24 November 2023

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS,
299 Bronkhorst Street
PRETORIA
0181

VIA EMAIL: **National Treasury** (2023AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

Dear Colleagues,

ANNEXURE C PROPOSALS FOR BUDGET 2024: CORPORATE TAX

Please find attached hereto the comments from the SAIT Corporate Tax Technical Work Group for consideration as part of the Budget 2024 Annexure C pertaining to Corporate Tax and related matters.

We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate.

Please do not hesitate to contact us should you need further information.

Yours sincerely,

SAIT Corporate Tax Technical Work Group

Unless otherwise indicated all references to legislation are to sections of, and schedules to, the Income Tax Act No. 58 of 1962 (the Act).

1. CONTINGENT LIABILITIES IN SECTION 41(10)

[Applicable provisions: Section 41(10)]

1.1. Background

1.1.1. A provision that was added in 2017 is Section 41(10) of the Act states that, for the purposes of the corporate rules, a contingent liability will be treated as a debt actually incurred. This is somewhat perplexing as the corporate rules serve to defer the taxation that would ordinarily arise when assets are transferred from one party to another in the circumstances set out in the relevant rules. A contingent liability is, as it says, a liability (albeit not even definite) so, without reference to the Explanatory Memorandum (EM) the purpose of section 41(10) it is not clear.

1.1.2. The 2017 EM explains that s41(10) assists with sections 42 and 44 of the Act, which cater for assets to be disposed to a specified transferee in return for equity shares and/or also specified liabilities and section 47, which caters for assets to be distributed to a shareholder as a dividend to the extent not covered by an assumption of liabilities. The objective of section 41(10) is to make it clear that the specified liabilities include contingent liabilities which also satisfy the specified criteria (e.g. arose as part of the going concern or more than 18 months prior to the relevant transaction etc.). Without section 41(10), it states, because contingent liabilities are not yet real obligations they would not be considered as "debts" for purposes of the provisions (s42(8), s44(4) and s47(3A) of the Act).

1.2. The legal nature of the problem

1.2.1. What then happens in the transferee's hands? Reference to Interpretation Note 94 and *Ackermans Ltd v Commissioner for South African Revenue Service, Pep Store (SA) Ltd v Commissioner for South African Revenue Service* (441/09) [2010] ZASCA 131, making it clear that the seller cannot allege that the contingent liability has been incurred (and deduct it for tax purposes) and the purchaser may only consider the amount incurred when the obligation ceases to be contingent, if it ever does.

1.2.2. IN 94 explains that, generally, until a continent liability becomes a real liability, the purchaser, which has used the contingent liability as part of the consideration for an asset, may not treat the cost of such asset, to the extent it is paid for with the contingent liability, as incurred i.e. the purchaser must wait until the liability becomes 'real' to be able to deduct the cost or portion thereof of the asset (or related allowances).

1.2.3. Since section 41(10) states that the deemed incurral only applies for purposes of the corporate rules, it can't be used for other purposes i.e. to facilitate additional amounts to be deducted for purposes of the general deduction formula (trading stock), capital allowances or base cost for capital assets.

1.2.4. However, the corporate rules generally allow the transferee to "step into the shoes of the transferor" insofar as the transferred assets and the claiming of the cost of trading stock or allowances/base cost are concerned Thus, the question arises: if the deductibility of trading stock, allowances or base cost in respect of assets purchased using contingent liabilities, in terms of a corporate rule, is not affected, what becomes of the contingent liability when it materializes?

1.2.5. IN 94, specifically in relation to the corporate rules (part 7), states that the rest of the IN must be taken into account, but "In making such an evaluation no regard must be had to the fact that the assumption of the contingent liabilities by the transferee was part of the consideration for the acquisition of the assets". Thus, despite the fact that it doesn't refer to s41(10), because IN 94 was issued in December 2016 (before s41(10) was introduced) and has not been updated, and there was thus, at the time of its issue, no legal support for the stance taken, the IN aligns with s41(10) in determining that the contingent liabilities may, essentially, be considered incurred when used as part of the consideration and, thus, the transferee may continue to claim the allowances for the assets purchased in the same manner as the transferor would have.

1.3. **Detailed factual description**

1.3.1. What happens to the contingent liabilities, however, when they become actual liabilities in the transferee's when the corporate rules have been used? IN 94 states that once the contingent liability transferred becomes unconditional, the transferee may claim the expense on the same basis as the transferor would have, the example given is that if the transferor would have claimed a revenue deduction e.g. for a bonus, then the transferee must, when actually incurred, claim it as such, even though the assumption of the liability was used to buy a capital asset. This is the opposite approach to the rest of IN 94.

1.3.2. This approach also brings into question, despite it stating that it only applies for the corporate rules, the intended extent of s41(10). Nowhere in sections 41 to 47 does it state that the transferee must step into the shoes of the transferor insofar as contingent liabilities are concerned. Thus, though the outcome is favourable to taxpayers (and one which would be preferred for non-corporate rule asset transfers), it is not supported by the legislation (an IN is not legislation). Nor is it consistent with the treatment of transactions outside the corporate rules which involve contingent liabilities.

1.4. **The nature of the businesses impacted.**

1.4.1. Companies employing the relief contained in the corporate rules.

1.5. **Proposal**

1.5.1. The law thus needs to be changed to align with the practice i.e. to state that the transferee will step into the shoes of the transferor insofar as contingent liabilities are concerned.

2. ASSET-FOR-SHARE TRANSACTIONS

[Applicable provision: section 42(6)]

2.1. Background

2.1.1. The anti-avoidance provision under section 42(6) is not triggered if the subsequent transaction is undertaken in terms of sections 45, 46, 47 or paragraph 65 to the Eighth Schedule.

2.2. The legal nature of the problem

2.2.1. The exclusionary provisions under section 42(6) do not cover the position where the transferee's qualifying interest is discontinued as a result of a further asset-for-share or amalgamation transaction.

2.3. Detailed factual description

2.3.1. Interpretation Notes 159 and 231 indicate that the above scenario is acceptable where the shareholder of a liquidated company in the amalgamation acquires the shares previously subject to an asset-for-for share transaction.

2.3.2. Section 42(6) is triggered, despite the fact that it sets out alternatives, if both the qualifying interest and the employment requirements were satisfied when the asset-for share transaction was entered into, but one ceases to be satisfied.

2.4. The nature of the businesses impacted.

2.4.1. Companies which have entered into asset-for-share transactions may be affected.

2.5. Proposal

2.5.1. An amendment to clarify that section 42(6) will not be triggered if a further asset-for-share or amalgamation transaction is entered into and the qualifying interest requirement is fulfilled via the new shareholding.

3. SECTION 24I AND SECTION 20

[Applicable provisions: Section 24I and Section 20]

3.1. Background

3.1.1. The provisions of section 24I of the Act provide that realised and unrealised foreign exchange gains and losses on exchange items are either to be included in income or deducted from income of a taxpayer. In the case of a company, these provisions apply notwithstanding the fact that the company may be conducting a trade or not. There are circumstances in which unrealised gains and losses are deferred until realised provided certain requirements are met (refer to section 24I(10A)).

3.2. Legal nature of the issue

3.2.1. The issue relates to unrealised gains and losses incurred in a company that does not trade or ceases to trade in circumstances where an assessed loss arises and is not allowed to be carried forward in terms of section 20 of the Act because the company in question is not trading.

3.3. Factual description

3.3.1. A simple example illustrates the point. Company A, a non-trading entity, owes a non-resident parent company an amount of USD 1 million. At the transaction date the ZAR: USD exchange rate amounted to 15:1 and at the translation date the ZAR: USD exchange rate amounted to 18:1. Assume section 24I(10A) does not apply.

3.3.2. The above has the effect that in the relevant year of assessment an unrealised exchange loss of R3 million would arise. The company in question is not trading so the provisions of section 20 will not allow the carry forward of the loss to the subsequent year of assessment.

3.3.3. Assume in the subsequent year of assessment the exchange item is realised when the ZAR: USD amounts to 16:1 then a realised exchange gain of R2 million would arise in year 2.

3.3.4. The overall position on the instrument is that a net exchange loss of R1 million arises economically but from a tax perspective the company has actually paid tax on R2 million. The latter shows in no uncertain terms that the tax result and the economic result do not match in the sense that the company has paid tax on a gain which is not supported economically and is cashflow negative.

3.4. Proposal

3.4.1. The provisions of section 20 be amended to allow (on a per instrument basis) the carry forward of losses arising on exchange items in circumstances where section 20 would not otherwise allow the carry forward of such losses (embedded in the assessed loss).

4. BENEFICIAL OWNERSHIP

[Applicable provisions: section 1 of the Tax Administration Act, No. 28 of 2011 (“the TAA”)]

4.1. Background

4.1.1. The definition of “beneficial ownership” was inserted under section 1 of the TAA in the 2023 Taxation Laws Amendment Bill.

4.2. Legal nature of the issue

4.2.1. It is uncertain at which point during a transaction a person will be regarded as a “beneficial owner”.

4.3. Factual description

4.3.1. Where a person acquires the right to shares, but the shares are only transferred to such person at a future date, it is unclear when the ownership requirement will be regarded as having been satisfied.

4.3.2. Two possibilities arise in this regard – ownership either vests at the time of the acquisition of the right to the share alternatively, when the shares are transferred the person.

4.4. The nature of the businesses impacted.

4.4.1. Persons or businesses receiving transfer of shares.

4.5. Proposal

4.5.1. An insertion be made in the TAA, to clarify at which point a person will be regarded as a beneficial owner in relation to shares.

End