Issue 20 | 2020
March

South African Institute of Tax Professionals

Unstructured CPD **150mins**

TAX CHRONICLES MONTHLY

Official Journal for the South African Tax Professional

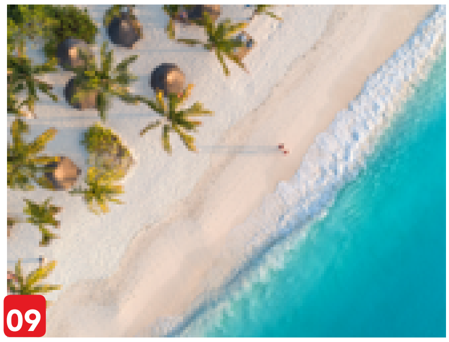
COMPANIES
SHARE REPURCHASE AND PROFIT EXTRACTION

TAX ADMINISTRATION
WRITE-OFF OF TAX DEBT

VALUE-ADDED TAX
EXPANSION OF CORPORATE REORGANISATION RULES

INTERNATIONAL TAX
OFFSHORE TRUSTS

CONTENTS



SHARE REPURCHASE AND PROFIT EXTRACTION

The favourable tax treatment afforded to dividends in contrast to other forms of income (including capital gains subject to capital gains tax) in terms of South African tax law has resulted in many opportunities for tax arbitrage especially where one is dealing with the sale of shares.

Given that dividends are generally exempt from tax in terms of the Income Tax Act, 1962 (the Act), and in certain instances (most notably payments by South African tax resident companies to other South African tax resident companies) exempt from dividends tax, many transactions have typically been structured to take advantage of the favourable dispensation afforded to dividends. A classic example would be for a corporate shareholder to exit its share investment in a company by means of a share repurchase transaction as opposed to the direct sale of shares. There are many commercial benefits in doing so but the tax benefit definitely cannot be ignored when one considers that no tax is being paid in terms of a sale structured as a repurchase of shares as opposed to tax at an effective rate of 22,4% (in the case of shares held on capital account) being paid in terms of a conventional sale.

The benefits achieved were, however, substantially curtailed by the introduction in 2017 of provisions (through substantial amendments to section 22B and to paragraph 43A of the Eighth Schedule to the Act) to counter the perceived abuse of the tax dispensation discussed above. Notwithstanding these amendments, not all variations of transactions were caught as the provisions were just not broad enough. Most notably, certain transactions which had the effect of diluting shareholdings (so-called subscription and dividend transactions) prior to disposal of the relevant shares were not caught. The latter transactions typically involved a target company declaring a substantial dividend to the existing shareholders prior to a prospective shareholder subscribing for shares in the target company which would have the effect of reducing the effective interest of the existing shareholders to nominal percentages. The proceeds derived on the subscription would then, typically, be applied in settlement of the dividend declared to the existing shareholders. The nominal holdings of the existing shareholders would then be bought back at a date in the future, typically, more than 18 months into the future to avoid the application of certain anti-avoidance provisions.

These types of transactions have not gone unnoticed and the Minister of Finance in his 2019 budget speech indicated that provisions would be introduced with effect from 20 February 2019 to counter the perceived abuse associated with these types of transactions (referred to as "dividend-stripping" transactions). Based on the Taxation Laws Amendment Act, 2019 (promulgated in the *Gazette* on 15 January 2020), these provisions are broad and their application would, in very simplistic terms, result in a "deemed disposal" if there is a reduction in the effective interest of the corporate shareholders in a target company pursuant to the issue of shares by the target company. So for example, if a corporate shareholder holds 100% of the equity shares in an unlisted target company and the target company issues shares

"Commercially there is still a place for share repurchase transactions, for example, the buying out of minorities; these can be structured tax-effectively in the current tax dispensation notwithstanding the cumbersome anti-avoidance provisions."

to a new shareholder such that the corporate shareholder's shareholding is diluted from 100% to 70% in the target company, then the corporate shareholder is deemed to have disposed of 30% of the equity shares in the target company. Does this mean that the provisions apply and one needs to determine a gain on the market value of the shares deemed to have been disposed? The answer to this question is a definite "no". When a deemed disposal is triggered in terms of these provisions, one still needs to consider whether the corporate shareholder held a qualifying interest, as defined in section 22B(1) of the Act, in the target company in the 18-month period prior to the deemed disposal. In our example, this requirement would be met. Secondly, one needs to determine whether an extraordinary dividend was received or had accrued to the corporate shareholder in that period. If yes, then the deemed disposal would have the effect that a portion of the dividend would be included as proceeds in the determination of the capital gain arising pursuant to the deemed disposal. If no, then the deemed disposal would not result in any negative tax consequences. The provisions are, therefore, clearly aimed at addressing the dividend-stripping type transactions as discussed above. The provisions are also framed widely and could include, for example, shares issued by the target company to a share-incentive scheme where this would have the effect that the effective interest of a corporate shareholder would reduce, resulting in a deemed disposal. But as mentioned, this is only cause for alarm where the other requirements, ie a qualifying interest (as defined in section 22B and paragraph 43A) and extraordinary dividend, are present.

Fortunately, where a deemed disposal has occurred and, later on, an actual disposal of the same shares occurs triggering the same provisions, then any extraordinary dividend determined on the actual disposal is only included in proceeds to the extent that it has not previously been included as proceeds in terms of the deemed disposal. The latter is to avoid double taxation.

Notwithstanding all of the above, there are still possibilities to repurchase shares and make use of the favourable tax dispensation that would not be caught by these specific anti-avoidance provisions, given that the provisions only apply to corporate shareholders that hold qualifying interests, where such shareholders received extraordinary dividends in the relevant 18-month period prior to the disposal or as part of the disposal. For example, an unlisted company having a corporate shareholder holding 51% of the equity shares (A) and another corporate shareholder holding 49% of the equity shares (B) is still able to repurchase the 49% equity shares held by B in terms of a specific share buy-back and afford B dividend treatment which means (subject to the general anti-avoidance rules not applying) that B will suffer no taxes on the exit of its 49% shareholding.

These provisions will no doubt be amended over time as more variations of these transactions are developed by advisors and ultimately considered by the revenue authorities and National Treasury. Commercially there is still a place for share repurchase transactions, for example, the buying out of minorities; these can be structured tax-effectively in the current tax dispensation notwithstanding the cumbersome anti-avoidance provisions.

ENSafrica

Act sections:

- Income Tax Act 58 of 1962: section 22B(1) (definition of "qualifying interest"); paragraph 43A(1) (definition of "qualifying interest") of the Eighth Schedule;
- Taxation Laws Amendment Act 34 of 2019.

Tags: corporate shareholder; repurchase of shares; target company; nominal holdings; equity shares; qualifying interest; extraordinary dividend.

UNBUNDLING TRANSACTIONS BY LISTED COMPANIES

From time to time, listed companies unbundle shares to their shareholders. It is important for the shareholders to understand the tax implications which may arise upon the receipt of the shares.

Absent any relief which may apply in terms of section 46 of the Income Tax Act, 1962 (the Act), which deals with unbundling transactions, the general principles are:

- If a South African tax resident company makes a distribution of an asset in specie to a person in respect of a share, and the distribution (1) does not result in the reduction of contributed tax capital (CTC), (2) does not constitute shares issued by the company making the distribution, or (3) does not constitute a general repurchase based on the relevant exchange's rules (in the context of listed shares), then the receipt of the distribution constitutes a receipt of a dividend for purposes of the Act.

- The receipt or accrual of an amount as a dividend is included in "gross income" in terms of paragraph *(k)* of the definition in section 1(1) of the Act. The dividend may be exempt from income tax but the exemption is subject to one of the provisos to the exemption not applying. If one of the provisos to the exemption were to apply then the dividend will be subject to income tax.

- In addition, a dividend is subject to dividends tax at the rate of 20%. However, in the context of a dividend that constitutes a distribution of an asset *in specie*, the liability for the dividends tax is on the company declaring and paying the dividend which would be the unbundling company. Various exemptions from dividends tax may apply. For example, if the beneficial owner of the dividend is a South African tax resident company, then the dividend is exempt from dividends tax.

- If a company makes a distribution of an asset *in specie* to a person in respect of a share and the distribution results in a reduction of CTC, then it will constitute a return of capital. CTC is defined in relation to a class of shares issued by a company, *inter alia* as the consideration received by or accrued to a company on or after 1 January 2011 and reduced by so much as the company has transferred on or after 1 January 2011, for the benefit of any person holding a share in that company of that class in respect of that share.

- Paragraph 76B(2) of the Eighth Schedule to the Act provides that where a return of capital by way of a distribution of cash or an asset *in specie* is received on or after 1 April 2012 and prior to the disposal of the share, the holder of the share must reduce its expenditure incurred in respect of the share with the amount of that cash or the market value of the asset on the date the asset or the cash is received. If the cash or the market value of the asset exceeds the expenditure incurred in respect of the share, then the excess is treated as a capital gain in the year of assessment in which the return of capital is received.

Based on the above, if a South African tax resident company unbundles shares (the unbundling company) that it holds in a resident subsidiary (the unbundled company) by distributing those shares to the unbundling company's shareholders (the shareholders), the receipt of the shares by the shareholders would constitute a dividend (if the distribution does not result in the reduction of CTC by the unbundling company) or a return of capital (to the extent that it reduces the CTC of the unbundling company).

Section 46 contains specific provisions for an unbundling transaction and broadly deals with the following:

- *The tax consequences for the unbundling company distributing the shares.* The unbundling company is required to disregard the distribution in determining its taxable income (any capital or revenue gain is not taxed).
- *The expenditure of the shareholder receiving the shares.* The shareholder is required to allocate a portion of the expenditure incurred in acquiring the shares in the unbundling company to the shares it received in the unbundled company in accordance with a specified ratio.
- *The CTC of the unbundling company and the unbundled company immediately after the distribution.* The CTC of the unbundling company is effectively proportionately split between the unbundling company and the unbundled company in accordance with a specified ratio.
- *The dividends tax implications for the unbundling company.* The distribution of the shares must be disregarded in determining any liability for dividends tax.
- *The impact of paragraph 76B for the shareholder.* It provides that paragraph 76B does not apply.

"The receipt or accrual of an amount as a dividend is included in 'gross income' in terms of paragraph *(k)* of the definition in section 1(1) of the Act."

It is therefore important to determine if the receipt is a return of capital or a dividend. If it is a return of capital then paragraph 76B does not apply.

If the receipt does not result in the reduction of CTC, then it would constitute a dividend. Dividends are exempt from tax in terms of section 10(1)*(k)*(i) of the Act. However, section 10(1)*(k)*(i) contains various provisos which, if applicable, would result in the exemption not applying to the dividend. By way of example, if the shareholder borrowed the shares in the unbundling company and receives the shares being unbundled as a dividend, then that dividend is not exempt from income tax.

Based on the above, shareholders in listed companies that receive shares by way of a distribution should, *inter alia*, check whether they are receiving the shares as a return of capital or as a dividend in order to ensure that they understand the tax implications.

ENSafrica

Act sections:

- Income Tax Act 58 of 1962: Sections 1(1) (paragraph *(k)* of definition of "gross income"), 10(1)*(k)*(i) & 46; paragraph 76B(2) of the Eighth Schedule.

Tags: unbundling transactions; tax resident company; dividends tax; gross income; beneficial owner; taxable income.

PHOTOVOLTAIC SOLAR ENERGY PLANTS

Section 12B(1) and (2) of the Income Tax Act, 1962, provides for a 50/30/20 income tax deduction in respect of certain machinery or plant owned by the taxpayer which was or is brought into use for the first time by that taxpayer, for the purpose of his or her trade to be used by that taxpayer in the generation of electricity from, amongst others, photovoltaic solar energy (both for energy of more than 1 megawatt and energy not exceeding 1 megawatt) or concentrated solar energy. The tax deduction also applies to any improvements to the qualifying plant or machinery which are not repairs.

In cases of plant and machinery used in the generation of electricity from photovoltaic solar energy in respect of energy less than 1 megawatt, the taxpayer may write off 100% of the cost of such plant or machinery in the year brought into use.

The cost of any asset for purposes of section 12B also includes the direct cost of installation or the erection thereof.

In a recent binding private ruling, BPR 311, the applicant proposed to install solar power systems at each of the sites it rented to reduce electricity costs. As each system will only supplement and not replace the electricity provided by the main grid, it was intended to generate less than 1 megawatt of electricity.

The taxpayer will purchase the photovoltaic solar panels, appoint and pay independent contractors to perform the installation planning, to procure and purchase all other relevant equipment and to install the systems at the relevant sites. These systems at each site are comprised of the panels, AC inverters, DC combiner boxes, racking, cables and wiring.

In terms of BPR 311, the taxpayer was entitled to claim the costs in respect of all the components of each system in terms of section 12B(1) and (2). As each system will generate less than 1 megawatt of electricity, 100% of these costs were deductible in the year brought into use. No deduction was, however, claimed in respect of the costs of distribution boxes as it did not form part of the photovoltaic solar energy system.

"Taxpayers installing solar energy systems should therefore carefully consider the tax deductions in terms of section 12B to ensure that all relevant costs are claimed for income tax purposes."

It was furthermore proposed that the taxpayer would incur certain related expenditure as part of the cost of the installation, including the installation planning costs, panel delivery costs and installation safety officer costs. SARS, in this regard, ruled that these costs all formed part of the direct costs of installation and erection of the systems and were therefore deductible in terms of section 12B(3).

Taxpayers installing solar energy systems should therefore carefully consider the tax deductions in terms of section 12B to ensure that all relevant costs are claimed for income tax purposes.

PKF

Editorial comment: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear. Furthermore, *a binding private ruling* has a binding effect *between SARS and the applicant only*, and is published for general information. It does not constitute a practice generally prevailing. A third party may not rely upon a binding private ruling under any circumstances. In addition, published binding private rulings may not be cited in any dispute with SARS, other than a dispute involving the applicant or any co-applicant(s) identified therein.

Act sections:

- Income Tax Act 58 of 1962: Section 12B(1), (2) and (3).

Other documents:

- Binding Private Ruling 311.

Tags: tax deduction.

OFFSHORE TRUSTS

A new world

The world of offshore trusts is now more dynamic than ever. The benefit of trusts as effective tools for the preservation of assets for future generations has been commonly known and accepted for decades. Globally, the trust environment has changed significantly due to the introduction of the common reporting standards (CRS) and resulting automatic exchange of information between various revenue authorities around the world. The identities of original funders and beneficial owners are no longer protected.

In addition, some jurisdictions view offshore trusts as transparent vehicles with potentially significant tax implications for the funder and beneficiaries of these vehicles. This increased transparency has made beneficiaries more aware of their rights against trustees and their entitlement to information relating to the management and administration of the trusts.

The increased transparency and the fact that information is more readily available will focus the attention of revenue authorities around the world on these structures. There is no reason why the South African Revenue Service should be an exception.

In terms of domestic law, an intricate range of tax provisions can apply to South African residents' relationship with offshore trusts. Foundations are also increasingly used which may have different tax consequences. The tax treatment of the funding of and distributions from offshore trusts has been the subject of debate for a number of years, more recently in amendments to the Income Tax Act, 1962 (the Act), which were promulgated in 2018 (the amendments).

"Globally, the trust environment has changed significantly due to the introduction of the common reporting standards (CRS) and resulting automatic exchange of information between various revenue authorities around the world."

Income and capital gains distributed from offshore trusts to South African resident beneficiaries are taxed in their hands when such distributions are made. The funding of these vehicles can also trigger a donations tax liability and resulting attribution rules can apply to include income and capital gains in the hands of the donors. Where a person connected to the trust sells assets to the trust on loan account, market-related interest may be required to be charged.

The above-mentioned amendments brought about an important change to structures where the assets are held by a company of which the trust is a major shareholder. Specifically, the tax implications arising from the payment of dividends from these companies and subsequent distributions to beneficiaries have changed from 1 March 2019.

SOME HIGHLIGHTS OF THE AMENDMENTS RELATING TO THE PARTICIPATION EXEMPTION

Attribution rules

Donors may be taxed on income received by or accrued to the offshore discretionary trust if this income was received by or accrued to the offshore trust by way of donation, settlement or other disposition made by the resident, provided that such income would have been included in the offshore trust's income had the trust been a resident. Interest-free loans or low-interest loans granted to the offshore trust are also covered by these provisions.

Previously, this rule could have excluded dividends distributed to a non-resident trust by a foreign company. Such a foreign dividend may not have constituted income had the trust been a resident, by virtue of the participation exemption in section 10B(2)*(a)* of the Act.

The participation exemption applies to the foreign dividends received by or accrued to a person that holds at least 10% of the total equity shares and voting rights in the foreign company declaring the dividend.

Capital distributions

Previously, a capital distribution to a South African resident beneficiary by an offshore trust arising from a prior year's foreign dividends derived from a foreign company held by the trust, may have been exempt from South African tax if the trust had qualified for the participation exemption. Therefore, such a capital distribution may not have been taxable in South Africa in the hands of the beneficiary on the basis that no amount of income (as defined) would have arisen for the trust if it had been a resident.

In terms of the recent amendments, capital distributions by an offshore trust that are derived from such foreign dividends are now taxable in the hands of the South African resident beneficiary if certain conditions are met. However, South African residents would also still be able to benefit from the *partial* tax exemption applicable to foreign dividends.

Amendments to distributions of capital gains from offshore trusts

Paragraph 80(1) of the Eighth Schedule to the Act provides that if a trust vested an asset in a resident beneficiary, the beneficiary would be subject to capital gains tax in respect of the related capital gain determined by the trust in respect of the disposal of the asset. Paragraph 80(2) provides that if a trust disposes of an asset and vests the resultant capital gain in a resident beneficiary in the same tax year, the beneficiary would be subject to capital gains tax in respect of the capital gain.

Previously, these provisions may not have been applicable to offshore trusts. Subsequent to the amendments, the resulting capital gain in respect of a disposal of an asset vested in a South African beneficiary of a trust is to be taken into account in determining the aggregate capital gain or loss of the resident beneficiary to whom the asset was disposed. This provision is now applicable to offshore trusts as well.

REPORTABLE ARRANGEMENTS

Some arrangements in respect of offshore trusts may need to be reported to the South African Revenue Service (SARS), unless they are excluded in terms of the Tax Administration Act, 2011. Such reportable arrangements include contributions made by a resident to an offshore trust which exceed ZAR10 million, and where such resident has or acquires a beneficial interest in the offshore trust. These arrangements must be reported to SARS within 45 business days.

CONCLUSION

Careful consideration should be given to current offshore structures. Firstly, resident taxpayers should be in touch with trustees and advisors acting in a fiduciary capacity to check what information is being exchanged with revenue authorities. It is likely that residents' participation in these structures in one way or another will be audited by SARS in years to come. Secondly, it is critical that disclosures now being made by offshore institutions in terms of the CRS correspond with disclosures made by individuals in their own returns and the necessary reporting is done. Taxpayers carry the onus of proof in most disputes with SARS and will therefore be required to explain any discrepancy.

ENSafrica

Act sections:

- Income Tax Act 58 of 1962: Section 10B(2)*(a)*; paragraph 80(1) & (2) of the Eighth Schedule;
- Tax Administration Act 28 of 2011.

Tags: offshore trusts; revenue authorities; donations tax; interest-free loans; low-interest loans; foreign dividends; reportable arrangements.

WRITE-OFF OF TAX DEBT

The write-off of tax debts is not unique to the South African tax regime. In the recent case of 'Burns and Commissioner of Taxation (Taxation)', *2019, heard in the Administrative Appeals Tribunal of Australia (the Tribunal), the decision by the Commissioner of Taxation (the Commissioner) to deny the release of the taxpayer from his taxation liability was reviewed.*

FACTS

The taxpayer was a sole proprietor who traded as a flooring installer and subcontractor. Over the period 2010 to 2017, the taxpayer's tax liabilities accumulated due to unpaid income taxes and unpaid goods and service taxes (GST), as well as the associated penalties and interest imposed due to his non-compliance with his tax obligations. Specifically, the Commissioner had imposed penalties for the taxpayer's failure to lodge certain documents within the prescribed time periods.

In 2018, the taxpayer applied to the Commissioner for release from his tax liabilities. In the application, the following reasons were forwarded for the taxpayer's failure to pay his taxes by the due date:

- The taxpayer was initially unaware of his GST remittance obligations as he had been employed prior to his sole proprietor endeavours and was therefore not familiar with the GST regime. When tax advice was subsequently sought, the taxpayer was incorrectly advised that he had no GST obligations as his contracting income was expected to be less than the threshold amount;

- The taxpayer suffered a back injury that prevented him from working for extended periods of time during the 2014 to 2017 financial years. He also incurred significant medical expenses incidental to his recovery and recuperation;

- As a result of his back injury, the taxpayer developed a reliance on alcohol which further interfered with his ability to work. This reliance on alcohol also resulted in the taxpayer losing his driver's licence as a result of a drunk driving conviction and this prevented the taxpayer from commuting to the various locations of his subcontracting contracts; and

- The taxpayer's relationship with his *de facto* partner broke down, causing the taxpayer to incur further expenses as a result of separate accommodation costs.

In the review application, it was contended on behalf of the taxpayer that the Commissioner had failed to take into account the taxpayer's aforementioned personal circumstances in deciding whether or not to release him from some of his tax liabilities.

THE LAW

Section 340-5 of Schedule 1 to the Australian Tax Administration Act, 1953 (the AUSTAA), provides that the Commissioner may release a taxpayer, in whole or in part, from an eligible tax liability if certain requirements are met. The AUSTAA specifies that, in the case of an individual, the condition that must be met in order for the Commissioner to release a taxpayer is that the taxpayer will suffer serious hardship if required to satisfy the tax liability.

The Tribunal explained that release may only be granted in respect of eligible taxation liabilities. These taxation liabilities are set out in section 340-10 of Schedule 1 to the AUSTAA and include income tax, general interest charges and certain administrative penalties. GST and penalties imposed for failure to lodge documents on time are ineligible for release.

The AUSTAA does not define "serious hardship"; however, in 2011, the Commissioner issued Practice Statement Law Administration 2011/17: Debt relief, waiver and write off (PSLA), which defined "serious hardship" as follows –

"'Serious hardship' is given its ordinary meaning. We consider serious hardship to exist where the payment of a tax liability would result in a person being left without the means to afford basics such as food, clothing, medical supplies, accommodation, or education. Tests are applied to determine whether serious hardship exists. The object of the tests is to determine whether the consequences of paying the tax would be so burdensome that the person would be deprived of what are considered necessities according to normal community standards."

> "The Tribunal reiterated that the determination of whether the taxpayer should be released from his eligible tax liability involves a two-stage inquiry."

The three tests that are applied to determine the merits of a serious hardship application are –

1. the income/outgoing test;

2. the asset/liabilities test; and

3. other relevant factors.

JUDGMENT

The Tribunal reiterated that the determination of whether the taxpayer should be released from his eligible tax liability involves a two-stage inquiry. The first stage requires the decision-maker to decide whether the settlement of the tax liability will result in serious hardship for the taxpayer. If this question is answered in the affirmative, it must be ascertained whether, in all the circumstances, it is just and proper to provide the requested relief to the taxpayer.

In considering the first stage of the inquiry, the Tribunal recognised that the specific circumstances of each case will dictate whether a taxpayer may suffer serious hardship if relief from his tax liabilities is not granted. It was found that serious hardship may be suffered even in those situations where a taxpayer would not be left destitute after payment of the pertinent tax liabilities and that an assessment of the individual taxpayer's circumstances must be made with reference to normal community standards.

The Tribunal then applied each of the three tests to determine whether the taxpayer in the Burns matter would suffer serious hardship if release from his tax liabilities was not granted.

Income/outgoing test

The purpose of the income/outgoing test is to assess a taxpayer's capacity to meet his tax liability from his current income, taking into account the number of dependants that a taxpayer has and the income of any other members of the household. Special consideration must also be given to the following factors:

- the taxpayer's capacity to pay in a reasonable timeframe on the basis of his income and outgoings;

- the scope for the taxpayer to increase his income;

- whether all expenditure could be considered reasonable and consideration of any discretionary components; and

- whether the taxpayer has made attempts to defer or reschedule other financial commitments.

In its judgment, the Tribunal found that the taxpayer in the *Burns* matter was not only able to afford his reasonable costs of living, including basic necessities such as food, clothing, medical supplies and accommodation, but would also be able to service his tax debts with the surplus of his and his partner's monthly income.

Assets/liabilities test

This test is used to assess a taxpayer's ownership in, or access to, assets which may be indicative of the taxpayer's ability to make payment of his tax liabilities. The Tribunal conceded that certain assets (that are of a modest nature) will be regarded as normal and reasonable possessions and that it could not be expected that such assets be surrendered by a taxpayer in order to pay a tax debt. Among these assets are –

- ownership of, or equity in, a residential property which is the taxpayer's home;
- a motor vehicle;
- furniture and household goods;
- tools of trade;
- cash on hand or bank balances sufficient to meet immediate day-to-day living expenses; and
- funds put aside by aged persons to cover funeral expenses.

The Tribunal concluded that the taxpayer's debts greatly exceeded his available assets and therefore, the taxpayer satisfied this test.

Other relevant factors

Lastly, the Tribunal took cognisance of the following factors which may justify a decision against granting release even when serious hardship may be suffered by a taxpayer:

- where a taxpayer appears to have unreasonably acquired assets ahead of meeting his tax liabilities;
- where a taxpayer appears to have disposed of funds or assets without giving consideration to his tax liability;
- where release would not result in reduction of hardship, such as where the person has other liabilities or creditors;
- where a taxpayer has paid other debts (either business or private), in preference to his tax debt;
- where the taxpayer, without good reason, has not pursued debts owed to him;
- where serious hardship is likely only to be short-term;
- where the taxpayer has a poor compliance history;
- where the taxpayer is unable to show that he has planned for future debts;
- where the taxpayer has structured his affairs to place himself in a position of hardship (for example, placing all assets in trusts or related entities over which he has control); and
- where the taxpayer has delayed lodgement of returns resulting in the accumulation of a large debt that he is unable to pay.

The Tribunal found that in the current matter, the taxpayer's poor compliance history was a pertinent factor to be considered in determining whether release should be granted. The Tribunal stated that the taxpayer's personal circumstances stemming from the back injury he sustained mitigated, but did not cancel out, his non-compliance in respect of the 2014 to 2017 financial years. Furthermore, this mitigating factor did not extend to the prior financial years during which the taxpayer was non-compliant with his tax obligations.

Ultimately, the Tribunal held that, although distressing, in the current matter the taxpayer's personal circumstances did not warrant release from his tax liabilities as he would not suffer serious hardship if he was required to satisfy the whole of his eligible tax debt.

COMPARISON WITH SOUTH AFRICAN LAW

The Tribunal's judgment provides a useful basis for comparing South Africa's tax debt relief provisions with the tax debt relief provisions in Australia that are discussed in the judgment. Whereas the AUSTAA provides for a person to be released from so-called eligible tax liabilities if he can prove that he would suffer serious hardship if he was required to pay the whole of such eligible tax debt, the position is slightly different under South African law.

In terms of section 197 of South Africa's Tax Administration Act, 2011 (the TAA), any portion of a person's tax debt can be written off permanently only –

- to the extent that SARS is satisfied that the tax debt is irrecoverable at law, in terms of section 198; or
- if the debt is compromised in terms of Part D of Chapter 14 of the TAA (sections 200 to 205).

"Ultimately, the Tribunal held that, although distressing, in the current matter the taxpayer's personal circumstances did not warrant release from his tax liabilities as he would not suffer serious hardship if he was required to satisfy the whole of his eligible tax debt."

In terms of section 198, a tax debt is irrecoverable at law if –

- it cannot be recovered by action and judgment of a court; or
- it is owed by a debtor that is in liquidation or sequestration and it represents the balance outstanding after notice is given by the liquidator or trustee that no further dividend is to be paid or a final dividend has been paid to the creditors of the estate; or
- it is owed by a debtor that is subject to a business rescue plan referred to in Part D of Chapter 6 of the Companies Act, 2008 (the Companies Act), to the extent that it is not enforceable in terms of section 154 of the Companies Act. (This only applies in the case of companies.)

Section 192 of the TAA defines a "debtor" as a taxpayer with a tax debt. One should note that a tax debt is not irrecoverable at law if SARS has not first explored action against or recovery from the assets of the persons who may be liable for the debt under Part D of Chapter 11 (sections 179 to 184) of the TAA.

Regarding the compromise of a tax debt, section 200 states that SARS will only authorise the compromise of a portion of a tax debt upon the request by a "debtor", where that request complies with the requirements of section 201, if the –

- purpose of the compromise is to secure the highest net return from the recovery of the tax debt; and
- compromise is consistent with considerations of good management of the tax system and administrative efficiency.

Section 201 lists three requirements that the debtor's request for compromise must meet, namely the following:

- The debtor's request must be signed by the debtor and supported by a detailed statement setting out eight specific things, including the current market value of the debtor's assets and liabilities and the debtor's reasons for seeking a compromise;
- The request must be accompanied by the evidence supporting the debtor's claims for not being able to make payment of the full amount of the tax debt; and
- The debtor must warrant that the information provided in the application is accurate and complete.

Section 202 states that in considering a request for the compromise of a tax debt, a senior SARS official must have regard to the extent that the compromise may result in –

- savings in the costs of collection;
- collection at an earlier date than would otherwise be the case without the compromise;
- collection of a greater amount than would otherwise have been recovered; or
- the abandonment by the debtor of some claim or right, which has a monetary value, arising under a tax Act, including existing or future tax benefits, such as carryovers of losses, deductions, credits and rebates.

Section 203 also lists circumstances where it is not appropriate to compromise a tax debt; if any of these circumstances are present, SARS will not approve an application for the compromise of a tax debt. Even if a compromise application is granted by SARS and an agreement is signed by SARS and the taxpayer giving effect to the compromise, SARS will not be bound by the compromise if any of the circumstances in section 205 are present, including if it comes to light that the debtor failed to disclose a material fact to which the compromise relates.

Generally speaking, it can be quite difficult for South African taxpayers to successfully apply for the compromise of a tax debt, especially considering the stringent criteria that must be met. Where an application for the compromise of a tax debt is rejected, a taxpayer would be entitled to review SARS' decision by instituting review proceedings in the High Court.

Where a compromise agreement is concluded, but SARS then argues that it is not bound by the compromise in terms of section 205, such a decision can also be taken on review to the High Court. An example of this arose in the matter of *Malema v Commissioner for South African Revenue Service*, 2016, where the applicant applied for a declaratory order that SARS was bound to the compromise agreement concluded.

It is recommended that any taxpayer seeking to apply to SARS for a compromise of their tax debt, should always obtain professional tax advice when making such an application.

Cliffe Dekker Hofmeyr

Act sections:

- Tax Administration Act 28 of 2011: Part D of Chapter 11 (sections 179 to 184); sections 192, 197 & 198; Part D of Chapter 14 (sections 200 to 205);
- Companies Act 71 of 2008: Part D of Chapter 6 (sections 150 to 154).

Cases:

- *Burns and Commissioner of Taxation (Taxation)* [2019] AATA 3860 (24 September 2019) (Australia);
- *Malema v Commissioner for South African Revenue Service* (76306/2015) [2016] ZAGPPHC 263; (2016) 78 SATC 279 (29 April 2016).

Tags: administrative penalties; tax liability; compliance history; tax debt relief; compromise of a tax debt.

EXPANSION OF CORPORATE REORGANISATION RULES

The corporate reorganisation rules of the Income Tax Act, 1962 (the Act), provide for a "rollover" mechanism when, for example, assets are transferred from one group company to another. Provided the various requirements of the applicable provisions are adhered to, no capital gains tax, transfer duty or securities transfer tax (to the extent applicable) is triggered at the time of such transactions – rather the transferee is regarded as "stepping into the shoes" of the transferor in relation to the assets transferred.

In terms of current law, in order for a similar "rollover" to apply in respect of the transfer of assets from a VAT perspective, section 8(25) of the Value-Added Tax Act, 1991 (the VAT Act), provides that it is necessary for the transfer to relate to an enterprise or a part of an enterprise capable of separate operation as a going concern.

The above-mentioned requirement gives rise to the anomaly that, where, for example, an intra-group transaction in terms of section 45 of the Act is entered into in respect of the disposal of immovable property which will be leased back to the transferor after the conclusion of the transaction, the tax effect will be the following:

- there will be a capital gains tax "roll-over" in respect of the transfer of the property – as a result of which no capital gains tax will be triggered on such transaction;
- on the basis that the disposal of the property will not constitute the supply of an enterprise as a "going concern" for purposes of the VAT Act, the transaction may be subject to VAT at the standard rate.

The Taxation Laws Amendment Act, 2019, promulgated in the *Gazette* on 15 January 2020, aims to address this anomaly so as to provide VAT relief in instances where:

- fixed property is transferred in terms of an asset-for-share transaction as contemplated in section 42 or an intra-group transaction as contemplated in section 45 of the Act; and
- the supplier and recipient agree in writing that immediately after the transaction the supplier (ie the transferor) will lease the fixed property from the recipient (ie the transferee).

The amendments are scheduled to come into operation on 1 April 2020.

PKF

Act sections:

- Income Tax Act 58 of 1962: Sections 42 and 45;
- Value-Added Tax Act 89 of 1991: Section 8(25);
- Taxation Laws Amendment Act 34 of 2019: Sections 40, 42 & 68.

Tags: capital gains tax; transfer duty; securities transfer tax; fixed property; asset-for-share transaction; intra-group transaction.