	9.0293	12.2435	14.2411	8.9967
Attributable Earnings	58.6213	8.5967	-1.919	11.1153
Dividend / Share	2.9947	29.4647	8.7422	-21.7609
Earnings / Share	9.0819	11.9071	11.7322	-8.1623
Growth In Cash From Operating Activities	36.448	-9.5348	9.7083	-4.4567
Internal Growth Rate (After Tax) %	30.5981	14.8405	16.7493	12.4655
Net Turnover	14.8301	1.4165	-3.6084	6.067
Sustainable Growth (After Tax)	28.2563	13.9816	15.237	11.7102
Total Assets	23.7338	1.2963	-2.6323	25.7123
Total Shareholders' Interest	26.3241	4.5311	5.4426	2.3331
Enterprise Value	8.58E+09	6.68E+09	1.35E+10	4.16E+09
Enterprise Value / Cash	799.2676	558.6537	1218.579	565.5048
Enterprise Value / EBIT	170.2315	195.2773	412.0185	108.8055
Enterprise Value / EBITDA	139.0352	149.9933	310.8985	80.8987
Enterprise Value / PAT	202.5789	252.1438	541.6442	158.323
Enterprise Value / Share	1156.977	967.9884	883.4098	737.509

Forestry and paper

MNP:XJSE:EQU

Mondi Plc

YRK:XJSE:EQU|SAP:XJSE:EQU|MNP:XJSE:EQU|MND:
XJSE:EQU

York Timber Holdings Ltd, Sappi Ltd, Mondi Plc, Mondi
Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	5.8776	6.8252	6.9784	6.461
Assets / Capital Employed	1.1702	1.2666	1.2894	1.2444
Book Value / Share (c)	3961.496	3871.952	3404.54	4043.995
Cash Flow / Share (c)	1014.248	1091.452	905.3316	915.6986
Cash Flow Dividend Cover	1.7157	2.064	2.3338	4.1196
Cash Flow Interest Cover	3.7015	3.6822	3.0445	2.8183
Current Ratio	1.3919	1.3114	1.1772	1.2719
Debt / Assets	0.5377	0.4497	0.4802	0.5213
Debt / Equity	1.3852	1.0942	1.2143	1.4469
Directors Remuneration % Profit Before Tax	2.0139	2.082	1.8545	-14.6597
Dividend / Share (c)	591.141	528.8126	387.9227	222.2779
Dividend Cover	2.4581	2.5081	2.6456	-0.8042
Dividend Yield %	0.6992	1.7493	0.3842	0.6734
Earnings / Share (c)	1453.083	1326.295	1026.276	-178.75
Earnings Yield %	6.8545	9.1601	7.0744	-1.5626
Inflation Adjusted Profit / Share (c)	269.3061	133.8967	104.8283	-383.773
Inflation Adjusted Return On Assets %	6.4978	5.3691	5.3803	-0.1193
Inflation Adjusted Return On Average Equity %	5.7052	2.6789	2.0051	-5.8835
Inflation Adjusted Return On Average Total Assets %	6.585	5.3891	5.013	-0.0909
Inflation Adjusted Return On Equity %	5.9592	2.72	2.1298	-5.9871
Interest Cover	2.7953	2.3996	2.3674	0.6448
Leverage Factor	1.1305	0.9638	0.9371	-2.1381
Long Term Loans % Total Debt	56.6956	45.439	45.1966	54.5551
NAV / Share (c)	4718.828	5185.37	4474.983	5373.432
Net Profit Margin %	3.5038	2.9438	2.8705	-1.5128
Operating Profit / Employee	212087	190175.4	170689.9	41686.79
Operating Profit Margin %	7.9847	7.4328	7.7461	1.9639
Price / Book Value	5.3513	3.7395	4.2611	2.8286
Price / Cash	57.197	28.0005	38.4959	21.8078

Financial Year	2012	2011	2010	2009
Price / Cash Flow	20.9012	13.2658	16.024	12.4921
Price / Earnings	14.589	10.9169	14.1356	-63.9944
Price / EBIT	27.6773	20.3564	20.6066	54.6053
Price / EBITDA	15.8488	11.5465	11.56	11.924
Price / Inflation Adjusted Profit	78.7171	108.1356	138.3882	-29.8067
Price / NAV	4.4924	2.7923	3.2418	2.1288
Price / Share (c)	21199	14479	14507	11439
Quick Ratio	0.8479	0.8335	0.7458	0.826
Retention Rate %	60.3739	1.9517	69.3437	147.7326
Return On Assets %	7.5046	7.5491	8.1772	1.8663
Return On Average Assets %	7.8052	7.7749	7.6937	1.7409
Return On Average Equity %	8.5821	7.6327	7.5661	-3.7106
Return On Average External Investments %	12.8664	13.2966	16.2255	36.9692
Return On Capital Employed %	3.8537	3.7869	3.9073	-1.789
Return On Equity %	8.4842	7.2755	7.6629	-3.9903
Return On External Investments %	19.8547	13.6299	16.2047	37.7539
Total Assets Turnover	0.9399	1.0156	1.0557	0.9503
Total Debt / Cash Flow	5.4103	3.8817	4.5666	6.3898
Turnover / Employee	2656165	2558599	2203558	2122618
Adequacy Ratio	66.1861	181.4287	237.19	101.9594
Cash Flow (Cata) To Current Liabilities	39.2716	41.227	37.7854	47.6605
Cash Flow (Cata) To Net Earnings After Tax	247.777	305.6108	264.3546	-1077.42
Cash Flow (Cata) To Turnover (Margin)	9.7285	9.9586	9.4199	11.8811
Cash Flow (Ncta) To All Investments	88.0962	106.2676	107.4214	127.1834
Cash Flow (Ncta) To Capital Investments	140.0398	183.7537	154.7676	130.7218
Cash Flow (Ncta) To Financial Investments	92.9839	1284.764	-1021.5	458.2291
Cash Flow Less Interest Paid To Income Before Tax	195.8335	234.9612	195.013	-1797.9
Cash Flow Return On Total Net Assets	15.582	19.1232	18.3207	19.154
Cash Flow Return On Total Net Operating Assets	17.2639	20.7614	20.341	13.7943
Cash Flow To Capital Redemption	189.7803	-390.837	-286.158	546.5694
Cash Flow To Total Shareholders' Equity	21.5349	21.6009	22.3091	27.5545
Change In Working Capital To Operating Cash Flow	-10.4872	-9.1701	-10.2	47.9418

Financial Year	2012	2011	2010	2009
Dividend Coverage	0.1948	0.1979	0.0868	0.071
Interest Coverage	410.8733	402.7158	358.3194	475.8124
Price / Share To Cash Flow / Share	2271.632	1519.336	1694.509	902.6163
Reinvestment Rate	9.3067	11.2182	12.7983	14.137
Attributable Earnings	19.336	4.749	-287.248	-33.9702
Dividend / Share	11.7865	36.3191	74.5215	-47.7237
Earnings / Share	9.5596	29.2337	-674.14	-109.565
Growth In Cash From Operating Activities	5.1176	-1.4896	-3.8404	37.9993
Internal Growth Rate (After Tax) %	6.0767	0.0933	17.2765	-3.06
Net Turnover	0.2622	2.1425	-1.3171	-12.4104
Sustainable Growth (After Tax)	8.8501	0.1107	21.0783	9.463
Total Assets	8.3458	6.1661	-11.1663	-12.5897
Total Shareholders' Interest	2.3339	10.3268	-2.4946	-13.0978
Enterprise Value	4.78E+08	3.3E+08	3.42E+08	2.7E+08
Enterprise Value / Cash	70.7526	34.9951	48.2368	31.7771
Enterprise Value / EBIT	34.2368	25.4415	25.8208	79.5679
Enterprise Value / EBITDA	19.605	14.4309	14.485	17.3751
Enterprise Value / PAT	69.6256	58.0316	56.1299	-141.708
Enterprise Value / Share	262.2315	180.9592	181.7779	166.6831

Health care

AIP:XJSE:EQU

Adcock Ingram Hldgs Ltd

MDC:XJSE:EQU|LHC:XJSE:EQU|NTC:XJSE:EQU|ACT:XJSE:EQU|AVL:XJSE:EQU|APN:XJSE:EQU|AIP:XJSE:EQU|LHG:XJSE:EQU|NUT:XJSE:EQU|ASC:XJSE:EQU

Mediclinic Internat Ltd, Life Healthc Grp Hldgs L, Netcare Limited, Afrocentric Inv Corp Ltd, Advanced Health Ltd, Aspen Pharmacare Hldgs L, Adcock Ingram Hldgs Ltd, Litha Healthcare Grp Ltd, Nutritional Holdings Ltd, Ascendis Health Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	5.277	5.2975	5.7132	5.2411
Assets / Capital Employed	0.9215	0.8772	0.8827	0.8582
Book Value / Share (c)	640.1058	664.0066	545.7132	501.9521
Cash Flow / Share (c)	147.6028	202.1769	172.5194	194.9248
Cash Flow Dividend Cover	0.3911	1.2328	0.5292	0.8917
Cash Flow Interest Cover	1.8657	2.5688	2.0024	1.4962
Current Ratio	1.2929	1.124	1.189	1.3587
Debt / Assets	0.8151	0.8533	0.8531	0.8878
Debt / Equity	2.3775	2.3753	2.6098	3.9335
Directors Remuneration % Profit Before Tax	-6.3995	1.2898	1.5906	1.9413
Dividend / Share (c)	377.45	164	326	218.6
Dividend Cover	4.1431	9.011	3.7923	4.8449
Dividend Yield %	0.1191	0.1414	0.1153	0.0954
Earnings / Share (c)	1563.8	1477.8	1236.3	1059.095
Earnings Yield %	5.7161	7.0194	6.2547	8.0728
Inflation Adjusted Profit / Share (c)	37.3117	138.098	104.5742	112.9368
Inflation Adjusted Return On Assets %	1.3739	13.8437	14.0106	11.5672
Inflation Adjusted Return On Average Equity %	5.9058	22.5659	22.3766	21.5316
Inflation Adjusted Return On Average Total Assets %	1.332	14.6054	14.2588	11.4983
Inflation Adjusted Return On Equity %	5.7446	20.3171	18.5736	21.4877
Interest Cover	0.3275	3.2874	2.7562	2.03
Leverage Factor	4.4478	1.5238	1.3975	1.9821
Long Term Loans % Total Debt	73.3857	70.6222	73.024	81.5588
NAV / Share (c)	345.1846	271.2585	245.3015	249.4351
Net Profit Margin %	2.8702	10.4949	8.5309	8.0935
Operating Profit / Employee	20120.48	180822.9	180455.8	186989.2
Operating Profit Margin %	1.8823	19.1729	18.6753	18.0796

Financial Year	2012	2011	2010	2009
Price / Book Value	42.7398	31.706	36.2205	26.3192
Price / Cash	173.2038	127.9651	132.5534	104.1375
Price / Cash Flow	185.3488	104.1316	114.5726	67.7749
Price / Earnings	17.4946	14.2462	15.988	12.4739
Price / EBIT	1055.964	81.3688	83.2392	49.9508
Price / EBITDA	102.2372	66.4921	67.5779	40.2861
Price / Inflation Adjusted Profit	733.2289	152.4497	189.0141	116.9769
Price / NAV	79.2561	77.6123	80.5784	52.9637
Price / Share (c)	27358	21053	19766	13211
Quick Ratio	1.0407	0.9136	0.9715	1.1184
Retention Rate %	17.445	79.5156	80.1625	89.1986
Return On Assets %	1.3877	13.9974	14.2234	11.8928
Return On Average Assets %	1.465	14.9461	14.6489	11.8465
Return On Average Equity %	6.3723	23.7727	24.0875	23.4732
Return On Average External Investments %	26.8488	41.4656	67.9804	104.0222
Return On Capital Employed %	1.9715	6.7903	5.7814	4.5821
Return On Equity %	6.172	21.3292	19.8771	23.5873
Return On External Investments %	19.8811	30.9068	57.2125	101.8921
Total Assets Turnover	0.7372	0.7301	0.7616	0.6578
Total Debt / Cash Flow	10.3105	7.801	8.2553	10.1293
Turnover / Employee	1068952	943116.5	966282.4	1034254
Adequacy Ratio	113.0006	103.7346	141.3815	52.0595
Cash Flow (Cata) To Current Liabilities	45.618	43.5075	47.756	41.3971
Cash Flow (Cata) To Net Earnings After Tax	-409.142	135.4548	157.5955	136.751
Cash Flow (Cata) To Turnover (Margin)	13.4236	14.9383	14.4296	10.3038
Cash Flow (Ncta) To All Investments	109.1926	94.628	81.0672	
Cash Flow (Ncta) To Capital Investments	130.4733	210.637	167.6651	70.4599
Cash Flow (Ncta) To Financial Investments	496.1338	130.4458	170.0553	-445.411
Cash Flow Less Interest Paid To Income Before Tax	-558.589	124.3629	132.9685	120.5726
Cash Flow Return On Total Net Assets	15.749	15.8427	16.6093	12.4106
Cash Flow Return On Total Net Operating Assets	17.0009	15.5146	16.6062	13.5477
Cash Flow To Capital Redemption	2433.103	660.0703	-2348.34	
Cash Flow To Total Shareholders' Equity	28.5627	26.4105	28.5838	24.0306

Financial Year	2012	2011	2010	2009
Change In Working Capital To Operating Cash Flow	-35.1457	1.7289	-0.441	-9.1454
Dividend Coverage	0.2048	0.1712	0.1226	0.0747
Interest Coverage	319.507	338.6324	300.8695	204.5977
Price / Share To Cash Flow / Share	14900.93	10515	10865.83	8945.36
Reinvestment Rate	7.6086	8.1815	8.6486	5.3033
Attributable Earnings	-69.1215	35.0729	29.5653	66.2903
Dividend / Share	130.1524	-49.6933	49.1308	257.1895
Earnings / Share	5.8195	19.5341	16.7318	61.9163
Growth In Cash From Operating Activities	-87.2837	14.3223	39.8995	49.3296
Internal Growth Rate (After Tax) %	0.9497	46.1093	45.1858	190.8424
Net Turnover	12.9054	9.7952	22.9227	37.7253
Sustainable Growth (After Tax)	0.9223	129.7242	113.0626	-360.355
Total Assets	11.8082	14.5408	6.1666	-0.7751
Total Shareholders' Interest	6.7105	25.8772	53.7497	-0.9632
Enterprise Value	1.7E+09	1.2E+09	1.09E+09	5.51E+08
Enterprise Value / Cash	181.8196	136.6183	141.1957	118.8545
Enterprise Value / EBIT	1108.492	86.871	88.6663	57.0099
Enterprise Value / EBITDA	107.3229	70.9884	71.9839	45.9795
Enterprise Value / PAT	-635.942	151.028	180.849	136.7953
Enterprise Value / Share	287.1889	224.7663	210.5472	150.7801

Industrial goods

ADR:XJSE:EQU

RLO:XJSE:EQU|AEN:XJSE:EQU|ELI:XJSE:EQU|AEL:XJSE:EQU|SOH:XJSE:EQU|JSC:XJSE:EQU|ARH:XJSE:EQU|CIL:XJSE:EQU|CAC:XJSE:EQU|DGC:XJSE:EQU|ANS:XJSE:EQU|AER:XJSE:EQU|LAB:XJSE:EQU|MPT:XJSE:EQU|NPK:XJSE:EQU|APK:XJSE:EQU|TPC:XJSE:EQU|BCF:XJSE:EQU|BAW:XJSE:EQU|BVT:XJSE:EQU|REM:XJSE:EQU|EQS:XJSE:EQU|KAP:XJSE:EQU|ART:XJSE:EQU|BEL:XJSE:EQU|HDC:XJSE:EQU|IVT:XJSE:EQU|HWN:XJSE:EQU|ASO:XJSE:EQU|PSV:XJSE:EQU|MRI:XJSE:EQU|MDI:XJSE:EQU|GND:XJSE:EQU|SNV:XJSE:EQU|IPL:XJSE:EQU|SPG:XJSE:EQU|VLE:XJSE:EQU|TRE:XJSE:EQU|OLG:XJSE:EQU|CRG:XJSE:EQU|MFL:XJSE:EQU|MIX:XJSE:EQU|MOR:XJSE:EQU|MMG:XJSE:EQU|CMA:XJSE:EQU|ADR:XJSE:EQU|KEL:XJSE:EQU|WKF:XJSE:EQU|CSG:XJSE:EQU|PMV:XJSE:EQU|NT1:XJSE:EQU|ILA:XJSE:EQU|ELR:XJSE:EQU|WNH:XJSE:EQU|TOR:XJSE:EQU|MMP:XJSE:EQU|RAR:XJSE:EQU|IWE:XJSE:EQU

Reunert Ltd, Allied Elec Corp N, Ellies Holdings Ltd, Allied Electronics Corp, South Ocean Holdings Ltd, Jasco Electron Hldgs Ltd, Arb Holdings Limited, Cons Infrastructure Grp, Cafca Limited, Digicore Holdings Limite, Ansys Limited, Amalgamated Elec Corp Lt, Labat Africa Ltd, Mpact Limited, Nampak Ltd, Astrapak Limited, Transpaco Ltd, Bowler Metcalf Ltd, Barloworld Ltd, Bidvest Ltd, Remgro Ltd, Eqstra Holdings Ltd, Kap Industrial Hldgs Ltd, Argent Industrial Ltd, Bell Equipment Ltd, Hudaco Industries Ltd, Invicta Holdings Ltd, Howden Africa Hldgs Ltd, Austro Group Ltd, Psv Holdings Ltd, Mine Restoration Inv Ltd, Master Drilling Grp Ltd, Grindrod Ltd, Santova Logistics Ltd, Imperial Holdings Ltd, Super Group Ltd, Value Group Ltd, Trencor Ltd, Onelogix Group Ltd, Cargo Carriers Ltd, Metrofile Holdings Ltd, Mix Telematics Ltd, Morvest Business Grp Ltd, Micromega Holdings Ltd, Command Holdings Limited, Adcorp Holdings Limited, Kelly Group Ltd, Workforce Holdings Ltd, Csg Holdings Ltd, Primeserv Group Ltd, Net 1 Ueps Tech Inc, Iliad Africa Ltd, Elb Group Ltd, Winhold Ltd, Torre Industries Limited, Marshall Monteagle Plc, Rare Holdings Ltd, Interwaste Hldgs Ltd

Adcorp Holdings Limited

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	6.2708	6.4956	6.6655	6.7019
Assets / Capital Employed	1.293	1.2999	1.3204	1.3079
Book Value / Share (c)	1286.276	1018.475	846.6907	961.0389
Cash Flow / Share (c)	319.4677	243.0734	172.2631	554.0488
Cash Flow Dividend Cover	0.0806	0.0744	0.0664	0.2563
Cash Flow Interest Cover	6.718	6.7118	4.8715	9.6119
Current Ratio	1.506	1.4728	1.4106	1.4123
Debt / Assets	0.5149	0.4904	0.4916	0.5282
Debt / Equity	1.031	0.9377	0.9346	1.0719

Financial Year	2012	2011	2010	2009
Directors Remuneration % Profit Before Tax	2.7248	2.8588	3.8022	4.228
Dividend / Share (c)	3965.184	3268.427	2595.195	2161.7
Dividend Cover	2.9255	2.8207	2.9634	3.7411
Dividend Yield %	0.0494	0.0411	0.0287	0.6726
Earnings / Share (c)	11600.17	9219.281	7690.721	8087.235
Earnings Yield %	9.2667	9.607	8.6979	11.2531
Inflation Adjusted Profit / Share (c)	194.954	146.1157	84.8175	430.0911
Inflation Adjusted Return On Assets %	11.2822	11.4405	9.2159	8.9924
Inflation Adjusted Return On Average Equity %	15.5701	14.7655	9.9849	0.4537
Inflation Adjusted Return On Average Total Assets %	10.6282	9.8749	8.1442	0.1171
Inflation Adjusted Return On Equity %	14.7493	13.7313	9.6266	42.401
Interest Cover	5.4909	5.1945	3.8866	2.9086
Leverage Factor	1.5299	1.5392	1.2382	5.309
Long Term Loans % Total Debt	37.8041	34.4342	31.7692	33.2609
NAV / Share (c)	1249.473	992.2523	818.3468	919.9926
Net Profit Margin %	5.6797	5.414	3.7438	14.4512
Operating Profit / Employee	117208.2	107834.7	84148.87	81036.96
Operating Profit Margin %	7.429	6.7212	5.7471	5.5225
Price / Book Value	97.3492	96.3598	104.4301	74.8992
Price / Cash	447.9358	499.0001	543.7932	332.6065
Price / Cash Flow	391.9582	403.7464	513.2847	129.9182
Price / Earnings	10.7945	10.6451	11.497	8.9006
Price / EBIT	479.5508	521.6803	643.356	429.3412
Price / EBITDA	335.1613	360.8737	410.5175	279.0778
Price / Inflation Adjusted Profit	642.2953	671.6593	1042.474	167.3622
Price / NAV	100.2167	98.9063	108.0471	78.2409
Price / Share (c)	125218	98140	88420	71981
Quick Ratio	1.0226	1.0073	0.9758	0.9798
Retention Rate %	71.2621	82.5063	64.4709	-10.3019
Return On Assets %	10.138	9.6607	8.5382	8.597
Return On Average Assets %	11.0189	10.3964	8.6383	0.1236
Return On Average Equity %	16.512	15.9696	11.0424	0.4632
Return On Average External Investments %	4.1658	3.8107	4.3392	4.6548
Return On Capital Employed %	10.625	10.9502	8.1449	30.5291
Return On Equity %	15.52	14.8787	10.574	45.6499
Return On External Investments %	3.994	3.6139	4.0701	6.0128

Financial Year	2012	2011	2010	2009
Total Assets Turnover	1.3647	1.4374	1.4857	1.5567
Total Debt / Cash Flow	4.1511	3.9291	4.5936	1.8593
Turnover / Employee	1577717	1604399	1464204	1467384
Adequacy Ratio	58.6531	72.48	113.3007	76.6266
Cash Flow (Cata) To Current Liabilities	28.5144	30.3088	35.351	30.0349
Cash Flow (Cata) To Net Earnings After Tax	110.657	113.955	189.5418	174.7451
Cash Flow (Cata) To Turnover (Margin)	6.6913	6.7807	7.9813	6.802
Cash Flow (Ncta) To All Investments	134.1339	116.5543	115.326	175.4199
Cash Flow (Ncta) To Capital Investments	89.7224	105.2985	151.5375	132.4503
Cash Flow (Ncta) To Financial Investments	463.5217	1361.137	487.4109	-991.135
Cash Flow Less Interest Paid To Income Before Tax	102.081	104.1679	160.0892	160.8944
Cash Flow Return On Total Net Assets	22.0562	24.357	29.4518	29.8722
Cash Flow Return On Total Net Operating Assets	23.6839	24.9895	25.6348	25.955
Cash Flow To Capital Redemption	240.5605	789.064	-60906.8	1640.467
Cash Flow To Total Shareholders' Equity	17.204	17.6712	21.2734	20.346
Change In Working Capital To Operating Cash Flow	-15.6438	-9.5264	9.8358	9.6913
Dividend Coverage	0.2864	0.23	0.1918	0.2547
Interest Coverage	568.4702	600.7009	614.524	436.3337
Price / Share To Cash Flow / Share	53356.64	51828.16	46439.39	35414.37
Reinvestment Rate	11.378	13.8202	18.0359	14.5166
Attributable Earnings	18.5559	62.9752	-74.6894	-99.9865
Dividend / Share	21.3178	25.9415	20.0534	-24.0812
Earnings / Share	25.8251	19.8754	-4.903	-99.9994
Growth In Cash From Operating Activities	10.388	-0.6552	3.5836	-99.9948
Internal Growth Rate (After Tax) %	18.2915	26.4431	14.0864	-1.6359
Net Turnover	13.0111	12.6973	-2.2997	-99.3451
Sustainable Growth (After Tax)	33.3442	47.6503	20.2313	-2.8965
Total Assets	19.0308	16.4854	2.3722	-99.2761
Total Shareholders' Interest	13.6573	15.8233	9.2706	-99.4901
Enterprise Value	1.7E+10	1.48E+10	1.39E+10	9.13E+09
Enterprise Value / Cash	451.6441	502.8132	547.6216	336.3214
Enterprise Value / EBIT	483.5208	525.6667	647.8853	434.1365
Enterprise Value / EBITDA	337.9359	363.6314	413.4075	282.1948
Enterprise Value / PAT	594.0376	593.7649	884.2548	615.9343

Financial Year	2012	2011	2010	2009
Enterprise Value / Share	1262.546	988.8994	890.4248	727.8494

Industrial metals

AEA:XJSE:EQU

African Eagle Res Plc

HLM:XJSE:EQU|MML:XJSE:EQU|ZCI:XJSE:EQU|ISB:XJSE:EQU|AEA:XJSE:EQU|ACL:XJSE:EQU|KIO:XJSE:EQU|EHS:XJSE:EQU|BSS:XJSE:EQU|FCR:XJSE:EQU

Hulamin Ltd, Metmar Ltd, Zci Limited, Insimbi Ref & Alloy Sup, African Eagle Res Plc, Arcelormittal Sa Limited, Kumba Iron Ore Ltd, Evraz Highveld Steel & V, Bsi Steel Limited, Ferrum Crescent Limited

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	10.4782	11.1238	10.7488	9.5553
Assets / Capital Employed	1.2064	1.2467	1.1652	1.1686
Book Value / Share (c)	1321.185	1503.61	1627.128	1467.656
Cash Flow / Share (c)	446.0257	676.2701	688.3884	444.0519
Cash Flow Dividend Cover	0.1635	0.1506	0.1911	0.3023
Cash Flow Interest Cover	15.7497	40.7826	21.1448	11.9766
Current Ratio	1.9437	1.9008	2.7131	2.5744
Debt / Assets	0.2371	0.2262	0.2156	0.245
Debt / Equity	0.4273	0.3866	0.3458	0.4072
Directors Remuneration % Profit Before Tax	0.7745	0.4104	0.4702	0.7678
Dividend / Share (c)	2728.3	4490	3602	1469
Dividend Cover	0.9671	1.1703	1.1819	1.6451
Dividend Yield %	0.6408	0.7062	0.4279	0.6914
Earnings / Share (c)	2638.493	5254.522	4257.075	2416.596
Earnings Yield %	4.3097	8.408	6.9867	5.3199
Inflation Adjusted Profit / Share (c)	295.35	521.8725	527.6125	249.3992
Inflation Adjusted Return On Assets %	25.2691	36.5195	33.1739	18.0504
Inflation Adjusted Return On Average Equity %	20.06	31.4616	30.5598	12.7429
Inflation Adjusted Return On Average Total Assets %	24.8554	38.1189	35.1619	16.3332
Inflation Adjusted Return On Equity %	21.0845	31.1884	28.4635	14.2945
Interest Cover	22.1796	61.3563	29.4138	13.635
Leverage Factor	0.8707	0.902	0.9191	0.8961
Long Term Loans % Total Debt	24.0089	8.226	29.67	36.2025
NAV / Share (c)	1816.273	1989.128	2046.783	1841.885
Net Profit Margin %	11.0853	17.5581	18.5587	11.0384
Operating Profit / Employee	814262	1191502	1307747	685094.1
Operating Profit Margin %	22.9416	33.23	32.3824	20.4761

Financial Year	2012	2011	2010	2009
Price / Book Value	46.3433	41.5626	37.447	30.9514
Price / Cash	629.1685	293.0497	183.1645	155.9729
Price / Cash Flow	137.2746	92.4098	88.5125	102.2989
Price / Earnings	23.2057	11.8934	14.3129	18.7975
Price / EBIT	97.4785	61.4234	63.6294	89.856
Price / EBITDA	83.4128	56.2658	58.4358	76.4371
Price / Inflation Adjusted Profit	207.3066	119.7496	115.4844	182.1417
Price / NAV	33.7108	31.4178	29.7692	24.6628
Price / Share (c)	61228	62494	60931	45426
Quick Ratio	0.8524	0.9237	1.5409	1.4563
Retention Rate %	-29.2685	17.907	52.4876	-15.2355
Return On Assets %	26.3828	39.5819	36.6969	20.723
Return On Average Assets %	26.4337	41.6543	39.5233	19.6121
Return On Average Equity %	22.4112	36.485	36.9257	17.2345
Return On Average External Investments %	6.1887	10.8848	10.703	25.4734
Return On Capital Employed %	15.3922	26.2025	24.6318	13.1552
Return On Equity %	22.972	35.7533	33.7285	18.5692
Return On External Investments %	5.8687	10.3949	10.2655	23.6945
Total Assets Turnover	1.15	1.1911	1.1332	1.0121
Total Debt / Cash Flow	1.2656	0.8596	0.8174	1.3459
Turnover / Employee	3549281	3585619	4038450	3345823
Adequacy Ratio	71.504	101.4546	139.7591	85.1215
Cash Flow (Cata) To Current Liabilities	132.6397	150.52	176.9886	130.9385
Cash Flow (Cata) To Net Earnings After Tax	137.3004	114.3733	101.6658	146.5248
Cash Flow (Cata) To Turnover (Margin)	20.7822	26.2272	23.6851	20.2208
Cash Flow (Ncta) To All Investments	37.0777	86.172	115.7049	66.4305
Cash Flow (Ncta) To Capital Investments	23.7393	97.8799	151.4598	81.4264
Cash Flow (Ncta) To Financial Investments	351.7365	2440.557	11620.68	617.3554
Cash Flow Less Interest Paid To Income Before Tax	117.0137	101.4474	102.3085	133.0023
Cash Flow Return On Total Net Assets	40.7779	54.4785	47.3759	36.1507
Cash Flow Return On Total Net Operating Assets	43.4615	57.8714	51.0408	31.6447
Cash Flow To Capital Redemption	676.1448	-3510.34	-956.214	-3707.03
Cash Flow To Total Shareholders' Equity	39.3618	48.5521	39.5369	32.581

Financial Year	2012	2011	2010	2009
Change In Working Capital To Operating Cash Flow	-6.979	-5.9986	-7.7496	13.8363
Dividend Coverage	0.9178	0.7088	0.4649	0.7659
Interest Coverage	2063.152	4894.567	2197.678	1387.215
Price / Share To Cash Flow / Share	10760.72	7782.388	8699.437	9099.056
Reinvestment Rate	2.579	12.2308	17.8592	6.0064
Attributable Earnings	-38.811	10.4321	119.6784	-64.1376
Dividend / Share	-39.2361	24.653	145.2008	-65.419
Earnings / Share	-49.7862	23.4304	76.16	-67.4831
Growth In Cash From Operating Activities	-29.2335	21.771	61.573	-39.276
Internal Growth Rate (After Tax) %	-2.1612	3.404	20.8143	-1.1609
Net Turnover	-3.0817	16.7253	30.6614	-22.0205
Sustainable Growth (After Tax)	-3.513	5.7745	35.2856	-1.6895
Total Assets	0.3863	11.0503	16.6897	-10.176
Total Shareholders' Interest	-4.7663	4.1781	20.9437	-13.4116
Enterprise Value	2.13E+09	2E+09	1.73E+09	1.19E+09
Enterprise Value / Cash	633.8764	294.7239	183.8392	156.9957
Enterprise Value / EBIT	98.208	61.7743	63.8638	90.4452
Enterprise Value / EBITDA	84.037	56.5873	58.651	76.9383
Enterprise Value / PAT	148.8507	89.5182	88.7693	134.198
Enterprise Value / Share	616.8616	628.5102	611.5543	457.2388

Media

AME:XJSE:EQU

African Media Ent Ltd

NPN:XJSE:EQU|AME:XJSE:EQU|CAT:XJSE:EQU|TMG:
XJSE:EQU|MNY:XJSE:EQU|CATP:XJSE:EQU

Naspers Ltd -N-, African Media Ent Ltd, Caxton Ctp
Publish Print, Times Media Group Ltd, Money Web
Holdings Ltd, Caxton Ctp Publish 6%Pf

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	4.6453	4.9501	4.928	4.4544
Assets / Capital Employed	0.9021	0.8663	0.8121	0.436
Book Value / Share (c)	5731.316	4836.083	4183.251	4167.462
Cash Flow / Share (c)	1222.397	1288.716	652.7532	935.2644
Cash Flow Dividend Cover	3.7348	4.1438	1.3713	2.4032
Cash Flow Interest Cover	8.8071	8.7844	6.8296	9.8223
Current Ratio	1.5334	1.5164	1.3778	1.5056
Debt / Assets	0.4584	0.4776	0.5053	0.4675
Debt / Equity	0.5741	0.5731	0.551	0.4802
Directors Remuneration % Profit Before Tax	0.742	0.4362	0.5329	0.365
Dividend / Share (c)	327.3	311	476	389.1765
Dividend Cover	5.6001	4.9466	2.5821	3.1194
Dividend Yield %	0.2644	0.2579	0.2976	0.5389
Earnings / Share (c)	1832.9	1538.4	1229.1	1214.012
Earnings Yield %	3.766	3.5172	3.4598	7.1072
Inflation Adjusted Profit / Share (c)	360.596	592.6287	377.9927	710.3015
Inflation Adjusted Return On Assets %	9.9899	16.1622	14.6041	21.0398
Inflation Adjusted Return On Average Equity %	6.637	13.0309	8.8811	17.3831
Inflation Adjusted Return On Average Total Assets %	4.4546	11.5577	10.0352	17.7961
Inflation Adjusted Return On Equity %	6.243	12.0405	8.8346	16.7459
Interest Cover	2.1828	4.2014	4.8837	8.0916
Leverage Factor	1.5173	1.1801	0.9181	0.968
Long Term Loans % Total Debt	51.3519	51.5905	44.2691	40.3289
NAV / Share (c)	3887.564	3031.56	2256.26	2279.233
Net Profit Margin %	7.551	15.2646	11.2609	21.0494
Operating Profit / Employee	110453	266412.7	248591.8	405925.8
Operating Profit Margin %	6.2327	15.5212	13.3737	22.335
Price / Book Value	8.4888	9.0443	8.4922	4.4991
Price / Cash	40.4448	40.2247	38.219	21.2552

Financial Year	2012	2011	2010	2009
Price / Cash Flow	39.8005	33.94	54.4233	20.0478
Price / Earnings	26.5437	28.4315	28.9033	15.4447
Price / EBIT	160.585	70.9634	76.108	24.3358
Price / EBITDA	58.2099	44.5652	47.1587	18.3119
Price / Inflation Adjusted Profit	134.9211	73.8051	93.9833	26.3972
Price / NAV	12.5148	14.4279	15.7451	8.2265
Price / Share (c)	48652	43739	35525	18750
Quick Ratio	1.4129	1.4091	1.2764	1.389
Retention Rate %	64.9344	81.3954	73.1086	86.2389
Return On Assets %	4.2209	10.6212	10.2336	17.9998
Return On Average Assets %	4.5976	12.0235	10.568	18.4343
Return On Average Equity %	6.8397	13.5959	9.4218	18.0394
Return On Average External Investments %	2.9301	3.6719	4.8816	7.3091
Return On Capital Employed %	4.6129	-9.4743	-9.1475	13.5566
Return On Equity %	6.4043	12.5343	9.3953	17.4236
Return On External Investments %	2.6358	3.0362	4.7042	6.8081
Total Assets Turnover	0.6772	0.6843	0.7652	0.8059
Total Debt / Cash Flow	2.6916	2.1506	3.531	2.1397
Turnover / Employee	1772140	1716443	1858810	1817446
Adequacy Ratio	130.9142	77.1348	121.645	-176.614
Cash Flow (Cata) To Current Liabilities	50.3009	49.3755	55.412	42.755
Cash Flow (Cata) To Net Earnings After Tax	186.2997	97.5046	151.6795	65.5617
Cash Flow (Cata) To Turnover (Margin)	16.5631	16.6822	20.3938	14.8004
Cash Flow (Ncta) To All Investments	137.6489	164.4804	132.9587	81.2834
Cash Flow (Ncta) To Capital Investments	211.2225	218.6852	263.096	218.7231
Cash Flow (Ncta) To Financial Investments	257.6007	92.6168	134.7272	-119.811
Cash Flow Less Interest Paid To Income Before Tax	143.0883	88.9215	123.9004	68.4463
Cash Flow Return On Total Net Assets	24.8649	23.8097	25.0217	20.5974
Cash Flow Return On Total Net Operating Assets	20.1508	22.02	21.5288	22.3419
Cash Flow To Capital Redemption	1128.926	149.6022	337.129	-84.4912
Cash Flow To Total Shareholders' Equity	13.5048	13.0399	16.1787	11.7463
Change In Working Capital To Operating Cash Flow	4.2171	-6.6824	9.8764	-10.8437

Financial Year	2012	2011	2010	2009
Dividend Coverage	0.3445	0.2805	0.1988	0.2638
Interest Coverage	632.3295	489.5747	770.4493	552.4047
Price / Share To Cash Flow / Share	6042.996	6602.642	4991.095	3672.626
Reinvestment Rate	11.816	11.9991	15.1594	10.3988
Attributable Earnings	-41.4508	58.1001	-45.7722	64.4819
Dividend / Share	5.2412	-34.6639	22.3096	67.0285
Earnings / Share	19.1433	25.1648	1.2428	0.0669
Growth In Cash From Operating Activities	-55.826	4.1635	-25.3797	57.1413
Internal Growth Rate (After Tax) %	10.0598	65.9081	25.6003	496.6778
Net Turnover	18.3588	16.6322	1.3651	17.0114
Sustainable Growth (After Tax)	9.0585	62.2859	21.7677	309.5948
Total Assets	19.597	30.4208	6.7561	4.9471
Total Shareholders' Interest	14.5919	18.5063	0.5657	7.3275
Enterprise Value	4.65E+08	4.3E+08	3.41E+08	1.83E+08
Enterprise Value / Cash	42.1545	41.7596	39.6592	22.468
Enterprise Value / EBIT	167.3734	73.6711	78.9761	25.7242
Enterprise Value / EBITDA	60.6706	46.2656	48.9359	19.3567
Enterprise Value / PAT	117.3371	66.8334	78.5554	25.4509
Enterprise Value / Share	507.0867	454.0792	368.6376	198.1979

Mining

ARI:XJSE:EQ

FSE01:XJSE:DER|EXX:XJSE:EQ|CZA:XJSE:EQ|WSL
:XJSE:EQ|KEH:XJSE:EQ|BDM:XJSE:EQ|SAH:XJSE
:EQ|HWA:XJSE:EQ|BUC:XJSE:EQ|FSE:XJSE:EQ|
RSG:XJSE:EQ|WCC:XJSE:EQ|TSX:XJSE:EQ|DRN:
XJSE:EQ|DMC:XJSE:EQ|RDI:XJSE:EQ|DMCCB:XJ
SE:IBI|AGL:XJSE:EQ|BIL:XJSE:EQ|MRF:XJSE:EQ|
ASR:XJSE:EQ|PET:XJSE:EQ|ARI:XJSE:EQ|SNU:XJ
SE:EQ|GLN:XJSE:EQ|IRA:XJSE:EQ|MMH:XJSE:EQ
U|GGM:XJSE:EQ|CMO:XJSE:EQ|SMM:XJSE:EQ|TA
W:XJSE:EQ|KBO:XJSE:EQ|THA:XJSE:EQ|ANG:XJ
SE:EQ|HAR:XJSE:EQ|GFI:XJSE:EQ|DRD:XJSE:EQ
U|PAN:XJSE:EQ|SGL:XJSE:EQ|VIL:XJSE:EQ|CRD:
XJSE:EQ|GBG:XJSE:EQ|RNG:XJSE:EQ|PZG:XJSE:
EQ|GIY:XJSE:EQ|AMS:XJSE:EQ|IMP:XJSE:EQ|L
ON:XJSE:EQ|NHM:XJSE:EQ|AQP:XJSE:EQ|RBP:X
JSE:EQ|EPS:XJSE:EQ|ATL:XJSE:EQ|WEZ:XJSE:E
QU|JBL:XJSE:EQ|BAU:XJSE:EQ|PLL:XJSE:EQ|IMP
CB:XJSE:IBI

Firestone Energy Ltd Opt, Exxaro Resources Ltd, Coal
Of Africa Ltd, Wescoal Holdings Ltd, Keaton Energy
Hldgs Ltd, Buildmax Ltd, South African Coal Minin,
Hwange Colliery Ltd, Buffalo Coal Corp, Firestone
Energy Limited, Resource Generation Ltd, The
Waterberg Coal Co Lt, Trans Hex Group Ltd, Delrand
Resources Ltd, Diamondcorp Plc, Rockwell Diamonds
Inc, Soapstone Investment Ltd, Anglo American Plc,
Bhp Billiton Plc, Merafe Resources Ltd, Assore Ltd,
Petmin Ltd, African Rainbow Min Ltd, Sentula Mining
Ltd, Glencore Plc, Infradors Holdings Ltd, Miranda
Mineral Hldgs Ld, Goliath Gold Mining Ltd, Chrometco
Ltd, Sable Metals And Min Ltd, Tawana Resources NI,
Kibo Mining Plc, Tharisa Plc, Anglogold Ashanti Ltd,
Harmony Gm Co Ltd, Gold Fields Ltd, Drd Gold Ltd,
Pan African Resource Plc, Sibanye Gold Limited,
Village Main Reef Gm Co, Central Rand Gold Ltd, Great
Basin Gold Ltd, Randgold & Expl Co Ltd, Pamodzi Gold
Limited, Giyani Gold Corporation, Anglo American Plat
Ltd, Impala Platinum Hlgs Ltd, Lonmin Plc, Northam
Platinum Ltd, Aquarius Platinum Ltd, Royal Bafokeng
Platinum, Eastern Platinum Ltd, Atlatsa Resources
Corp, Wesizwe Platinum Ltd, Jubilee Platinum Plc,
Bauba Platinum Limited, Platfields Limited, Impala
Platinum Hldgs Lt

African Rainbow Min Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	7.1988	8.1724	7.315	7.9482
Assets / Capital Employed	1.2489	1.1336	1.1121	1.1202
Book Value / Share (c)	4526.799	4311.205	4545.825	4244.401
Cash Flow / Share (c)	996.6097	1291.308	1338.831	1156.378
Cash Flow Dividend Cover	0.2272	0.2488	0.2579	0.3065
Cash Flow Interest Cover	10.4994	19.9807	17.2836	12.5628

Financial Year	2012	2011	2010	2009
Current Ratio	1.1909	1.6789	1.9217	1.6037
Debt / Assets	0.4181	0.2741	0.2802	0.3397
Debt / Equity	0.8868	0.4703	0.4876	0.645
Directors Remuneration % Profit Before Tax	0.6422	0.3482	0.3985	0.4536
Dividend / Share (c)	4386.432	5189.851	5191.932	3772.732
Dividend Cover	3.8121	3.9111	3.5085	4.3691
Dividend Yield %	0.1108	0.0997	0.0794	0.1193
Earnings / Share (c)	16721.66	20298.11	18215.63	16483.35
Earnings Yield %	5.1383	7.542	6.1713	7.0771
Inflation Adjusted Profit / Share (c)	424.0914	978.1051	838.4426	459.6013
Inflation Adjusted Return On Assets %	7.0925	18.6902	16.8712	10.9893
Inflation Adjusted Return On Average Equity %	10.3814	23.207	19.0035	0.0033
Inflation Adjusted Return On Average Total Assets %	8.5321	19.468	16.9821	0.0048
Inflation Adjusted Return On Equity %	9.0372	21.3632	17.5722	10.0911
Interest Cover	7.2439	21.9109	17.4558	10.0768
Leverage Factor	1.3774	1.2223	1.1163	0.9967
Long Term Loans % Total Debt	42.793	47.086	54.0869	55.393
NAV / Share (c)	5586.037	5370.498	5693.48	5321.419
Net Profit Margin %	5.1259	24.9309	20.9067	10.5216
Operating Profit / Employee	676585.1	1059331	841523.2	534016.9
Operating Profit Margin %	7.8905	34.9935	32.5876	20.0438
Price / Book Value	42.096	50.4794	61.6185	59.4656
Price / Cash	356.33	261.2916	328.528	312.1475
Price / Cash Flow	191.2083	168.5322	209.2176	218.2644
Price / Earnings	11.396	10.7215	15.3773	15.3122
Price / EBIT	277.1381	153.6855	207.1541	272.1109
Price / EBITDA	177.6787	126.6562	163.313	191.9099
Price / Inflation Adjusted Profit	449.3371	222.4986	334.0801	549.1629
Price / NAV	34.1136	40.5227	49.1979	47.4302
Price / Share (c)	190560	217627	280107	252396
Quick Ratio	0.7678	1.2534	1.4111	1.1618
Retention Rate %	51.1738	77.6172	76.7347	36.7583
Return On Assets %	7.1623	19.1405	17.0945	11.5094
Return On Average Assets %	9.0357	20.549	17.9321	0.0049
Return On Average Equity %	11.4515	25.2845	20.8467	0.0035

Financial Year	2012	2011	2010	2009
Return On Average External Investments %	5.7114	7.9645	7.329	10.8047
Return On Capital Employed %	5.8798	15.6551	12.3938	6.8555
Return On Equity %	9.8675	23.4009	19.0832	11.4715
Return On External Investments %	3.9395	7.3251	6.8169	11.661
Total Assets Turnover	0.9077	0.547	0.5246	0.5742
Total Debt / Cash Flow	4.0279	1.5703	1.6555	2.3674
Turnover / Employee	8574722	3027224	2582340	2664249
Adequacy Ratio	53.1108	123.7577	100.4971	70.8275
Cash Flow (Cata) To Current Liabilities	42.9377	134.9613	112.1071	112.2025
Cash Flow (Cata) To Net Earnings After Tax	222.1003	135.5303	121.0312	260.1464
Cash Flow (Cata) To Turnover (Margin)	11.3152	35.7847	27.4949	29.6091
Cash Flow (Ncta) To All Investments	81.0673	156.2043	102.811	138.6036
Cash Flow (Ncta) To Capital Investments	80.4773	160.6318	104.0152	102.62
Cash Flow (Ncta) To Financial Investments	113.3046	855.4649	-1207.57	-1160.96
Cash Flow Less Interest Paid To Income Before Tax	191.1366	119.93	104.8978	193.9539
Cash Flow Return On Total Net Assets	22.0855	32.1369	24.7042	30.6806
Cash Flow Return On Total Net Operating Assets	21.7985	31.469	26.2517	27.7257
Cash Flow To Capital Redemption	154.6698	1229.797	-1372.07	802.3715
Cash Flow To Total Shareholders' Equity	20.3497	31.9441	23.9056	30.974
Change In Working Capital To Operating Cash Flow	-1.7725	0.3711	-7.5031	10.1052
Dividend Coverage	0.2747	0.1807	0.2252	0.253
Interest Coverage	1092.919	2289.885	1539.927	1537.773
Price / Share To Cash Flow / Share	19328.93	15029.12	24554	18420.92
Reinvestment Rate	11.642	21.3437	14.5197	16.8427
Attributable Earnings	-41.7067	44.0952	100.2307	-99.9964
Dividend / Share	-15.4806	-0.0401	37.6173	-58.6134
Earnings / Share	-17.6196	11.4324	10.5093	-58.9542
Growth In Cash From Operating Activities	-25.8476	35.708	26.886	-99.9921
Internal Growth Rate (After Tax) %	4.4672	57.9058	33.3624	3.0815
Net Turnover	183.5251	20.8361	0.7685	-98.5787
Sustainable Growth (After Tax)	8.0841	144.7426	66.5591	5.013
Total Assets	70.8478	15.8874	10.3043	-99.9786

Financial Year	2012	2011	2010	2009
Total Shareholders' Interest	38.2432	17.508	20.3648	-99.9849
Enterprise Value	6.36E+10	5.44E+10	5.65E+10	4.54E+10
Enterprise Value / Cash	362.6233	262.5138	329.989	314.3748
Enterprise Value / EBIT	282.0327	154.4043	208.0754	274.0525
Enterprise Value / EBITDA	180.8167	127.2487	164.0393	193.2792
Enterprise Value / PAT	436.8043	204.6376	298.4828	482.6212
Enterprise Value / Share	1939.255	2186.45	2813.527	2541.97

Oil and gas

OAO:XJSE:EQU

Oando Plc

SOL:XJSE:EQU|OAO:XJSE:EQU|SOLBE1:XJSE:EQU|SCL:
L:XJSE:EQU|CME:XJSE:EQU

Sasol Limited, Oando Plc, Bee - Sasol Limited, Sacoil Holdings Ltd, Camac Energy Inc.

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	6.2458	5.8915	5.9551	6.9332
Assets / Capital Employed	1.205	1.2146	1.1829	1.2386
Book Value / Share (c)	3495.125	3142.183	3579.586	4592.668
Cash Flow / Share (c)	940.5694	854.8246	918.5739	1227.939
Cash Flow Dividend Cover	0.5979	0.6576	0.8628	1.4165
Cash Flow Interest Cover	11.3301	12.2478	9.5511	7.1083
Current Ratio	1.5444	1.7789	2.0217	1.5865
Debt / Assets	0.2538	0.2521	0.2358	0.2881
Debt / Equity	0.431	0.439	0.4004	0.5282
Directors Remuneration % Profit Before Tax	0.4084	0.4678	0.6601	0.3981
Dividend / Share (c)	1573	1300	1064.631	866.8811
Dividend Cover	2.7003	2.605	2.5269	2.9426
Dividend Yield %	0.7124	0.5426	0.6995	1.3289
Earnings / Share (c)	4247.518	3386.471	2690.189	2550.895
Earnings Yield %	11.8242	11.8308	9.4642	8.7064
Inflation Adjusted Profit / Share (c)	618.9146	520.9268	528.4747	649.9842
Inflation Adjusted Return On Assets %	16.5141	14.3012	12.4393	13.2288
Inflation Adjusted Return On Average Equity %	17.41	15.1371	12.62	11.3061
Inflation Adjusted Return On Average Total Assets %	17.1081	14.881	12.5562	13.0553
Inflation Adjusted Return On Equity %	16.5496	14.7963	12.0937	11.0678
Interest Cover	12.3968	12.3438	9.5161	7.9609
Leverage Factor	1.0566	1.1197	1.1079	1.0083
Long Term Loans % Total Debt	15.7829	22.4161	26.6192	17.665
NAV / Share (c)	4427.433	4092.251	4645.367	5994.335
Net Profit Margin %	11.7598	11.6892	11.7055	9.0687
Operating Profit / Employee	1086922	917750.5	758414.9	772500.1
Operating Profit Margin %	18.8945	18.1795	17.9417	16.4901
Price / Book Value	10.2777	11.2196	7.9409	6.3904
Price / Cash	71.6842	66.0447	45.5053	25.1744

Financial Year	2012	2011	2010	2009
Price / Cash Flow	38.1918	41.2412	30.9447	23.901
Price / Earnings	8.4572	10.4102	10.5662	11.5054
Price / EBIT	34.9054	40.9206	31.0586	21.3413
Price / EBITDA	27.6569	32.7051	24.3213	16.9555
Price / Inflation Adjusted Profit	58.0403	67.6755	53.7869	45.1534
Price / NAV	8.1135	8.6148	6.119	4.8961
Price / Share (c)	35922	35254	28425	29349
Quick Ratio	1.0893	1.2517	1.4206	1.1859
Retention Rate %	60.0447	65.4883	66.6979	48.5252
Return On Assets %	17.3438	15.7453	15.0561	16.3325
Return On Average Assets %	18.4243	16.9784	15.4839	16.4069
Return On Average Equity %	19.6992	18.7898	17.7922	17.144
Return On Average External Investments %	20.8273	29.7389	43.168	65.0107
Return On Capital Employed %	13.2068	12.5582	11.8469	11.4726
Return On Equity %	18.326	17.6295	16.6806	16.4676
Return On External Investments %	18.983	30.239	34.7156	73.7927
Total Assets Turnover	0.9179	0.8661	0.8392	0.9904
Total Debt / Cash Flow	1.6014	1.6136	1.5603	1.9755
Turnover / Employee	5752577	5048279	4227112	4684643
Adequacy Ratio	96.5516	89.4582	104.1206	184.8876
Cash Flow (Cata) To Current Liabilities	85.763	83.6443	72.643	108.5526
Cash Flow (Cata) To Net Earnings After Tax	165.0521	158.2833	124.587	285.5003
Cash Flow (Cata) To Turnover (Margin)	19.974	18.8886	14.9776	25.9977
Cash Flow (Ncta) To All Investments	92.2747	106.528	73.7096	185.9326
Cash Flow (Ncta) To Capital Investments	95.8035	96.6389	89.7172	195.6198
Cash Flow (Ncta) To Financial Investments	1037.895	34538.84	1144.415	-858.212
Cash Flow Less Interest Paid To Income Before Tax	132.0589	123.6722	104.3682	196.6348
Cash Flow Return On Total Net Assets	30.176	26.055	21.1345	44.8398
Cash Flow Return On Total Net Operating Assets	30.6316	27.9205	24.4764	33.7088
Cash Flow To Capital Redemption	2366.595	1315.186	-902.78	-866.851
Cash Flow To Total Shareholders' Equity	28.6326	25.9999	19.4698	42.6908
Change In Working Capital To Operating Cash Flow	-2.4175	-8.5213	-14.1247	38.6634

Financial Year	2012	2011	2010	2009
Dividend Coverage	0.226	0.2057	0.2452	0.1942
Interest Coverage	1303.984	1290.677	817.0895	1282.632
Price / Share To Cash Flow / Share	3369.771	4023.166	3836.11	1353.653
Reinvestment Rate	17.3938	15.8834	11.0121	28.2118
Attributable Earnings	20.791	20.5806	15.7575	-38.1021
Dividend / Share	21	22.108	22.8117	-35.2894
Earnings / Share	25.4261	25.8823	5.4606	-34.164
Growth In Cash From Operating Activities	36.7362	28.9869	-38.6195	37.7052
Internal Growth Rate (After Tax) %	14.7147	17.831	19.0328	7.8371
Net Turnover	20.0666	20.748	-10.3181	3.2868
Sustainable Growth (After Tax)	23.8823	30.5528	30.5238	12.1664
Total Assets	13.2882	16.9932	5.8485	0.916
Total Shareholders' Interest	16.2002	14.0902	14.2797	8.5661
Enterprise Value	1.39E+09	1.3E+09	8.14E+08	5.83E+08
Enterprise Value / Cash	74.068	67.983	47.1571	26.5233
Enterprise Value / EBIT	36.0661	42.1215	32.186	22.4847
Enterprise Value / EBITDA	28.5766	33.6649	25.2041	17.864
Enterprise Value / PAT	56.3108	64.1682	48.0353	40.7175
Enterprise Value / Share	371.1655	362.8863	294.5675	309.2152

Personal and households

BEG:XJSE:EQU

Beige Holdings Limited

SHF:XJSE:EQU|RBA:XJSE:EQU|NWL:XJSE:EQU|CFR:XJSE:EQU|SER:XJSE:EQU|SRN:XJSE:EQU|BEG:XJSE:EQU|ILE:XJSE:EQU|BTI:XJSE:EQU

Steinhoff Int Hldgs Ltd, Rba Holdings Ltd, Nu-World Hldgs Ltd, Compagnie Fin Richemont, Seardel Inv Corp Ltd, Seardel Inv Corp -N-, Beige Holdings Limited, Imbalie Beauty Limited, British American Tob Plc

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	3.9101	4.0983	4.8036	6.1514
Assets / Capital Employed	0.906	0.874	0.8673	0.8753
Book Value / Share (c)	2004.622	1797.194	1540.993	1558.731
Cash Flow / Share (c)	730.4138	553.4908	523.2138	581.2334
Cash Flow Dividend Cover	0.3397	0.3052	0.3435	0.3744
Cash Flow Interest Cover	6.9467	5.485	5.7781	6.3959
Current Ratio	1.4755	1.3827	1.5327	1.4507
Debt / Assets	0.8118	0.8183	0.7961	0.8555
Debt / Equity	1.4235	1.3742	1.24	1.469
Directors Remuneration % Profit Before Tax	0.6264	0.6225	0.8164	0.7239
Dividend / Share (c)	2150.435	1813.391	1523.358	1552.496
Dividend Cover	1.5785	1.3866	1.6307	1.5894
Dividend Yield %	0.5513	0.5291	0.6641	0.9308
Earnings / Share (c)	3394.406	2514.36	2484.162	2467.487
Earnings Yield %	6.2771	5.3464	7.5702	8.936
Inflation Adjusted Profit / Share (c)	596.0268	435.5513	365.0866	453.5606
Inflation Adjusted Return On Assets %	25.7914	23.1431	24.8802	24.435
Inflation Adjusted Return On Average Equity %	30.7843	25.7282	23.1077	24.9911
Inflation Adjusted Return On Average Total Assets %	25.4879	23.2116	21.5619	19.9072
Inflation Adjusted Return On Equity %	29.0331	23.6756	23.0931	28.2743
Interest Cover	8.0739	6.3477	6.1714	6.785
Leverage Factor	1.2499	1.1639	1.0368	1.2862
Long Term Loans % Total Debt	47.8078	48.197	50.5304	50.7159
NAV / Share (c)	661.6596	548.2142	489.3206	386.7413
Net Profit Margin %	19.0257	16.7848	15.2118	16.5707
Operating Profit / Employee	589271.5	545384.8	477361.7	507434.7
Operating Profit Margin %	26.6917	24.2172	22.8507	22.1227

Financial Year	2012	2011	2010	2009
Price / Book Value	26.9752	26.1675	21.2947	17.8241
Price / Cash	119.4787	117.0944	90.2383	55.421
Price / Cash Flow	74.0334	84.9662	62.7181	47.8001
Price / Earnings	15.9306	18.7038	13.2097	11.2596
Price / EBIT	63.697	73.4182	58.7214	45.0591
Price / EBITDA	57.0447	62.3595	48.8528	38.736
Price / Inflation Adjusted Profit	90.7258	107.9735	89.8828	61.2553
Price / NAV	81.7263	85.784	67.0624	71.8387
Price / Share (c)	54075	47028	32815	27783
Quick Ratio	0.8579	0.8311	0.9315	0.8565
Retention Rate %	51.218	44.1272	41.6763	44.4268
Return On Assets %	24.15	21.2249	23.2831	23.0374
Return On Average Assets %	26.1218	23.8779	22.1996	20.7018
Return On Average Equity %	32.0002	26.8721	24.1941	26.5792
Return On Average External Investments %	5.3194	6.3882	4.9184	4.835
Return On Capital Employed %	23.8195	18.8252	18.5983	15.0856
Return On Equity %	30.1862	24.7031	24.1411	29.6298
Return On External Investments %	5.8658	5.8152	5.1685	7.3105
Total Assets Turnover	0.9048	0.8764	1.0189	1.0413
Total Debt / Cash Flow	3.9068	4.462	3.6521	3.9394
Turnover / Employee	2207693	2252057	2089049	2293727
Adequacy Ratio	91.7767	106.2425	231.5182	135.556
Cash Flow (Cata) To Current Liabilities	42.505	45.4856	60.1309	48.533
Cash Flow (Cata) To Net Earnings After Tax	98.5412	126.0706	141.1335	119.7054
Cash Flow (Cata) To Turnover (Margin)	19.904	22.0011	23.2422	19.6504
Cash Flow (Ncta) To All Investments	295.84	123.5475	131.8839	106.8827
Cash Flow (Ncta) To Capital Investments	138.1648	222.0281	431.4855	201.4165
Cash Flow (Ncta) To Financial Investments	-813.719	248.311	1221.683	420.4957
Cash Flow Less Interest Paid To Income Before Tax	93.9428	110.856	123.3619	110.1542
Cash Flow Return On Total Net Assets	26.4555	27.8414	32.5529	29.5885
Cash Flow Return On Total Net Operating Assets	27.9482	26.4581	29.4639	28.5814
Cash Flow To Capital Redemption	791.1791	4366.187	-391.372	-1226.1
Cash Flow To Total Shareholders' Equity	29.7305	30.7312	35.415	33.6878

Financial Year	2012	2011	2010	2009
Change In Working Capital To Operating Cash Flow	-11.4425	-1.1929	4.0469	-7.3489
Dividend Coverage	0.5145	0.4741	0.4232	0.5918
Interest Coverage	661.8027	634.9222	694.6424	671.7088
Price / Share To Cash Flow / Share	8568.071	8091.945	5782.041	5082.575
Reinvestment Rate	8.9654	10.4936	14.0321	8.6084
Attributable Earnings	37.8212	22.0273	-18.1655	-7.1926
Dividend / Share	18.5863	19.0391	-1.8768	-24.0961
Earnings / Share	35.0008	1.2156	0.6758	2.9143
Growth In Cash From Operating Activities	20.3676	9.3483	10.9179	-6.0511
Internal Growth Rate (After Tax) %	17.2402	11.0504	10.6162	12.956
Net Turnover	21.5886	10.5911	-10.855	8.8791
Sustainable Growth (After Tax)	28.1545	15.761	13.6646	19.6986
Total Assets	17.7806	28.5698	-8.8933	-18.4097
Total Shareholders' Interest	12.7869	19.251	0.4403	-18.6691
Enterprise Value	6.65E+09	5.72E+09	3.91E+09	3.31E+09
Enterprise Value / Cash	124.68	122.1268	94.3349	58.8804
Enterprise Value / EBIT	66.47	76.5735	61.3872	47.8716
Enterprise Value / EBITDA	59.528	65.0396	51.0706	41.1539
Enterprise Value / PAT	87.8373	106.2604	85.1783	64.5148
Enterprise Value / Share	564.2905	490.4913	343.0472	295.1721

Retail

ADH:XJSE:EQU

CLS:XJSE:EQU|PIK:XJSE:EQU|SHP:XJSE:EQU|SPP:XJSE:EQU|PWK:XJSE:EQU|SHPCB:XJSE:IBI|MPC:XJSE:EQU|TRU:XJSE:EQU|TFG:XJSE:EQU|HSP:XJSE:EQU|AOO:XJSE:EQU|AON:XJSE:EQU|RTO:XJSE:EQU|RTN:XJSE:EQU|AOVP:XJSE:EQU|WHL:XJSE:EQU|MMSM:XJSE:EQU|V MK:XJSE:EQU|NCS:XJSE:EQU|LEW:XJSE:EQU|JDG:XJSE:EQU|CSB:XJSE:EQU|ITE:XJSE:EQU|AET:XJSE:EQU|ADH:XJSE:EQU|COH:XJSE:EQU|CMH:XJSE:EQU

Clicks Group Ltd, Pik N Pay Stores Ltd, Shoprite Holdings Ltd, The Spar Group Ltd, Pik N Pay Holdings Ltd, Shoprite Investments Lim, Mr Price Group Ltd, Truworths Int Ltd, The Foschini Group Limited, Holdsport Limited, African & Over Ent Ltd, African & Over Ent Ltd -, Rex Trueform Cloth Co Ltd, Rex Trueform CI Co -N-, African & Over Ent Ltd P, Woolworths Holdings Ltd, Massmart Holdings Ltd, Verimark Holdings Ltd, Nictus Ltd, Lewis Group Ltd, Jd Group Ltd, Cashbuild Ltd, Italtile Ltd, Alert Steel Holdings Ltd, Advtech Ltd, Curro Holdings Limited, Combined Motor Hldgs Ltd

Advtech Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	9.9711	8.7108	10.8863	11.2862
Assets / Capital Employed	1.7463	1.9145	1.9448	1.9637
Book Value / Share (c)	639.7239	837.9932	731.2999	653.9968
Cash Flow / Share (c)	260.2514	363.2769	368.0007	328.7447
Cash Flow Dividend Cover	0.0653	0.1107	0.1272	0.124
Cash Flow Interest Cover	16.2959	17.7566	17.5974	12.2332
Current Ratio	1.4083	1.2987	1.2768	1.2748
Debt / Assets	0.6009	0.6037	0.6129	0.6284
Debt / Equity	1.4241	1.4898	1.5558	1.6744
Directors Remuneration % Profit Before Tax	2.2873	2.9154	5.0376	2.308
Dividend / Share (c)	3982.888	3281.1	2893.4	2651.3
Dividend Cover	1.9703	1.8761	1.9164	1.8713
Dividend Yield %	0.0723	0.1368	0.145	0.2171
Earnings / Share (c)	7847.647	6155.8	5544.9	4961.4
Earnings Yield %	6.2892	6.6322	7.2747	9.0429
Inflation Adjusted Profit / Share (c)	172.9356	224.3663	213.604	195.286
Inflation Adjusted Return On Assets %	15.5027	15.7587	16.1507	16.2545
Inflation Adjusted Return On Average Equity %	29.3825	27.9782	29.7349	29.7684
Inflation Adjusted Return On Average Total Assets %	16.8174	16.7651	16.7136	16.8273
Inflation Adjusted Return On Equity %	26.5822	25.7917	28.0409	28.3891

Financial Year	2012	2011	2010	2009
Interest Cover	14.9176	16.4258	14.8728	11.0267
Leverage Factor	1.7433	1.6989	1.7861	1.7958
Long Term Loans % Total Debt	15.7484	9.1397	9.7709	11.4987
NAV / Share (c)	605.1164	819.5337	718.6228	647.6516
Net Profit Margin %	4.0278	3.8045	3.6642	3.6137
Operating Profit / Employee	70271.77	61008.96	58459.19	53736.26
Operating Profit Margin %	5.4555	5.5108	5.1505	5.2535
Price / Book Value	200.3927	110.761	104.2281	83.8918
Price / Cash	557.1958	433.1337	308.146	242.2377
Price / Cash Flow	492.5853	255.4993	207.1246	166.8924
Price / Earnings	16.3356	15.078	13.7463	11.0584
Price / EBIT	538.097	276.1997	245.0683	185.1524
Price / EBITDA	433.3077	222.1461	195.9339	150.3215
Price / Inflation Adjusted Profit	741.2932	413.685	356.8379	280.9469
Price / NAV	211.8535	113.2559	106.0668	84.7138
Price / Share (c)	128196	92817	76222	54865
Quick Ratio	0.8725	0.8134	0.7837	0.7582
Retention Rate %	49.857	45.535	50.4028	41.8839
Return On Assets %	15.7135	16.2505	16.7542	17.0036
Return On Average Assets %	17.2146	17.4275	17.4421	17.6162
Return On Average Equity %	30.6715	30.0795	32.2314	32.4606
Return On Average External Investments %	76.9755	69.8005	69.7626	90.9011
Return On Capital Employed %	20.2609	21.4808	23.1821	22.9701
Return On Equity %	27.4956	27.6854	30.257	31.1669
Return On External Investments %	71.5729	71.7982	71.2561	79.619
Total Assets Turnover	2.8803	2.9488	3.2529	3.2366
Total Debt / Cash Flow	3.5006	3.4365	3.0918	3.331
Turnover / Employee	1288099	1107082	1135022	1022871
Adequacy Ratio	69.2967	75.7635	108.6327	92.3819
Cash Flow (Cata) To Current Liabilities	29.3959	22.6381	27.9195	30.0068
Cash Flow (Cata) To Net Earnings After Tax	127.8432	104.2823	120.4343	132.4501
Cash Flow (Cata) To Turnover (Margin)	5.1667	4.211	4.7464	5.1557
Cash Flow (Ncta) To All Investments	384.9115	61.5442	130.1097	252.3214
Cash Flow (Ncta) To Capital Investments	105.4614	76.0063	134.0332	139.7119

Financial Year	2012	2011	2010	2009
Cash Flow (Ncta) To Financial Investments	-1505.63	214.8893	1582.718	2835.037
Cash Flow Less Interest Paid To Income Before Tax	111.3011	97.6446	107.0912	102.9059
Cash Flow Return On Total Net Assets	38.2509	38.7989	45.8374	47.5336
Cash Flow Return On Total Net Operating Assets	40.1051	47.3563	49.4677	47.0952
Cash Flow To Capital Redemption	272.6174	1340.75	4175.492	495.1791
Cash Flow To Total Shareholders' Equity	34.0251	29.3928	37.5078	42.723
Change In Working Capital To Operating Cash Flow	-5.8938	-21.3125	-8.7117	0.2736
Dividend Coverage	0.4079	0.5169	0.4064	0.4297
Interest Coverage	1403.06	1236.871	1349.525	958.653
Price / Share To Cash Flow / Share	56912.08	36278.53	26687.38	18878.63
Reinvestment Rate	16.8547	12.5842	19.8843	21.4086
Attributable Earnings	25.2538	8.8237	10.6346	3.7684
Dividend / Share	21.3888	13.3995	9.1314	7.5884
Earnings / Share	27.4838	11.0173	11.7608	-5.7789
Growth In Cash From Operating Activities	44.185	-4.1823	0.7056	45.8577
Internal Growth Rate (After Tax) %	9.1474	7.6532	10.1491	7.114
Net Turnover	18.3094	4.8091	9.1098	12.0816
Sustainable Growth (After Tax)	22.2631	19.2205	27.1776	18.5342
Total Assets	21.124	15.6171	8.5634	7.4752
Total Shareholders' Interest	26.1187	18.932	13.9616	8.6616
Enterprise Value	1.3E+10	5.74E+09	4.54E+09	3.22E+09
Enterprise Value / Cash	560.0864	437.8464	311.5957	245.8654
Enterprise Value / EBIT	540.8885	279.2049	247.8118	187.9252
Enterprise Value / EBITDA	435.5555	224.5632	198.1273	152.5728
Enterprise Value / PAT	730.1313	381.0371	323.8592	253.6274
Enterprise Value / Share	1288.61	938.2691	770.7531	556.8666

Technology

ADI:XJSE:EQU

EOH:XJSE:EQU|DTC:XJSE:EQU|DCT:XJSE:EQU|BCX:XJSE:EQU|ISA:XJSE:EQU|GIJ:XJSE:EQU|CVN:XJSE:EQU|ADI:XJSE:EQU|FRT:XJSE:EQU|CCL:XJSE:EQU|SQE:XJSE:EQU|TCS:XJSE:EQU|ALM:XJSE:EQU|SVB:XJSE:EQU|PNC:XJSE:EQU|MST:XJSE:EQU|HUG:XJSE:EQU|FWX:XJSE:EQU|POY:XJSE:EQU|ATR:XJSE:EQU

Eoh Holdings Ltd, Datatec Ltd, Datacentrix Holdings Ltd, Business Connexion Grp L, Isa Holdings Limited, Gijima Group Limited, Convergenet Holdings Ltd, Adaptit Holdings Limited, Faritec Holdings Ltd, Compu Clearing Outs Ltd, Square One Solutions Grp, Total Client Services Ld, Alliance Mining Corp Ltd, Silverbridge Holdings, Pinnacle Hldgs Ltd, Mustek Ltd, Huge Group Ltd, Foneworx Holdings Ltd, Poynting Hldgs Ltd, Africa Cellular Towers

Adaptit Holdings Limited

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	4.5927	4.6587	4.4715	4.7246
Assets / Capital Employed	1.729	1.6191	1.7135	1.6718
Book Value / Share (c)	310.0392	249.4534	240.6573	234.4906
Cash Flow / Share (c)	54.6505	30.9528	37.7208	44.1701
Cash Flow Dividend Cover	0.2908	0.1629	0.2857	0.2365
Cash Flow Interest Cover	6.7269	5.9853	7.1816	5.2225
Current Ratio	1.3449	1.4118	1.4408	1.4183
Debt / Assets	0.6857	0.6708	0.6566	0.688
Debt / Equity	1.4117	1.2903	1.321	1.4312
Directors Remuneration % Profit Before Tax	8.6611	15.895	12.7578	8.6879
Dividend / Share (c)	187.95	190	132.05	186.8
Dividend Cover	5.0346	3.3368	4.6671	4.7191
Dividend Yield %	0.083	0.063	0.0852	0.1898
Earnings / Share (c)	946.2565	633.9952	616.2913	881.5319
Earnings Yield %	7.979	7.1426	9.0322	20.3114
Inflation Adjusted Profit / Share (c)	33.2321	13.4964	19.1177	24.5113
Inflation Adjusted Return On Assets %	9.1287	5.9256	7.1163	8.5695
Inflation Adjusted Return On Average Equity %	11.3382	5.5159	7.6823	10.7979
Inflation Adjusted Return On Average Total Assets %	10.002	5.9194	6.8319	8.8413
Inflation Adjusted Return On Equity %	10.6463	5.3627	7.8801	10.3469
Interest Cover	7.2724	5.6416	6.7455	5.0719
Leverage Factor	1.1857	0.9433	1.1294	1.2353

Financial Year	2012	2011	2010	2009
Long Term Loans % Total Debt	5.4426	7.7357	5.3209	8.5146
NAV / Share (c)	200.6576	157.9463	166.2754	152.1736
Net Profit Margin %	2.1863	1.2015	1.7721	2.1133
Operating Profit / Employee	99686.59	57830.62	94241.59	130506.7
Operating Profit Margin %	3.7954	2.45	3.1534	3.5488
Price / Book Value	38.25	35.7021	28.4928	18.666
Price / Cash	129.0329	113.95	67.173	46.401
Price / Cash Flow	216.9972	287.7283	181.7832	99.0942
Price / Earnings	12.5325	14.0474	11.1262	4.9652
Price / EBIT	200.7216	305.2549	193.5362	102.0359
Price / EBITDA	150.8311	197.3491	140.1524	76.092
Price / Inflation Adjusted Profit	356.8538	659.8781	358.6731	178.5708
Price / NAV	59.1007	56.3862	41.2388	28.7632
Price / Share (c)	11859	8906	6857	4377
Quick Ratio	1.0442	1.1288	1.1782	1.1428
Retention Rate %	71.0689	59.7938	71.0475	69.2716
Return On Assets %	9.2554	6.0804	7.3174	8.7944
Return On Average Assets %	10.1791	6.1151	7.0197	9.1964
Return On Average Equity %	11.702	5.8973	8.0744	11.6136
Return On Average External Investments %	33.3428	32.886	41.6794	61.1042
Return On Capital Employed %	9.2184	4.8281	7.0463	8.7557
Return On Equity %	10.9772	5.7358	8.2733	10.8941
Return On External Investments %	30.9247	30.8632	44.2305	53.9324
Total Assets Turnover	2.4386	2.4818	2.3205	2.4782
Total Debt / Cash Flow	8.0089	10.3991	8.428	7.5978
Turnover / Employee	2626527	2360387	2988541	3677523
Adequacy Ratio	93.657	-7.1895	546.2491	149.7274
Cash Flow (Cata) To Current Liabilities	7.5557	-0.6144	18.4421	15.2226
Cash Flow (Cata) To Net Earnings After Tax	85.2265	-11.6722	254.0022	177.4022
Cash Flow (Cata) To Turnover (Margin)	2.0088	-0.1532	4.9406	3.8664
Cash Flow (Ncta) To All Investments	75.5624	-21.9575	174.8947	159.7399
Cash Flow (Ncta) To Capital Investments	111.986	-52.8202	438.9782	367.8477
Cash Flow (Ncta) To Financial Investments	192.9473	-35.1896	829.2005	157.5951

Financial Year	2012	2011	2010	2009
Cash Flow Less Interest Paid To Income Before Tax	88.5688	36.8419	185.7331	142.3771
Cash Flow Return On Total Net Assets	17.5188	5.6873	26.2353	24.1779
Cash Flow Return On Total Net Operating Assets	24.5229	19.0809	21.4442	21.9196
Cash Flow To Capital Redemption	1707.864	-128.923	-502.86	426.5872
Cash Flow To Total Shareholders' Equity	9.6149	-0.7031	21.9929	18.7273
Change In Working Capital To Operating Cash Flow	-33.3158	-95.5873	27.538	11.4508
Dividend Coverage	0.3334	-3.292	0.1097	0.1639
Interest Coverage	437.0427	8.2065	1088.651	602.6788
Price / Share To Cash Flow / Share	37923.74	-488085	12352.76	9365.27
Reinvestment Rate	6.3978	-2.9147	18.8076	14.4886
Attributable Earnings	118.4407	-26.6524	-27.6232	-15.0014
Dividend / Share	-1.0789	43.8849	-29.3094	-8.0709
Earnings / Share	49.2529	2.8727	-30.0886	-13.8174
Growth In Cash From Operating Activities	-3203.19	-102.53	-8.2018	81.6517
Internal Growth Rate (After Tax) %	12.8111	4.5275	9.6634	11.6019
Net Turnover	20.0487	8.1788	-13.6863	20.8047
Sustainable Growth (After Tax)	23.2679	6.5186	16.3172	19.397
Total Assets	22.1732	1.1482	-7.8203	9.58
Total Shareholders' Interest	14.1381	5.7976	-4.696	14.1419
Enterprise Value	4.97E+08	4.06E+08	3.07E+08	2.16E+08
Enterprise Value / Cash	132.7722	117.0301	69.2488	48.8823
Enterprise Value / EBIT	206.5385	313.5061	199.517	107.4923
Enterprise Value / EBITDA	155.2022	202.6835	144.4835	80.161
Enterprise Value / PAT	332.5774	585.0996	323.459	175.0264
Enterprise Value / Share	122.0267	91.4673	70.689	46.1106

Telecommunications

BLU:XJSE:EQU

Blue Label Telecoms Ltd

TKG:XJSE:EQU|TLM:XJSE:EQU|MTN:XJSE:EQU|VOD:X
JSE:EQU|BLU:XJSE:EQU

Telkom Sa Soc Ltd, Telemaster Holdings Ltd, Mtn
Group Ltd, Vodacom Group Ltd, Blue Label Telecoms
Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	4.8615	4.9872	6.6199	6.3995
Assets / Capital Employed	1.2087	1.1939	1.1906	1.2039
Book Value / Share (c)	3108.644	2966.998	2546.506	2640.986
Cash Flow / Share (c)	1450.734	1225.656	1871.862	1050.086
Cash Flow Dividend Cover	1.0621	0.7959	0.6227	1.1358
Cash Flow Interest Cover	5.5366	6.6665	9.428	5.8255
Current Ratio	1.0632	1.1447	1.0859	0.7579
Debt / Assets	0.4996	0.512	0.5503	0.5715
Debt / Equity	0.8697	0.8894	1.0066	1.1087
Directors Remuneration % Profit Before Tax	0.3637	0.404	0.2169	0.3811
Dividend / Share (c)	1365.85	1540	3006	924.5
Dividend Cover	1.5914	1.3808	0.4677	2.4915
Dividend Yield %	1.7141	1.5485	1.8526	1.1539
Earnings / Share (c)	2173.65	2126.5	1406	2303.4
Earnings Yield %	7.1012	8.2054	6.2866	10.3729
Inflation Adjusted Profit / Share (c)	652.4287	598.8354	1159.097	480.0704
Inflation Adjusted Return On Assets %	22.8532	20.9141	35.6914	16.0157
Inflation Adjusted Return On Average Equity %	19.1683	18.9053	38.4185	15.9392
Inflation Adjusted Return On Average Total Assets %	22.7352	21.9718	33.8193	17.6045
Inflation Adjusted Return On Equity %	19.6263	17.619	39.6248	15.4467
Interest Cover	5.0646	6.7097	9.3292	5.3133
Leverage Factor	0.904	0.9341	1.1989	1.0966
Long Term Loans % Total Debt	30.0814	32.0747	35.8279	29.4805
NAV / Share (c)	2707.605	2514.774	2094.551	2195.336
Net Profit Margin %	12.2288	13.0254	24.7144	10.2584
Operating Profit / Employee	1005423	1075455	1662705	896588.8
Operating Profit Margin %	23.547	24.2196	37.7042	18.1474
Price / Book Value	9.8464	8.7348	8.7826	8.4082

Financial Year	2012	2011	2010	2009
Price / Cash	42.3026	29.0349	24.0043	34.8707
Price / Cash Flow	21.099	21.1446	11.948	21.1468
Price / Earnings	14.0818	12.1872	15.9068	9.6405
Price / EBIT	23.0652	21.0085	12.0746	23.1854
Price / EBITDA	15.4672	14.2135	8.866	14.9941
Price / Inflation Adjusted Profit	46.9155	43.2773	19.2952	46.2557
Price / NAV	11.3048	10.3055	10.6777	10.1151
Price / Share (c)	30609	25916	22365	22206
Quick Ratio	1.005	1.0776	1.0318	0.7106
Retention Rate %	23.8703	39.5104	65.8728	53.4279
Return On Assets %	24.5243	23.937	39.7667	18.694
Return On Average Assets %	24.8223	25.1012	37.8677	20.83
Return On Average Equity %	22.4156	24.0236	46.8017	21.5027
Return On Average External Investments %	60.5188	64.5451	39.4772	60.738
Return On Capital Employed %	15.3938	15.3694	31.0344	12.7221
Return On Equity %	22.1702	22.3604	47.6774	20.4999
Return On External Investments %	54.9411	57.1104	38.77	57.0935
Total Assets Turnover	1.0415	0.9883	1.0547	1.0301
Total Debt / Cash Flow	1.8636	2.1529	1.3693	2.7883
Turnover / Employee	4269850	4440425	4409864	4940589
Adequacy Ratio	123.3184	169.4026	167.1544	78.3999
Cash Flow (Cata) To Current Liabilities	80.673	74.996	82.6323	68.3457
Cash Flow (Cata) To Net Earnings After Tax	197.1513	181.0291	106.9876	255.7318
Cash Flow (Cata) To Turnover (Margin)	27.059	26.3913	27.6676	26.7392
Cash Flow (Ncta) To All Investments	92.8571	89.4845	190.6115	112.7937
Cash Flow (Ncta) To Capital Investments	115.5214	176.4985	143.5582	99.6248
Cash Flow (Ncta) To Financial Investments	-8702.83	373.1697	-195.528	422.478
Cash Flow Less Interest Paid To Income Before Tax	145.5266	133.1607	93.4568	195.0077
Cash Flow Return On Total Net Assets	48.6827	43.0256	48.8584	53.0236
Cash Flow Return On Total Net Operating Assets	49.4649	45.4147	47.3899	53.1194
Cash Flow To Capital Redemption	-735.615	-538.334	-473.192	371.1136
Cash Flow To Total Shareholders' Equity	47.4633	43.785	51.8311	51.4292

Financial Year	2012	2011	2010	2009
Change In Working Capital To Operating Cash Flow	-1.9201	-5.7908	2.3362	-0.2451
Dividend Coverage	0.3898	0.3435	0.3775	0.2386
Interest Coverage	594.5821	760.3062	713.6467	853.8527
Price / Share To Cash Flow / Share	2007.16	1927.976	1645.473	1573.548
Reinvestment Rate	22.4858	21.8346	22.9382	30.5394
Attributable Earnings	1.3687	-45.5633	124.1842	6.9847
Dividend / Share	-11.3084	-48.7691	225.1487	6.8786
Earnings / Share	2.2173	51.2447	-38.9598	-9.1325
Growth In Cash From Operating Activities	10.733	-36.0653	79.4713	0.2323
Internal Growth Rate (After Tax) %	4.0131	8.1282	69.4313	12.5248
Net Turnover	7.9721	3.2882	-6.9467	42.7838
Sustainable Growth (After Tax)	5.1149	11.388	181.051	19.3308
Total Assets	2.4599	10.2245	-9.1154	25.8001
Total Shareholders' Interest	2.2387	16.071	-3.6071	10.2865
Enterprise Value	1.46E+09	1.27E+09	1.11E+09	1.13E+09
Enterprise Value / Cash	44.8076	30.7684	25.6425	38.2471
Enterprise Value / EBIT	24.431	22.2627	12.8986	25.4304
Enterprise Value / EBITDA	16.3831	15.0621	9.471	16.4459
Enterprise Value / PAT	41.9147	36.9857	18.8059	44.137
Enterprise Value / Share	324.2157	274.6325	238.9128	243.5615

Travel and leisure

1TM:XJSE:EQU

1Time Holdings Ltd

COM:XJSE:EQU|1TM:XJSE:EQU|SUI:XJSE:EQU|TSH:XJSE:EQU|PHM:XJSE:EQU|CLH:XJSE:EQU|GDN:XJSE:EQU|FBR:XJSE:EQU|TAS:XJSE:EQU|SUR:XJSE:EQU|WIL:XJSE:EQU|CUL:XJSE:EQU

Comair Limited, 1Time Holdings Ltd, Sun International Ltd, Tsogo Sun Holdings Ltd, Phumelela Game Leisure, City Lodge Hotels Ltd, Gooderson Leisure Corp, Famous Brands Ltd, Taste Hldgs Ltd, Spur Corporation Ltd, Wilderness Holdings Ltd, Cullinan Holdings Ltd

Financial Year	2012	2011	2010	2009
Accounts Receivable / Turnover	14.3852	11.3324	10.9403	11.1935
Assets / Capital Employed	1.0372	1.0595	1.2404	1.1882
Book Value / Share (c)	397.1606	343.6599	273.6585	245.7716
Cash Flow / Share (c)	152.5517	107.59	116.1065	118.3779
Cash Flow Dividend Cover	0.1772	0.1397	0.1742	0.1867
Cash Flow Interest Cover	5.7714	4.3719	4.6517	3.5325
Current Ratio	0.6403	0.5737	0.6476	0.7352
Debt / Assets	0.5967	0.5886	0.6274	0.684
Debt / Equity	1.3292	1.3404	1.7833	2.1736
Directors Remuneration % Profit Before Tax	3.4583	4.4092	4.6661	3.9039
Dividend / Share (c)	860.8591	770	666.5	633.9
Dividend Cover	2.0291	1.6514	2.447	2.4628
Dividend Yield %	0.1537	0.0618	0.0872	0.1466
Earnings / Share (c)	1746.797	1271.549	1630.944	1561.2
Earnings Yield %	6.3777	5.1226	7.1769	7.4517
Inflation Adjusted Profit / Share (c)	90.2124	40.8576	53.6264	57.7205
Inflation Adjusted Return On Assets %	19.9884	14.1754	15.8993	19.1294
Inflation Adjusted Return On Average Equity %	22.3874	14.1149	20.0991	17.9034
Inflation Adjusted Return On Average Total Assets %	20.2261	15.8474	16.6571	18.5851
Inflation Adjusted Return On Equity %	21.9367	11.1831	18.3649	21.5859
Interest Cover	6.8902	4.6405	5.24	4.7215
Leverage Factor	1.1426	0.8996	1.2511	1.2547
Long Term Loans % Total Debt	46.0749	42.7188	47.9008	55.279
NAV / Share (c)	356.7887	321.9588	289.8012	246.8087
Net Profit Margin %	10.3092	7.1362	7.6973	7.7948
Operating Profit / Employee	175971.6	196167.3	157167.3	195080.1

Financial Year	2012	2011	2010	2009
Operating Profit Margin %	20.0649	18.0357	17.4459	19.6924
Price / Book Value	68.9595	72.2284	83.0414	85.2458
Price / Cash	279.6117	322.6268	287.1392	241.2248
Price / Cash Flow	179.5326	230.7091	195.7255	176.9841
Price / Earnings	15.679	19.5211	13.9336	13.4198
Price / EBIT	150.3803	217.3572	173.7494	132.415
Price / EBITDA	114.7092	153.652	125.429	99.7587
Price / Inflation Adjusted Profit	303.5946	607.5253	423.7653	362.9736
Price / NAV	76.7625	77.0968	78.4158	84.8876
Price / Share (c)	27388	24822	22725	20951
Quick Ratio	0.5856	0.5182	0.5904	0.6702
Retention Rate %	55.0134	66.0312	65.6842	50.9615
Return On Assets %	20.5861	14.5922	16.8154	20.2582
Return On Average Assets %	21.0533	16.8996	17.6325	21.4495
Return On Average Equity %	24.3555	16.6178	23.2814	26.6371
Return On Average External Investments %	27.4222	26.2947	43.8211	66.665
Return On Capital Employed %	10.995	6.1317	9.2669	9.585
Return On Equity %	23.5609	13.1482	21.0871	25.4824
Return On External Investments %	33.4703	22.9748	40.6687	67.1285
Total Assets Turnover	1.026	0.8091	0.9639	1.0287
Total Debt / Cash Flow	3.4605	4.2815	4.2031	4.5128
Turnover / Employee	877013	1087664	900884.3	990634.4
Adequacy Ratio	100.2218	345.1878	126.3386	74.5683
Cash Flow (Cata) To Current Liabilities	58.556	48.4266	48.3548	56.6142
Cash Flow (Cata) To Net Earnings After Tax	147.4341	214.5239	165.9548	156.7155
Cash Flow (Cata) To Turnover (Margin)	18.3649	20.1806	16.3988	16.834
Cash Flow (Ncta) To All Investments	109.5515	114.234	85.9725	92.3657
Cash Flow (Ncta) To Capital Investments	145.4416	181.976	116.4059	94.0188
Cash Flow (Ncta) To Financial Investments	191.313	-585.294	795.8655	229.7107
Cash Flow Less Interest Paid To Income Before Tax	132.4503	166.5233	145.7841	135.4199
Cash Flow Return On Total Net Assets	28.8757	26.3539	31.4311	34.5683
Cash Flow Return On Total Net Operating Assets	29.0125	25.7567	31.1378	34.359
Cash Flow To Capital Redemption	506.5642	-249.217	-737.973	360.33

Financial Year	2012	2011	2010	2009
Cash Flow To Total Shareholders' Equity	33.2382	28.6087	35.3874	43.4953
Change In Working Capital To Operating Cash Flow	-0.692	1.5131	0.7311	0.4326
Dividend Coverage	0.2665	0.1412	0.2406	0.3333
Interest Coverage	710.1623	603.4772	596.1518	505.013
Price / Share To Cash Flow / Share	17336.39	20293.28	18485.45	15490.08
Reinvestment Rate	12.6591	13.9376	15.5427	14.3756
Attributable Earnings	91.7024	7.0559	1.9739	0.7983
Dividend / Share	11.7999	15.5289	5.1428	-38.8894
Earnings / Share	37.3755	-22.036	4.4673	0.0705
Growth In Cash From Operating Activities	36.1909	22.9869	-1.7425	2.8509
Internal Growth Rate (After Tax) %	13.1371	13.8111	16.601	9.8352
Net Turnover	32.6989	15.4738	3.2654	-1.7014
Sustainable Growth (After Tax)	25.264	21.7893	39.3696	22.7554
Total Assets	4.6447	37.5653	10.2158	12.4956
Total Shareholders' Interest	6.9801	71.6959	23.229	9.4925
Enterprise Value	9.02E+08	8.82E+08	5.92E+08	4.95E+08
Enterprise Value / Cash	284.38	328.0535	292.4415	246.5096
Enterprise Value / EBIT	152.9448	221.0132	176.9579	135.316
Enterprise Value / EBITDA	116.6653	156.2365	127.7452	101.9443
Enterprise Value / PAT	246.3658	423.7321	312.4214	248.0697
Enterprise Value / Share	278.5505	252.3952	231.4464	214.1001

Utilities

IPS:XJSE:EQU

Ipsa Group Plc

Financial Year	2012	2011	2010	2009
General				
Accounts Receivable / Turnover	5.3566	0.2701		0.4366
Assets / Capital Employed	2.2119	6.1227		3.8777
Book Value / Share (c)	11.621	7.2844		13.2321
Cash Flow / Share (c)	6.716	-3.6473		-4.8977
Cash Flow Dividend Cover				
Cash Flow Interest Cover	5.8843	-1.6017		-3.0632
Current Ratio	0.0562	0.0748		0.0683
Debt / Assets	0.5479	0.8367		0.7558
Debt / Equity	1.2119	5.1227		2.9307
Directors Remuneration % Profit Before Tax	5.4236	-13.9175		-0.9879
Dividend / Share (c)	0	0	0	0
Dividend Cover				
Dividend Yield %	0	0		0
Earnings / Share (c)	5.3	-5.5	0	-5.9
Earnings Yield %	9.5455	-6.1111	0	-3.8312
Inflation Adjusted Profit / Share (c)	5.2221	-4.926		-5.7793
Inflation Adjusted Return On Assets %	24.4136	-5.8698		-8.114
Inflation Adjusted Return On Average Equity %	52.7264	-125.882		-34.7082
Inflation Adjusted Return On Average Total Assets %	17.8731	-11.7397		-8.3793
Inflation Adjusted Return On Equity %	43.5827	-62.9412		-42.2587
Interest Cover	5.5982	-1.1401		-2.6103
Leverage Factor	1.8168	11.4908		5.3457
Long Term Loans % Total Debt	0	0		0
NAV / Share (c)	11.621	7.2844		12.5311
Net Profit Margin %	129.078	-653.933		-526.083
Operating Profit / Employee	274760	-126864		-188810
Operating Profit Margin %	157.1494	-348.44		-381.617
Price / Book Value	4.7328	12.3552		11.6384
Price / Cash	1689.349	2931.927		1075.781
Price / Cash Flow	8.1894	-24.6757		-31.4434

Financial Year	2012	2011	2010	2009
Price / Earnings	10.3774	-16.3636		-26.1017
Price / EBIT	8.6078	-34.6663		-36.8994
Price / EBITDA	7.7119	-119.745		-46.4169
Price / Inflation Adjusted Profit	10.5321	-18.2705		-26.647
Price / NAV	4.7328	12.3552		12.2895
Price / Share (c)	55	90	114	154
Quick Ratio	0.0562	0.0748		0.0683
Retention Rate %	100	100		100
Return On Assets %	24.858	-5.821		-8.1338
Return On Average Assets %	18.1768	-11.642		-8.3975
Return On Average Equity %	55.5206	-133.776		-35.4383
Return On Average External Investments %				
Return On Capital Employed %	45.1613	-66.888		-43.481
Return On Equity %	45.1613	-66.888		-43.481
Return On External Investments %				
Total Assets Turnover	0.1582	0.0167		0.0213
Total Debt / Cash Flow	2.097	-10.2311		-7.9179
Turnover / Employee	174840	36409.09		49476.19
Cash Flow				
Adequacy Ratio	90.081	-422.044		-1198.98
Cash Flow (Cata Less Pref. Dividend) / Share				
Cash Flow (Cata) To Current Liabilities	-75.6407	-5.2498		-3.1893
Cash Flow (Cata) To Net Earnings After Tax	-202.978	40.2062		21.4965
Cash Flow (Cata) To Total Debt				
Cash Flow (Cata) To Turnover (Margin)	-262	-262.921		-113.09
Cash Flow (Ncta) To All Investments	112.3075	541.3882		
Cash Flow (Ncta) To Capital Investments	49.9847	-3829.09		-3916.67
Cash Flow (Ncta) To Financial Investments				
Cash Flow Less Interest Paid To Income Before Tax	-224.584	82.3024		47.8046
Cash Flow Return On Total Net Assets	355.5141	7.8284		5.5584
Cash Flow Return On Total Net Operating Assets	-87.1699	10.3202		37.4149
Cash Flow To Capital Redemption	90.0739	-474.324		

Financial Year	2012	2011	2010	2009
Cash Flow To Total Shareholders' Equity	-91.6673	-26.8931		-9.3469
Change In Working Capital To Operating Cash Flow	-185.862	-40.2307		-198.921
Dividend Coverage	0	0		0
Interest Coverage	-932.681	-76.1029		-72.0211
Price / Share To Cash Flow / Share	-516.305	-4594.19		-12451.6
Reinvestment Rate	355.7627	8.8495		5.9699
Growth				
Attributable Earnings	-207.713			22.8039
Dividend / Share				
Earnings / Share	-196.364		-100	18
Growth In Cash From Operating Activities	646.3719			-160.429
Internal Growth Rate (After Tax) %				
Net Turnover	445.6929		-100	-63.2603
Sustainable Growth (After Tax)				
Total Assets	-42.3676		-100	6.7001
Total Shareholders' Interest	59.5326		-100	-31.2196
Enterprise Value				
Enterprise Value	74232.2	136836.6	0	183012.2
Enterprise Value / Cash	2120.92	4146.564		1345.678
Enterprise Value / EBIT	10.8068	-49.0278		-46.1569
Enterprise Value / EBITDA	9.682	-169.352		-58.0622
Enterprise Value / PAT	13.1571	-26.1238		-33.4819
Enterprise Value / Share	0.6905	1.2729		1.9264