27 August 2021

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

Via email: 2020AnnexCProp@treasury.gov.za and Acollins@sars.gov.za

RE: COMMENTS ON THE 2021 DRAFT TLAB

Dear Colleagues,

Kindly see below the comments from the SAIT Wealth & Family Business Tax Technical Work Group (the WG) on the 2021 draft Taxation Laws Amendment Bill.

All references to legislation are to the Income Tax Act, No. 58 of 1962 (the ITA) unless otherwise indicated.

1. Clarifying the timing of disposal rules in respect of an asset acquired from a deceased estate (1.3)

[Applicable provisions: Section 1(1) new definition of "liquidation and distribution account" and section 25(3) of the ITA]

1.1 WG response

The timing and authority for the distribution of the estate amongst the heirs is provided for in terms of clause 35 of the Administration of Estates Act, No. 66 of 1965. To this end, it would appear that the insertion of this definition is merely providing clarity in terms of the ITA.

No further comment required.

2. Tax treatment of the cession of a right to receive an asset (1.4)

[Applicable provision: new section 57B of the ITA]

2.1 Government proposal

It would appear that the insertion of this new section relates to specifically devised schemes aimed at undermining the donations tax provisions. Should the general anti-avoidance rules (GAAR) in section 80A to section 80L, specifically section 80A describing what an "*impermissible avoidance arrangement*" is, apply, the Commissioner is empowered to take action in terms of section 80B.

Example:
A is a contractor of XYZ, where A will provide services in exchange for an asset. A cedes his right to the asset to a family trust in advance. On day 1, before starting work, the right is ceded and the right is worth nothing as its value is contingent on A fulfilling the services. The employer and family trust are not connected persons; therefore, the family trust would not have been able to get a base cost for the asset.

Paragraph (c) of the "gross income" definition would apply, and the value of the asset is taxed in hands of A.

Analysis:
The problem arises when the asset is transferred and avoids donations tax as the right to the asset is antecedently divested when the right is worth nothing. The proposal avoids the circumvention of donations tax, section 7 and paragraphs 68 to 73.

The insertion of the proposal as section 57B in the donations tax part of the ITA may not be the appropriate location, as this section gives a base cost to the asset. What if the asset is trading stock?

2.2 WG response

Our recommendation is that further clarity is required to understand the specific circumstances which give rise to this scenario while also understanding the rationale for the inclusion in this particular section of the ITA. While this amendment will not have much impact on legitimate succession planning, we query whether this scheme works under current law.

Besides GAAR, this avoidance appears to be suspect under judicial substance-over-form principles. Also, can the asset transferred really be viewed as a liability associated with the asset transferred (diminishing its value). The liability appears more personal in nature to the service-provider. Alternatively, the abuse may relate more to the removal of a contingency because the services are essentially being donated to remove the contingency.

3. Strengthening anti-avoidance rules in respect of loan transfers between trusts (1.5)

[Applicable provision: section 7C of the ITA]

3.1. Government proposal

As per the explanatory memorandum, section 7C was introduced to curb "*the tax-free transfer of wealth to trusts using low interest or interest-free loans*".

According to our understanding, the amendments to section 7C will result in all interest free loans between trusts with the same or connected beneficiaries being subject to donations tax or alternatively, imposing a requirement for trusts to charge interest on loans to other trusts with connected beneficiaries.

3.2. WG response

Despite the above, the schemes referred to in the draft Explanatory Memorandum (draft EM) giving rise to this anti-avoidance measure are not permissible in terms of the prevailing Exchange Control Regulations and policy of the South African Reserve Bank. A South African registered trust is not permitted to hold shares in offshore companies.

Notwithstanding the observation that the example given in the draft EM is not permissible, the draft EM indicates that the draft legislation is targeted at a very specific structure of transactions. However, the legislation drafted has the consequence that it will give rise to undue tax consequences for many different transactions. For instance, trusts often lend funds to beneficiaries rather than dilute the trust estate for reasons wholly unrelated to tax. The real issue is when trusts are lending to other trusts and the anti-avoidance rule should be limited to that (or to entities wholly owned by the trust) – not from trusts to natural persons.

Any proceeds on capital that is held at trust level in a family group by one or multiple trusts, are generally taxed at the higher inclusion rate for CGT and without the benefit of a progressive scale of taxation with regards to income. This, we respectfully submit is designed to erode the estate planning value from an estate duty point of view already.

Section 7C further addresses the funding mechanism used to transfer wealth into trust using interest free loan accounts.

When transactions, within the same connected group, are done between trusts, the consequences are moot from an estate duty point of view, and in some instances are even beneficial to the fiscus.

If capital is loaned from one SA trust to another, within the connected group, both trusts are subject to equal tax treatment on capital gains tax and income, the mechanism of addressing the estate duty benefit of using an interest free loan or low interest loan has already been addressed in terms of section 7 and the higher rate of taxation in trusts. The loan between the trusts therefore has no benefit to either the trusts, or the beneficiaries and no taxation situation is affected through the loan. This is very much akin to loans between groups of companies. The capital stays within the same taxation band and no dividend tax applies between companies.

It’s also a normal function of trusts to loan funds to its beneficiaries or trusts set up for beneficiaries. Where trusts are set up within the same group of connected persons, there is no benefit of these transaction for the members of the group or the trusts within the connected group.

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Interest free loans from trusts to beneficiaries, actually benefits the fiscus from a wealth tax point of view, as the reverse happens as what is contemplated in section 7C. Growth assets are now acquired by the natural person taxpayer and the wealth base that is subject to estate growths.

Examples where loans are granted to natural person beneficiaries:

1. *The beneficiary acquiring a primary residence – it is preferable that the immoveable property be held in the name of the natural person;*
2. *Only an individual taxpayer is permitted to remit funds abroad in terms of the annual Foreign Investment Allowance;*

Any bequests to a trust or beneficiation of a trust would be subject to full estate duty on transfer of the asset to the trust. None of the beneficiaries were involved in the transfer of the wealth into trust and hence could never have been party to a section 7C contemplated transaction.

It seems very contrived to apply a tax dispensation on loans between trusts that applies to situations were more than one trust is in existence within a connected family group, where none would have applied had a single trust been used.

As connected families grow, its simply becomes impractical to use a single trust, or a multitude of trusts could have been the result of different phases of planning. Loans between these entities should be a taxation non-event as it does not allow for the avoidance of any form of taxation.

Loan from trusts to beneficiaries also assist in what section 7C tries to legislate against.

The proposed amendment will only result in increasing the difficulty of managing trusts and increase the tax compliance for both SARS and tax practitioners without addressing any potential tax loophole one can think of.

Our concerns with the draft legislation and draft EM are as follows:

1. The draft legislation is inconsistent with the objectives of section 7C. The legislation seeks to bring loans between trusts into the ambit of section 7C. However, such loans would not be used to transfer wealth from individuals to trusts but rather to transfer assets between trusts. The assets considered are outside of the individual's tax and estate duty net already and thus should be considered separately from section 7C, which was specifically introduced to curb situations where individuals seek to reduce their estate duty exposure through utilising low interest loans to trusts.
2. The example given in the explanatory memorandum appears to us to be vague and misleading. The draft EM is an important document to provide guidance to taxpayers on policy choices. As the example given appears to describe an illegal transaction and since is unclear as to what mischief the legislation is aiming to curb, the result is that it confuses the reader and detracts from purpose of the draft legislation. It thus remains unclear what the purpose of the draft legislation is.

In our view therefore: The proposed amendment has far-reaching consequences that go beyond the scope of the stated reasons for the change; we anticipate that the amendment will give rise to unintended consequences which go far beyond the original purpose of section 7C as stated above; and the position as outlined in Step 2 of the draft EM is unclear.

We request that further clarity be provided to describe the details of the specific schemes or the circumstances which gave rise to this situation. Furthermore that the specific details of the offending transactions be addressed specifically so as to avoid the stated unintended consequences.

In the absence of the above, we recommend that the draft legislation be removed in its entirety.

4. Allowing members to use retirement interest to acquire annuities on retirement (1.6)

[Applicable provisions: Paragraph (b)(ii) of the proviso to the definition of "retirement annuity fund", paragraph (ii)(dd) of the proviso to the definition of "pension fund", paragraph (e) of the definition of "provident fund" and paragraph (e) of the definition of "provident preservation fund" in section 1(1) of the ITA]

4.1 WG response

No comment required.

5. Applying tax on retirement fund interest when an individual ceases to be a tax resident (1.7)

[Applicable provisions: Section 9H and new section 9HC of the ITA]

5.1 WG response proposal

From our reading of the proposed legislation, the amendment to and insertion of these sections are ambiguous from a legal and practical implementation perspective and requires further consideration of international tax concepts, tax administration concepts and legal concepts allowing taxpayers reasonable and procedurally fair administration rights.

Further consideration is required, *inter alia*, of the following points:

1. Deemed tax debt deferral – from March 2021, an individual who tax emigrates may only withdraw and receive payment from their retirement fund after they have been non-tax resident for a continuous period of three years. In terms of the proposed new section 9HC, a deemed tax debt arises on the full retirement fund value, the day before that individual cease to be a South African tax resident, but only becomes due on the day of exit from the retirement fund.

2. Interest charged on deemed tax debt deferral – the deemed tax debt as discussed above is deferred until the date of exit from the retirement fund and once payment is made. However, interest accrues on this deemed tax debt deferral until exit from the retirement fund. In terms of sections 189 and 187(3) of the Tax Administration Act, No. 28 of 2013, interest can only be imposed on a tax that is due and payable.

3. Double Tax Treaty – post emigration, certain double tax treaties give the sole taxing right on retirement funds to the Contracting States / Jurisdictions. Such Contracting Jurisdictions include the United Kingdom, Australia, New Zealand, Denmark, Portugal, Spain, China, and Hong Kong. With the insertion of the new section 9HC, retirement interest may be subject to double taxation, namely in South Africa on emigration and in the Contracting Jurisdiction on subsequent withdrawal from the retirement fund.

4. Failed emigration – there is no clarity on whether a tax credit is granted on the deemed tax debt deferral (and accrued interest) if and when an individual returns to South Africa, for whatever reason, as a failed emigrant.

5. Pension, pension preservation funds and retirement annuity funds – in terms of the rules for pension, pension preservation funds and retirement annuity funds, one-third of the value may be commuted in cash while an annuity has to be purchased with the remaining two-third of the value. In this instance, the deemed tax debt deferral is levied on the full fund value, while the resultant cash flows on exit from the fund, relate only to one-third of the value.

Our recommendation is for a complete reconsideration of this section including detailed engagement with stakeholders.

6. Transfers between retirement funds by members who are 55 years or older (1.8)

[Applicable provisions: Paragraph (e) of the definition of “gross income”, paragraph (a) of the definitions of “pension preservation fund” and “provident preservation fund”, paragraph (e) of the definitions of “pension preservation fund” and “provident preservation fund” in Section 1(1) of the ITA, read with paragraphs 2(1)(c) and 6A of the Second Schedule to the ITA]

6.1 WG response

No comment required.

<u>End</u>