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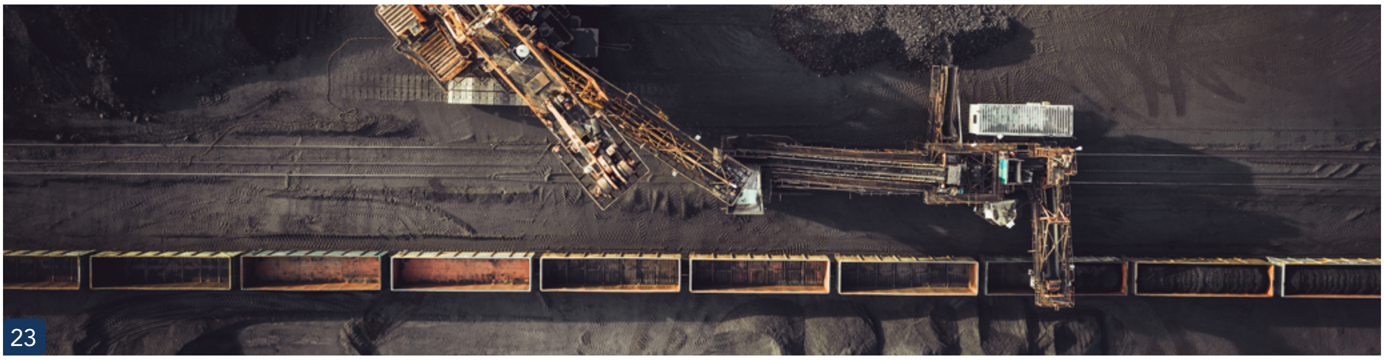
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INVESTORS

It has been more than three years since SARS' media statement on cryptocurrencies. In this statement SARS stated that it will apply "normal income tax rules" to cryptocurrencies when assessing whether a gain is revenue or capital in nature and that cryptocurrencies are not seen as currency for income tax purposes but referred to as crypto assets.

Following this statement, further guidance has been scarce. Crypto traders, especially those that have no financial or tax background, often turn to fellow traders on social media platforms for advice (this is not an advisable option). Based on our interaction with cryptocurrency HODLers, uncertainty remains with many being surprised when the so-called "normal rules", which become pretty complicated as the crypto market continues to develop, are explained. [*Editorial note*: HODL is a term derived from a misspelling of "hold" that refers to buy-and-hold strategies in the context of bitcoin and other cryptocurrencies.]

Media outlets along with SARS Commissioner, Edward Kieswetter, have been quick to state that SARS will crack down on non-compliant taxpayers who do not declare their crypto asset profits. However, many of these taxpayers do not even know that they are non-compliant. So why not provide more guidance to assist taxpayers in declaring their crypto asset profits? The only guidance to date is the previously mentioned media statement along with 15 FAQs on cryptocurrencies on the SARS website.

Anecdotally, it seems that SARS still views crypto assets as highly speculative intangible assets. However, it should be noted that exponential change has taken place in this industry since the initial media statement on 6 April 2018. Crypto assets have provided us with various initiatives and businesses that are shaping this alternative financial system. These initiatives include crypto asset arbitrage, investments into predefined crypto asset bundles, lending and borrowing through the use of decentralised finance (DeFi), staking and mining rewards for solo or pooled staking and mining.

"Anecdotally, it seems that SARS still views crypto assets as highly speculative intangible assets."

"For true transparency, SARS should attempt to detail as much of the current crypto transactions of which they are aware in an interpretation note."

At a minimum it is suggested that SARS, together with National Treasury, should state that gains (and losses) on crypto assets are deemed to be capital in nature if held for a period of, say, more than one year (similar to section 9C of the Income Tax Act, 1962 (the Act), which provides that equity shares are deemed to be capital in nature after three years). In this way, SARS can at least assist taxpayers in having more certainty in their disclosures. It will also assist in bringing taxpayers to SARS, instead of SARS needing to try and find non-compliant taxpayers in a space they are ill-equipped to conquer.

With all tax-collection methods, the cost of the collection must be weighed up against the actual amount that can be collected. Providing this form of incentive will encourage taxpayers to disclose their positions and save SARS the cost of funding extremely expensive methods of obtaining this information from markets. For true transparency, SARS should attempt to detail as much of the current crypto transactions of which they are aware in an interpretation note. An interpretation note should deal with aspects like –

- the interaction between crypto assets and section 24J of the Act (interest);
- the question whether crypto-to-crypto conversions qualify as disposals (in our opinion they do);
- the rebalancing of crypto bundle investment and the question whether these should fall within the ambit of a collective scheme of investments;
- staking rewards that could be characterised as being interest; and
- the tax implication of collateralised lending through DeFi.

In the meantime, if taxpayers have not declared crypto asset profits, it remains advisable to follow the voluntary disclosure programme provided for by SARS. Failing to disclose any relevant amounts could result in substantial penalties and/or harsh criminal sanctions.

Crypto assets were originally designed to facilitate peer-to-peer transactions across the internet. This meant that there was no need for any intermediary or monetary regulations which led people to believe that crypto assets should operate independently from any form of regulation. However, they fail to realise that certain regulations are, in fact, imposed to protect consumers and economic stability.

Tertius Troost

Mazars

Acts and Bills

- Income Tax Act 58 of 1962: Sections 9C & 24J.

Other documents

- SARS' media statement on cryptocurrencies (2018);
- 15 FAQs on cryptocurrencies (SARS website).

Tags: non-compliant taxpayers; decentralised finance (DeFi); voluntary disclosure programme.

RENEWABLE ENERGY CAPEX

In response to the persistent energy constraints faced by South Africa, the President has made the eagerly anticipated announcement that the government intends amending the Electricity Regulation Act, 2006, to allow for the construction of embedded generation projects of up to 100 megawatts, without a generation licence.

This crucial policy directive will broaden the ability for self-generation to meet commercial needs in an environment of unstable supply. The potential for renewable energy projects to be part of the energy solution is bolstered by the availability of capital allowances in the Income Tax Act, 1962 (the Act).

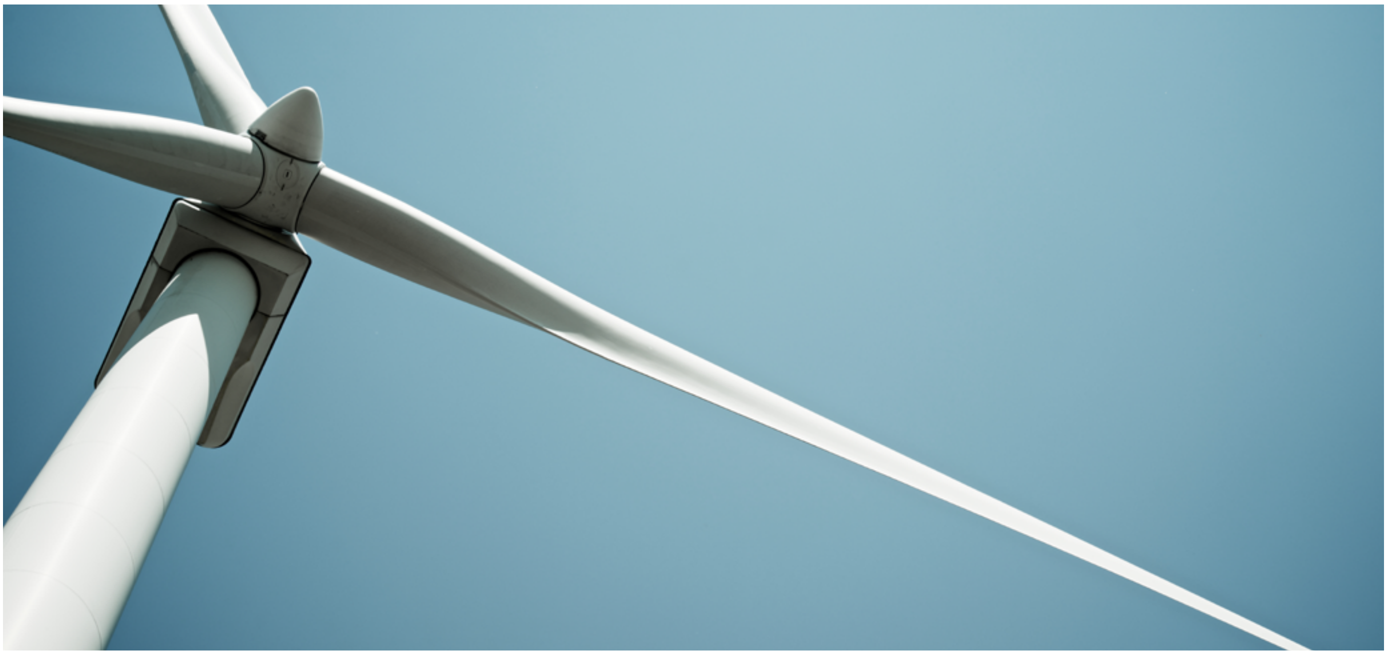
The Act contains capital allowances aimed at assisting the renewable energy sector through accelerated capital expenditure deductions for various types of renewable energy generation infrastructure builds and certain types of ancillary structures. Although these incentives are not new, they present a welcome net cost reduction method in constructing new renewable energy generation projects or improving existing sites.

THE RENEWABLE ENERGY CAPEX ALLOWANCES – SECTIONS 12B AND 12U

Section 12B provides for a deduction of the lesser of the actual and arm's length costs of acquiring and installing any machinery, plant, implement, utensil or article used in the types of generation projects listed in section 12B(1)*(h)* of the Act (Generation Asset). The following types of renewable generation projects may benefit from the allowance:

- wind power;
- photovoltaic solar energy of more than 1 megawatt;
- photovoltaic solar energy not exceeding 1 megawatt;
- concentrated solar energy;
- hydropower to produce electricity of not more than 30 megawatts; and
- biomass comprising organic wastes, landfill gas or plant material.

To claim the allowance the Generation Assets must be brought into use for the first time, be applied in the taxpayer's trade and be owned by the taxpayer or purchased under a qualifying instalment credit agreement.



"It is also notable that the requirement that the Generation Assets be applied in a taxpayer's trade does not mean that the taxpayer's business must necessarily be the sale of electricity."

The capital allowance for the costs of Generation Assets is spread over three years on a 50%/30%/20% basis. However, an exception is made for photovoltaic solar energy not exceeding 1 megawatt, which is deductible fully in the first year of expenditure.

Any foundation or supporting structure which is designed for a Generation Asset and built for the purpose of a generation project ought to be deemed to be part of the Generation Assets, subject to the allowance and claimable under the section.

Where improvements, excluding repairs, are made to Generation Assets, foundations or supporting structures, then an allowance under section 12B(1)*(i)* on the same 50%/30%/20% basis will be granted to the taxpayer for the costs of purchase and installation.

Section 12U(1)*(a)* of the Act provides for capital allowances for roads and fencing used in the generation of electricity in excess of 5 megawatts from the following sources:

- wind;
- solar;
- hydropower to produce electricity of not more than 30 megawatts; and
- biomass comprising organic wastes, landfill gas or plant material.

The section 12U allowance is granted in full in the year of expenditure. It covers improvements to the roads and fencing related to the generation project, as well as the foundations or supporting structures to such roads and fencing.

COMMENT

The renewable energy capital expenditure allowances are not new and are based on criteria familiar to South African taxpayers. Similar requirements have historically been and are currently applied for the allowances for expenditure on farming implements. Therefore, SARS' position on a particular project or Generation Assets qualifying for the allowance is predictable.

It is also notable that the requirement that the Generation Assets be applied in a taxpayer's trade does not mean that the taxpayer's business must necessarily be the sale of electricity. It will likely be sufficient that the electricity generated is used by the taxpayer's business. The allowances may also potentially be claimed where the expenditure is incurred prior to the business beginning to trade, in the circumstances outlined in the sections of the Act.

The proposed increase in the embedded generation thresholds presents an opportunity for new generation projects to come on line and existing projects to be improved to increase their output capacity. Both of these will require capital investment. The availability of the capital allowances for renewable energy generation projects and the resultant reduced tax cost of such investments may just be the green light investors have been waiting for to tackle South Africa's energy shortages.

Tsanga Mukumba

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 12B (more specifically subsection (1)*(h)* & *(i)*) and 12U (more specifically subsection (1)*(a)*);
- Electricity Regulation Act 4 of 2006.

Tags: capital expenditure deductions; renewable energy capital expenditure allowances.

TRANSFERRING LISTED SHARES TO AN OFFSHORE EXCHANGE

The recently introduced section 9K of the Income Tax Act, 1962 (the Act), triggers a potential tax liability when dual-listed shares are migrated from a South African to an offshore stock exchange.

When the rand depreciates, buying dual-listed shares on an offshore exchange instead of a South African exchange offers advantages under paragraph 43(1) of the Eighth Schedule to the Act for individuals and non-trading trusts. But this advantage does not seem to be available under the recently introduced section 9K, which applies when shares are transferred from a South African exchange to an offshore exchange on or after 1 March 2021.

WHY SECTION 9K?

Why does section 9K trigger a deemed disposal and reacquisition of the shares that are migrated to the offshore exchange, thus accelerating the imposition of income tax (including capital gains tax (CGT)) on any unrealised gain? Given that the shares remain within the South African tax net after the deemed disposal, the need for this measure is questionable. It may be intended to reduce the future risk of loss to the fiscus from non-disclosure when the shares are subsequently disposed of on the offshore exchange, or to discourage capital flight.

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020, explains the background to the introduction of section 9K as follows:

> "As indicated in Annexure E of the 2020 *Budget Review*, Government proposes to review the current exchange control rules to be replaced by implementing a new capital flow management framework that is aimed at promoting investment, reducing unnecessary burdensome approvals by SARB and providing a modern, transparent and risk-based approvals framework for cross-border flows. One of the changes to the current exchange control rules is the phasing out of the approval requirement by SARB when a resident individual or company that owns a listed domestic security is exporting that listed domestic security abroad."

Before examining section 9K, it is worth taking a look atparagraph 43 to understand the benefits of investing on an offshore exchange, rather than buying the identical share on a South African exchange.

"One of the changes to the current exchange control rules is the phasing out of the approval requirement by SARB when a resident individual or company that owns a listed domestic security is exporting that listed domestic security abroad."

PARAGRAPH 43 ADVANTAGE

Before 1 March 2013, the sale of a foreign equity instrument was dealt with under paragraph 43(4), which, in simple terms, translated the base cost to rands at the time of acquisition and the proceeds to rands at the time of disposal. But on or after that date, paragraph 43(4) was deleted and natural persons and non-trading trusts were required to determine a capital gain or loss under paragraph 43(1) when buying and selling a share in the same foreign currency. Under paragraph 43(1), the capital gain or loss is determined in the foreign currency and translated to rands using the spot rate at the time of disposal or the average exchange rate for the year of assessment in which the asset is disposed of. If natural persons or non-trading trusts dispose of a share in different currencies (including the rand), they fall into paragraph 43(1A) together with companies and trading trusts. Paragraph 43(1A) determines a capital gain or loss in the same way as the old paragraph 43(4).

The effect can be illustrated with a simple example:

Example

Jack bought 100 dual-listed shares on the JSE for R20,000 and sold them on the same exchange for R50,000 five years later. His capital gain is R30,000.

Jill bought 100 of the same listed shares on the LSE when £1 = R10 and paid £2,000 for her shares on the same date as Jack. She too sold her shares on the LSE five years later when £1 = R20. She received proceeds of £2,500 and made a capital gain of £500. Under paragraph 43(1), Jill has a rand gain of £500 × 20 = R10,000.

Jack's capital gain is therefore R20,000 higher than Jill's, because his base cost has remained fixed while Jill's base cost is determined in GBP and translated at the rate ruling at the time of disposal. Her base cost in rand is £2,000 × 20 = R40,000 compared with Jack's base cost of R20,000.

So, if your view is that the rand is going to continue to depreciate against the currency of the offshore exchange, it would be more tax efficient to buy the shares on the offshore exchange.

SECTION 9K TRIGGERS TAX ON DELISTING ON SOUTH AFRICAN AND LISTING ON OFFSHORE EXCHANGE

Section 9K came into operation on 1 March 2021. It applies to any security listed on an exchange outside South Africa on or after that date. It provides as follows:

> **"9K. Listing of security on exchange outside Republic**
>
> (1) Where a natural person or a trust that is a resident holds a security in a company and that security is delisted on an exchange as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act, and subsequent to that delisting that security is listed on an exchange outside the Republic, that person must be treated as having –
>
> *(a)* disposed of that security for an amount received or accrued equal to the market value of that security as contemplated in the definition of 'market value' in section 9H(1) on the day that the security is listed on the exchange outside the Republic; and
>
> *(b)* reacquired that security on the same day on which that security is treated as having been disposed of under paragraph *(a)* for expenditure in an amount equal to that market value.
>
> (2) For the purposes of section 9C(2), a security that is listed on an exchange outside the Republic as contemplated in subsection (1) must be treated to be one and the same security that is delisted."'

The term "market value" as defined in section 9H(1) reads as follows:

> **" 'market value'**, in relation to an asset, means the price which could be obtained upon a sale of that asset between a willing buyer and a willing seller dealing at arm's length in an open market."

The term "security" is not defined in the Act and would probably have its ordinary meaning. The *Cambridge English Dictionary* (online) defines "a security" as an "investment in a company or in government debt that can be traded on the financial markets…". It would therefore include dual-listed shares, depository receipts and bonds and debentures.

Section 9K(1) refers to a situation in which –

- a security is held by a resident natural person or trust;
- that security is delisted on a South African exchange; and
- that security is then listed on an offshore exchange.

In these circumstances, the holder is treated as having disposed of that security for an amount equal to its market value and to have reacquired it for expenditure equal to the same market value.

The security referred to is the security trading on the South African exchange, and its market value must therefore be determined in the currency in which it trades on that exchange, which is the rand. Since the reacquisition cost is the same market value, it too will be denominated in rand, even though section 9K does not explicitly deal with the currency of disposal and reacquisition. This interpretation is consistent with the exit charge in section 9H. Section 9H(7) provides that for the purposes of section 9H(2) and (3), "the market value of any asset must be determined in the currency of expenditure incurred to acquire that asset".

Therefore, transferring dual-listed shares to an offshore exchange will not provide a natural person or trust shareholder with any CGT advantage under paragraph 43 when the shares on the offshore exchange are subsequently disposed of, for example, upon cessation of residence under section 9H or as a result of a sale to a third party.

The proceeds will be in the foreign currency of the offshore exchange, while the base cost will be in rands and the natural person or trust will therefore fall under paragraph 43(1A).

The time of disposal and reacquisition is the date on which the shares become listed on the offshore exchange. There was no need for a "day before" deeming rule, since the shareholder remains a resident after the deemed disposal.

THE THREE-YEAR SAFE HAVEN RULE IN SECTION 9C(2)

Section 9K applies to securities, whether held as capital assets or as trading stock.

Under section 9K(2), for the purposes of determining whether the disposal of the security (in this instance an "equity share", as defined in section 9C(1)) gives rise to a receipt or accrual of a capital nature under section 9C(2), a security that is listed on an exchange outside South Africa as contemplated in section 9C(1) must be treated as the same security that is delisted.

Under section 9C(1) the definition of "equity share" excludes a share in a company which was not a resident, other than a company contemplated in paragraph *(a)* of the definition of "listed company" in section 1(1). Paragraph *(a)* of the definition of "listed company" refers to a company with its shares or depository receipts listed on an "exchange", as defined in section 1(1) of the Financial Markets Act, 2012, and licensed under section 9 of that Act. Section 9C(2) therefore applies to shares in a non-resident company with shares listed on a South African exchange and would include a dual-listed share.

Example
Transfer of a listed share from a South African exchange to an offshore exchange

Facts:

Jim owned 100 shares in XYZ plc which he acquired on the JSE at a cost of R100,000 on 1 March 2019. In February 2021, he instructed his broker to transfer his shares to the LSE, which was done on 1 March 2021. On that day the shares were trading at R5,000 each on the JSE and at £250 a share on the LSE. The exchange rate was £1 = R20. On 30 April 2022, Jim ceased to be a resident, and on 29 April 2022 the shares were trading at £280 a share and the exchange rate was £1 = R21. Jim elected to use the spot rate to determine the capital gain or loss.

Result:

Under section 9K, Jim is deemed to dispose of and reacquire the shares on 1 March 2021 for proceeds of R500,000 resulting in a capital gain of R400,000 (R500,000 – R100,000). He is deemed to reacquire them at a cost of R500,000 on 1 March 2021. On 29 April 2022 Jim will be deemed to dispose of the shares under section 9H, and since their base cost is denominated in rands, the calculation of the capital gain must be determined under paragraph 43(1A). The proceeds in rands are 100 × £280 × 21 = R588,000. Jim therefore will have a capital gain of R88,000 (R588,000 – R500,000) on 29 April 2022. Since he had held the shares for more than three years, the capital gain will be of a capital nature, based on section 9C(2), read with section 9K(2).

CONCLUSION

For South African residents, there are adverse tax consequences if dual-listed shares are transferred to an offshore exchange. The payment of tax will potentially be accelerated and the resident may be exposed to foreign death duties and dividend withholding taxes.

(This article was first published in Accountancy SA.)

Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "listed company" & "listed share"), 9C (specifically subsections (1) (definition of "equity share") & (2), 9H (specifically subsections (1) (definition of "market value"), (2), (3) & (7)) & 9K; Eighth Schedule: Paragraph 43(1), (1A) and (4);
- Financial Markets Act 9 of 2012: Sections 1(1) (definition of "exchange") & 9.

Other documents

- *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020* (20 January 2021);
- *Cambridge English Dictionary* (online) (definition of "security").

Tags: dual-listed shares; capital flow management framework; spot rate; market value; at arm's length; equity share.

KUWAIT-SA PROTOCOL AFFECTS THE LOWER WHT ON DIVIDENDS BETWEEN RSA AND THE NETHERLANDS

The following questions have been raised after the signing of the Kuwait – South Africa Protocol (KU–SA Protocol), due to the interplay of the Protocol with the Most Favoured Nation (MFN) clause in the Netherlands – South Africa Double Tax Agreement (NL–SA DTA):

- What are the effects of the KU–SA Protocol on dividend distributions made between Netherlands' subsidiaries and South African parent companies?
- What does this mean for companies qualifying for a dividend withholding tax (WHT) exemption under the NL–SA DTA?
- Are South African subsidiaries of Netherlands parent companies (still) entitled to a full elimination of dividend WHT under the NL–SA DTA?
- What are the current and future anti-avoidance considerations for claiming 0% WHT on dividends?
- Can South African or Netherlands companies claim a refund of any dividend WHT paid to Netherlands/South African parent companies and/or what is the statutory time limit in this regard?

This article will outline the recent developments surrounding the dividend WHT exemption and address these key questions in relation thereto.

BACKGROUND – POSITION BEFORE THE KU-SA PROTOCOL

MFN clauses

MFN clauses are commonly found in DTAs between developed and developing countries. These clauses are negotiated into DTAs to ensure that if one of the treaty partners offers a more beneficial treatment to another country, such treatment will also automatically apply under the DTA that includes the MFN clause. Although MFN clauses are a popular topic of discussion in the context of treaty law, it is difficult to keep up with the actual application of these clauses because of their inter-dependence and also the complexity of language.

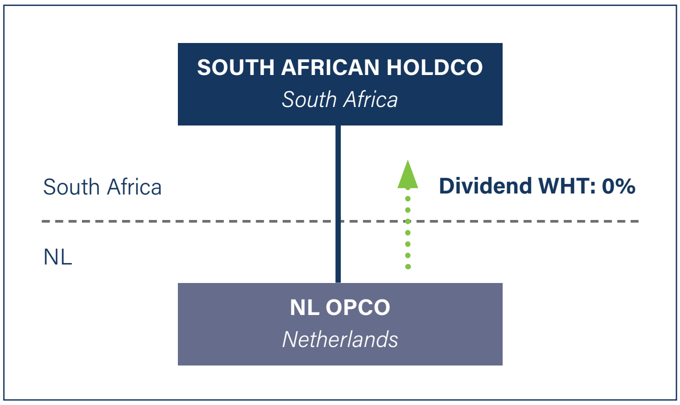
With regard to the effective WHT rate on dividends under the NL–SA DTA, two key court decisions paved the way for a 0% WHT rate (subject to some conditions), by way of applying multiple MFN clauses. These two court decisions are briefly discussed below.

Decision of the Dutch Supreme Court

On 18 January 2019, the Dutch Supreme Court (No 17/04584. ECLI:NL:HR:2019:57) ruled in favour of a South African company holding more than 10% in a Dutch subsidiary, which claimed a refund of the 5% dividend WHT it had previously paid, based on the MFN clause in the NL–SA DTA. The court observed that, while Article 10(2)(a) of the NL–SA DTA provides that the source state may withhold tax on dividends at 5%, Article 10(10) (the MFN clause) provides that if South Africa agreed on a lower rate of tax on dividends with a third state, the same treatment would have to be afforded to dividends under the NL–SA DTA.

The MFN clause in the NL–SA DTA was introduced in 2008 (by way of a Protocol). The MFN clause in the NL–SA DTA only applies to treaties with third states that have been concluded after the inclusion of the MFN clause in the NL–SA DTA. At first glance, this eliminates application of the (preferential) Kuwait – South Africa Double Tax Agreement (KU–SA DTA) of 2006. However, the KU–SA DTA was concluded (in 2006) before the inclusion of the MFN clause in the NL–SA DTA (in 2008) and provides for a 0% dividend WHT rate.

Decision January 18th 2019 – Dutch Supreme Court <u>and</u> amendments to Dutch domestic dividend WHT provisions

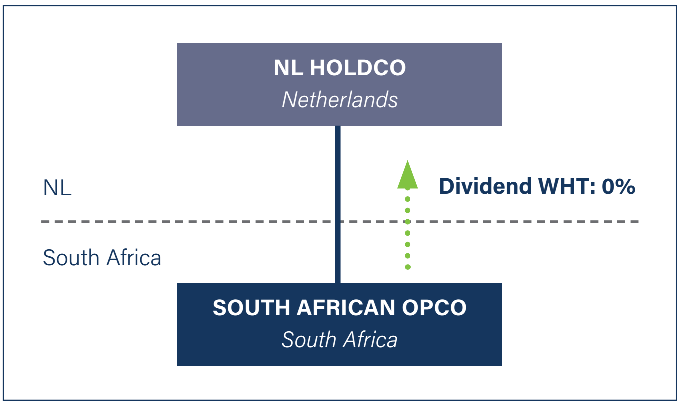


In 2010, the DTA between South Africa and Sweden was amended to include a similar MFN clause (to that in the NL–SA DTA). This MFN clause in the Sweden – South Africa DTA (SW–SA DTA) was introduced in the existing SW–SA DTA via a Protocol, which entered into force in 2012. Interestingly, the MFN clause in the SW–SA DTA applied irrespective of the conclusion date of treaties with third states. This is contrary to the restricted application of the MFN clause in the NL–SA DTA. Hence, the South African parent of the Dutch subsidiary reasoned that it could apply the 0% dividend WHT rate of the KU–SA DTA via the application of the SW–SA DTA MFN clause. The court agreed with the arguments of the taxpayer and applied the 0% WHT rate on dividends between the Netherlands and South Africa, entitling the taxpayer to a refund of the WHT paid.

Decision of the Tax Court of South Africa

On 12 June 2019, the tax court of South Africa, in *ABC Proprietary Limited v Commissioner for the South African Revenue Services*, [2019], decided in favour of the taxpayer, a South African subsidiary of a Dutch parent company (holding more than 10% in its subsidiary). The court applied, in general, the same reasoning (interposing the aforementioned MFN clauses). It ruled that the effective rate of WHT on dividends paid by the South African subsidiary to the Dutch parent company was 0% in accordance with the MFN clause in the SW–SA DTA and the exemption from WHT on dividends provided for in the KU–SA DTA.

Decision June 12th 2019 – Tax Court South Africa



Precedent – 0% WHT on dividends between South Africa and the Netherlands

In light of the two cases described above, both the courts in the Netherlands and in South Africa confirmed that the effective WHT rate on dividends under the NL–SA DTA is 0%, should a company hold at least 10% of the shares in the company paying the dividend. This rate was conditional upon three factors, namely:

(i) the MFN clause in the NL–SA DTA remaining unchanged;

(ii) the MFN clause in the SW–SA DTA remaining unchanged; and

(iii) the exemption from dividend WHT in the KU–SA DTA remaining in force.

Accordingly, the aforementioned court decisions set a precedent for an exemption from dividend WHT on dividends flowing between South Africa and the Netherlands for qualifying companies (subject to, for instance, beneficiary ownership provisions, the main purposes test (MPT test) in the NL–SA DTA and the impact of the multilateral instrument (MLI)). At the same time, the South African Revenue Service (SARS) has tried to end the application of the exemption via directly amending the preferential dividend provision in the KU–SA DTA (instead of amending the MFN clauses in the SW–SA DTA and the NL–SA DTA).

POSITION AFTER THE KU-SA PROTOCOL

On 1 April 2021, the KU–SA Protocol was signed, which will amend the KU–SA DTA. The KU–SA Protocol will, among other amendments, replace the dividends article (Article 10) (the Protocol also deals with the replacement of the interest (Article 11), capital gains (Article 13) and exchange of information (Article 26) articles). The new Article 10 introduces a right for the source state to impose a WHT on dividends at a rate of 5%, where the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends (and 10% in all other cases), effectively bringing an end to the 0% dividend WHT rate. The most critical question for qualifying companies is whether they will be able to claim the exemption of dividend WHT when the KU–SA Protocol becomes enforceable. This question is answered below.

Effective date of the KU-SA Protocol

In terms of Article 7(1) of the KU–SA Protocol, each of the contracting states (Kuwait and South Africa) shall notify the other, in writing, of the completion of procedures required by their respective laws for the bringing into force of the Protocol. The Protocol shall enter into force on the date of the later of these notifications. Article 7(2) states that the Protocol shall have effect from the date on which a system of taxation at shareholder level of dividends declared enters into force in South Africa.

According to the South African domestic laws, the Protocol requires ratification before it can come into force. Currently, it is unclear which domestic steps have been taken to ratify the KU–SA Protocol, as there are no government statements/notices available in this regard. According to SARS (update of 4 June 2021), ratification has not taken place in South Africa or in Kuwait, and it therefore seems that no public notification has been made. In general, we note that upon tabling of the KU–SA Protocol before the South African Parliament, the Parliament typically requires at least eight weeks to process such agreements. Accordingly, the Protocol may already enter into force in the second part of this year (assuming that the government of Kuwait takes similar steps). We are currently monitoring the South African as well as the Kuwaiti ratification process; however, the 0% dividend WHT rate may still apply for some months.

Interplay with the Netherlands dividend WHT Act

From the Netherlands point of view, the impact of the Protocol may be limited. As of 1 January 2018, a full exemption of dividend WHT should in principle be applied on dividends distributed to entities resident in the EU/EEA or in a state with which the Netherlands has concluded a DTA that includes a dividend article (eg, the NL–SA DTA). As an additional requirement, the recipient entity must be able to apply the Dutch participation exemption if it would have been a resident of the Netherlands. The rationale behind this requirement is to ensure that the dividend WHT exemption will only be available for “active” businesses/holding companies (with sufficient economic nexus at the recipient level).

Typically and reasonably speaking, in cases involving active companies an exemption of Netherlands dividend WHT should apply. Accordingly, relief may still be available under the Dutch Dividend WHT Act for dividends flowing from the Netherlands to South Africa. This, however, would need to be checked/validated based on the facts of the case.

"If companies have withheld dividend WHT in excess of 0% (or 5% following the entry into force of the KU-SA Protocol), they may request a refund of the excess amount."

Application of case law as support for the exemption of dividend WHT

Both the aforementioned cases are reliant on the fact that (i) the exemption from dividend WHT in the KU–SA DTA would remain in force; and (ii) the MFN clause in the SW–SA DTA and the NL–SA DTA remains unchanged. Accordingly, the replacement of Article 10 by the KU–SA Protocol will result in the fact that the first requirement will no longer be satisfied. Therefore, it is expected that these decisions will not support claims for 0% dividend once the KU–SA Protocol comes into force.

Main purpose test in relation to Netherlands – South Africa DTA

It is noted that Article 10(8) of the NL–SA DTA provides for a main purpose test as an anti-abuse measure in respect of the application of the DTA to dividend distributions. This also includes the MFN clause as stipulated in Article 10(10) of the NL–SA DTA. Therefore, the 0% WHT benefits under the NL–SA DTA shall not apply if the main purpose (or one of the main purposes) of the particular entity/taxpayer is to take advantage of the MFN clause, and accordingly, the preferential dividend provision in the KU-SA DTA. The main purpose test should be considered when setting up cross-border investments and/or to maintain/monitor treaty entitlement. Once the KU–SA Protocol becomes effective and is in force, a beneficial owner company would, at minimum, pay dividend WHT at a rate of 5% (subject to the fact that it is not the main purpose of the company to take advantage of the dividend WHT provision). The additional relief of 5% is only available under the Dutch WHT Act (which provides for separate/additional anti-avoidance measures – see discussion above).

Applying MFN clauses

In day-to-day advisory, caution is required when relying on MFN clauses due to their inter-dependence and complexity of language. Furthermore, countries tend to renegotiate DTAs to reflect their current and future economic policies (for instance, via protocols like the KU–SA Protocol). Until a few years ago, a number of South African DTAs (Cyprus, Oman and Kuwait) granted full taxation rights, with regard to dividends, to the respective resident states. The Cyprus and Oman treaties have since been renegotiated/amended to grant/increase WHT rights to the source state at 5%. Since the KU–SA DTA has been amended in a similar manner, these treaties can now be said to broadly align with the economic policies of South Africa.

APPLICATION FOR RESTITUTION OF TAX LEVIED CONTRARY TO THE NETHERLANDS – SOUTH AFRICA DTA

If companies have withheld dividend WHT in excess of 0% (or 5% following the entry into force of the KU-SA Protocol), they may request a refund of the excess amount. Based on Protocol no II at Articles 10, 11 and 12 of the NL–SA DTA, an application for the restitution of tax levied contrary to the application of the MFN clause as mentioned in Article 10(10) of the NL–SA DTA (read with the SW–SA DTA and the KU–SA DTA) has to be lodged with the Netherlands tax authorities (or with SARS) within a period of three years after the expiration of the calendar year in which the tax has been levied. Conceptually, the arguments discussed in this note could have been applied as from 2012 (from the time that the MFN clause was introduced in the existing SW–SA DTA). Looking forward, 0% WHT claims on dividends, based on the NL–SA DTA, will only be possible until such time that the KU–SA Protocol enters into force.

KEY ISSUES

- Under South African domestic law, the WHT on dividends paid to foreign companies is 20%. Hence, DTAs and especially, MFN clauses play a significant role in the decision-making process of companies looking to invest in South Africa. In this respect, both court decisions, of South Africa (of 12 June 2019) and the Netherlands (of 18 January 2019), were welcomed because they offered a possibility for an elimination of dividend WHT between South Africa and the Netherlands.

- Due to the KU–SA Protocol, more specifically Article 10(1) coming into force, the exemption of dividend WHT based on the interplay with the MFN clauses in the SW–SA DTA and the NL–SA DTA comes to an end.

- According to the South African domestic laws, the Protocol requires ratification before it comes into force. Currently, it is unclear which domestic steps have been taken to ratify the KU–SA Protocol, as there are no government statements/notices available in this regard. According to SARS (update of 4 June 2021), ratification has not taken place in South Africa or in Kuwait, and therefore, it seems that no public notification has been made.

- In general, we note that, upon tabling of the KU–SA Protocol before the South African Parliament, the SA Parliament typically requires at least eight weeks to process these types of agreements. Accordingly, the Protocol may already enter into force in the second part of this year (assuming that the government of Kuwait takes similar steps). We are currently monitoring the South African ratification process, but companies may consider applying the exemption from dividend WHT and/or liaise with South African counsel for a sign-off.

- In relation to the Netherlands, Dutch domestic law may still provide for a 0% WHT on dividends where a company is able to satisfy the Dutch participation exemption criteria/requirements and the additional (domestic) anti-avoidance measures as well as the main purpose test of Article 10(8) of the NL–SA DTA.

- Observing the fact that the MFN clause of the SW–SA DTA was concluded in 2012, and that both court cases confirm that the requirements of the MFN clause of the NL–SA DTA has been satisfied, companies may lodge a request for restitution of dividend WHT within a period of three years after the expiration of the calendar year in which the tax has been levied. Entities wishing to distribute dividends at 0% would only be able to do so until the KU–SA Protocol enters into force.

INTERPLAY OF INTERNATIONAL DEVELOPMENTS (IE, EUROPEAN COURT OF JUSTICE (ECJ) CASE LAW)

In this article we have commented on the legal interpretation of tax treaties. It should be noted that in the context of base erosion and profit shifting it is recommended to embed legal ownership with economic rationale. In addition, and observing internal developments in view of the Danish cases of the European Court of Justice (C-115/16, 116/16, C-117/16, C-118/16, C-119/16 & C-299/16), as well as the ratification of the Multilateral Instrument, concepts such as "beneficial ownership" and "abuse of law" should also be considered. Reference is made to the specific indications presented by the ECJ in the Danish cases that could lead to the conclusion that there is an abuse of law and/or question the beneficial ownership of dividend entitlements. It is recommended that this be discussed, in advance, with a local (South African) and Dutch counsel.

Dewald Claassen & Patrick Schrievers

Noviotax

Other documents

- Protocol amending the Agreement between the Government of the Republic of South Africa and the Government of the State of Kuwait for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, 2021 (KU–SA Protocol);
- Agreement between the Government of the Republic of South Africa and the Government of the State of Kuwait for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, 2007 (KU–SA DTA);
- Convention between the Republic of South Africa and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, 2009 (NL–SA DTA);
- Convention between the Republic of South Africa and the Kingdom of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, 1995 (SW–SA DTA);
- Protocol amending the Convention between the Republic of South Africa and the Kingdom of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, 2012;
- Agreement between the Republic of South Africa and the Republic of Cyprus for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, 1998;
- Agreement between the Government of the Republic of South Africa and the Government of the Sultanate of Oman for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, 2004.

Cases

- No 17/04584. ECLI:NL:HR:2019:57 (Dutch Supreme Court, 18 January 2019);
- *ABC Proprietary Limited v Commissioner for the South African Revenue Services* (14287) [2019] ZATC 9 (12 June 2019);
- Danish cases of the European Court of Justice (C-115/16, 116/16, C-117/16, C-118/16, C-119/16 & C-299/16).

Tags: dividend withholding tax; main purpose test; base erosion and profit shifting; beneficial ownership.

MISLEADING ADVICE TO EXPATRIATES

Post-Covid economic resurgence has seen an increase in international work opportunities. With skills in hand, many South African professionals have become sought after in other countries. As a result, their finances and subsequent taxation have come under scrutiny. However, along with the awareness of tax complications, another threat has emerged.

Financial emigration (FE) and double tax agreements (DTAs) became instant buzz words among expats and tax experts alike. While the ideal should be to seek every possible relief for clients, there are independent tax advisors who mislead clients or give them misinformation to acquire the business.

This negligent and unethical conduct may have a catastrophic effect on the individual's financial status in the long run, not to mention the severe legal consequences that are sure to follow. Now more than ever, South Africans in the process of emigrating or earning an income in another country, must be vigilant when seeking counsel from tax consultants.

HOW TO TELL THE WOLF FROM THE SHEEP?

Unethical tax advisors confuse clients with legal jargon and financial terminology, while making promises that cannot be kept or assumptions that have no merit. While their actions create a lot of confusion about expatriate taxation laws or SARS submission processes, the challenge has become to avoid these agents of misinformation.

HERE ARE SOME RED FLAGS TO LOOK OUT FOR

If you are in consultation with a tax advisor, or you are in the market for advice, there are sure-fire ways to know whether you are being misled. Any of these should set off alarm bells:

1. Now that you live abroad, you do not have to submit or declare anything to SARS;
2. SARS will never find you in another country;
3. You automatically qualify for a DTA;
4. You are seen as a non-resident if you have been outside of SA long enough;
5. You must give up your passport and/or dispose of all your South African assets;
6. SARS is not asking for a tax residency certification.

These points seem rather mundane mid-conversation, but, once in effect, each untruth can have devastating financial consequences. Here is why:

NOW THAT YOU LIVE ABROAD, YOU DO NOT HAVE TO SUBMIT OR DECLARE ANYTHING TO SARS

It is a common misconception that SARS will forget or forgive transgressions. In reality, every stone gets turned over twice. While an uninformed consultant or advisor might sell clients on the idea that the tax-regulating authority in their country will forget about expats, professional tax practitioners will stay up to date with current legal consequence. As long as you are a tax resident of South Africa, you must submit annual tax returns and declare all worldwide income.

"Whether you plan to claim DTA relief or follow the financial emigration route to cease tax residency, it is imperative to consult a licensed and professional service provider with a strong legal component."

SARS WILL NEVER FIND YOU IN ANOTHER COUNTRY

As per the Common Reporting Standards (CRS) and the Automatic Exchange of Information (AEOI), SARS receives information on offshore income and financial information of South African tax residents. If you have not been submitting tax returns declaring your foreign income, you will be seen as non-compliant and face harsh consequences. More so, if you do fill out tax returns and they do not correlate with the information to which SARS has been privy, it could be seen as a criminal offence.

YOU AUTOMATICALLY QUALIFY FOR DTA

When it comes to taxation, you seldom qualify for anything by default. There will always be a submission process. It is wrong to assume that being subject to tax in both countries automatically exempts you from paying tax in the country where you are not currently residing. DTAs are a relief mechanism that must be applied for and, so doing, "claimed" from SARS. As such, SARS will almost always review or challenge every application for tax exemption.

YOU ARE SEEN AS A NON-RESIDENT IF YOU HAVE BEEN OUTSIDE OF SA LONG ENOUGH

Your tax residency status will never change unless you have applied and been granted that change. Even if you are a taxpayer who temporarily wants to cease your tax residency, there is a procedure to follow. Even if you have given up your passport, you will still be taxed in South Africa until you conclude a legal emigration process.

YOU CAN GET PERMANENT NON-RESIDENCY BY WAY OF A DTA

DTA non-residency needs to be claimed annually and there is no guarantee that you will qualify. In no way does it permanently alter your tax residence status. If you have no intention of returning to South Africa, then financial emigration is the only way to cease your tax residency. Then you can seek to obtain an emigration tax clearance certificate. However, if you are a taxpayer who is temporarily ceasing tax residency, you must still submit your tax returns for income generated in South Africa.

YOU MUST GIVE UP YOUR PASSPORT AND/OR DISPOSE OF ALL YOUR SOUTH AFRICAN ASSETS

You do not lose citizenship by financially emigrating. You are also able to financially emigrate without being a permanent resident or citizen of another country. Furthermore, even if you cease your citizenship in South Africa, your tax residency status still remains. You can keep all your assets in South Africa after ceasing your tax residency.

IN CLOSING

When considering your foreign earned income, never forget the tax man in South Africa. Ensure that you are complying with your new local tax jurisdiction and the South African one, as well as the income tax laws in both. Whether you plan to claim DTA relief or follow the financial emigration route to cease tax residency, it is imperative to consult a licensed and professional service provider with a strong legal component. Ensure that you avoid finding yourself liable for a practitioner's negligence and do not fall prey to misleading advice. Remember, if the solution sounds too good to be true, it probably is.

Thomas Lobban, Reabetswe Maloi & Victoria Lancefield

Tax Consulting SA

Other documents

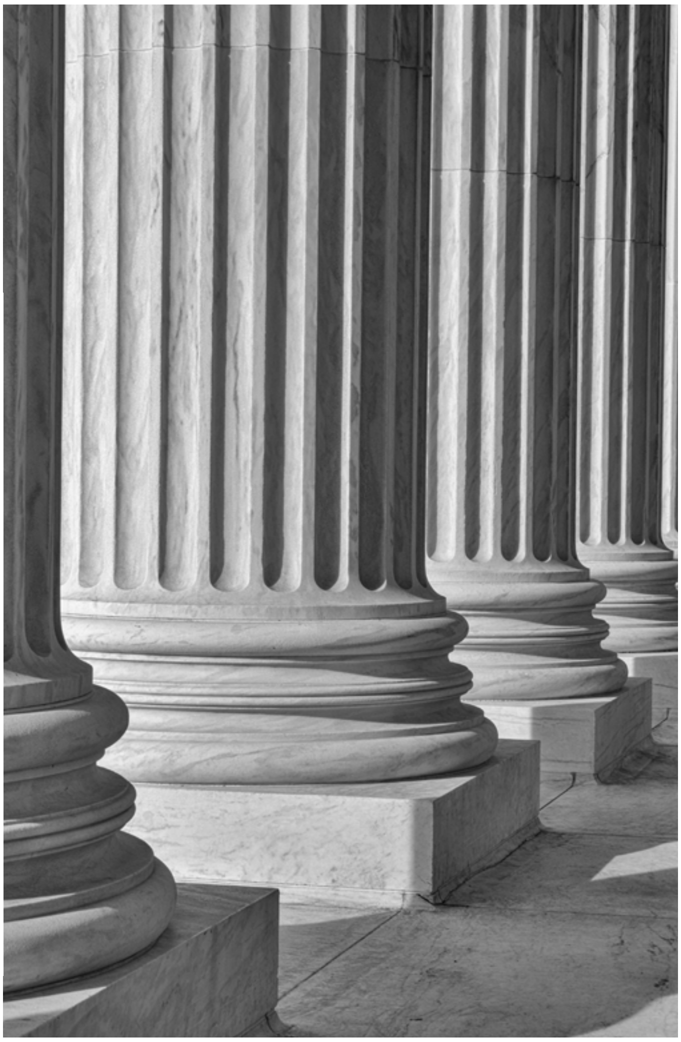
- Double tax agreements (DTAs).

Tags: Common Reporting Standards (CRS); Automatic Exchange of Information (AEOI); offshore income; tax residency status.

THE G7 FINANCE MINISTERS' GLOBAL TAX AGREEMENT – PILLARS 1 AND 2

As has been fairly widely reported with a great deal of fanfare on the international television news stations and also in the financial pages, early in June 2021 the G7 finance ministers came to what has been referred to variously as an historic or a seismic agreement on global tax reform.

This agreement is pursuant to the ongoing initiative of the Organisation for Economic Co-operation and Development (OECD) towards reforming the worldwide tax system and reducing tax avoidance and evasion. There have been a number of developments over the past few years, including the programme relating to base erosion and profit shifting (BEPS) and the various initiatives that accompany this; these decisions relate to what the OECD has called, Pillars One and Two.



PILLAR ONE

This initiative is aimed primarily at the very large tech companies operating in the digital economy. As we all know, it is relatively easy to locate one's business in a low-tax jurisdiction and provide services and products to customers located in high-tax jurisdictions without having any discernible presence in the latter, and therefore not paying tax in them.

In latter years this has caused a considerable amount of disgruntlement, including among the advanced economies of the world, such as in Western Europe, and some of them have gone so far as to introduce unilateral measures to extract some of the taxes in these circumstances, such as the digital services tax in the UK.

The agreement now reached should, in principle at any rate, eliminate the need for such unilateral action, and its focus is to ensure that these companies do not merely pay tax where they are resident and have their head office, but also pay tax in the countries where they operate and from whose residents and citizens they derive their profits.

The proposed rules will take the following form:

- They will apply to global groups with a profit margin of at least 10%.
- 20% of any profit above that 10% margin will be reallocated to the countries in which that company operates, and be subject to tax in those countries.

PILLAR TWO

Under this proposal every country in the world will have to have a corporation tax of at least 15%.

This will clearly not go down well with a number of offshore jurisdictions where the tax rate is zero, including jurisdictions such as in the Channel Islands, Isle of Man, Liechtenstein, Cayman Islands, Seychelles, and many others.

On the other hand, having a headline rate of 15% is one thing; however, having an effective tax rate of 15% is another story altogether. And it does not take too much imagination to introduce provisions into one's tax laws that have the effect of reducing the headline rate of 15% to an effective rate of a couple of per cent.

"One can debate the appropriateness or otherwise of Pillars One and Two having regard to the inequities in the world economy and having regard to other considerations, such as free trade and the like."

CONCLUSION

One can debate the appropriateness or otherwise of Pillars One and Two having regard to the inequities in the world economy and having regard to other considerations, such as free trade and the like. And one can debate whether these are populist moves or are seriously justified.

But whatever view one takes on the matter, it is clear that, in the case of both Pillar One and Pillar Two, this is just the beginning of a very long road. It is one thing to express a principle in a few lines, as appears above. It is altogether different to put in place a comprehensive set of rules, with all the checks and balances and all the measures to prevent loopholes, which can be adopted in a way that is sufficiently the same in each of the relevant countries, and which does not itself create tax competition among countries.

And then, of course, comes the challenge of ensuring that the offshore jurisdictions who introduce their minimum corporation tax of 15% do so in a way that meets a minimum standard of acceptability to the large economies of the world.

In light of the above, the question can be asked whether tax havens are dead. Well, maybe their death sentence has been pronounced in relation to their current form, but all one has to do is make oneself sufficiently more attractive, fiscally speaking, compared to another country such that there will be a significant saving of taxes, and one can continue to thrive in that sphere.

Ernest Mazansky

Werksmans

Tags: Organisation for Economic Co-operation and Development (OECD); base erosion and profit shifting (BEPS); low-tax jurisdictions; high-tax jurisdictions.

WITHHOLDING TAXES – SERVICES AND ROYALTIES

In this article, we discuss the differences between paying for services and paying for the use of intellectual property (IP). The latter is generally considered a royalty payment, which results in a very different transaction from a tax perspective. This is discussed from the South African (SA) context today, but the issue is relevant across the board.

For SA purposes, IP is any patent, design, trademark, copyright, property or right, or any knowledge connected to the use of such patent, design, trademark, copyright, property or right. Each of these types of IP is defined further in the relevant legislation.

Now, what is a service in the context of group companies? To prove that intercompany services have been provided, there should be an activity that provides one entity with some sort of economic or commercial value. It could be something that either the entity would have to perform itself or that they would pay for externally. It should be beneficial; typically, in a group context, we deal with management, administrative, and technical services.

SO WHY IS THERE CONFUSION?

Often the provision of services involves the use of IP, hence a payment purportedly for services rendered may actually be a royalty "in disguise". Take for example, a payment to a Microsoft systems engineer for resolving problems in respect of Windows. Although you are seemingly paying the engineer for her services, it could be argued that you are actually paying for the use of knowledge connected to the Microsoft patents, designs, and trademarks. It can be very hard to distinguish between the two.

WHY IS THIS IMPORTANT?

The difference between the two has significant tax consequences when the payment is cross-border, mainly because of withholding taxes.

SA imposes a 15% withholding tax (WHT) on royalty payments made to a non-resident. Unlike other African countries, SA levies nothing on payments for services rendered by a non-resident. African countries, however, often have a lower WHT on royalties payments than their payments for services.

"It is always necessary to perform a detailed analysis of whether any IP or intangibles have been or will be developed in your business or whether simply services are being provided."

In SA, the royalty WHT applies to royalties from an SA source. Royalties are regarded as arising from an SA source if:

- An SA tax resident is the user of the IP regardless of where in the world it is used; or
- IP is used in SA regardless of whether the user is an SA tax resident or not.

The royalty must be withheld by the user of the IP and paid over to the South African Revenue Service (SARS). The applicable double taxation agreement (DTA) should always be consulted to confirm whether the WHT rate can be reduced.

The good news is that royalty payments are deductible for SA tax purposes.

TRANSFER PRICING ROYALTY ISSUES

It is important to note that if IP is held by a person connected to you, the amount of the royalty must be determined on an arm's length basis for SA transfer pricing purposes.

The pricing of royalties and IP transactions in general is a highly complex area, particularly from a transfer pricing perspective. To establish an arm's length royalty, the Organisation for Economic Co-operation and Development has produced many hundreds of pages of scintillating documents. One of these is how to ascertain where value lies by using the so-called DEMPE concept. This means looking at the location for each composite part of the IP value chain as follows: **d**evelopment, **e**nhancement, **m**aintenance, **p**rotection, and **e**xploitation of the IP.

DON'T FORGET ROYALTY EXCHANGE CONTROL

Exchange control approval is generally required for both overseas service payments and royalties, but the latter is usually much more cumbersome.

It is important to know and decide where IP is being maintained and developed. IP must be registered with the SA Reserve Bank for regulatory reasons. Exchange control approval is generally required to transfer IP offshore. Obtaining exchange control approval for the transfer of IP is a time-consuming and complex procedure. Hence, if it is intended for IP to be moved offshore at any stage, we recommend that exchange control approval should be obtained at the beginning of the process.

CONCLUSION

It is always necessary to perform a detailed analysis of whether any IP or intangibles have been or will be developed in your business or whether simply services are being provided. You should also consider who would own such intangibles and who would be compensated for the creation of value for such intangibles.

It is recommended that experts or specialists be consulted for advice if you have any uncertainty or questions about this issue.

Kate James & Caoilfhionn van der Walt

Regan van Rooy

Acts and Bills

- Patents Act 57 of 1978: Section 2(1) (definition of "patent");
- Copyright Act 98 of 1978: Section 1(1) (definition of "copyright");
- Trade Marks Act 194 of 1993: Section 2(1) (definition of "trade mark");
- Designs Act 195 of 1993: Section 1(1) (definition of "design").

Tags: withholding tax (WHT); double taxation agreement (DTA); arm's length basis.

WITHHOLDING TAX IN AFRICA

One thing we know is that African tax authorities love withholding tax (WHT). In this article, we discuss how WHT comes about, why it can be particularly painful in Africa, and what you can consider to mitigate the tax consequences.

What is a WHT? Well, it is a tax on an income stream which the payer (ie, not the person earning the income) is obliged to collect and pay over to the revenue authorities of a country. It is paid on behalf of the recipient from which the tax is due. The payer effectively withholds the tax from the payment it owes to the recipient hence the name "withholding tax".

WHEN IS WHT APPLIED

WHT is generally applied by tax authorities in situations where the recipient has few ties to the country in which the income was earned. Generally, this is where the recipient is a non-resident. In such a case it is simply easier to make the resident payer responsible for the non-resident's fiscal obligations.

Historically, WHTs have been imposed on passive income streams, including dividends, royalties, and interest paid by residents to non-residents. More recently, however, and especially in African countries, it has become common to also levy WHT on payments for services rendered by non-residents to residents. In the investment context, non-resident companies that provide management and technical services to their African subsidiaries face WHT when they attempt to recover the costs of making these services available to the group entities. Generally, they are obliged to do this from a transfer pricing perspective.

SERVICES WHT

It is fair to say that these WHTs on service fees are anathema to international investors. What makes them worse than most other taxes is that they are imposed on the gross amount of an income stream as opposed to the net. In other words, expenses the investor incurs in generating the income stream from services it renders in the foreign country do not reduce the WHT imposed thereon. So, while a 20% tax on net income might be bearable, a 20% tax on gross turnover can have a huge impact. This is particularly true where margins are low, as they typically are on services.

In theory, relief from WHT on service fees is usually available under the terms of a double tax agreement (DTA), which is an international treaty. A DTA allocates taxing rights between countries and this prevents businesses residing in one country from being taxed again on the same income that was generated in another country. Most DTAs that are concluded worldwide follow, more or less, the wording of a model or pro forma tax treaty. Model DTAs are produced, for example by the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN Model).

OECD APPROACH TO WHT

The OECD Model DTA generally prevents a non-resident from being taxed on service fees that non-residents earn, (i) unless the non-resident has a fixed place of business (referred to as a permanent establishment) in the country where the services are being

> "The likely culprits of African countries that apply WHT on services in contravention of their DTAs include Botswana, Eswatini, Lesotho, Mozambique, Rwanda, Tanzania, Uganda, Zambia and Zimbabwe."

rendered and (ii) unless the service fees are attributable to that permanent establishment. Even if such a permanent establishment exists, a WHT will not be imposed. Instead, the permanent establishment will be taxed on the service fees earned by the non-resident as if it were a resident of the country. This is not as bad as a WHT because it means only the net amount of income earned by the non-resident from its services will be hit.

WHT IN AFRICA

However, many African countries either ignore this provision and levy WHT on services regardless, typically at high rates, or (less commonly but at least legitimately) apply the so-called UN Model Article 12A treatment. This is a principle from the UN Model Tax Convention that generally allows the country in which the payer is resident to impose WHT on service fees irrespective of whether a permanent establishment has been established.

In terms of relief for this foreign tax suffered on service fees earned, the recipients can generally claim double tax relief in their home country. However, countries often do not grant double tax relief where the WHT has been illegally imposed, ie, where WHT has been applied in contravention of the DTA. This happens very often in Africa where the relevant DTA follows the OECD Model and the payer's country had no taxing rights over the service fees paid to the non-resident. However, the taxation authorities impose WHT anyway.

In these instances, the tax credit can be denied to the recipient in his home country. Double tax is thus suffered. South Africa, for example, used to permit a limited tax credit where WHT was illegally levied; however, from 2016 onwards it became tired of giving double tax credit for the tax imposed in contravention of the DTA. This relief summarily fell away.

The likely culprits of African countries that apply WHT on services in contravention of their DTAs include Botswana, Eswatini, Lesotho, Mozambique, Rwanda, Tanzania, Uganda, Zambia and Zimbabwe. Practice does, however, change regularly.

FURTHER ISSUES

To make matters worse, many African countries seek to disallow service fee payments to connected persons for corporate tax deduction purposes. A growing number of African countries have blanket disallowances for connected person payments. This is a blatant abuse of transfer pricing provisions and can lead to a trifecta of tough tax impacts. An example is where WHT is levied in contravention of the applicable DTA on a payment that the payee is not permitted to deduct BUT where the recipient must pay corporate tax on the income in its home country AND is unable to claim double taxation relief.

The impact of such effective triple taxation can significantly alter the economics of doing business in a particular country.

INVESTING IN AFRICA

Under these circumstances, it should come as no surprise that investors are reluctant to put their resources into the African continent, as they may experience such punitive impacts. African Governments that apply WHT in contravention of their DTAs while also being overly aggressive in disallowing payments to a connected person are simply shooting themselves in the foot.

The African withholding tax framework is extremely complex. It is recommended that experts or specialists in this field be consulted if any uncertainty exists or if there are any queries in this regard.

Caoilfhionn van der Walt

Regan van Rooy

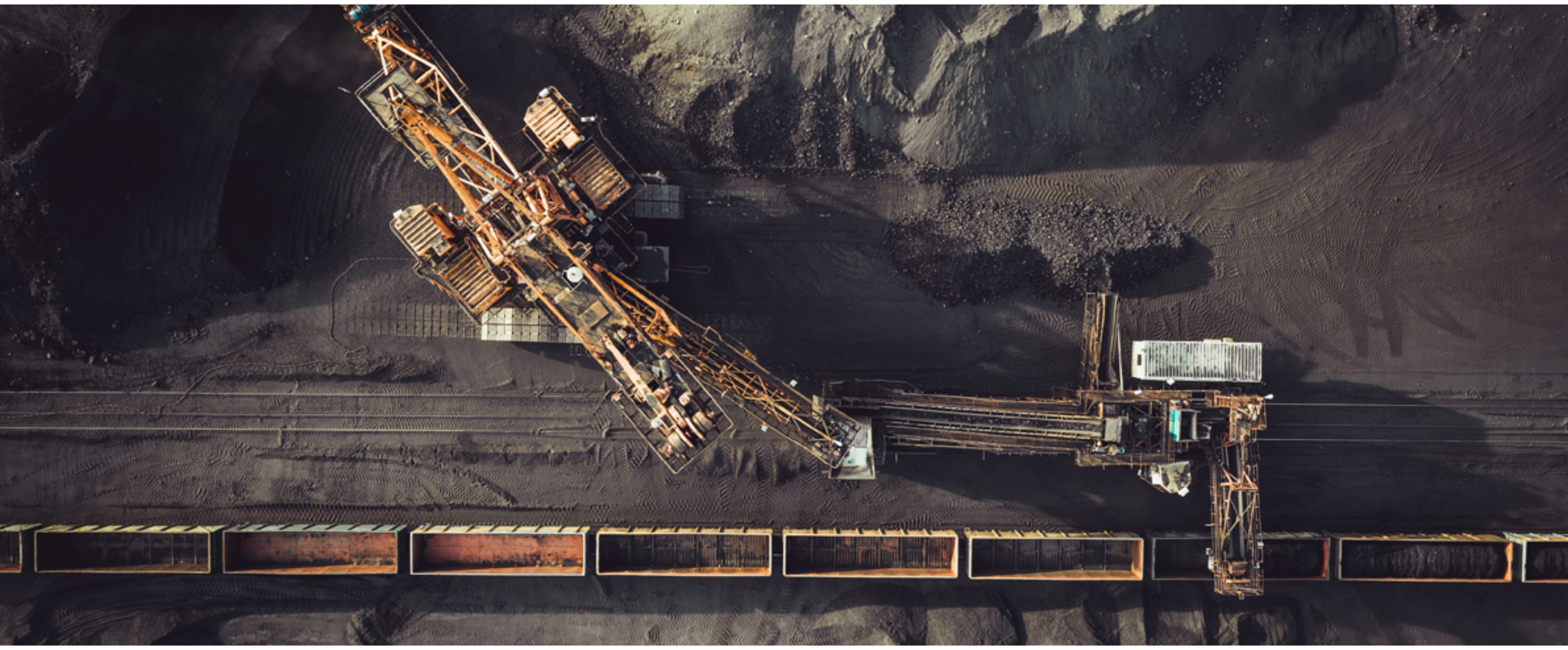
Other documents

- Organisation for Economic Cooperation and Development (OECD) Model Tax Convention;
- United Nations Model Tax Convention (UN Model): Article 12A.

Tags: withholding tax (WHT); double tax agreement (DTA); Organisation for Economic Co-operation and Development (OECD); UN Model Tax Convention.

AMENDING AN APPEAL TO THE TAX COURT

In DEF Mining (Pty) Ltd v the Commissioner for the South African Revenue Service, [2021] *(as yet unreported), the tax court dismissed an application brought by the applicant, DEF Mining, in terms of rule 35(2) of the tax court's dispute resolution rules to amend its statement of grounds of appeal under rule 32. These dispute resolution rules were promulgated under section 103 of the Tax Administration Act, 2011.*



In terms of rule 35, there are two ways in which the parties to a dispute can amend a statement. Rule 35(1) enables parties to agree to an amendment, or, where there is no agreement, rule 35(2) allows them to apply to the tax court for an order in terms of rule 52. Under rule 52(7), this includes an order concerning the postponement of the hearing.

A court has the discretion whether or not to allow an amendment and will usually allow it in instances where –

- the party seeking the amendment can prove that the amendment will not prejudice the other party;
- the amendment is made in good faith; and
- granting the amendment will ensure that justice is done in deciding the real issues between the parties.

As the tax court's dispute resolution rules do not specifically outline the procedural steps to follow when seeking to amend a statement, rule 42(1) must be considered. Rule 42(1) provides that –

> "[if] these rules do not provide for a procedure in the tax court, then the most appropriate rule under the Rules for the High Court ... may be utilised by a party or the tax court".

In this regard, rule 28 of the Uniform Rules of Court becomes relevant as it deals with the amendment of pleadings and documents, and outlines the procedure to follow.

BACKGROUND

Two weeks before trial, DEF Mining provided the respondent, the Commissioner for the South African Revenue Service (SARS), with notice to amend its rule 32 statement. The notice to amend was brought in terms of the approach outlined above. Accordingly, DEF Mining sought to –

- present as an additional ground of appeal, the deductibility of its qualifying expenditure in terms of section 11*(a)* of the Income Tax Act, 1962 (the Act), for the 2013, 2014, and 2015 years of assessment from income derived by DEF Mining from its mining operations;

- attach as an annexure to its rule 32 statement, a document which reflected the classification of its expenditure during the relevant years of assessment; and

- provide a summary of its arguments in relation to the section 11*(a)* issue.

SARS opposed the application, alleging that DEF Mining had abandoned the section 11*(a)* issue by not including it as part of its appeal and having admitted to SARS' finding in relation to this ground at the objection stage. Moreover, the contents of the annexure which DEF Mining sought to attach were inconsistent with the documents provided to SARS, as the amounts claimed had not all been included during the objection.

In considering the position in relation to amendments, the court referred to *Caxton Ltd v Reeva Forman (Pty) Ltd and Another*, [1990], in which it was held that the court has the discretion to allow or deny an application to amend an appeal, with due regard to certain fundamental principles. In *Ciba-Geigy (Pty) Ltd v Lushof Farms (Pty) Ltd en 'n Ander*, [2002], also referred to by the court, it was held that where a party seeks an amendment at an advanced stage of the proceedings (much like in this case), that party would be required to provide reasons for the delay. In this instance, the considerations that would apply included DEF Mining being required to –

- prove that it did not delay its application after becoming aware of the evidentiary material upon which it intended to rely;

- provide an explanation of the reason for the amendment; and

- show *prima facie* that it had a triable issue (ie, a dispute that would be relevant if proved by DEF Mining in its application).

FIRST GROUND OF AMENDMENT

DEF Mining had previously raised the section 11*(a)* issue as a ground of objection but did not include it as part of its grounds of appeal. According to DEF Mining, the reason for the omission was that it relied on advice from its professional advisors at the objection stage that SARS' decision to disallow this ground of objection appeared to be correct. Thereafter, and on that basis, DEF Mining admitted SARS' finding and confirmed that it would not base its deduction on the provision. As a result, the appeal proceeded on the issues which remained between the parties.

DEF Mining further alleged that it had subsequently received contrary advice that its expenditure for the relevant years of assessment qualified to be deducted under section 11*(a)*, which motivated DEF Mining to bring the notice of amendment and thus revive the section 11*(a)* issue. In addressing SARS' arguments, DEF Mining submitted that although the section 11*(a)* issue effectively amounted to a new ground, because SARS had considered this ground at the objection stage, its introduction in the appeal would not cause prejudice to SARS. In addition, DEF Mining submitted that its decision not to pursue the ground at the first instance did not amount to an abandonment of the section 11*(a)* issue in the appeal.

The question therefore became whether DEF Mining's decision not to pursue the issue amounted to an abandonment and whether it could withdraw the admission previously made to SARS in the latter's decision to disallow the ground at the objection stage.

In relation to the abandonment issue, the tax court held that as a result of its decision not to include the section 11*(a)* issue in its rule 32 statement, DEF Mining had created the impression that it would waive its right to raise the issue in the appeal. This is especially the case since DEF Mining had previously admitted that SARS' finding in relation to the issue was correct (ie, that the expenditure was capital in nature and did not qualify for deduction under section 11*(a)*).

In this regard, the court referred to *Amod v South African Mutual Fire & General Insurance Co Ltd*, [1971], in which it was held that in the case of an amendment involving a withdrawal of an admission, the court has a discretion to grant or refuse an application for the amendment of a pleading, but will require a reasonable explanation of the circumstances under which the admission was made and the reasons why it is sought to be withdrawn. The court concluded that DEF Mining had failed to explain the circumstances under which the admission was made to SARS and the reasons why it sought to withdraw the admission.

SECOND AND THIRD GROUNDS OF AMENDMENT

The court considered whether DEF Mining could include the document reflecting the classification of its expenditure during the relevant years of assessment, which it sought to attach as an annexure to its rule 32 statement, as well as the summary of its arguments in relation to the section 11*(a)* issue.

DEF Mining submitted that the new annexure differed from the annexures that related to the initial grounds of objection, on the basis that the new annexure included a classification of all expenditure incurred in the relevant years of assessment. Furthermore, the new annexure did not only apply to its argument in relation to the section 11*(a)* issue, but to the remaining issues in the appeal too. SARS, on the other hand, opposed the inclusion of the new annexure on the basis that it would have to consider expenditure with which it did not previously deal. It argued that DEF Mining had previously accepted that certain of the expenditure constituted capital expenditure, and DEF Mining had conceded that the contents of the new annexure and the initial annexures differed.

In considering these arguments, the court held that the difference in the annexures was an indication of prejudice to SARS as it would be required to deal with a case which had not previously been presented to it. In addition, the court could not find sufficient reason as to why the new annexure was not presented to SARS at an earlier stage. The court further referred to rule 7(2)*(b)* of the tax court's dispute resolution rules, which requires that a taxpayer lodging an objection to an assessment includes the documents required to substantiate the grounds of objection, and which the taxpayer had not previously delivered to SARS for purposes of the disputed assessment. On this basis, the court concluded that DEF Mining was not permitted to introduce the new annexure in terms of the tax court's dispute resolution rules.

In light of the above, the court refused to allow the application for amendment on all grounds.

COMMENT

A few lessons can be learned from this judgment. Firstly, taxpayers and their tax advisors must be cognisant of the opportunity afforded to them at the time of lodging an objection to an assessment to deliver documents substantiating the grounds of objection. Secondly, where a taxpayer seeks to introduce (at the appeal stage) documents that were not delivered at the objection stage but which were required to substantiate a ground of objection or appeal, the taxpayer may run the risk of not succeeding with an application to include these documents. The key issue is whether the introduction of the new documents could be seen as an attempt to introduce a new ground of appeal. Finally, where parties make an admission of fact, they must understand the consequences of the admission and how it may affect their case going forward, especially if they want to withdraw the admission at a later stage.

"The question therefore became whether DEF Mining's decision not to pursue the issue amounted to an abandonment and whether it could withdraw the admission previously made to SARS in the latter's decision to disallow the ground at the objection stage."

Ursula Diale-Ali

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 11*(a)*;
- Tax Administration Act 28 of 2011: Section 103.

Other documents

- Tax court's dispute resolution rules: Rules 7(2)*(b)*, 32, 35(2), 42(1) & 52 (specifically rule 52(7));
- Uniform Rules of Court: Rule 28.

Cases

- *DEF Mining (Pty) Ltd v the Commissioner for the South African Revenue Service* (IT24578) (27 January 2021) (as yet unreported);
- *Caxton Ltd v Reeva Forman (Pty) Ltd and Another* [1990] (3) SA 547 (A);
- *Ciba-Geigy (Pty) Ltd v Lushof Farms (Pty) Ltd en 'n Ander* [2002] (2) SA 447 (SCA);
- *Amod v South African Mutual Fire & General Insurance Co Ltd* [1971] (2) SA 611 (N).

Tags: dispute resolution rules; capital expenditure; disputed assessment.

ASSOCIATED ENTERPRISE RULES

Nowadays international tax and transfer pricing (TP) are largely synonymous terms, as the key tax focus is on what should be taxed where and why, ie, how revenues are allocated between group entities. This of course is the whole focus of the Pillar I of the Organisation for Economic Co-operation and Development (OECD) initiatives.

All TP says is that cross-border (although sometimes also domestic) transactions must be on arm's length terms. This is simple enough in theory. But what does arm's length mean, and what are connected persons? In this article we will focus on the latter question from the South African (SA) perspective. We often say that the "connected person" definition in section 1(1) of the Income Tax Act, 1962 (the Act), is very simple to understand 99% of the time; however, in complex situations, it can seem to be the trickiest section of the entire Act. And now it is getting worse…

In simple terms, for an individual, a connected person is any individual related, by marriage or by blood, to the third degree of consanguinity, which includes parents, children, grandparents, great-grandparents, siblings, nephews, nieces, uncles and aunts, and any trust of which the person, or anyone connected to him, is a beneficiary.

In respect of companies, two companies will be connected when they are part of the same group of companies as defined in the Act, except that the shareholding requirement in the definition of a "group of companies" in section 1(1) drops from 70% to 50%. So, the first step is to determine the appropriate definition of a "group of companies", and then to apply the 50% exception to that definition to determine whether or not one complies with the first test of the "connected person" definition.

The second test for a company in relation to another company is that company will be a connected person if at least 20% of the equity shares or voting rights in the company are held by that other company, and no shareholder holds the majority voting rights in the company. This seems straightforward to determine but, again, there are exceptions.

In terms of section 31(4) of the Act, for TP purposes, and transactions relating to intellectual property or financial assistance, the phrase "and no shareholder holds the majority voting rights in the company" in the section 1(1) definition of "connected person", should be disregarded. This has the effect of lowering the threshold of a connected person for purposes of specified TP provisions.

These two tests apply in circumstances where there is a direct shareholding.

The tricky part comes in when we look at options other than direct shareholding. Two companies will be connected to each other if both are managed or controlled by the same person. Also, if two connected persons control separate companies, those two companies will be connected. In practice, this requires careful analysis.

The final twist in this complicated situation is that the connected person test must be applied conversely. Therefore, if company B is a connected person in respect of company A, company A will automatically be a connected person in relation to company B. This sounds simple and logical, but it is quite different and difficult to test in complicated corporate transactions.

It is to be noted that, as with effect from 1 January 2022 "associated enterprises" will also fall within the scope of connected persons.

What is an associated enterprise?

The definition of "associated enterprise" in section 31(1) of the Act refers back to the definition from the OECD Model Tax Convention (the MTC). Most of SA's tax treaties are based on the MTC, which contains the OECD's interpretation of the application thereof. Article 9(1) of the MTC defines an associated enterprise as follows:

> "Where
>
> *a)* an enterprise of a Contracting State participates directly or indirectly in the management, control, or capital of an enterprise of the other Contracting State,
>
> or
>
> *b)* the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State."

The commentary on the articles of the MTC, states the following:

> "This Article deals with adjustments to profits that may be made for tax purposes where transactions have been entered into between associated enterprises (parent and subsidiary companies and companies under common control) on other than arm's length terms".

The 2017 OECD TP Guidelines confirm that two entities will be associated if one of the enterprises meets the conditions of Article 9(1)*(a)* or 9(1)*(b)* with respect to the other enterprise.

Under these conditions, two enterprises are associated if one of the enterprises participates directly or indirectly in the management, control, or capital of the other or if "the same persons participate directly or indirectly in the management, control, or capital" of both enterprises (ie, if both enterprises are under common control).

How to apply the definition

This is a simultaneously broad, yet vague definition which, in addition to the connected party definition, brings many entities into the TP net. Essentially though, the common control element

"To summarise, from the beginning of 2022, SA TP regulations will apply equally to associated enterprises and to connected persons."

is what is critical. There is further confusion arising in that the MTC commentary does not mention participation in capital, merely common control. Therefore, in the absence of any further commentary in any of the guidance upon which is relied, it is possible for tax authorities to argue that the breadth of cover is there in terms of an amount of capital being held to create an associated enterprise.

Perhaps you are asking yourself: if I hold shares in two companies in different countries, does that make both companies associated enterprises? Presumably, where there are minority holdings and, in particular, a dominant large shareholder, it would be assumed that the minority holder has minimal influence on the pricing, ie, there would be less of a risk that the two companies would be associated enterprises. However, if that shareholder has influence over the majority shareholder in any way, this may change that risk profile.

To summarise, from the beginning of 2022, SA TP regulations will apply equally to associated enterprises and to connected persons.

This means that you need to be aware of the tax consequences, and more specifically TP consequences of holding capital or controlling companies across a few jurisdictions. If you are concerned that this may apply to your business, it is recommended that assistance is sought from experts or specialists in this field.

Kate James & Vanessa Turnbull-Kemp

Regan van Rooy

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "connected person" & "group of companies"); 31(1) (definition of "associated enterprise") & 31(4) (definition of "connected person").

Other documents

- Pillar I of the Organisation for Economic Co-operation and Development (OECD) initiatives;
- OECD Model Tax Convention (the MTC): Article 9 (more specifically 9(1)(a) and 9(1)(b));
- 2017 OECD Transfer Pricing Guidelines.

Tags: connected person; associated enterprise; OECD Model Tax Convention.

DEREGISTRATION AND THE VAT EXIT CHARGE

The Value-Added Tax Act. 1991 (the VAT Act), requires persons carrying on an enterprise whose taxable supplies have exceeded or are expected to exceed R1 million in a period of 12 months to register as a vendor. A person may also voluntarily register if their supplies have exceeded R50 000 or are expected to exceed R50 000 in a 12-month period. A person may opt to voluntarily register for various reasons amongst them to secure the claiming of input VAT.

Where a person no longer meets the requirements for registration, the vendor may apply to SARS for deregistration. A person may also deregister if they cease to carry on an enterprise, in which case the vendor must advise SARS, who will cancel the vendor's registration. It is worth noting that on ceasing to be a vendor, the vendor will still be liable for all its VAT obligations that arose whilst he was still a vendor. Thus, deregistering as a vendor does not absolve one from obligations already incurred under the VAT Act.

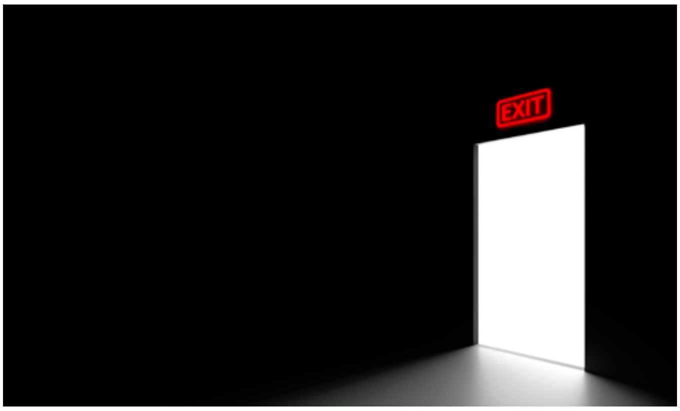
There are procedures that a vendor has to follow to deregister, including the completion and submission of the VAT 123e form to SARS. On deregistration as a vendor there are immediate VAT implications of which the vendor must be aware. The implications on deregistration are often overlooked, yet they could be significant depending on various factors such as the total amount of enterprise assets of the vendor, etc. Depending on the value of the enterprise assets of the vendor at the date of deregistration, the amount of output VAT to be accounted for and paid to SARS may be significant and may put a strain on the vendor's cash flow.

Section 8(2) of the VAT Act provides that where a person ceases to be a vendor, he is deemed to have made a supply of any goods and rights owned that formed part of his enterprise on the date of deregistration (subject to certain exceptions). That simply means if a vendor deregisters, he must account for output VAT on any goods or rights owned on date of deregistration. Output tax is accounted for at a rate of 15/115 on the lesser of:

- The VAT inclusive cost of all goods and rights owned; and
- The market value of all the goods and rights owned on the date that the person ceases to be a vendor.

The exit VAT charge is also applicable to creditors' balances that are less than 12 months old. On deregistration as a vendor, the vendor must account for output VAT on the amounts due to creditors on which he previously claimed input VAT within a period of 12 months before deregistration. The VAT on unpaid debts must be accounted for immediately before ceasing to be a vendor.

There is also a general provision applicable to all vendors and not only to those in the process of deregistration. This general provision requires a vendor to account for output VAT on the amounts due to creditors which are not paid within 12 months from date they become payable.



There is a minor relief but just in terms of payment date. The VAT payable on deregistration must be paid to SARS within 6 months of deregistration where a vendor deregisters solely because the total value of taxable supplies in the preceding 12 months did not exceed the voluntary registration threshold of R50 000 or the compulsory registration threshold of R1 million.

Vendors who wish to embark on the deregistration process should be aware and take note of the final VAT implications of such a step. The decision to deregister should not be taken lightly but a vendor must weigh the pros and cons of such action and make an informed decision. The timing of deregistration should also be properly planned in order to take into account the effect of the deregistration on cash flow, etc. It is also advisable to reduce or pay off the creditors before deregistration to avoid paying an exit charge on creditors balances. Therefore, proper planning should be undertaken before deregistration to avoid any surprises.

Memory Damba

PKF

Acts and Bills

- Value-Added Tax Act 89 of 1991: Section 8(2).

Other documents

- VAT 123e form.

Tags: taxable supplies; enterprise assets; output VAT.