Issue 33 | 2021
APRIL

sait South African Institute of Tax Professionals

Unstructured CPD 150mins

TAX CHRONICLES MONTHLY

Official Journal for the South African Tax Professional

ANTI-AVOIDANCE
UTILISATION OF ASSESSED LOSSES

GENERAL
2020 TAX AMENDMENTS

TAX ADMINISTRATION
SARS COLLECTION POWERS

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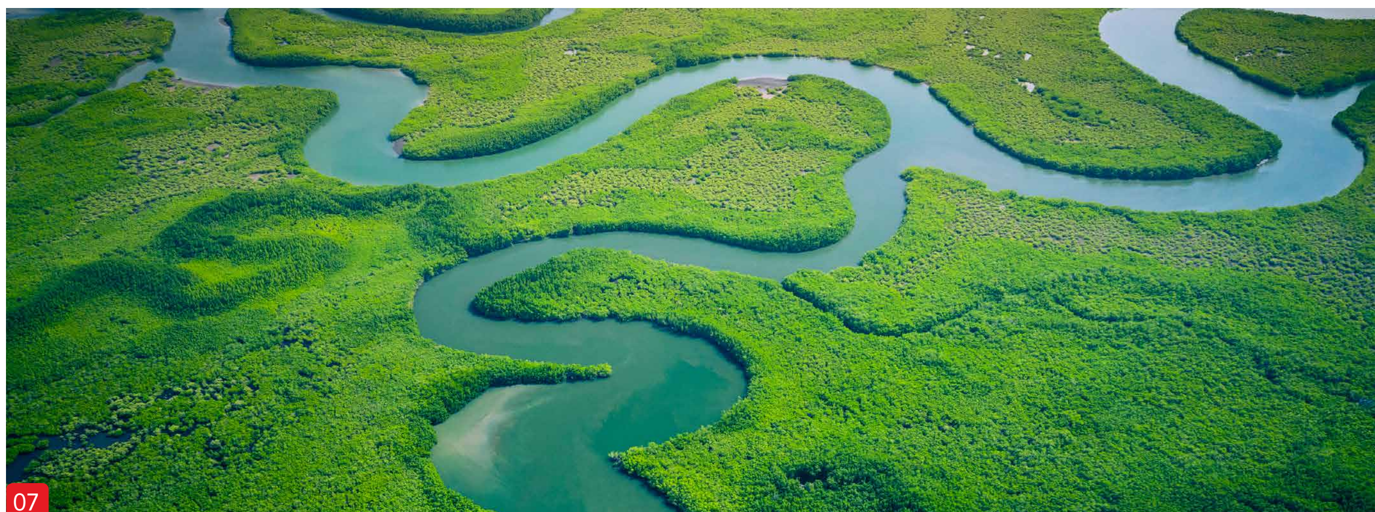
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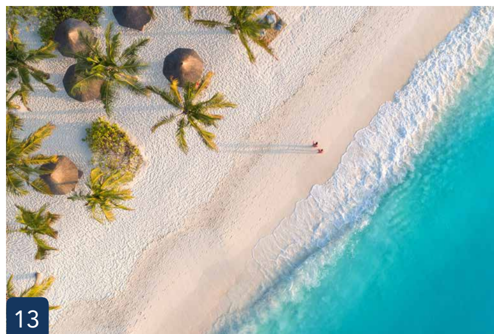
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UTILISATION OF ASSESSED LOSSES

In the economic environment impacted by COVID-19, many corporate taxpayers have been negatively impacted and, in many instances, operating losses suffered have translated directly into assessed losses for tax purposes. In addition, the fact that businesses that were already in distress prior to the advent of COVID-19 are now also suffering operational losses, could result in an increase in an existing assessed loss balance being brought forward from a prior year of assessment.

In these circumstances and because South Africa does not have a system of "group taxation", it might be tempting to combine a profitable business with a loss-making business (typically, the latter would benefit from having an assessed loss for tax purposes). The question that often arises is whether there are any negative tax consequences of such a transaction that could result in an adverse tax outcome and potential penalties and interest.

The response from tax practitioners is always the same: one has to have regard to section 103(2) of the Income Tax Act, 1962 (the Act). The section deals with what is commonly referred to as "trafficking in assessed losses" which, if successfully applied, has the effect that any "diverted income" is not capable of being set off against the assessed loss of the transferee company.

However, this may be detrimental, not only to the arrangement as a whole because it has failed in what was intended, but also to the very ability of the transferee to carry forward the assessed loss as envisaged in section 20 of the Act in circumstances where the transferee company has not traded in the particular year of assessment.

Section 103(2) reads as follows:

"(2) Whenever the Commissioner is satisfied that —

(a) any agreement affecting any company or trust; or

(b) any change in —

(i) the shareholding in any company; or

(ii) ... ;

(iii) ... ,

as a direct or indirect result of which —

(A) income has been received by or accrued to that company or trust during any year of assessment; or

(B) any proceeds received by or accrued to or deemed to have been received by or to have accrued to that company or trust in consequence of the disposal of any asset, as contemplated in the Eighth Schedule, result in a capital gain during any year of assessment,

"In terms of section 103(4), the taxpayer bears the onus of proving or showing that the relevant change in shareholding or the entering into the agreement was not with the sole or main purpose of utilising an assessed loss to reduce, postpone or avoid tax."

has at any time been entered into or effected by any person solely or mainly for the purpose of utilising any assessed loss, any balance of assessed loss, any capital loss or any assessed capital loss, as the case may be, incurred by the company or trust, in order to avoid liability on the part of that company or trust or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof —

(aa) the set-off of any such assessed loss or balance of assessed loss against any such income shall be disallowed;

(bb) the set-off of any such assessed loss or balance of assessed loss against any taxable capital gain, to the extent that such taxable capital gain takes into account such capital gain, shall be disallowed; or

(cc) the set off of such capital loss or assessed capital loss against such capital gain shall be disallowed."

In addition to the charging section as set out in subsection (2), due regard must also be had to subsection (4), which reads as follows:

"(4) If in any objection and appeal proceedings relating to a decision under subsection (2) it is proved that the agreement or change in shareholding or members' interests or trustees or beneficiaries of the trust in question would result in the avoidance or the postponement of liability for payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act or any other law administered by the Commissioner, or in the reduction of the amount thereof, *it shall be presumed*, until the contrary is proved in the case of any such agreement or change in shareholding or members' interests or trustees or beneficiaries of such trust, that it has been entered into or effected solely or mainly for the purpose of utilising the assessed loss, balance of assessed loss, capital loss or assessed capital loss in question in order to avoid or postpone such liability or to reduce the amount thereof." (*our emphasis added*)

In terms of section 103(4), the taxpayer bears the onus of proving or showing that the relevant change in shareholding or the entering into the agreement was not with the sole or main purpose of utilising an assessed loss to reduce, postpone or avoid tax. The onus of proof will be on the parties to show that their "sole or main purpose" in, for example, acquiring the businesses from another entity is not the avoidance of tax through the utilisation of an assessed loss.

In analysing the requirements of section 103(2), it is clear that all of the following three requirements must be satisfied before the provisions apply to a particular transaction:

1. There must be an agreement affecting any company *or* there must be a change in shareholding in a company. It is important to note here that either of these scenarios will suffice, ie, either a change of shareholding in a company or any agreement affecting a company. The latter is of utmost importance as there is a perception in the market that the relevant agreement should result in a change in shareholding which is clearly not what the provision envisages. Refer in this regard to the judgment in *Commissioner for Inland Revenue v Ocean Manufacturing Ltd*, [1990].

"It is also important to note that the Commissioner for SARS may also invoke the general anti-avoidance provisions found in section 80A of the Act in dealing with impermissible tax avoidance arrangements, provided the respective requirements are met."

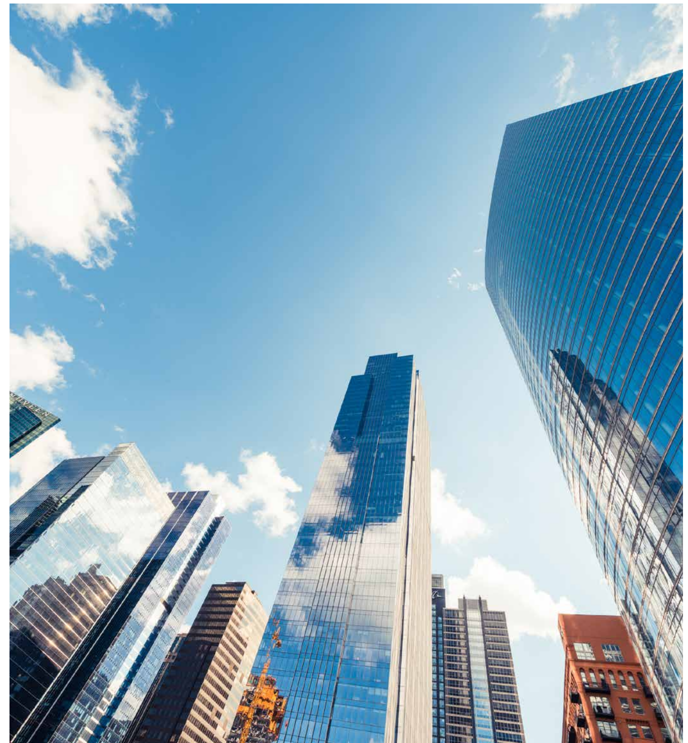
2. Income as a direct or indirect result of the agreement *or* change in shareholding referred to above, must have been received by or accrued to that company during any year of assessment. The terms of the agreement or change in shareholding must result in income having accrued to or received by the company with the assessed loss. The latter is very often clearly identifiable when looking through the financial statements of a company, ie an increase in turnover from one year to the next (for example) could result in a query from the South African Revenue Service (SARS).

3. The agreement *or* change in shareholding must have, at any time, been entered into or effected by any person *solely or mainly* for the purposes of utilising any assessed loss, any balance of assessed loss, any capital loss, or any assessed capital loss, incurred by the company, *in order to avoid liability* on the part of a company or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof.

It is almost inevitable that requirement 1 and requirement 2 would be satisfied in many (if not all) scenarios because of the broad application to any agreement or change in shareholding in a company that results in a receipt or accrual of income in the company. The only defence in this scenario is to demonstrate that the transaction was entered into solely or mainly for purposes other than the utilisation of an assessed loss. At face value, it is difficult to see how the company with the assessed loss could be seen to be avoiding liability for tax (if one has regard to the judgment in *Smith v Commissioner for Inland Revenue*, [1964], where it was held that to avoid liability is "to get out of the way of, escape or prevent an anticipated liability").

Notwithstanding the latter academic point, the provisions clearly find application where the relevant transaction has been entered into solely or mainly in order to avoid liability on the part of (not only) the company but *any other person* for the payment of any tax, duty or levy on income. Regard must thus be had to the sole or main purpose of the transferor. The commercial rationale (other than tax) for the transaction must thus be interrogated to determine whether the sole or main purpose of the transaction is susceptible to challenge and whether any commercial reasons provided can stand up to scrutiny and cross examination in court, ie, those commercial reasons must be evidenced and defendable.

It is also important to note that the Commissioner for SARS may also invoke the general anti-avoidance provisions found in section 80A of the Act in dealing with impermissible tax avoidance arrangements, provided the respective requirements are met. These provisions can be argued by SARS in the alternative or in addition to section 103(2). It is also important to remember that in certain instances, these transactions are required to be reported to SARS in terms of the reportable arrangement provisions contained in Part B of Chapter 4 of the Tax Administration Act, 2011, read together with the relevant regulations thereto.



ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Sections 20, 80A & 103(2) & (4); Eighth Schedule;
- Tax Administration Act 28 of 2011: Part B of Chapter 4 (sections 34–39).

Other documents

- Regulations in terms of the Tax Administration Act (those relevant to Part B of Chapter 4 (sections 34–39) of the Tax Administration Act 28 of 2011).

Cases

- *Commissioner or Inland Revenue v Ocean Manufacturing Ltd* [1990] (3) SA 610 (A);
- *Smith v Commissioner for Inland Revenue* [1964] (1) SA 324 (A).

Tags: corporate taxpayers; operating losses; assessed losses; avoiding liability for tax.

LOOP STRUCTURE RELAXATIONS

The long-awaited relaxation of the rules relating to "loop structures" has finally been announced and most South African residents may now invest in these structures.

However, such investments may still be subject to some form of supervision. It is also important to note that various tax measures have been introduced to address potential tax leakage arising as a result of the relaxation.

In his February 2020 Budget Speech, the Minister of Finance announced various proposed relaxations to the existing exchange control regime, including the relaxation of the rules relating to loop structures.

A loop structure arises where a South African exchange control resident (individual or company) has an interest in a foreign structure and that foreign structure directly or indirectly owns assets in the Common Monetary Area, consisting of Eswatini, Lesotho, Namibia and South Africa.

Until recently, these structures were permitted only in very limited circumstances, typically where South African exchange control residents in aggregate did not own more than 40% of the shares in the foreign company, regardless of the extent of ownership held by the foreign company in the South African assets, including resident companies.

In terms of Exchange Control Circular No 1/2021 (the Circular), the restrictions on loop structures pertaining to individuals, companies and private equity funds that are tax resident in South Africa have been further relaxed. The Circular does not refer to trusts and it thus seems that trusts will still not be permitted to invest in loop structures.

The changes outlined in the Circular apply with effect from 1 January 2021 and are summarised below.

INDIVIDUALS, COMPANIES AND PRIVATE EQUITY FUNDS

Individuals, companies and private equity funds may utilise authorised foreign assets to invest in South African assets through a loop structure, subject to the following:

- The investment must be reported to an Authorised Dealer (AD), ie local bank, as and when the transaction(s) is finalised. An annual progress report must be submitted to the Financial Surveillance Department of the South African Reserve Bank (the Finsurv) via an AD;
- An AD must view an independent auditor's report verifying that the transaction(s) is concluded on an arm's length basis and at a fair and market-related price;
- Upon completion of the transaction, the AD must submit a report to the Finsurv which should, among others, include the name(s) of the South African affiliated foreign investor(s), a description of the assets to be acquired, the name of the South African target investment company (if applicable), the date of the acquisition and the foreign currency amount introduced;

"All clients who are either currently invested in loop structures or who have been unable to make investments as a result of the loop structure restrictions, should carefully consider the impact of the proposed relaxations on their current or future investments."

- All inward loans from South African affiliated foreign investors must still comply with the current exchange control rules applying to inward foreign loans; and
- Existing unauthorised loop structures (ie created prior to 1 January 2021), must still be regularised with the Finsurv.

FOREIGN INHERITANCE

Where a resident has inherited foreign assets held by the deceased offshore in compliance with exchange control regulations, the resident may apply to the Finsurv for approval to retain the assets offshore. Until recently, such approval would have been subject to the condition that the assets may not be used to invest in a loop structure. The prohibition on the investment in loop structures has now been scrapped.

INWARD FOREIGN LOANS

Inward foreign loans received from foreign lenders will no longer be subject to the restriction that –

- the loan funds may not represent or be sourced from a South African resident's authorised foreign assets; and
- there may not be any direct or indirect South African interest in the foreign lender.

All clients who are either currently invested in loop structures or who have been unable to make investments as a result of the loop structure restrictions, should carefully consider the impact of the proposed relaxations on their current or future investments.

It is particularly important for investors to obtain advice regarding the impact of the proposed tax changes on existing loop structures. As the proposed changes are intended to address potential tax leakage arising from the relaxation of loop structures, it could have a negative impact on the tax treatment of existing loop structures.

Bowmans

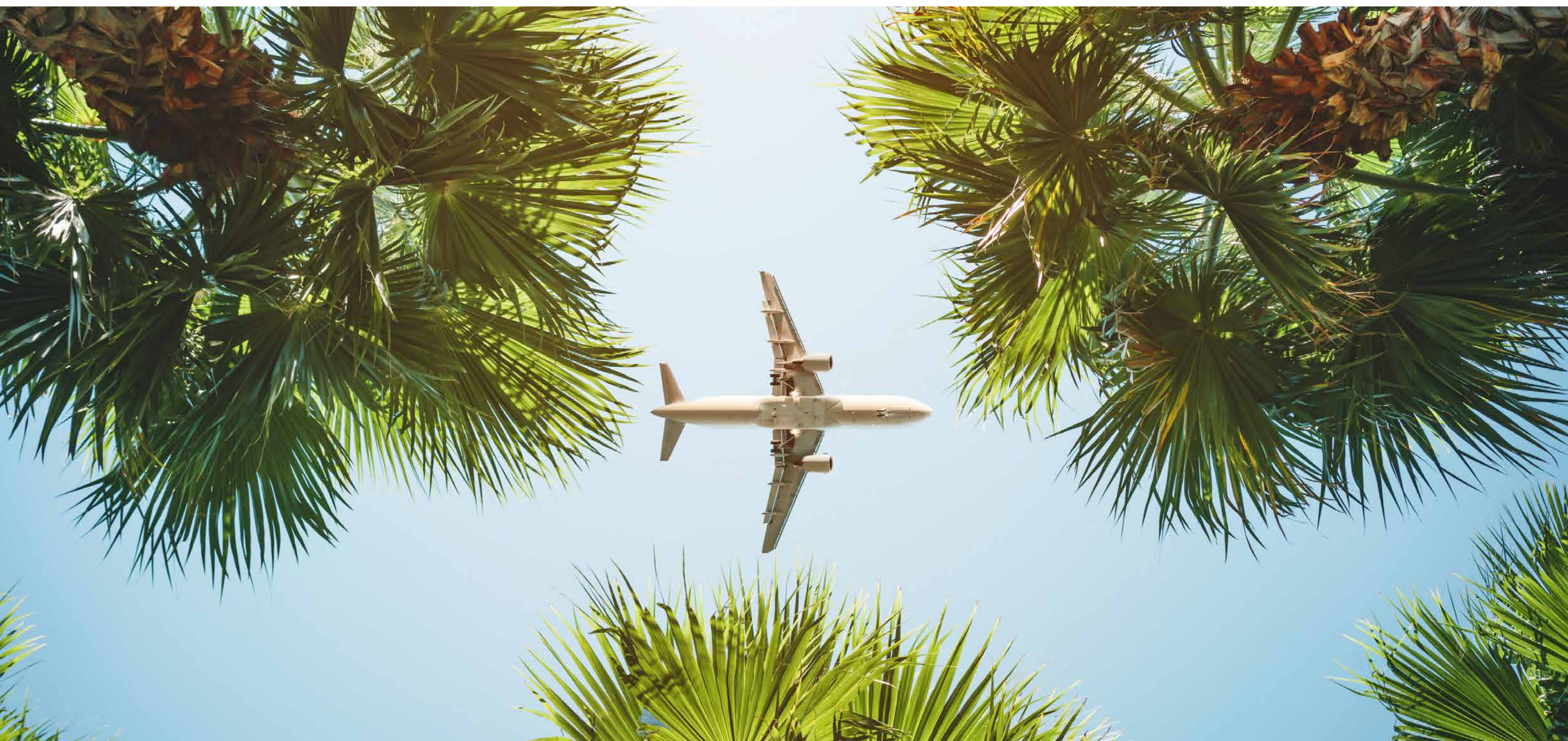
Other documents

- Exchange Control Circular No 1/2021.

Tags: loop structures; private equity funds.

UNDISCLOSED OFFSHORE ASSETS

The days where SARS shut its eyes to taxpayers' offshore holdings are a thing of the past. SARS is finally utilising the Automatic Exchange of Information (AEOI) regime to pin down taxpayers who have not disclosed their offshore interests and numerous taxpayers have already received some alarming notices to this effect.



THE NOTICE

The notice informs the taxpayer that SARS intends to initiate a review of their tax affairs, based on information it received from 87 foreign jurisdictions through the AEOI regarding the offshore holdings of South African taxpayers.

After delivering the shock in the introductory words of the notice, SARS extends an olive branch and states that it wishes to engage with the taxpayer first, in the interests of administrative justice. The consolation is short-lived though because SARS then proceeds to direct a detailed and onerous information request at the taxpayer.

This starts off with a request to confirm that you have offshore holdings and then requires detailed information regarding the amount invested, the nature of the investment and the location thereof. The final question asks the taxpayer to explain why this was not disclosed on their tax return.

As if SARS knows your next move, the notice asks the taxpayer to inform them in the response if the taxpayer intends to file an application under the SARS Voluntary Disclosure Programme (VDP), referred to in sections 225 to 233 of the Tax Administration Act, 2011 (the TAA).

The notice signs off by informing the taxpayer that they have 21 working days to respond to this Gordian knot of a request and reminds you that a failure to do so constitutes a criminal offence.

"SARS now has the means and the guile to uncover your interests and, with prevailing budget constraints, SARS has no choice but to turn to untapped pools of revenue."

WHAT TO DO NEXT

It is perplexing that SARS almost invites taxpayers to do a VDP, even after they have received this notice. It is critical to note that a VDP application must be "voluntary", otherwise it does not meet the requirements of a valid VDP application under section 227 of the TAA. Technically, if the SARS notice prompts the taxpayer to come forth and file a VDP application, it may not be considered "voluntary". It is not clear whether SARS is making a concession on this aspect, but it would be very interesting to see if the VDP Unit will accept an application if it was filed pursuant to this notice.

In any event, it is important to note that the SARS notice does not give you the option to either respond or to file a VDP; it just asks you to confirm your intention. You are still very much obliged to respond to SARS' queries. If you have received such a notice, you would be well-advised to speak to a professional before you respond, especially if you have not disclosed your offshore interests to SARS.

FIRST-MOVER ADVANTAGE

If you have undisclosed offshore interests and you have not yet received this notice, then you have a small window to file a VDP application in the ordinary course. A timeous VDP application may avoid the unpleasant information-gathering process initiated in terms of this SARS notice and provides you with amnesty from criminal prosecution and understatement penalties.

A VDP should be your immediate course of action. Be warned though, the VDP process may be the path of least resistance in this instance, but it should not be undertaken without the help of a professional.

CONCLUSION

For those with undisclosed offshore holdings, this should serve as a wake-up call. SARS now has the means and the guile to uncover your interests and, with prevailing budget constraints, SARS has no choice but to turn to untapped pools of revenue. It is no longer a question of whether SARS will come knocking, but when.

Tax Consulting SA

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 225 to 233 (more specifically section 227).

Tags: offshore holdings; voluntary disclosure programme; undisclosed offshore interests.

2020 TAX AMENDMENTS

INTRODUCTION

On 28 October 2020, when the Minister of Finance presented his Medium Term Budget Policy Statement to Parliament, he also tabled the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2020, the Tax Administration Laws Amendment Bill, 2020, and the Taxation Laws Amendment Bill, 2020. All of these Bills have been passed by Parliament, assented to by the President and promulgated in the *Government Gazette* as Acts. Only the Taxation Laws Amendment Act, 2020 (the TLA Act), is discussed in this article.

As has been the trend in recent years, the number of significant amendments each year has been reduced, and the majority in number of the amendments are of a highly technical or esoteric nature; many amendments are more of interest to tax professionals than to business people in general. Additionally, National Treasury was under greater drafting pressure this year as there was also the tax legislation that had to be prepared and passed by Parliament relating to the tax relief measures arising from COVID-19.

Accordingly we limit our discussion to amendments which are likely to be of interest in the general business environment.

One of the "victims" of COVID-19 – and it was probably as a result of inadequate resources because of the need for additional tax legislation as described above – was the deferral to 2022 of two major tax measures to be introduced into the Income Tax Act, 1962 (the Act). These were:

- the intention to limit the amount of interest which may be deducted by a corporate taxpayer to an amount equal to 30% of (tax) EBITDA (earnings before interest, taxes, depreciation, and amortisation) where that taxpayer forms part of a group that operates in more than one country; and

- the intention to limit the extent to which a current year's taxable income may be sheltered by an assessed loss brought forward to 80% of that taxable income, so that, despite the loss, there will still be tax payable on 20% of the current year's taxable income.

CORPORATE TAXPAYERS

Corporate restructuring rules

Section 45 of the Act is one of the corporate restructuring provisions which allows assets or businesses to be sold intragroup without tax consequences, and where the purchase price can be in the form of cash or either by the issue of debt or a share which is not an equity share as defined in section 1(1) of the Act (an equity share is one that has an unlimited right to participate either in dividends or in capital, or both).

There are certain anti-abuse provisions in the section, but two of them, which potentially carry the most risk, are as follows:

- The first is the so-called degrouping provision, which, in a nutshell, states that if the transferee and transferor companies cease to form part of any group (being a group for tax purposes) within six years of the transferee acquiring the asset under section 45 of the Act, in short, the transferee is deemed –

    - to sell the asset at market value, (usually) at the date on which the transaction took place; and then

    - to repurchase it at that price, thereby triggering a taxable recoupment of depreciation and/or a capital gain subject to CGT.

  This is colloquially known as the "degrouping charge".

- The second is that if debt or a non-equity share was issued (typically) to the seller to fund the acquisition of the asset, in the holder's hands the debt or share will have no base cost. This means that any repayment of the debt or any reduction of capital on the share will represent a capital gain subject to CGT. However, this gain is disregarded for so long as the debtor and creditor/issuer and holder remain part of the same group for tax purposes. Unfortunately, there is no longstop date after which this provision ceases to apply, such as the six-year period applicable to degrouping.

A new subsection (3B) has been inserted in section 45 to take effect in respect of years of assessment commencing on or after 1 January 2021. In summary, what it provides is that if the creditor under the debt, or holder of the share, ceases to form part of the same group as the issuer, which cessation triggers the degrouping charge, the holder of the debt or share is effectively deemed to acquire a base cost equal to the original face value or issue price, reduced by the amount of any subsequent repayment of capital, thereby eliminating the zero base cost situation.

This amendment makes no sense to us whatsoever. The purpose of having a zero base cost is to create a potentially punitive situation if the parties seek to abuse the benefits of section 45. On the other hand, parties who genuinely use the section for the purpose for which it was intended, should not be prejudiced. It therefore makes no sense whatsoever that:

- the holders have a zero base cost and suffer capital gains, which are then disregarded, provided that the parties remain part of the same group;
- when they cease to form part of the same group within six years, which is a minimum period for non-abuse, the base costs are restored without any tax being suffered; one must therefore ask why the legislature bothered to introduce this anti-abuse provision in the first place; but
- no relief is given for the holder of the debt or share if there is no degrouping within the six-year period, or if the parties degroup after the period of six years – one would have expected that this is precisely the time when the reinstatement of base cost should have occurred instead, but it does not.

Relief is therefore given to the holder of debt or a share in a non-compliant scenario, but not to a holder in a compliant scenario!

National Treasury have since indicated that they are aware of this anomaly and will seek to address it in the 2021 legislative process.

Scholarships and bursaries

Paragraphs *(q)* and *(q*A*)* of section 10(1) of the Act allow for tax-exempt scholarships and bursaries to be received by individuals, including where an employer grants scholarships or bursaries to its employees or their relatives. There are certain limits and requirements in order for the latter scholarships or bursaries to be tax-exempt.

With effect from tax years commencing on or after 1 March 2021, the exemption will no longer apply to the scholarship or bursary if any remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited as a result of the grant of the scholarship or bursary.

We foresee some difficulty in applying this provision given that it applies only to remuneration to which the employee was "entitled" – after all, salary sacrifice arrangements only apply properly where there is no prior entitlement. What is going to be even more problematic is to suggest that a scholarship or bursary given at a future time arose from an amount that the employee "might" in the future become entitled to.

"In the documentation accompanying the Minister's Budget Speech in February 2020, it was noted that the corporate tax rate of 28% is too high in relation to South Africa's trading partners, and that there is a need to reduce this rate to make South Africa more competitive."

Termination of incentives

In the documentation accompanying the Minister's Budget Speech in February 2020, it was noted that the corporate tax rate of 28% is too high in relation to South Africa's trading partners, and that there is a need to reduce this rate to make South Africa more competitive. Given the economic constraints we have, any such reduction has to be revenue-neutral.

No doubt with this in mind, the TLA Act contains a number of provisions in terms of which tax incentives (which reduce the tax base, and therefore the tax revenues) will be phased out. These include the following:

Section of the Act	Incentive	Date of termination
12DA	Deduction: rolling stock	28 February 2022[1]
12F	Deduction: airport and port assets	28 February 2022[2]
12R	Special economic zones	1 January 2031[3]
12S	Deduction: buildings in special economic zones	1 January 2031[4]
13*quat*	Deduction: buildings in urban development zones	31 March 2021[5]
13*sept*	Deduction: low-cost residential units	28 February 2022[6]

Notes relating to the third column above:

1. Allowance limited to rolling stock brought into use during a tax year ending on or before 28 February 2022.
2. Deduction limited to an asset brought into use during a tax year ending on or before 28 February 2022.
3. The section ceases to apply from a tax year commencing on or after 1 January 2031.
4. The section ceases to apply to expenditure incurred during a tax year commencing on or after 1 January 2031.
5. Building or improvements must be brought into use by 31 March 2021.
6. Deduction only allowed in a tax year ending on or before 28 February 2022.

INTERNATIONAL TAX

Loop

Historically the South African Reserve Bank, in administering the Exchange Control Regulations, 1961, has prohibited a so-called loop, where South African residents hold shares in a foreign company which, in turn, holds assets in South Africa. There have been relaxations over the past few years such that, without special approval for a greater proportion, it is possible for either corporates, undertaking foreign direct investment, or individuals, making personal investments, to hold interests in foreign companies which have South African assets, provided that South African residents collectively do not hold more than 40% of the shares or voting rights of the foreign company. What is still considered a breach, is if a foreign company, holding interests in South African assets, is held by an offshore trust in which beneficiaries, even discretionary beneficiaries, are residents of South Africa.

Given the announcement that the current exchange control regulations are to be replaced by a new set of regulations, scheduled to be enacted on 1 March 2021, coupled with a completely new (and less restrictive) exchange control framework, the concept of a loop is to disappear. The main reason for the exchange control prohibition was, in any event, to protect the tax base. In order to compensate for the removal of the exchange control prohibition, two major amendments to the Act form part of the TLA Act as follows.

Controlled foreign companies

The first amendment is to section 9D of the Act, dealing with treatment of a controlled foreign company (CFC). The general principle is that, subject to any exemptions, the profit of the CFC is recomputed to arrive at the equivalent of taxable income under the Act, and the South African-resident shareholder's proportion thereof is effectively taxed in the shareholder's hands.

In computing the taxable income, any dividend from a South African company would obviously be treated as exempt income from an income tax perspective. An amendment now requires that, in computing the (equivalent of) taxable income of the CFC, 20/28 of the South African dividend must be included as taxable income. The effect of this is that where the shareholder of the CFC is a South African company, and 28% of this amount is taxed, the effective tax rate becomes 28% of 20/28 = 20%, which is the rate of dividends tax on a dividend from a South African company (and the effective tax rate attributable to a foreign dividend). (Note: Of course, if an individual or a trust is the shareholder, then the effective rate is 45% of 20/28 = 32%, which is greater than the rate at which tax on South African or foreign dividends is imposed.)

Recognising that the South African dividend itself would have been subject to dividends tax at 20%, or possibly less under a relevant double tax agreement, the amendment includes an adjustment mechanism to ensure that, to the greatest extent possible, the tax payable by the shareholder on the CFC's profits as determined above, together with the dividends tax withheld on the South African dividend, will not exceed an effective rate of 20%. For the reason given above, this mechanism can only work properly where the shareholder of the CFC is a company.

This amendment applies to any South African dividends received by a CFC on or after 1 January 2021.

"The first amendment is to section 9D of the Act, dealing with treatment of a controlled foreign company (CFC)."

Capital gains tax

The second amendment relates to the so-called participation exemption applicable to capital gains, found in paragraph 64 of the Eighth Schedule to the Act. The general principle is that where a South African resident holds at least 10% of the equity shares and voting rights in a foreign company and, stated in short, and subject to certain requirements, a capital gain arises on disposal, that capital gain is exempt from capital gains tax (CGT).

An amendment now states that this exemption will not apply in respect of a capital gain determined in respect of the disposal of a share in a CFC, to the extent that the value of the assets of the CFC "is attributable to assets directly or indirectly located, issued or registered in" South Africa. The formulation sounds simple, but in practice, determining the attribution could be complex, depending upon the criteria used to arrive at the sale price of the shares in the CFC.

This amendment applies to any disposal of shares in a CFC on or after 1 January 2021.

"Section 9H of the Act deals with the tax consequences, *inter alia* when a person, including a company, ceases to be a resident of South Africa."

Loops and offshore trusts

Nothing is included in the TLA Act in relation to loops where an offshore trust with South African-resident beneficiaries holds an interest in an offshore company which holds interests in South African assets. The Explanatory Memorandum on the TLAB noted the amendments introduced in 2018, whereby distributions out of capitalised profits by an offshore trust, where those capitalised profits represented either a dividend from, or disposal proceeds of, shares in a company held of more than 50%, would still be taxable if distributed to a South African-resident beneficiary, and that the exemption which previously applied would no longer apply. It went on to state that these amendments were sufficient to deal with this issue.

A further CFC change

Another, somewhat surprising, amendment to the CFC rules, relates to the attribution of capital gains in a CFC. In 2001, both CGT and comprehensive CFC rules were introduced. Since that year, where a CFC made a capital gain, in determining the amount of the CFC income to be taxed in the shareholder's hands, the inclusion rate applicable to the shareholder was applied so that, using current rates –

- if the shareholder was an individual, the capital gain was effectively taxed at 18%;
- if it was a company, it was effectively taxed at 22.4%; and
- if it was a trust, it was effectively taxed at 36%.

This rule has now been amended to remove this concession to all shareholders other than an insurer in respect of its individual policyholder fund. The effect of this is that for all other taxpayers the inclusion rate will be determined based on the company inclusion rate. This will not affect a trust, as now the inclusion rate for companies and trusts is the same at 80%, but it is double the inclusion rate applicable to individuals. The consequence of this is that where a natural person is a shareholder of a CFC any underlying capital gains made by the CFC will effectively be taxed at the rate of 36% in the shareholder's hands, instead of at 18%.

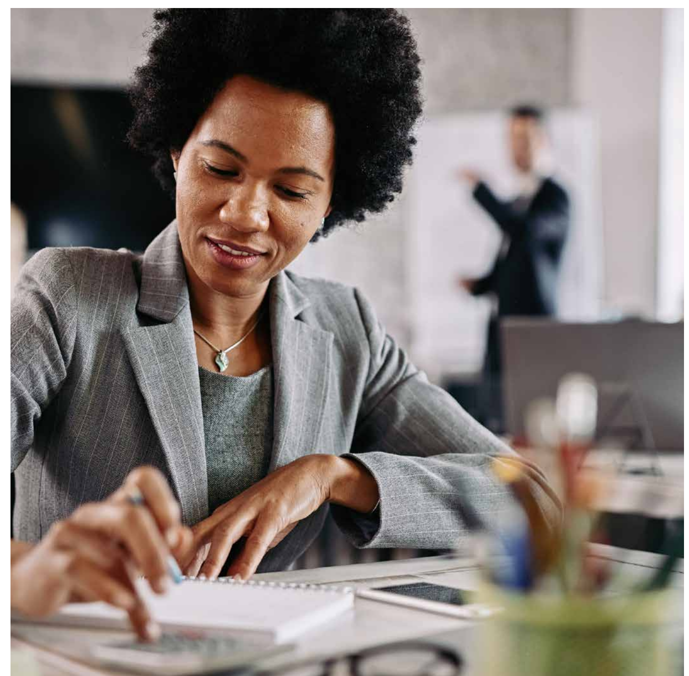
As no specific commencement date was given for this amendment, it commenced on 20 January 2021, the date of promulgation of the TLA Act, 2020.

Cessation of residence

Section 9H of the Act deals with the tax consequences, *inter alia* when a person, including a company, ceases to be a resident of South Africa. In the case of a company, on the day before cessation of residence (a) the company is deemed to sell its assets at market value and reacquire them at that same market value, thereby triggering capital gains and possible recoupments of tax allowances, and (b) the company is also deemed to have distributed a dividend *in specie* equal, in short and in effect, to the realised and unrealised profits of the company, which dividend is subject to dividends tax. These two charges are colloquially known as the exit tax.

This deemed dividend will, however, be exempt from dividends tax if the shareholder is a South African-resident company that either forms part of the same group for tax purposes or, if not, has submitted the required declaration and undertaking to the company which enables it to be exempt from the tax. An amendment now introduced states that in these circumstances, if the shareholder holds at least 10% of the equity shares and voting rights in the company whose residence ceases, the shareholder is deemed to have disposed of the shares on the date prior to cessation of residence for proceeds equal to market value, and then to have reacquired the shares at that value, thereby triggering a capital gain.

One can understand the logic but it is not necessarily so that the amount of the gain would equal the amount of what the dividends tax would have been but for the exemption; nor is the tax rate the same (20% for dividends tax and an effective 22.4% for CGT). Also, the party being taxed is different – it is the company which ceases residence that bears the exit tax in the form of CGT and dividends tax, but now, because there is no dividends tax, the shareholder has to pay a tax when the shareholder is not taking any action itself! It might have been better rather to say that, in these circumstances, the relevant exemption from dividends tax would not apply, thereby putting all shareholders on the same footing.



INDIVIDUALS

Section 7C

As is now widely known, any person who has, broadly speaking, made an interest-free or low-interest loan to a local or offshore trust, or to a local or offshore company owned by a local or offshore trust, is subject to donations tax on a deemed donation. The donation is calculated by multiplying the loan by the "official rate of interest" as defined in section 1 of the Act, and deducting any interest actually accrued on the loan, and multiplying the result by the rate of donations tax. The tax is payable in March of each year.

It did not take long for planners to realise that a way around this problem was to finance the structure, onshore or offshore, by means of having the company owned by the trust issuing preference shares, which could be zero-coupon preference shares or, if not, certainly not cumulative preference shares.

To counter this, an amendment is made to the Act, which in short –

- deems any such preference share to be a loan; and
- deems any dividend or foreign dividend to be interest.

The expression "preference share" is given the same meaning as in section 8EA(1) of the Act, and therefore means (a) any share which is not an equity share (see above), or (b) any equity share if any amount of a dividend or foreign dividend is based on or determined with reference to a specified rate of interest or the time value of money.

The amendment came into operation on 1 January 2021 and applies in respect of any dividend or foreign dividend accruing during any tax year commencing on or after that date. In other words it will apply for the first time in the year ending 28 February 2022. This is a rather strange formulation, because what happens if there is no dividend at all? What is a taxpayer then supposed to do in determining a donations tax liability at 28 February 2022?

Transfer of a listing

Once again, motivated by the relaxation of the exchange controls pursuant to the adoption of new regulations in 2021, a new section 9K has been introduced, which applies only to a natural person or trust that holds a security (not defined) which is listed on a South African exchange.

If the listing of this security ceases on the local exchange and thereafter it is listed on a foreign exchange, the holder is deemed to dispose of the security for proceeds equal to market value on the day that the security lists on the foreign exchange, and then to reacquire it at the same market value, thereby triggering a capital gain. This provision applies in respect of any security listed on a foreign exchange on or after 1 March 2021.

Frankly, this is a most puzzling amendment. A South African resident is subject to CGT on worldwide assets, and if a security's listing is transferred from a local to a foreign exchange, it is still the same asset held by the same shareholder in the same issuer, acquired at the same cost, and when sold will trigger the same capital gain. It makes no sense that this transfer of a listing, which has nothing to do with the economic nature of the asset acquired and which is continued to be held, nor has anything to do with the tax laws, should give rise to a cashless (deemed) sale on which cash tax is payable.

The justification for the amendment is, once again, the loosening of exchange controls, but one fails to see the link between the fact that even a local issuer of shares or debt can transfer the listing to a foreign exchange as being a reason to trigger a notional capital gain resulting in actual tax payable.

Expatriate tax

As is well known, when a resident works abroad for a lengthy period, the remuneration is exempt from tax in South Africa (the exemption to be limited to R1.25 million from 2021). The requirements for the exemption are that the individual must be outside South Africa (i) for a period or periods exceeding 183 full days in aggregate during any period of 12 months, and (ii) for a continuous period exceeding 60 full days during that period of 12 months.

Given the fact that individuals could have been prevented from leaving South Africa during the lockdown, with the result that they might not have met the 183 day threshold, an amendment has been made, effective 29 February 2020, stating that, in respect of any tax year between 29 February 2020 and 28 February 2021, the requirement is to spend 117 full days in aggregate outside South Africa during any period of 12 months. This reduction of 66 days supposedly correlates to the period of lockdown when not even flights for business purposes were available. [*Editorial comment*: There is another aspect not specifically dealt with in this article. While the person is trapped in South Africa, the concession only applies to work done outside South Africa. If the person was locked here for eight months over this past year, the remuneration for his work in those months is South African source income to which the exemption does not apply.]

Emigration

For some years now, when a member of a pension or pension preservation fund, provident or provident preservation fund or retirement annuity fund (a retirement fund) emigrates, including emigrating for exchange control purposes, that individual is entitled to receive 100% of the value of their retirement fund, even though this might be contrary to the general rules in the case of a resident.

Given the proposed exchange control relaxations, one of which will be that there will no longer be a distinction between a resident and an emigrant, and thus no longer any formal emigration procedure, the reference point in granting this dispensation can no longer be exchange control emigration. Accordingly, with effect from 1 March 2021, the requirement, in order to access the money in the retirement fund, is that the person must not be a South African resident for an uninterrupted period of three years or longer from that date.

As a phasing-out provision, a concession has been made such that the old rules will continue to apply to any person who has submitted an application for emigration to the South African Reserve Bank (the SARB). The application must have been received by the SARB on or before 28 February 2021, and approved by it or an authorised dealer on or before 28 February 2022.

Werksmans

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "official rate of interest"), 7C, 8EA(1) (definition of "preference share"), 9D, 9H, 9K, 10(1)*(q)* & *(q*A*)*, 12DA, 12F, 12R, 12S, 13*quat*, 13*sept* & 45(especially subsection (3B)); Eighth Schedule: Paragraph 64;
- Taxation Laws Amendment Act 23 of 2020;
- Rates and Monetary Amounts and Amendment of Revenue Laws Bill 26 of 2020;
- Taxation Laws Amendment Bill 27B of 2020;
- Tax Administration Laws Amendment Bill 28 of 2020.

Other documents

- The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020;
- Medium Term Budget Policy Statement, 2020.

Tags: corporate taxpayer; non-equity share; zero base cost; corporate tax rate; special economic zones; taxable income; dividends tax; interest-free or low-interest loan; official rate of interest; exchange control relaxations.

SARS COLLECTION POWERS

A third-party appointment (TPA), akin to the fiscus' Robin Hood, is governed in terms of section 179 of the Tax Administration Act, 2011 (the TAA).

In essence, the legislation provides a senior SARS official the power to issue a notice to any person who holds money for or owes money to a taxpayer. The TPA requires such person to pay the money to SARS in satisfaction of the taxpayer's outstanding tax debt, instead of to the taxpayer.

SARS' collection powers are emphasised with this section, as no judgment is required to remove funds from a taxpayer's bank account or to force the taxpayer's debtor to pay SARS directly. This must be contrasted with ordinary civil litigation where a judgment is required before a creditor can collect against a debtor.

The double-edged sword of the section provides that the third party cannot show benevolence towards the taxpayer, as the third party could be held personally liable for the tax debt should they part with the money contrary to the notice.

However, the TPA should not deny taxpayers their basic rights as embodied in the Bill of Rights, including the right to just administrative action. SARS may, upon request, extend the payment period for the third party to allow the taxpayer to receive money for the basic living expenses of the taxpayer and his or her dependants.

In 2015, section 179(5) was amended to even the playing field between SARS and taxpayers, in that a TPA may only be issued "after delivery to the tax debtor of a final demand for payment which must be delivered at the latest 10 business days before the issue of the notice….". This is a peremptory requirement before the step can be taken to issue a TPA for recovery of an outstanding tax debt.

"This is a timely reminder that SARS cannot simply do as they please, as they are a creature of statute and should not act outside of the tax Acts."

Prior to this amendment, there was no obligation on SARS to deliver a demand for an outstanding debt before issuing a TPA and taxpayers could be caught off guard when funds were suddenly removed from their accounts.

The validity of the TPA was recently tested in the matter of *SIP Project Managers (Pty) Ltd v The Commissioner for the South African Revenue Service*, [2020], by the Gauteng division of the High Court.

The key finding of this case is that it is not enough for SARS to prove the existence of a final demand; the letter of demand should be delivered to the taxpayer. Furthermore, it is not lawful for SARS to issue a final demand in respect of a debt that is not yet payable.

A simplified summary of the facts follows:

- SARS raised an additional assessment creating a tax liability on the account of the taxpayer in the amount of R1 233 231.00.
- The taxpayer only became aware of the tax liability when funds in the region of R1,2 million were removed from his bank account.
- According to SARS, three final demands were sent to the taxpayer before a TPA was issued to the taxpayer's bank. The bank complied with the TPA and paid an amount over to SARS.

The critical consideration in the matter is that the taxpayer denied having received any of the final demands and provided the court with a screenshot of its e-filing profile to support its contention. SARS failed to deal with this crucial allegation and provided contradictory submissions as to who actually sent the letters or to whom they were sent.

Despite SARS being able to produce the letters of demand, the court stated that it is not sufficient for SARS to just prove the existence thereof; SARS must be able to demonstrate that it actually sent the final demand to the taxpayer. Where e-filing is used, as in this case, SARS would have to demonstrate that it placed the final demand on the taxpayer's e-filing profile in order to meet the requirements set out in the Rules for Electronic Communication, prescribed under section 255(1) of the TAA. In this instance SARS failed to prove that the letter of final demand did appear on the e-filing system. The court therefore found that no final demands were delivered by SARS to the taxpayer.

Furthermore, the court found the final demand relied upon by SARS was premature and therefore unlawful because the debt was not yet due and payable as the due date for payment on the assessment had not arrived by the time the demand was delivered.

This is a timely reminder that SARS cannot simply do as they please, as they are a creature of statute and should not act outside of the tax Acts.

Shepstone & Wylie

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 179 & 255(1).

Other documents

- Rules for Electronic Communication (prescribed under section 255(1) of the TAA).

Cases

- *SIP Project Managers (Pty) Ltd v The Commissioner for the South African Revenue Service* [2020] JDR 1093 (GP).

Tags: letter of final demand; administrative action; outstanding tax debt; tax liability.