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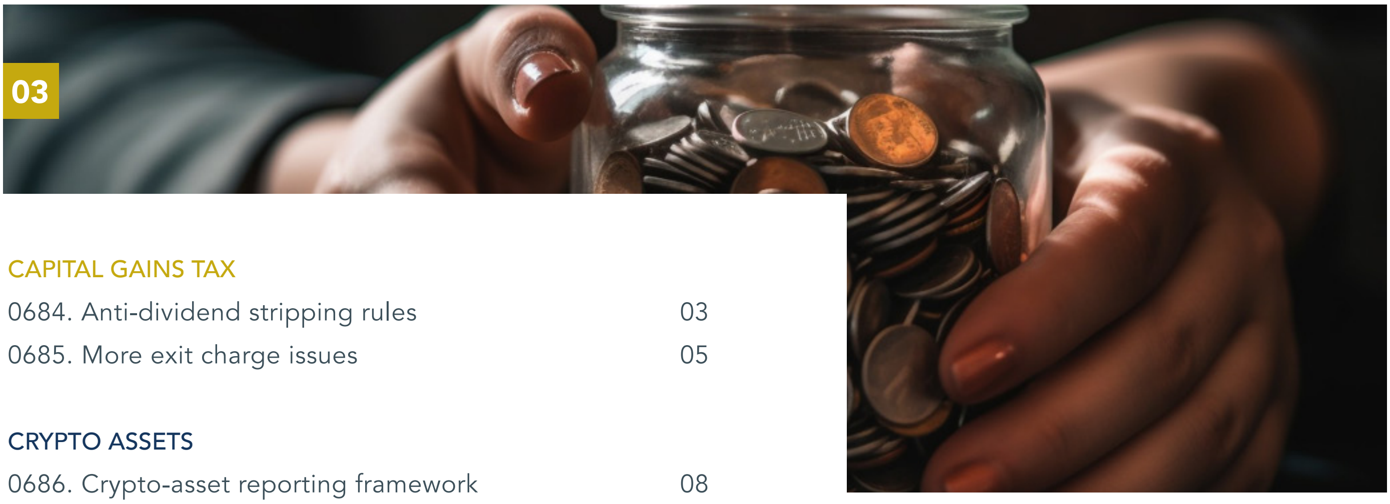


ANTI-DIVIDEND STRIPPING RULES

Dividend stripping has been under the watchful eyes of the South African Revenue Service (SARS) for some time. This is a highly technical topic, and this article will only focus on anti-dividend stripping rules that may apply to dividend stripping.

In South Africa, dividends are typically subject to dividends withholding tax (DWT) at a rate of 20%. Dividends declared from one resident company to another resident company in South Africa, however, are exempt from DWT. The result is that shareholders who structure their shareholding optimally can benefit from this exemption. Yet, as is the case whenever there is a benefit, it is open to abuse. The abuse of this exemption has been dubbed dividend stripping and used as a strategy by shareholders of a company to minimise their tax liabilities by exploiting the DWT rules in South Africa. Whilst a legal and tax-efficient way to reduce taxes, it has also raised regulatory concerns regarding its potential abuse.

The practice of dividend stripping involves declaring dividends from a company to another resident company prior to the disposal or dilution of its shares. In other words, the reserves of the company are reduced by declaring dividends out of the company. This in turn reduces (or "strips") the value of the shares in the company, allowing shareholders to sell or dilute their shares without, in some instances, incurring any taxes on the disposal.

To combat potential abuse of dividend stripping, South African tax laws have anti-dividend stripping provisions embodied in their framework for shares that are held as capital assets. In terms of paragraph 43A of the Eighth Schedule to the Income Tax Act, 1962 (the Act), the following requirements in relation to equity shares, if met, would result in dividend stripping falling within the anti-avoidance dividend stripping rules (the rules for capital assets under paragraph 43A are used for the example below, but similar rules are found for trading assets in section 22B):

1. A company disposes of shares or dilutes its shareholding, held by it as a capital asset, in another company.

2. The disposing company held a qualifying interest at any time in a period of 18 months prior to the disposal or dilution. A shareholder will have a qualifying interest in the company, whether alone or together with any connected person, if it holds at least 50% of the equity shares or voting rights in the company, or, where no shareholder has the majority of the shares, at least 20% of the equity shares or voting rights in the company.

3. The disposing company received an exempt, extraordinary dividend, in relation to its equity shares, within 18 months from the date of the disposal or dilution of the shares or in respect of, by reason of, or in consequence of such disposal.

What constitutes an extraordinary dividend depends on the shares that are the subject matter of the transaction. For preference shares, an extraordinary dividend is any dividend received or accrued that exceeds the amount that would have accrued had an interest rate of 15% per annum been applied to the consideration for the preference shares. If it is any other share, an extraordinary dividend is a dividend to the extent that it exceeds 15% of the higher of the –

(i) market value of the share at the beginning of the 18-month period; or

(ii) value of the shares at the date of disposal.

The terminology used in the Act surrounding extraordinary dividends is technical and requires scrutiny when determining whether a dividend is extraordinary or not.

The anti-dividend stripping provisions are broad in scope and therefore apply to all shares, whether equity or preference. They will also apply in instances where a company reacquires its shares by means of share buybacks or redemptions, making such transactions potentially subject to the dividend stripping rules.

"To combat potential abuse of dividend stripping, South African tax laws have anti-dividend stripping provisions embodied in their framework for shares that are held as capital assets."

In the event that the requirements for dividend stripping are met, a portion of the dividend is treated as part of the proceeds on the disposal or dilution of the shares. In other words, a part of the extraordinary dividends will trigger the anti-avoidance provisions and as the dividends will be treated as proceeds, there will be a capital gains tax implication for the disposing company.

The following example provides a basic illustration of dividend stripping and its application:

Company B is the sole shareholder in Company A. Company A declares a dividend to its shareholder Company B on 01 January 2023. The dividend to Company B is R25,000.00. The dividend is exempt from DWT because no dividend tax is levied between South African resident companies.

On 01 February 2024, Company B sells all its shares in Company A to Company C. The following information is available:

1. Company B holds the shares as a capital asset.

2. On 01 February 2024, being the date of disposal, the shares held by Company B are valued at R50,000.00 (the assumption is that this value is higher than the value of the shares 18 months prior to the disposal).

3. No DWT was withheld from the dividend declared on 01 January 2023 as the dividend was declared between resident companies.

When applying the anti-dividend stripping rules to the example, we observe the following:

1. Company B disposed of shares in Company A that it held as a capital asset.

2. Company B has a qualifying interest in Company A as it holds more than 50% of the equity shares and voting rights therein.

3. The dividend received on 01 January 2023 was exempt from DWT. In addition, the value of the dividend is 50% of the value of the shares on 01 February 2024, being the date of disposal. This means that R17,500.00 of the dividend received is deemed to be an extraordinary dividend as it exceeds 15% of the value of the shares (ie, the excess of dividend of R25,000.00 over 15% of R50,000.00).

4. The dividend was declared within 18 months from the date of disposal.

In the example, all the requirements for a dividend stripping have been met. The consequence is that the extraordinary dividend will be included as part of the proceeds that Company B receives from Company C for its shares and will be taxed accordingly.

Despite concerns about abuse, dividend stripping in South Africa still has the potential for legitimate tax use and can offer benefits when properly used and not abused. Given the anti-avoidance tax rules and accompanying tax consequences, it is prudent to involve a specialist corporate or tax expert is therefore a prudent consideration should one wish to give or receive a donation.

Dr Candice Reynders

PH Attorneys

Acts and Bills

- Income Tax Act 58 of 1962: Section 22B; Eighth Schedule: Paragraph 43A.

Tags: dividends withholding tax (DWT); dividend stripping; anti-dividend stripping rules; equity shares; extraordinary dividend.

MORE EXIT CHARGE ISSUES

Ceasing to be resident can have some harsh tax consequences, including potential double taxation despite the presence of a tax treaty. This article includes an examination of the amendment to the annual exclusion in the Taxation Laws Amendment Act, 2022. Some of the consequences can be explained by way of illustration.

THE CONSEQUENCES OF EXITING WHILE HOLDING SHARES IN A LAND-RICH COMPANY

John owns shares in a resident company which holds his primary residence in South Africa as its sole asset. The base cost of the property is R1 million and its market value at the time of exit is R3 million. For the sake of simplicity, assume that the shares also have a market value on the date of exit of R3 million and a base cost of R1 million. (In practice, the shares may well be worth less because of the contingent liability for CGT on the property and dividends tax on undistributed reserves.)

John permanently leaves South Africa ("exits") on 1 July 2023. At that time, he will be deemed under section 9H of the Income Tax Act, 1962 (the Act), to have disposed of the shares for R3 million on 30 June 2023 and will be subject to CGT on a capital gain of R2 million (R3 million proceeds – R1 million base cost). If he is on the maximum marginal rate of 45%, the CGT will be R2 million × 40% inclusion rate × 45% = R360 000 (ignoring the annual exclusion; the primary residence exclusion does not apply where the property is held by a company or trust (other than by a "special trust")).

The following should be noted:

First, despite the fact that the shares are held in a land-rich company which will remain potentially taxable after exit under paragraph 2(1)*(b)* of the Eighth Schedule to the Act, read with paragraph 2(2), section 9H(4)*(a)* excludes only from the exit charge "immovable property situated in the Republic". The term "immovable property" does not extend to movable assets such as shares in a land-rich company contemplated in paragraph 2(2) of the Eighth Schedule. (Section 35 of the Companies Act, 2008, confirms that a share is movable property.) Under paragraph 2(2), a non-resident is deemed to hold an interest in immovable property in South Africa if that non-resident holds, together with connected persons, an interest of at least 20% of the equity shares in a company and 80% or more of the market value of those equity shares at the time of their disposal is attributable directly or indirectly to immovable property in South Africa.

Section 9H was substituted with effect from 8 May 2012 by the Taxation Laws Amendment Act, 2012, and at that time section 9H(4)*(b)* excluded from section 9H

> "*(b)* any interest or right of whatever nature of that person to or in immovable property situated in the Republic, including an interest in immovable property contemplated in paragraph 2(2) of the Eighth Schedule;".

However, section 9H(4)*(b)* was deleted by the Taxation Laws Amendment Act, 2013, with effect from 12 December 2013. One of the reasons for its deletion was National Treasury's concern that the fiscus would lose its taxing rights if the person emigrated to a country with a tax treaty (like, for example, Luxembourg) that did not contain the standard land-rich share clause (article 13(4) of the OECD Model Tax Convention on Income and on Capital)–; it therefore does not contain a clause similar to:

> "4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State."

Although SARS argues, somewhat optimistically, in paragraph 4.2 in its *Comprehensive Guide to Capital Gains Tax* (Issue 9) *(CGT Guide)*, that the absence of article 13(4) in a tax treaty is not an obstacle to it being able to tax shares in a land-rich company, it is submitted that most tax practitioners do not share SARS' view.

As a result of the deletion of section 9H(4)*(b)*, the exit charge will apply to shares in a land-rich company, and the taxpayer will have to determine a capital gain or loss and then receive a step-up or step-down in the base cost of the shares. When the shares are subsequently disposed of by the non-resident, a further capital gain may have to be determined under paragraph 2(2) if the market value of the shares has increased from the time of exit and the tax treaty confers a taxing right on South Africa. The taxpayer may also have to pay CGT on that same amount in their new country of residence (the base cost is usually determined with reference to the time when residence is taken up), but if a double taxation agreement (DTA) exists, the CGT will be confined to one country in terms of the DTA. The problem arises if the property is sold from the company.

John, for instance, wants to dispose of the shares to a third party after ceasing to be resident. Many potential resident buyers would not want the shares for at least two reasons. First, they would not be entitled to the primary residence exclusion because to qualify for this the residence has to be held in the individual's own name (In this regard, see the definition of "an interest" in paragraph 44 of the Eighth Schedule, which does not include shares except shares in a share block company.), and secondly, a buyer would be reluctant to take over shares in a company because of the danger of undisclosed liabilities.

John's other option is to sell the property to the buyer out of the company and the company would pay the CGT at an effective rate of 21,6% (27% × 80% inclusion rate). Thereafter, the after-CGT proceeds would be distributed by way of a dividend to John, which would attract dividends tax at 20% unless a tax treaty provides for a lower rate. The dividends tax works out at an effective rate of 15,68% (100 – 21,6 = 78,4 × 20% = 15,68%), making the cost of extraction 21,6% + 15,68% = 37,28%.

Assuming the property is sold for R3 million, the CGT in the company will be R2 million × 21,6% = R432 000. That leaves an after-tax profit of R1 568 000 which, upon distribution, will attract dividends tax at, say, 20% of R313 600. John's total tax bill is thus R360 000 + R432 000 + R313 600 = R1 105 600, which amounts to nearly 37% of the value of the property.

Had John originally acquired the property in his own name, he would have paid no exit tax under section 9H(4)*(a)*, and the full capital gain of R2 million would have been disregarded under the primary residence exclusion in paragraph 45. This example exposes the folly of placing a primary residence in a company.

CEASING TO BE RESIDENT WHILE HOLDING FOREIGN IMMOVABLE PROPERTY

The problem of double taxation can also raise its ugly head when a person ceases to be resident while holding foreign immovable property. For example, Jane holds a flat in London with a base cost of R1 million and a market value at the time of exit of R6 million.

"What the EM ignores is the fact that when persons cease to be resident, all their assets, barring a few exceptions, are deemed to be disposed of, thus resulting in a bunching effect, similar to what happens when a person dies."

When she ceases to be resident, the flat is deemed to be sold for R6 million and, assuming she is on the maximum marginal rate, she must pay CGT on a capital gain of R5 million at 18% = R900 000. If she then decides to sell the flat after exit, she will be subject to CGT in the United Kingdom but will receive no credit for the South African exit tax because the United Kingdom would not have recognised a disposal when she exited South Africa. Of course, the reverse situation would apply when a United Kingdom resident holding South African immovable property exits the United Kingdom and has to pay CGT in that country. South Africa will give no credit for the foreign CGT when the resident disposes of the South African property.

THE ANNUAL EXCLUSION AND THE PROVISO TO PARAGRAPH 5(1)

The Taxation Laws Amendment Act, 2022 introduced a proviso to paragraph 5(1) of the Eighth Schedule. The proviso came into operation on 1 March 2023 and applies in respect of years of assessment commencing on or after that date:

"5. Annual exclusion

(1) Subject to subparagraph (2), the annual exclusion of a natural person and a special trust in respect of a year of assessment is R40 000: Provided that where any person's year of assessment is less than a period of 12 months, the total annual exclusions for years of assessments during the period of 12 months commencing in March and ending at the end of February the immediately following calendar year must not exceed R40 000."

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2022 (the EM), points out that persons ceasing to be resident have two years of assessment during the 12 months ending on the last day of February, since section 9H deems their year of assessment to end on the day before exit. Since the annual exclusion is per year of assessment, it is unacceptable from a policy point of view to grant two annual exclusions during the same 12-month period.

"As a result of the deletion of section 9H(4)*(b)*, the exit charge will apply to shares in a land-rich company, and the taxpayer will have to determine a capital gain or loss and then receive a step-up or step-down in the base cost of the shares. "

What the EM ignores is the fact that when persons cease to be resident, all their assets, barring a few exceptions, are deemed to be disposed of, thus resulting in a bunching effect, similar to what happens when a person dies. By rights the annual exclusion should be increased to cater for this effect but presumably the fiscus is not going to be kind to anyone departing from the country for greener pastures. It is surprising that the fiscus would concern itself with a trivial amount like this, since the annual exclusion is worth a maximum of R7 200 (R40 000 × 18%).

So how does the proviso work? Assume a person exited on 1 July 2023 and the sum of their capital gains is R30 000 for the period up to and including 30 June 2023 (first period). In the second period (1 July 2023 to 29 February 2024), the person sells immovable property in South Africa and realises a capital gain of R60 000. In the first year of assessment (first period), the capital gain of R30 000 must be disregarded as it is less than the annual exclusion. In the second year of assessment (second period), the annual exclusion must be reduced by the portion used in the first period, leaving R10 000 available for set-off against the capital gain of R60 000 in the second period.

But what happens if there is a capital loss of R40 000 in the first period and a capital gain of R60 000 in the second period? It would seem that the capital loss of R40 000 must be disregarded in full and in the second period the full amount of R60 000 must be brought to account because the annual exclusion was fully used in the first period. This outcome seems unfair because if the taxpayer had a single year of assessment, the capital loss could have been set off against the capital gain, leaving R20 000, which would have been reduced to nil by the annual exclusion. Even before the proviso, the taxpayer would have been able to disregard R40 000 of the capital gain of R60 000, leaving a capital gain of R20 000 to be brought to account.

It seems the drafter did not factor in that an annual exclusion applies to both gains and losses. It would have made more sense to restrict the proviso to situations in which there are only capital gains or only capital losses in both periods.

CONCLUSION

The exit charge in section 9H can result in double taxation for foreign immovable property because no tax credit is likely to be available in the destination country.

Tax practitioners should be aware of the limitation of the annual exclusion when their clients cease to be resident and continue to have capital gains in the period immediately following their departure.

This article was first published in ASA March 2023

Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Section 9H (emphasis on subsection (4)*(a)* & *(b)*); Eighth Schedule: Paragraphs 2(1)*(b)* & (2), 5(1) & 44 (definition of "an interest");
- Companies Act 71 of 2008;
- Taxation Laws Amendment Act 22 of 2012;
- Taxation Laws Amendment Act 31 of 2013;
- Taxation Laws Amendment Act 20 of 2022.

Other documents

- OECD Model Tax Convention on Income and on Capital: Article 13(4);
- *Comprehensive Guide to Capital Gains Tax* (Issue 9): paragraph 4.2;
- Draft Explanatory Memorandum on the Taxation Laws Amendment Bill, 2022.

Tags: contingent liability for CGT; double taxation agreement (DTA); foreign immovable property; primary residence exclusion.

CRYPTO-ASSET REPORTING FRAMEWORK

South Africa is following in the footsteps of 50 other jurisdictions in the world of cryptographic assets.

On 10 November 2023, the South African Revenue Service (SARS) announced in a media release that it will be adopting a new Crypto-Asset Reporting Framework (CARF) with the intention of facilitating global tax transparency. The Organisation for Economic Co-operation and Development (OECD) first developed the CARF framework, which SARS intends to adopt and implement into South African domestic law. The goal is to commence with information exchanges by 2027, subject to the standard national legislative processes. So, get ready for a new era of transparency regarding crypto assets in South Africa’s tax landscape.

WHAT IS A CRYPTO ASSET?

As per the SARS website, a crypto asset is a digital manifestation of value that lacks issuance by a central bank. This is basically an asset that is electronically traded, transferred, and stored. Such assets are generally used to facilitate payments and the underlying technology employs cryptographic techniques to ensure security and integrity.

HOW ARE CRYPTO ASSETS CURRENTLY TAXED IN SOUTH AFRICA?

Firstly, crypto assets are included in the definition of “financial instrument” in section 1(1) of the Income Tax Act, 1962 (the Act). Secondly, the disposal of crypto assets is a taxable event. The Act does not provide specific rules pertaining to crypto assets, so they would be subject to the usual income tax rules for financial instruments. Thus profits or gains from selling or realising crypto assets can be subject to taxation as either income or capital, following the same income tax regulations applicable to the sale of financial instruments.

"South Africa is showing that it is definitely going to tax crypto asset transactions. The adoption of this framework into its laws shows that SARS is focussing on this area."

Uncertainty arises when determining whether the profits or gains from these assets are capital or revenue in nature. The taxpayer's intent, substantiated by objective factors like the duration of holding and the frequency of trades, dictates whether the gains from crypto assets are categorised as revenue, subject to a maximum tax rate of 45%, or as capital, with a maximum tax rate of 18%. Case law sets out that a relevant question is whether the taxpayer was engaged in a scheme of profit making, ie, was the asset disposed of for the purpose of generating revenue as part of a profit-making scheme?

SARS has set out three circumstances in which crypto assets may attract certain tax consequences, namely the exchange of local currency for a crypto asset, goods or services being exchanged for crypto assets, and mining. Broadly, the tests generally used are:

- Where one acquired the crypto assets with the intention of actively trading with them, this points towards revenue;
- Where the crypto asset was held as a long-term investment, this points towards capital;
- Where the asset was held for a lengthy period, this would generally point towards capital.

SO, WHAT DOES THE NEW CARF CHANGE?

The CARF establishes a standardised process for automatically sharing tax information on transactions involving crypto assets with the taxpayers' jurisdictions of residence each year. In a general sense, the CARF comprises regulations and explanatory notes that can be adopted into local legislation. This adoption enables the gathering of information from Reporting Crypto-Asset Service Providers who have a significant connection to the jurisdiction implementing the CARF.

The CARF is structured around four pivotal components: firstly, it outlines the inclusion criteria for crypto assets. Subsequently, it designates specific individuals and entities as central figures responsible for data collection and reporting. Thirdly, the focus is on transactions, identifying those requiring reporting and specifying the information to accompany such reports. Finally, the framework incorporates due diligence procedures where crypto asset users and controlling persons are identified and the relevant tax jurisdictions for reporting and exchange purposes are determined.

CONCLUSION

South Africa is showing that it is definitely going to tax crypto asset transactions. The adoption of this framework into its laws shows that SARS is focussing on this area.

Kendra Saunders

Regan van Rooy

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definition of "financial instrument").

Tags: cryptographic assets; Crypto-Asset Reporting Framework (CARF); Organisation for Economic Co-operation and Development (OECD); financial instruments.

INCENTIVES FOR ELECTRIC VEHICLES

Climate change has been a hot topic for many years now. It is, therefore, probably understood by most (if not all) that the effects of climate change will worsen as long as greenhouse gases continue to be added to the atmosphere.

With no positive action to counteract or reduce the amount of greenhouse gas emissions, climate change extremities will worsen. As such, there is an urgent need to reduce greenhouse gas emissions and combat climate change globally.

AUTOMOTIVE INDUSTRY AND CLIMATE CHANGE IN THE GLOBAL CONTEXT

At a global level, the transport sector accounts for more than a third of greenhouse gas emissions. This has meant that the sector is amongst those that are prioritised for reducing emissions.

As such, many countries are setting pathways for reducing emissions for the various modes of transportation. In terms of road transport, policy announcements have been made by countries like the UK and political and economic blocks like the European Union (EU) for the effective ban on the sale of internal combustion energy (ICE) vehicles by 2035. Other countries have introduced carbon taxes which are set to increase over time and will contribute to achieving price parity between ICE vehicles and electric vehicles (EVs) over time.

"In terms of the Green Transport Strategy (2018–2050) published by the Department of Transport, South Africa has an ambitious goal of a 5% reduction of emissions in the transport sector by 2050."

Worldwide, incentives are playing an important role in the initial adoption of EVs and in supporting the growth of the EV manufacturing and battery industries. Other important measures being used include purchase subsidies, registration taxes, and tax rebates. Countries like Norway (1990s), the US (2008), and China (2014) were among the first to offer such measures.

Across the rest of Africa, some notable progression in EV policies has also been initiated. Morocco, for example, has introduced custom duty exemptions for EVs and VAT exemptions for importers and distributors of EVs. On the production side, EVs qualify for the standard automotive incentives, which include corporate tax exemptions for up to five years, VAT exemptions and withholding tax exemptions for dividends.

THE AUTOMOTIVE INDUSTRY AND CLIMATE CHANGE IN SOUTH AFRICA

In South Africa, some studies indicate that the transport industry is South Africa's third largest source of emissions, accounting for about 11% of the total emissions. Road transport specifically, contributes 91,2% of transport emissions from the combustion of petrol and diesel.

In terms of the Green Transport Strategy (2018–2050) published by the Department of Transport, South Africa has an ambitious goal of a 5% reduction of emissions in the transport sector by 2050.

In response, South Africa's Just Energy Transition Investment Plan (JET IP, 2022) for the initial period of five years (2023–2027) identifies key areas of investment in the transport space for the transition to a greener economy, which includes improved and more accessible public transport, manufacturing, and EV-related charging infrastructure.

"While existing policies like the Automotive Production Development Programme (APDP) and the Automotive Investment Scheme (AIS) provide a good framework for developing EV productive capacity, including in assembly and component manufacture, additional action is required, and it needs to be implemented as soon as possible."

SOUTH AFRICA'S AUTOMOTIVE MANUFACTURING INDUSTRY

South Africa's automotive manufacturing industry contributes significantly to the South African economy; it is the fourth largest in terms of output across all manufacturing sectors and contributes materially to export revenues. In 2022, the industry contributed 2,9% to South Africa's GDP and approximately 10% to the country's manufacturing output.

As South Africa exports approximately 63% (2022) of the vehicles it produces, the country cannot ignore global developments. The announcements by key export markets such as the EU and the UK of the effective bans on the sale of ICE vehicles by 2035, coupled with incentives aimed at increasing the uptake of EVs in these markets and a general consumer trend towards climate-friendly modes of transportation, will inevitably reduce demand for many of the ICE vehicles currently produced in South Africa.

This could be catastrophic for the country's economy as the automotive industry's direct jobs account for 8% of manufacturing employment and 0,8% of total employment in South Africa. Further, the automotive industry is responsible for attracting a substantial amount of foreign investment. Between 2021 and 2022 it accounted for a total of R26,1 billion in green and brownfield investment.

In this context, it is important for South Africa to keep up with global trends and introduce policies and incentives now that will support investment in the domestic production of EVs.

ACTIONS TO DRIVE INVESTMENT IN AUTOMOTIVE MANUFACTURING

While existing policies like the Automotive Production Development Programme (APDP) and the Automotive Investment Scheme (AIS) provide a good framework for developing EV productive capacity, including in assembly and component manufacture, additional action is required, and it needs to be implemented as soon as possible.

The Minister of Trade, Industry and Competition in December 2023 issued the Electric Vehicles White Paper (the White Paper), which outlines South Africa's strategy to transition towards greater EV production and consumption in South Africa. The strategy looks to move the automotive industry from primarily producing ICE vehicles to a dual platform that includes EVs by 2035.

The White Paper identifies 10 actions in support of the development of cost-competitive EV productive capacity in South Africa. From a tax perspective these actions include –

- the introduction of a temporary reduction on import duties for batteries in vehicles produced and sold in the domestic market, to improve cost-competitiveness;
- securing or maintaining duty-free export market access for vehicles and components produced in South Africa to support the resilience of the industry; and
- leveraging research and development tax incentives to deepen domestic value addition.

To further encourage the production of EVs in South Africa, the Minister, in the 2024 Budget, proposed the introduction of an investment allowance for new investments in the production of EVs from 1 March 2026.

RESEARCH AND DEVELOPMENT INCENTIVE

Research and development (R&D) is crucial for the sustainability of the automotive industry in the evolving technological space of EVs. Deepening South Africa's participation in the value chain will require technology adoption, adaptation and innovation. All these processes require ongoing investment in R&D.

The South African Government already provides a tax incentive to companies that incur expenditure related to R&D. The incentive is provided for in section 11D of the Income Tax Act, 1962 (the Act), and is currently based on a pre-approval system. In this context, companies intending to conduct R&D activities in South Africa need to apply to the Department of Science and Innovation for pre-approval, showing that the proposed activities will fall within the definition of "scientific or technological research or development", as set out in section 11D(1).

Once approved, companies can benefit from the incentive, which allows for a deduction of an amount equal to 150% of expenditure incurred by the taxpayer on R&D carried out in South Africa. This translates into a benefit of 13,5 cents per rand spent on R&D, at a corporate tax rate of 27%. Importantly, the section 11D R&D incentive has been extended to 31 December 2033.

A NEW INCENTIVE FOCUSED ON ELECTRIC VEHICLES

Similar to the R&D allowance, the proposed investment allowance will permit producers to claim 150% of qualifying investment spending on EVs and hydrogen-powered vehicles in the first year.

Unfortunately, there is not much guidance on how a taxpayer will qualify for the allowance or what will constitute "qualifying investment spending". Although the incentive is a welcome proposal, especially considering the global trends, it is notable that the allowance will only be available from 1 March 2026.

Importantly, the Minister of Trade, Industry and Competition recognised in the White Paper that, given the speed at which markets are developing, the pace at which the transition to EVs needs to take place must be swift. This is even more important due to the long lead times for investment decisions. It is hoped that the Minister is providing the automotive industry and potential investors with enough time to ensure that the incentive is impactful.

As noted in the 2024 Budget, the tax expenditure related to the incentive is estimated to amount to R500 million for 2026/27. With current spending pressures and there already being a deficit in revenue collection, it is essential that the incentive not only works to maintain tax revenues in the industry, but also potentially grow them in the future.

Those in the automotive manufacturing industry are therefore encouraged to take part in the consultations and discussions in anticipation of the enactment of the incentive.

Puleng Mothabeng

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 11D (specific emphasis on definition of "scientific or technological research or development" in subsection (1)).

Other documents

- Green Transport Strategy (2018–2050) (published by the Department of Transport);
- Just Energy Transition Investment Plan for South Africa (JET IP, 2022) (for the initial period of five years (2023–2027));
- Electric Vehicles White Paper (issued in December 2023).

Tags: greenhouse gas emissions; carbon taxes; Just Energy Transition Investment Plan (JET IP, 2022); research and development.

RENEWABLE ENERGY INCENTIVES

INTRODUCTION

Section 12B of the Income Tax Act, 1962 (the Act), deals with, amongst other things, renewable energy tax incentives.

It assists companies investing in renewable energy assets with cash flow constraints through an accelerated capital depreciation allowance on qualifying assets and supporting infrastructure. Given South Africa's critical energy shortage and the global move to a greener energy mix, this tax incentive is a cornerstone of South Africa's current fiscal policy.

The Minister announced two key tax policy proposals in the 2024 Budget that will assist in clarifying certain aspects of the allowance and which will be welcomed by the industry.

REMOVING THE DISTINCTION BETWEEN ENERGY GENERATION THRESHOLDS ELIGIBLE FOR THE INCENTIVE

Paragraph 2 of Schedule 2 to the Electricity Regulation Act, 2006, previously stated that energy systems that produced less than 1 MW of power did not need to apply for a licence, nor hold a licence in terms of that Act. In other words, as long as the energy-producing plant's capacity was below 1 MW, then it did not need to be registered. Any plant with generating capacity above 1 MW would need to follow the licensing process.

The licensing threshold for energy producing plants was also reflected in the renewable energy tax incentive in section 12B. In this context, a solar PV plant that produced less than 1 MW could be written off over a one-year period (ie, 100% write-off in year one). Comparatively, a solar PV plant that produced more than 1 MW could only be written off over three years on a 50/30/20 basis.

However, after several calls from industry to ease red tape and open up the energy generation market, President Cyril Ramaphosa announced on 10 June 2021 that the registration threshold for self-generation facilities would be raised from 1 MW to 100 MW. On 12 August 2021 the Minister of Mineral Resources and Energy released the much-awaited exemption which raised the registration threshold for self-generation facilities from 1 MW to 100 MW.

"On 12 August 2021 the Minister of Mineral Resources and Energy released the much-awaited exemption which raised the registration threshold for self-generation facilities from 1 MW to 100 MW."

As a consequence of this exemption section 12B needs to be aligned with the amendments to the electricity regulations in that the 100% accelerated depreciation allowance in section 12B should not distinguish between different generation capacities of solar PV plants. In other words, given the increase in the licensing threshold for embedded power generation from 1 MW to 100 MW, one should likewise raise the thresholds in section 12B in accordance with the amended registration thresholds. This will mean that a larger portion of embedded solar PV projects could benefit from the incentive, thereby increasing uptake.

The renewable energy industry calls have been answered, as the Minister announced in the 2024 Budget that Government would reconsider the generation threshold in section 12B. It is hoped that the generation threshold will be removed entirely, as is the case with the current 125% temporary renewable energy incentive in section 12BA of the Act. This will further encourage South Africa's transition to renewable energy and will ensure fewer constraints on the unstable national grid.

"During public consultations on section 12B's sister provision, section 12BA (the temporary increased renewable energy incentive), Government proposed applying the same treatment to finance lease arrangements as for operating leases. In this context, the distinction between finance leases and operating leases in section 12BA was removed from the final published legislation."

REMOVING LEASING RESTRICTIONS UNDER THE SECTION 12B ALLOWANCE

Section 12B does not allow a lessor (ie, the owner of the asset) to claim a section 12B allowance under a lease, unless one of the following requirements is met:

- the lease is an "operating lease" as defined; or
- the lease is for at least five years and the lessee earns income under that lease.

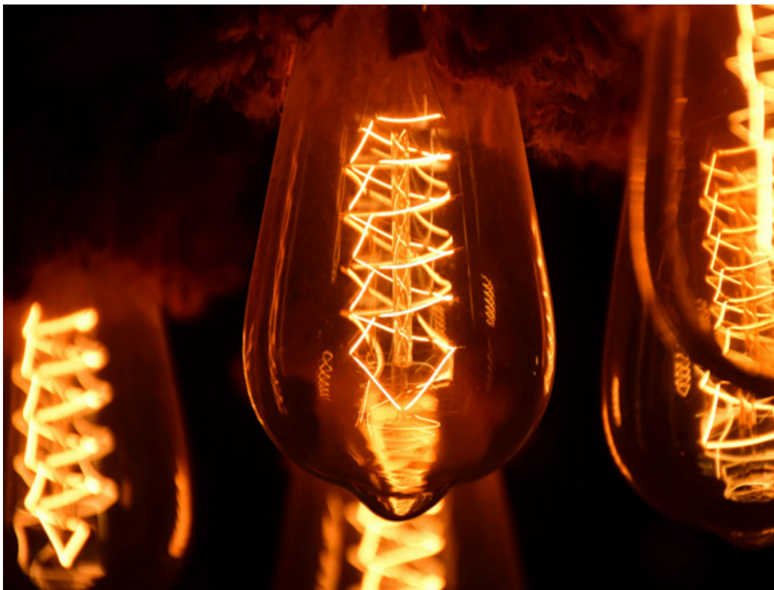
In addition, in terms of section 23A of the Act, a lessor is limited in claiming the section 12B allowance to the rental income earned, unless the lease is an "operating lease". It has been commented that these restrictions are not necessarily still fit for purpose with reference to renewable energy assets.

For example, one of the requirements of an "operating lease" (defined in section 23A(1)) is that the asset must be made available to be leased to the general public for a period of less than one month. From a practical and commercial perspective, many renewable energy assets cannot be leased to the general public for less than a month. For instance, it is questionable whether a hydropower plant could ever meet these requirements.

A further issue is that a finance lease type arrangement with a residential household would fall within the "missing middle", whereby in that scenario, no taxpayer would potentially qualify for the tax incentive.

During public consultations on section 12B's sister provision, section 12BA (the temporary increased renewable energy incentive), Government proposed applying the same treatment to finance lease arrangements as for operating leases. In this context, the distinction between finance leases and operating leases in section 12BA was removed from the final published legislation.

The Minister has now announced that similar considerations would be investigated for the permanent section 12B renewable energy allowance. This announcement is welcomed, and it is hoped that clarity, certainty and equity between commercial arrangements in this space are achieved during this process.



Jerome Brink

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 12B, 12BA & 23A (definition of "operating lease" in subsection (1));
- Electricity Regulation Act 4 of 2006: Schedule 2: Paragraph 2.

Tags: renewable energy tax incentives; section 12B allowance; operating lease; finance lease.

UNITRANS CASE: EXPENDITURE INCURRED FOR THE BENEFIT OF GROUP COMPANIES

A High Court judgment handed down by the Gauteng Division in January 2024 is not only relevant for interest expenditure, but also for all expenses that may be incurred for the benefit of other companies in a group.

The judgment is of importance as it illustrates the principle that, in order for expenditure to be deductible, a company must be able to show *inter alia* that such expenditure was incurred in the production of its own income and not for the purpose of furthering the interests of other group companies.

Further, in respect of understatement penalties, if reliance is to be placed on the "inadvertent *bona fide* error" exclusion, a taxpayer must be able to provide sound arguments as to why the taxpayer was reasonable in its belief that its tax position was correct.

While this does not necessarily mean that a taxpayer must obtain a tax opinion with respect to each and every aspect of its tax affairs (which is not feasible), the taxpayer must be able to show (with reference to extrinsic evidence) that it has duly considered the tax implications of, for example, expenditure incurred, and reached a conclusion as to the correctness of its tax treatment on a reasonable basis.

THE FACTS

In *Unitrans Holdings Limited v Commissioner for the South African Revenue Service* [2024] ZAGPJHC 3, the court dealt with the deductibility of interest expenditure under section 24J(2) of the Income Tax Act, 1962 (the Act).

Section 24J(2) provides *inter alia* that interest must be deducted "from the income of that person derived from carrying on <u>any trade</u>, if that amount is incurred <u>in the production of the income</u>" (own emphasis).

Unitrans Holdings (Unitrans or the Taxpayer), an investment holding company, earned interest income of approximately R34 million from its subsidiaries and had paid interest of approximately R68 million to its shareholder. SARS partially disallowed the interest deduction on the basis that it did not meet the requirements of section 24J(2) in that the expenditure was not incurred in the conduct of any trade and was not incurred in the production of income. SARS also imposed a 10% understatement penalty on the basis that there had been a "substantial understatement".

The tax court found in favour of SARS. The High Court had to consider whether (a) interest was incurred in the production of income derived from carrying on any trade and (b) the understatement penalty was correctly imposed.

THE FINDINGS

SARS argued that Unitrans did not carry on the trade of a moneylender, that the purpose of the interest expenditure was to further the interest of subsidiaries and that the interest was therefore not incurred "in production of income". The court concurred with the Taxpayer that, provided all the other requirements are met, interest may be deducted from income derived from carrying on <u>any</u> trade, and not only money lending.

Unitrans provided loan funding to its wholly owned subsidiaries and had a cash management system with Standard Bank. This meant that the group's bank accounts were balanced to zero on a daily basis. If the group's net position was an overdraft, Unitrans would borrow from Standard Bank on call loan and if the net position was positive, Unitrans would pay back on the call loan.

Unitrans argued that it is carrying on a trade as an investment and holding company and that the interest was incurred by it in carrying on this trade. The Taxpayer cited *Commissioner, South African Revenue Service v Tiger Oats Ltd* [2003] ZASCA 43 in support of its argument. In *Tiger Oats* the SCA held that an investment holding company, advancing low-interest and/or interest-free loans to its subsidiaries in whose businesses it is intimately involved, is carrying on a business and as such, carrying on a trade for tax purposes.

Based on the evidence before the court *a quo*, the court noted that the Taxpayer lent funds to its subsidiaries to improve their future income-earning capacity by not charging interest and that in doing so, the Taxpayer "was subjugating its profit-making potential to the interests of the group companies".

According to the court, the Taxpayer did not present evidence in support of the assertion that it was intimately involved with the businesses of its subsidiaries, unlike in *Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue,* [1991]. Accordingly, it was held that the court *a quo*'s judgment was correct, and that Unitrans did not incur the expenditure in the production of income. It was noted that the Taxpayer did not lead evidence as to why it believed the interest was incurred in the production of income and also did not challenge SARS' evidence that the expenditure was not incurred in the production of income.

In relation to understatement penalties, the Taxpayer was of the view that, should the court find that the interest was not deductible, the understatement would be due to an "inadvertent *bona fide* error" on its part (as envisaged in section 222(1) of the Tax Administration Act, 2011) and that SARS must show that the understatement did not result from such an error.

The court, however, held that Unitrans did not present sufficient evidence to show that the understatement was due to an "inadvertent *bona fide* error". According to the court, the court *a quo* duly exercised its original discretion, and the Taxpayer did not present sufficient arguments to necessitate the court's interference with the court *a quo*'s decision. The appeal was dismissed with costs.

"SARS argued that Unitrans did not carry on the trade of a moneylender, that the purpose of the interest expenditure was to further the interest of subsidiaries and that the interest was therefore not incurred 'in production of income.'"

Annalie Pinch & Trusty Malindisa

Bowmans

Acts and Bills

- Income Tax Act 58 of 1962: Section 24J(2);
- Value-added Tax Act 89 of 1991: Section 222(1).

Cases

- *Unitrans Holdings Limited v Commissioner for the South African Revenue Service* [2024] ZAGPJHC 3; (A3094/2022) (9 January 2024);
- *Commissioner, South African Revenue Service v Tiger Oats Ltd* [2003] ZASCA 43, 65 SATC 281;
- *Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue* [1991] (2) SA 257 (A), 53 SATC 1.

Tags: deductibility of interest expenditure; wholly owned subsidiaries; understatement penalties.

CONSEQUENCES OF MAKING A DONATION

A donation, made with the best of intent, may still land one in "hot" water with SARS. This article explains why a donation could result in donations tax being payable to SARS and when and how this could happen.

For tax purposes, a "donation" is defined (in section 55(1) of the Income Tax Act, 1962 (the Act)) as "any gratuitous disposal of property including any gratuitous waiver or renunciation of a right".

This means that the donation must be free or at no charge; should the *donee* (recipient) who receives a donation give anything of equivalent value to the *donor* in return, it will not constitute a donation. Donations are not limited to particular types of property and, therefore, both corporeal and incorporeal assets, as well as movable and immovable assets, may be the subject of a donation. In terms of section 55(3) of the Act, a donation will take effect once "all the legal formalities for a valid donation have been complied with".

Donations broadly fall into two main categories, namely *mortis causa* donations and *inter vivos* donations.

A *mortis causa* donation occurs where the donor promises to gift property to the donee and where the donation shall become effective upon the donor's passing. For a *mortis causa* donation to be valid, it must be reduced to writing and signed by the donor in the presence of two witnesses. Furthermore, the donation should be accepted by the donee before the donor's passing.

An *inter vivos* donation is a donation made between living persons, with the donation not being contingent upon the passing of the donor. Generally, once the donated property has been transferred by the donor to the donee and the donee accepts the transfer, the donation is deemed to have taken place and is subsequently irrevocable.

Donations tax is for the most part levied on the aggregate value of the property donated. There are, however, certain exemptions to donations tax as contemplated in terms of section 56 of the Act, namely:

- Certain donations are completely exempt from donations tax, for example, a donation between "spouses" as defined in section 1(1) of the Act, ie, a person who is a partner of another person in any of the following marital-like unions:

  (a) A marriage or customary union recognised under South African law.

  (b) A union recognised as a marriage in accordance with the tenets of any religion.

  (c) A same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent.

"Donations tax is payable by the end of the month following the month during which the donation was made or such longer period as SARS may allow."

- In the case of a donor who is not a natural person, there is an exemption from donations tax that is restricted to casual gifts not exceeding R10 000 in each year of assessment.

- In respect of property that is donated by a natural person, the first R100 000 is exempt from donations tax in each year of assessment. The property will include a monetary donation.

- Any *bona fide* contributions made by the donor towards the maintenance of any person are exempt from donations tax, with the exemption being limited to what the Commissioner for SARS considers to be reasonable.

An important consideration that should be kept in mind is where an asset is disposed of for so-called "inadequate consideration". In such a case the difference between the actual value of the asset and the consideration given will be deemed to be a donation and be subject to donations tax. Whether an asset is disposed of for an "inadequate consideration" will be dependent on the discretion of the Commissioner based on the facts.

Donations tax is only payable by South African residents and, therefore, donations tax is not applicable where a non-resident donates to a resident. Very importantly, where donations tax is payable, the donor is liable for the payment thereof. Should the donor, however, fail to pay the donations tax within the applicable payment period, both the donor and donee will be jointly and severally liable for the payment thereof.

Donations tax is payable by the end of the month following the month during which the donation was made or such longer period as SARS may allow. In respect of the payment of donations tax, the Commissioner may at any time assess either the donor or donee, or both, for the donations tax. The joint liability of the donor and donee for payment will be discharged upon payment of the amount due by either of them.

From the above, it should be clear that there are important considerations when making or receiving a donation. The last thing one wants is to receive a donation and then be hit by a donations tax liability. It may also be prudent to reduce a donation to writing and structure the donation correctly to avoid unforeseen donations tax consequences. Obtaining the help of a legal or tax expert is therefore a prudent consideration should one wish to give or receive a donation.

Dr Candice Reynders & Sian Angus

PH Attorneys

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "spouse"), 55(1) (definition of "donation") & (3) & 56;

- Recognition of Customary Marriages Act 120 of 1998.

Tags: *mortis causa* donations; *inter vivos* donations; inadequate consideration.

CONTROLLED FOREIGN COMPANIES

A controlled foreign company (CFC), as defined in section 1(1) (read with section 9D(1)) of the Income Tax Act, 1962 (the Act), is essentially a foreign company where 50% or more of its shares or voting rights are collectively held by South African residents.

A special tax regime, as set out in section 9D, applies to CFCs and specifically the residents who hold the relevant shares or voting rights.

In terms of section 9D(2), the "net income" (or portion thereof) of a CFC is included in the income of the residents for South African income tax purposes (unless any exceptions or exemptions otherwise apply), in accordance with the resident's proportional interest.

The net income of a CFC is calculated in terms of the Act as if that CFC were a resident.

PROPOSAL RELATING TO TRANSLATION FOR HYPERINFLATIONARY CURRENCIES

The net income must first be calculated in the "functional currency" of the CFC (usually a foreign currency) and is then translated into rand at an average exchange rate for the foreign tax year (section 9D(6)).

In section 1(1) of the Act "functional currency" in relation to a person is defined as:

> "[T]he currency of the primary economic environment in which the business operations of that person are conducted",

and in relation to a permanent establishment of any person as:

> "the currency of the primary economic environment in which the business operations of that permanent establishment are conducted."

Section 24I of the Act and paragraph 43 of the Eighth Schedule to the Act apply to CFCs and must in principle be used to calculate the net income of the CFC by including gains or losses on exchange items.

In this regard section 9D(2A)*(k)* is relevant; it provides that:

> "[F]or the purposes of section 24I and paragraph 43 of the Eighth Schedule, 'local currency' of a controlled foreign company otherwise than in relation to a permanent establishment of that controlled foreign company, means the functional currency of that company".

While the analysis is somewhat technical, the upshot is that where a CFC holds an exchange item that is neither attributable to a permanent establishment inside or outside of South Africa, the local currency is the functional currency, and it effectively means that no gain or loss is determined in relation to items denominated in the functional currency (there is no exchange item). If it is denominated in a currency other than the functional currency, exchange differences may arise.

In terms of the proviso to section 9D(6), any exchange item denominated in a currency other than the functional currency is deemed not to be attributable to any permanent establishment of that CFC if the functional currency is a currency of a country with an inflation rate of 100% or more for the year. In other words, a hyperinflationary currency must not be used for purposes of translation (section 9D(6)).

According to the proposals in the 2024 Budget, this principle is not currently reflected in the provisions of section 9D(2A)*(k)*. It is accordingly proposed that an amendment be introduced so as to not allow the use of hyperinflationary functional currencies for translation purposes.

TRANSLATION OF FOREIGN TAXES PAYABLE

Another proposal in respect of CFCs relates to the translation of foreign taxes payable by a CFC for purposes of ultimately determining the tax liability of the resident holder of shares or voting rights. The foreign taxes payable must be translated to rand at an average exchange rate for the year of assessment.

However, the net income of the CFC is translated to rand using the average rate for the foreign tax year of the CFC.

It has been proposed that amendments be introduced to align the years and curtail any mismatches that may result.

Heinrich Louw

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "controlled foreign currency" & "functional currency"), 9D (subsections (1) (definition of "controlled foreign currency"), (2), (2A) (definition of "net income"; proviso *(k)* (definition of "local currency")) & (6)) & 24I; Eighth Schedule: Paragraph 43.

Tags: controlled foreign company (CFC); net income; functional currency; permanent establishment.

TAX COMPLIANCE AND BUSINESS RESCUE

National Treasury may have thrown a lifeline to companies in business rescue in the 2024 Budget when it announced plans to review the circumstances under which SARS may decide to temporarily write off a tax debt under section 195 of the Tax Administration Act, 2011 (the TAA).

The proposed amendment comes at a critical point where financially distressed businesses are grappling with tight financial conditions, sluggish economic growth, and mounting tax obligations amid efforts to navigate the complexities of business rescue proceedings.

CHALLENGES WITH TAX COMPLIANCE IN BUSINESS RESCUE: SECTION 256

Where taxpayers find themselves in financial distress, often leading to business rescue interventions, tax compliance becomes increasingly challenging. The significance of this becomes apparent when considering the statistics of business rescue in South Africa. According to the Companies and Intellectual Property Commission's (CIPC) 2022/2023 Annual Report, of the 4 599 companies that commenced business rescue proceedings between 1 May 2011 and the end of the 2022/2023 reporting period, only about 20% reached substantial implementation (with 13% ending up in liquidation, 23% terminated, and 37% still active).

Section 256 of the TAA exacerbates this situation by requiring SARS to revoke a taxpayer's compliance status if it has outstanding tax debts. Reinstating this compliance status requires addressing outstanding issues, including the settlement of outstanding tax liabilities or, where this is not possible, devising compromise or instalment payment arrangements with SARS.

> "Section 195 of the TAA, as it is currently worded, confers powers on SARS to temporarily write off an amount of tax debt where a tax debt becomes irrecoverable or uneconomical to pursue, and where a debtor is subject to business rescue proceedings under the Companies Act, 2008."

The intricate nature of business rescue proceedings means rectifying historical non-compliance, which can often take time and effort, frequently involving extensive reconstruction of financial records due to mismanagement, fraud, or theft. SARS is also understandably dealing with a backlog of compromise and deferral requests, given the significant number of financially distressed businesses being forced to seek relief from SARS for pre-commencement tax debts.

Stable cash flows are imperative to the success of business rescue proceedings; significant delays in the reinstatement of a taxpayer's compliance status, therefore, often lead to disastrous results for distressed taxpayers, who typically cannot tender for any new contracts, or enforce payment for work already done (particularly taxpayers that supply services to government entities).

For example, the case of *Red Ant Security Relocation and Eviction Services (Pty) Ltd v CSARS* 80 SATC 431 involved a taxpayer which derived 96% of its revenue from government contracts, which it could not execute without a tax clearance certificate. The taxpayer could not receive payment for its services nor tender to provide new services, creating severe financial constraints that left its business on the brink of closure. The livelihoods of some 11 000 employees were at risk, and nine municipalities would potentially have been left without essential services if the taxpayer's business shut its doors.

The liquidation of businesses that could otherwise have traded back into solvency inevitably results in job losses, but SARS also loses out on the ongoing tax revenue these businesses could have generated. As a concurrent creditor, SARS also typically only recovers a very small percentage of the outstanding tax debt of the business in liquidation, compared to what could have been recovered over time, through a compromise and deferral arrangement, particularly if the taxpayer is given the opportunity to trade itself out of business rescue and back into a solvent financial position.

NAVIGATING THE CHALLENGES OF SECTION 195: SEEKING RELIEF FOR DISTRESSED TAXPAYERS

Section 195 of the TAA, as it is currently worded, confers powers on SARS to temporarily write off an amount of tax debt where a tax debt becomes irrecoverable or uneconomical to pursue, and where a debtor is subject to business rescue proceedings under the Companies Act, 2008.

Section 195 could, therefore, facilitate a temporary write-off of a taxpayer's outstanding tax debt, allowing the taxpayer's compliance status to be reinstated immediately. This could afford distressed taxpayers a chance to trade out of financial distress without the burden of a "non-compliant" status, without compromising SARS' mandate to collect revenue, as the tax debt owed to SARS is not permanently waived or compromised (save to the extent this is separately agreed between SARS and the taxpayer), and can be reinstated at an appropriate time.

However, the correct interpretation and application of section 195 is uncertain, and taxpayers have been unable to rely on this provision to secure temporary write-offs thus far, being forced instead to approach the courts for relief, as was the case in *Red Ants* and various other matters.

Treasury's commitment in the 2024 Budget to reviewing the discretion afforded to SARS by section 195 of the TAA accordingly represents a crucial step towards aligning tax administration practices with the objectives of the business rescue provisions in the Companies Act.

Such an amendment will hopefully prevent scenarios where SARS is compelled (by legislation or policy) to force viable businesses into insolvency due to their inability to secure a tax clearance certificate within a reasonable timeframe. Not only will this safeguard the interests of distressed taxpayers and promote economic resilience and sustainability, but it will also benefit SARS and the fiscus by prioritising extended repayment of tax debts over non-recovery (when distressed taxpayers are liquidated).

Treasury's commitment in the 2024 Budget to reconsider the ability of SARS to temporarily write off the tax debts of distressed taxpayers in order to reinstate their tax compliance status is a welcome development. If companies in business rescue are able to trade back to health without the noose of tax debts around their necks, this can only contribute towards a conducive environment for business recovery and economic growth in South Africa.

Julia Choate

Bowmans

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 195 & 256;
- Companies Act 75 of 2008.

Other documents

- Companies and Intellectual Property Commission's (CIPC) 2022/2023 Annual Report.

Cases

- *Red Ant Security Relocation and Eviction Services (Pty) Ltd v CSARS* 80 SATC 431.

Tags: business rescue interventions; tax clearance certificate.

THE *ABD* CASE: THE ARM'S LENGTH PRINCIPLE

With increasing economic globalisation, revenue authorities around the world continue to shift their focus to issues of transfer pricing. Broadly, this fits in with the global move to combat so-called "profit shifting", a practice where multinational groups attempt to concentrate their profits in low-tax countries in which they operate.

This global move has been spearheaded by the Organisation for Economic Co-operation and Development (OECD) through its Base Erosion and Profit Shifting (BEPS) project. Although not a member of the OECD, South Africa has followed this and is a part of the BEPS project.

To address transfer pricing directly, South Africa enacted section 31 of the Income Tax Act, 1962 (the Act), in 2005 and amended it substantially in 2012. Linked to this, the South African Revenue Service (SARS) published its Interpretation Note 127 on thin capitalisation and the application of transfer pricing rules to inter-company loans on 17 January 2023. This confirms SARS' focus on transfer pricing.

The Tax Court, sitting in Johannesburg, on 14 February 2024 passed down its first judgment dealing with the merits of the arm's length price for transfer pricing purposes, in the case of *ABD Limited v Commissioner for the South African Revenue Service* (14302) [2024] ZATC 2. The Tax Court's decision in *ABD Limited* serves as a useful guide to the basics of transfer pricing within the context of South African tax law.

THE CONCEPT OF TRANSFER PRICING

The Tax Court explained the concept of transfer pricing as being the pricing of goods and services between companies under common control. At its most basic, this concerns the price one entity charges another entity for goods and services, where both entities form part of the same group of companies or are otherwise associated or connected with each other but are situated in different countries.

As pointed out above, and in *ABD Limited*, transfer pricing opens the door to one company operating in a low-tax country to over-charge for goods or services which it supplies to a related company operating in a high-tax country. The result is that the company in the high-tax country will shift a portion of its profits to the low-tax country because of the high price being charged by the related company situated there.

Therefore, the key to transfer pricing is ensuring that related companies (or entities) price goods and services supplied between them at arm's length. Simply put by the Tax Court in *ABD Limited*, arm's length prices are those that would be charged between two independent companies (as opposed to a company situated and taxed in one country, and its subsidiary situated and taxed in another).

THE BACKGROUND TO *ABD LIMITED*

The taxpayer in *ABD Limited* was a telecommunications company situated in South Africa, but with subsidiaries operating in various other countries (opcos). Between 2009 and 2012, the taxpayer licensed its intellectual property to these opcos against payment by these opcos of a royalty. For all of these opcos, this royalty was charged at the same flat rate of 1%.

The taxpayer had chosen this royalty rate on the advice of an independent external consultancy which had researched the most appropriate arm's length rate at which to charge the royalty and presented this research to the taxpayer. SARS, however, took the view that this 1% royalty was, in fact, not arm's length and should have been higher. Therefore, relying on section 31 of the Act, SARS raised additional assessments for the taxpayer's 2009 to 2012 tax years.

Initially, in coming to its conclusion (and raising the additional assessments), SARS relied on an expert report it had commissioned. However, during the course of proceedings before the Tax Court, SARS retained the services of a second expert who recommended that SARS adjust the royalty rate even further. This second expert's opinion was based on his view that the taxpayer should have charged a variable royalty rate based on both the relevant economic factors for the year in which the royalty was charged, and the country in which a specific opco was situated.

SARS' change in expert led the taxpayer to argue that SARS was "flip-flopping" and also challenged the additional assessments on procedural grounds. The Tax Court did not come to a decision on the procedural arguments but decided to consider the case on its merits.

PROFIT SHIFTING

Firstly, the Tax Court pointed out that there was no motivation or rationale for the taxpayer to charge the opcos an artificially low royalty rate. This is because the countries in which the opcos operated had (by and large) tax rates equal to or in excess of South Africa's tax rate and it was therefore not necessarily more beneficial for the taxpayer to charge lower royalty rates as its effective tax rate across jurisdictions would remain similar (if not the same). Furthermore, there were also minority shareholders of the opcos that would benefit from more of the profit generated by those opcos being retained in the opcos, which would not likely be the taxpayer's intention.

Although SARS contended that this was an irrelevant consideration, and the Tax Court agreed to some extent, arguably there was nevertheless some weight attached to it for the reason that this pointed towards the taxpayer's genuine reliance on the report presented to it by the independent external consultancy. Further, the Tax Court found that there were sound commercial reasons for the taxpayer adopting a flat royalty rate across all the opcos.

THE ARM'S LENGTH PRINCIPLE

Focusing on the issue of transfer pricing itself, and given the lack of case law, both sides placed great reliance on the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (Guidelines) published by the OECD. The court referred to the definition of arm's length pricing from these Guidelines, and also the approach to testing what an arm's length price would be in a specific situation.

Two of these approaches were used by the taxpayer to justify its choice of royalty rate: the Transactional Profit Split Method (TPSM) and the Comparable Uncontrolled Price Method (CUP). SARS relied on the TPSM.

As set out by the Tax Court, the Guidelines define the TPSM as:

> "[identifying] the relevant profits to be split for the associated enterprises from a controlled transaction … and then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm's length."

The CUP on the other hand is defined in the Guidelines as:

> "[Comparing] the price paid for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances."

The Tax Court commented that the transfer pricing study presented by the taxpayer using the TPSM was not always necessarily well suited for intangible assets such as intellectual property (which was the subject of the royalty rate in question in *ABD Limited*). It therefore did not make a finding on this method as presented by the taxpayer, and rather considered the CUP analysis presented by the taxpayer.

In particular, the Tax Court decided to consider the CUP analysis as it found that there was a similar transaction, involving the same intellectual property, which the taxpayer had concluded previously with an unrelated company. SARS challenged the reliance on this method on the basis that the previous transaction was not comparable, and thus inapplicable.

The Guidelines set out a number of relevant factors for consideration when determining comparability between transactions. The Tax Court pointed out that these included:

- the contractual terms of each transaction;
- the assets and risks involved in each transaction;
- the characteristics of the property transferred in each transaction;
- the economic circumstances of the parties in each transaction; and
- the business strategies pursued by the parties in each transaction.

The Tax Court also pointed out that, despite these factors, the Guidelines provide that differences between transactions do not render them incomparable if these differences can be measured and thus accounted for. Further, in the specific transaction used by the taxpayer for the CUP analysis in *ABD Limited*, the taxpayer's expert argued that any differences between that transaction and the transaction with the opcos in question were immaterial to the royalty rate applied.

Although arguing that each individual opco could not be compared with the unrelated party from the previous transaction used for the CUP analysis, SARS' own expert admitted that the opcos could be analysed collectively due to their comparable functional profiles. Therefore, the Tax Court found that the previous transaction entered into by the taxpayer with an independent third party was comparable and thus relevant to the CUP analysis.

THE DATA UNDERPINNING SARS' TPSM METHOD

Turning to SARS' reliance on the TPSM method, the Tax Court found that when SARS conducted its own TPSM analysis, its second expert used an incorrect understanding of the taxpayer's intellectual property that was licensed to the opcos. SARS' second expert developed a "willingness to pay" (WTP) test to determine an arm's length royalty. This test involved an assessment of what premium a customer would be willing to pay to use the taxpayer's branded product, as opposed to a comparative product from an unknown third party.

This WTP test, however, was measured using the taxpayer's full brand (ie, predicated on the taxpayer having licensed its complete brand, including goodwill, to the opcos). In reality, the taxpayer had only licensed its trademark to the opcos, and specifically excluded its goodwill. This meant that the basis of the TPSM analysis relied upon by SARS was incorrect. The Tax Court also raised questions regarding the applicability of the WTP test in a transfer pricing context.

In light of this, the Tax Court decided that the most persuasive analysis presented to it had been the one using the CUP method, which was based on the previous licensing agreement which the taxpayer had entered into with an independent third party. The royalty rate in that agreement had also been 1%, and therefore the Tax Court found in favour of the taxpayer.

COSTS

On the question of costs, the Tax Court accepted that this had to be decided in terms of the Tax Administration Act, 2011 (where costs do not necessarily follow an order). Nevertheless, on this metric, the Tax Court found that SARS had been unreasonable with its "flip-flop" between experts, and the taxpayer was thus entitled to a cost order in its favour.

NEXT STEPS

SARS' loss on the first transfer pricing issue to reach the Tax Court based on a determination of the arm's length price will undoubtedly be a disappointment to it (which the Tax Court observed in *ABD Limited*).

It is likely that SARS will appeal this decision. Considering that Tax Court decisions are not binding, a judgment given by a High Court, or the Supreme Court of Appeal (SCA), would be invaluable. Similar to other contentious tax issues currently before our courts, clarity on the interpretation and application of complex tax provisions such as transfer pricing is in the best interests of SARS and taxpayers. If the Tax Court grants SARS leave to appeal directly to the SCA, it remains to be seen whether the SCA decides in SARS' favour, which it has done in most tax cases it has heard in recent years. If leave to appeal directly to the SCA is not granted, the appeal would be heard by the Gauteng Division of the High Court (typically a full bench of three judges) and depending on the outcome in the High Court, the matter could be appealed to the SCA. Given the recent increase in tax cases being heard by the Constitutional Court (including the 2024 hearings in the *Thistle Trust* and *Coronation* cases *(Thistle Trust v Commissioner for the South African Revenue Service* (CCT 337/22) and *Coronation Investment Management SA (Pty) Limited v Commissioner for the South African Revenue Service* (CCT 47/23)), it may be that it has the final say in the matter. Therefore, some patience may be required before absolute certainty is achieved, and the matter has run its course.

Hopefully, the outcome of this case will give better insight into the application of transfer pricing principles in a South African context, thereby enabling better certainty for taxpayers and SARS in a complex area of tax law. Aside from the fact that the current matter could come before higher courts, taxpayers must appreciate that there are many different types of transfer pricing cases. For example, a case such as this one dealing with the application of transfer pricing to royalties is unlikely to play out in the same way as one dealing with the cross-border supply of other goods and services. While the judgment in *ABD Limited* is certainly groundbreaking considering its novelty (and has elicited excitement amongst the tax advisory community), only time will tell how the courts apply the transfer pricing rules in different contexts.

Jerome Brink & Nicholas Carroll

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 31;
- Tax Administration Act 28 of 2011.

Other documents

- Interpretation Note 127 (*Determination of the taxable income of certain persons from international transactions: intra-group loans*) – published on 17 January 2023;
- Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (published by the OECD) (emphasis on definitions of the *Transactional Profit Split Method* (TPSM) and the *Comparable Uncontrolled Price Method* (CUP)).

Cases

- *ABD Limited v Commissioner for the South African Revenue Service* (14302) [2024] ZATC 2 (14 February 2024);
- *Thistle Trust v Commissioner for the South African Revenue Service* (CCT 337/22));
- *Coronation Investment Management SA (Pty) Limited v Commissioner for the South African Revenue Service* (CCT 47/23)).

Tags: profit shifting; Base Erosion and Profit Shifting (BEPS); additional assessments; arm's length price; Transactional Profit Split Method (TPSM); Comparable Uncontrolled Price Method (CUP); "willingness to pay" (WTP) test.

REVALUING TRUST ASSETS TO AVOID CAPITAL GAINS TAX

Binding Private Ruling (BPR) 342, dated 30 April 2020 ("Donation by a resident to a foreign trust of property received from another foreign trust"), is particularly interesting because it revealed a novel way of avoiding capital gains tax (CGT).

The applicant was a resident beneficiary of Trust A which was resident in Country X. Trust A had been settled in 2012 by the applicant's son. The beneficiaries on the date of settlement were the applicant's son, the applicant's daughter-in-law, as well as any children or grandchildren of the applicant's son and such other persons or class of persons or any charitable institution which the trustees may add under the trust deed. The applicant was appointed a beneficiary of Trust A in 2019. The purpose of the arrangement was to transfer the net assets of Trust A to Trust B, which was resident in Country Y. Trust A would firstly revalue its assets and credit the revaluation surplus to its capital account. It would then vest this surplus plus the settled trust capital in the resident beneficiary on loan account. The beneficiary would then donate the resulting loan account in Trust A to Trust B. Finally, Trust A would transfer its net assets to Trust B in settlement of the loan account.

At this point one might be wondering why it was necessary to involve the resident beneficiary in the arrangement, since the beneficiary had nothing to gain from the transaction. One can only speculate, but it seems likely that the transaction may have been structured in order to avoid tax in a foreign jurisdiction.

The following rulings were made:

- The award by Trust A to the SA beneficiary will not constitute "gross income" as defined in section 1(1) of the Income Tax Act, 1962 (the Act) for the beneficiary, as it will constitute a receipt of a capital nature. Subsequent to this ruling, section 25B(1), which gives effect to the conduit principle, was amended on 20 January 2021 to exclude amounts of a capital nature that are not included in gross income.

- On the award of the amount by Trust A to the beneficiary, no amount must be included in the taxable income of the beneficiary under section 26A, read with the Eighth Schedule to the Act, as the beneficiary will not have disposed of any asset. This raises the question whether a beneficiary gives up a right to claim the amount in exchange for the vested right. But given that paragraph 20(1)*(h)*(vi) of the Eighth Schedule establishes the base cost of the vested claim, there is a necessary implication that underlying exchanges of rights are disregarded.

- On the donation by the beneficiary to Trust B, no amount must be included in the taxable income of the beneficiary under section 26A, read with the Eighth Schedule, as the disposal of the beneficiary's right to receive the award will not result in any capital gain, as the market value of the claim will be equal to its base cost. As mentioned above, paragraph 20(1)*(h)*(vi) establishes the base cost of the claim. It provides that a person that acquires an asset from a non-resident by way of donation is treated as having acquired the asset for a cost equal to market value on the date of acquisition. The proceeds on disposal of the claim to Trust B would be equal to the same market value under paragraph 38.

- Section 25B(2A), read with section 25B(2B), will not apply to the award to the beneficiary. This is merely confirmation that no part of the vested claim originated from trust capital comprising previously untaxed income. Since the vesting originated from the settled capital of the trust and the unrealised surplus, this would be the position.

- No asset of Trust A will have been disposed of, nor will any asset or right to any asset have been vested in the beneficiary, so that neither paragraph 80(1) nor paragraph 80(2) will apply to the award made to the beneficiary. This is where the CGT avoidance arises because the unrealised surplus does not represent the disposal of an asset, which would be a prerequisite for a capital gain.

- Paragraph 80(3), read with paragraph 80(4), will not apply to the award made to the beneficiary. Again, this is similar to section 25B(2A), and merely confirms that no part of the trust capital built up in prior years of assessment includes an untaxed capital gain or an amount that would have been a capital gain had the trust been a resident.

- The donation by the beneficiary to Trust B will be exempt from donations tax under section 56(1)*(g)*(ii). Section 56(1)*(g)*(ii) exempts from donations tax any property

  > "if such property consists of any right in property situated outside the Republic and was acquired by the donor … by a donation if at the date of the donation the donor was a person (other than a company) not ordinarily resident in the Republic".

  The resident beneficiary had acquired the claim through vesting from Trust A, which was not ordinarily resident in South Africa, and so the beneficiary was able to donate it free of donations tax.

The part of the arrangement that catches one's attention is the revaluation of the trust assets shortly before disposing of them and the vesting of this unrealised surplus on loan account in the resident beneficiary.

This is a somewhat aggressive way of avoiding paragraph 80 of the Eighth Schedule, since had the assets first been disposed of and the resulting proceeds vested in the resident beneficiary, any capital gains would have been attributed to the resident beneficiary under paragraph 80(2A) or (3). But the unrealised surplus is not a capital gain arising from the disposal of an asset; it merely represents a distribution of trust capital, placing it beyond the reach of the *fiscus* on a plain reading of paragraph 80. There is the danger that SARS could invoke sections 80A to 80L (the general anti-avoidance rules), since revaluing the trust assets, vesting the surplus in the resident beneficiary, and then disposing of those assets shortly afterwards seems to serve no commercial purpose other than to obtain a tax benefit. The ruling did not cover this aspect. However, as indicated earlier, it seems that the transactions were not aimed at avoiding tax in South Africa but more likely in an offshore jurisdiction such as the settlor's country of residence.

One aspect that was not canvassed in the ruling was that any capital gains arising in Trust B would be attributable to the resident beneficiary under paragraph 72, since the acquisition of the assets from Trust A was funded by the donation from the resident beneficiary. This may not have been of concern for reasons not disclosed in the ruling. For example, if the beneficiary was at an advanced age, any attribution would cease upon the death of the beneficiary. Alternatively, if the beneficiary intended to cease to be resident, attribution would also not be of concern.

Trustees act in a fiduciary capacity, and vesting an unrealised surplus in a beneficiary could be viewed as reckless and prejudicial to other beneficiaries, particularly if the unrealised surplus cannot be sustained. In *Dimbula Valley (Ceylon) Tea Co Ltd v Laurie,* [1961], it was held that a surplus on valuation of fixed assets is distributable by a company if –

- the articles authorise it;
- the valuation is made in good faith by a competent valuer; and
- the surplus is unlikely to fluctuate in the short term.

One would hope that a prudent trustee would adopt equivalent principles when considering whether to distribute an unrealised surplus. Instead of articles of association, the trustee would need to ensure that the distribution is permitted by the trust deed.

This problem was seemingly not an issue in the BPR, since the sale of the assets was likely to have taken place soon after their valuation, and so the trustees would have been aware that the unrealised surplus would soon become realised.

An arrangement of this nature may backfire if the asset was originally funded by a donation, settlement or other disposition and the donor is a resident. The problem is that when the actual capital gain arises, it will be subject to attribution back to the resident donor under paragraph 72. Thus, one would need to ensure that the person who originally funded the purchase of the trust assets is not a resident. It can be inferred from the ruling that the resident beneficiary's son was a non-resident, otherwise the capital gains that arose on the disposal of Trust A's assets to Trust B would likely have been attributed to him.

Australians have been exploiting the unrealised surplus loophole in their own country with discretionary trusts for decades. In *Fischer v Nemeske Pty Ltd* [2016] HCA 11 the High Court of Australia held in a 3–2 decision that a valid debt was created for the beneficiaries when the trust vested a revaluation surplus in the beneficiaries. The Australian Council of Social Service in a policy briefing dated November 2017 stated that:

> "Avoiding tax on capital gains (distributions of untaxed capital gains from the revaluation of assets within a discretionary trust to beneficiaries does not attract Capital Gains Tax, though it does for fixed trusts)." ["Ending tax avoidance, evasion and money laundering through private trusts", https://www.acoss.org.au/wp-content/uploads/2017/11/Tax-treatment-of-private-trusts_November-2017_final.pdf (accessed 20 June 2023).]

It seems that a fixed trust under Australian law is the equivalent of a vesting trust under SA law. However, Australia has a specific disposal event (E4) that deals with the situation when non-assessable amounts are paid to beneficiaries. Section 104-70 of the Australian Income Tax Assessment Act, 1997 requires the "cost base" (equivalent of base cost) of the asset to be reduced by such amounts and if the amount exceeds the cost base, a capital gain will arise. This treatment is similar to that found under paragraph 76B of the Eighth Schedule to the Act for returns of capital from companies.

With resident trusts, there seems to be little advantage to distributing an unrealised surplus to a resident beneficiary because the capital gain that will arise on realisation will be subject to CGT at the rate of 36% in the trust if it cannot be distributed. Trustees have other ways of achieving the same result, for example, by simply making a loan to the beneficiary.

CONCLUSION

Given that BPR 342 was issued on 30 April 2020, it is surprising that National Treasury has not yet acted to address the question of distributions by non-resident trusts out of unrealised surpluses.

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> "The part of the arrangement that catches one's attention is the revaluation of the trust assets shortly before disposing of them and the vesting of this unrealised surplus on loan account in the resident beneficiary."

Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income"), 25B(1), (2), (2A) & (2B), 26A, 56(1)*(g)*(ii), 76B & 80A to 80L; Eighth Schedule: Paragraph 20(1)*(h)*(vi)), 72 & 80(1), (2), (2A), (3) & (4);
- Income Tax Assessment Act 38 of 1997 (Australia): Section 104-70.

Other documents

- Binding Private Ruling 342 ("Donation by a resident to a foreign trust of property received from another foreign trust") (issued 30 April 2020);
- Policy briefing (Australian Council of Social Service) dated November 2017.

Cases

- *Dimbula Valley (Ceylon) Tea Co Ltd v Laurie* [1961] Ch 353 at 372–373, [1961] 1 All ER 769 at 780–781;
- *Fischer v Nemeske Pty Ltd* [2016] HCA 11.

Tags: base cost; market value; general anti-avoidance rules; unrealised surplus.

ELECTRONIC SERVICES

In 2014, South Africa adopted legislation to subject certain limited services supplied via electronic means to VAT, regardless of the place from where the services were supplied. The legislation was at such stage primarily directed at subjecting business-to-consumer (B2C) supplies to VAT, in keeping with international standards.

However, the current regulations (as revised) governing the scope of "electronic services" subject to VAT in South Africa ("*Regulations prescribing electronic services for the purpose of the definition of 'electronic services' in section 1 of the Value-Added Tax Act, 1991*" – (2019 Regulations)) have significantly broadened the concept from the original 2014 regulations.

Under current law, any non-resident person who supplies services to a resident person "by means of the internet" or other electronic communication will be required to register for VAT and levy VAT (at the standard rate, currently 15%) on such supplies, when the value of services exceeds R1 million in a 12-month period.

The above obligation arises even if the resident person to whom the non-resident supplies its services is registered for VAT and is entitled to deduct the full VAT amount so levied as input tax. In other words, unlike B2C transactions, where individual consumers usually cannot claim the VAT on the relevant supplies as input tax, there is, in the context of business-to-business (B2B) transactions, unlikely to be any additional revenue collected for the benefit of South Africa as a result of the VAT registration of the non-resident supplier. This unfortunate outcome is made worse by the administration costs incurred by both non-resident persons who are liable to comply with the obligation to register for VAT in South Africa and meet all attendant filing and payment obligations, as well as what one may assume are not insignificant costs incurred by the South African Revenue Service (SARS) to enforce and review the compliance of B2B electronic service suppliers.

> "With respect, it is submitted that IP rights are not legally or in any relevant way supplied 'by means of the internet' and thus do not fall within the scope of the 2019 Regulations."

A number of non-resident taxpayers, with various B2B business models, have been approached by SARS to advise them of a "mandatory" obligation to register for VAT under the domestic electronic services provisions.

Engagements of the authors with SARS flowing from these registration notices indicate the following:

- Applications for a prospective registration date to avoid late payment penalties and interest (which could be remitted post-assessment in terms of a separate process in terms of the Tax Administration Act, 2011) under section 23(4)*(b)* of the Value-Added Tax Act, 1991, have (despite the lack of additional revenue collected from the registration) in all cases yielded a registration date of 1 October 2019, ie, six months post an actual registration date of 1 April 2019, when the 2019 Regulations came into effect.

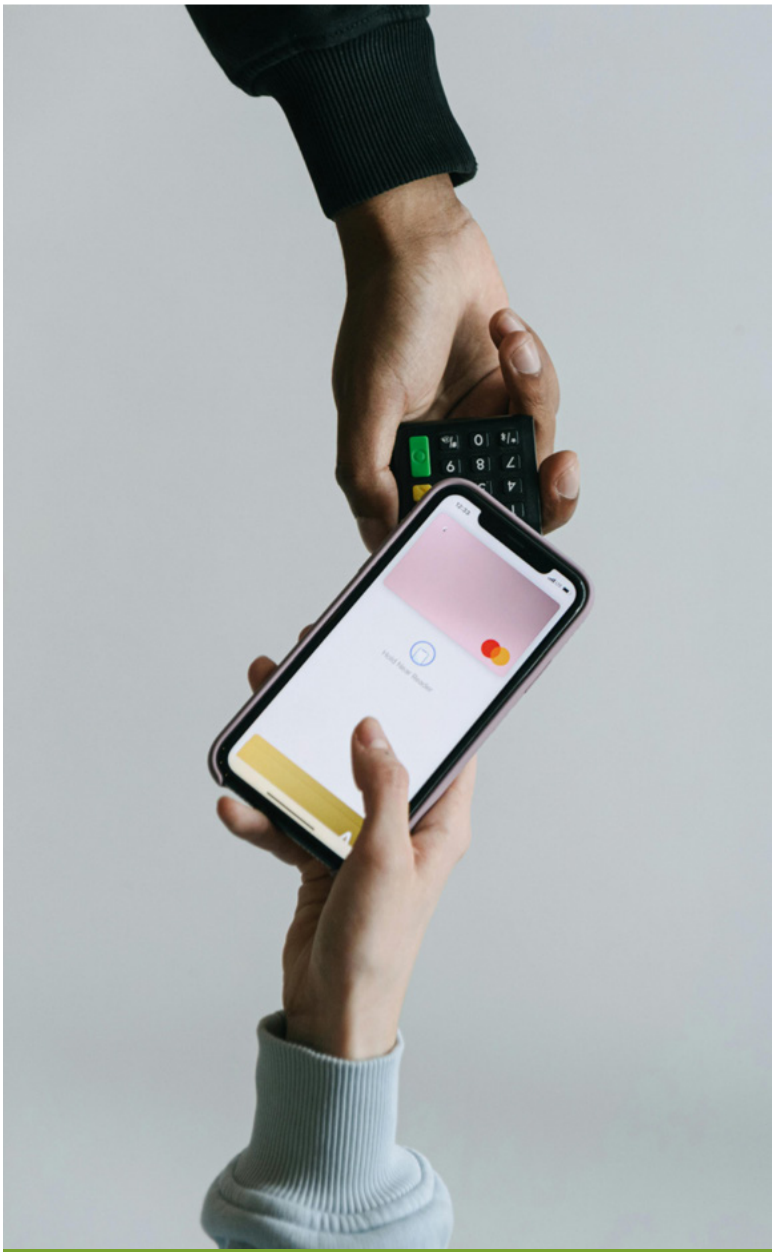
- While a very important distinction exists between intellectual property (IP) rights granted by a non-resident person (for example, a broadcast or media right) and the content which, if the broadcast right is exercised, may be acquired and commercialised, SARS regards the IP right and the content as one and the same thing for VAT purposes. With respect, it is submitted that IP rights are not legally or in any relevant way supplied "by means of the internet" and thus do not fall within the scope of the 2019 Regulations. The royalties withholding tax implications as a consequence of the VAT view adopted by SARS bear further consideration.

It was therefore a welcome surprise that the 2024 Budget Review contained an announcement that it is the intention of the legislature to revise and update the 2019 Regulations to limit the scope to only non-resident vendors supplying electronic services to non-vendors or end consumers. If these amendments are implemented, B2B suppliers will no longer have an obligation to be registered as vendors in South Africa.

The question thus arises: what do non-resident B2B suppliers do until the law changes or in respect of the past? It is submitted that, unless the changes in law signalled in the 2024 Budget Review are retroactive in effect (which does not seem likely), non-resident B2B suppliers must regularise their soon-to-be wholly historic VAT liabilities in South Africa. The changes proposed are therefore a positive development but are unlikely to provide any relief to foreign B2B suppliers with South African customers in respect of the past.

An important commercial consideration in this context is the five-year period for South African vendors in which to claim VAT as input tax. Accordingly, non-resident B2B suppliers must, even if the law is changed, carefully monitor whether they have incurred the obligation to register for VAT in South Africa in terms of prior iterations of the electronic services regulations. Additionally, they must ensure that their invoices are timeously re-issued (assuming they were not registered when the invoices were originally issued) in order to avoid the permanent VAT leakage that would arise if South African customers are time-barred from claiming the VAT levied in terms of the invoices.

On the basis that the amendments to the electronic services regime are expected to be effected by way of regulation, it would not be necessary to follow the same process and timeframes applicable to primary tax legislation. Law-makers therefore have the opportunity to fast-track the implementation of the regime change. It is, however, anticipated that draft regulations will be published for comment later in 2024 and that the effective date thereof will tie in with the typical effective dates for annual tax law amendments, being January or April of the year following the year in which the amendment is announced (in this case, 2025).



Jo-Paula Roman (*reviewed by* ***Charles de Wet***)

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Acts and Bills

- Tax Administration Act 28 of 2011;
- Value-added Tax Act 89 of 1991: Sections 1(1) (definition of "electronic services") & 23(4)*(b)*.

Other documents

- "*Regulations prescribing electronic services for the purpose of the definition of 'electronic services' in section 1 of the Value-Added Tax Act, 1991*" (published in *Government Gazette* 42316 on 18 March 2019).

Tags: business-to-consumer (B2C) supplies; VAT liabilities; business-to-business (B2B) transactions.

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