

25 November 2024

**To: The National Treasury**

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**The South African Revenue Service**

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SARS ([acollins@sars.gov.za](mailto:acollins@sars.gov.za))

**RE: ANNEXURE C PROPOSALS: SAIT CORPORATE TAX TECHNICAL WORK GROUP**

Dear Colleagues,

We attach the Annexure C proposals from the SAIT Corporate Tax Technical Work Group (the WG), as it pertains to technical proposals for possible inclusion in Annexure C of the 2025 Budget Review.

We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate. Please do not hesitate to contact us should you need further information.

Yours sincerely

**SAIT Corporate Tax Technical Work Group**

**Disclaimer**

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**Unless otherwise indicated, all references to sections of the Income Tax Act, No. 58 of 1962 (the Act)**

## **1. Amending the definition of “company” to include foreign hedge fund collective investment schemes (CIS), in addition to the existing categories of normal CIS and participation bond CIS.**

[Applicable provisions: Proviso (D) of section 9D(2)]

### **1.1. Background**

1.1.1. The Taxation Laws Amendment Bill, 2024 proposes to include a portfolio of a hedge fund collective investment scheme in para (e)(ii) of the definition of ‘company’ in s 1(1) of the ITA. The amendment comes into effect on the date of promulgation. However, no corresponding amendment is proposed to proviso (D) of s 9D(2).

### **1.2. The legal nature of the problem**

1.2.1. Proviso (D) of section 9D(2) prevents attribution, and states the following:

*(D) to the extent that the participation rights are held by a portfolio of a collective investment scheme in securities or a portfolio of a collective investment scheme in participation bonds that is a resident directly or indirectly in a scheme or arrangement contemplated in paragraph (e) (ii) of the definition of “company” in section 1; and:*

1.2.2. The result is that if a local hedge fund CIS invests in a para (e)(ii) entity, it could become a CFC, resulting in inconsistent treatment of hedge funds compared to other CISs.

1.2.3. The current provision requiring the amendment to take effect from the date of promulgation presents significant administrative challenges, as this date is arbitrary and does not align with standard tax reporting cycles. This creates potential confusion and inefficiencies in the application and compliance processes.

### **1.3. A detailed factual description**

1.3.1. Local CIS in hedge funds invests in offshore portfolio of a foreign CIS in hedge funds or any other type of portfolio. The effect may be to make the investment a CFC which may cause considerable administration. If a CIS and a participation bonds CIS are excluded, why not a hedge fund CIS?

### **1.4. The nature of the business / persons impacted**

1.4.1. Local hedge fund collective investment schemes with investments in a portfolio of a foreign hedge fund CIS.

### **1.5. Proposal**

1.5.1. It is administratively problematic to make such an amendment effective from the date of promulgation, which is an arbitrary date. A more practical solution would

be to align the amendment with the commencement of future years of assessment, starting from a clearly defined and specified date. This approach would ensure better alignment with existing fiscal and administrative practices, facilitating smoother implementation.

## 2. Clarification on policy rationale of excluding controlled foreign companies (CFC's) from the extraordinary dividend definition

[Applicable provisions: Paragraph 43A(1) of the Eighth Schedule to the Act]

### 2.1. The legal nature of the problem

2.1.1. In 2019, the definition of “extraordinary dividend” in paragraph 43A(1) of the Eighth Schedule was amended to exclude from its ambit in specie distributions received in terms of unbundling transactions and liquidation distributions involving resident companies (i.e. unbundling transactions contemplated in section 46(1)(a) and liquidation distributions contemplated in section 47(1)(a)). Thus, these types of distributions are disregarded when determining whether an extraordinary dividend accrued to or was received by the shareholder company.

2.1.2. The above relief was, however, not extended to foreign unbundlings and liquidations; that is, where a foreign company is unbundled or a foreign company makes a liquidation distribution, any foreign dividend received by the shareholder is not disregarded in determining whether an extraordinary dividend is received. There seems to be no policy rationale for this differential tax treatment, and it does seem anomalous that there should be this distinction drawn between domestic and foreign unbundlings/liquidations.

### 2.2. A detailed factual description

2.2.1. There may be a scenario where the following transaction steps are implemented and the provisions of paragraph 43A(2) will find application:

Step 1: Company B distributes its shares in Company C in terms of a section 46 “unbundling transaction”.

Step 2: Company A disposes of its shares in Company B to a third party.



2.2.2. Company A will be subject to the provisions of paragraph 43A if the dividend *in specie* from Company B constitutes an “extraordinary dividend” – the *in specie* dividend is not disregarded as the unbundling is not an unbundling transaction as defined in s46(1)(a).

- 2.2.3. This is a commercial transaction whereby a third party is interested in the business of Company B but is not interested in the business of Company C.
- 2.2.4. National Treasury, in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019, stated that the proviso to the “extraordinary dividend” definition was limited to transactions involving domestic unbundlings and domestic liquidation transactions. It is noted that in the facts above, Company B and Company A are both resident companies, yet the *in specie* dividend must be taken into account in determining whether Company A has received an extraordinary dividend due to Company C being a foreign company.

### **2.3. The nature of the business / persons impacted**

- 2.3.1. South African resident companies that hold controlled foreign companies.

### **2.4. Proposal**

- 2.4.1. We recommend that the proviso to the “extraordinary dividend” definition be amended to exclude from its scope *in specie* dividends received pursuant to both domestic and foreign unbundlings and liquidation distributions.

## **3. Consideration of the de-grouping charge**

[Applicable provisions: Section 45(4)(B) of the Act]

### **3.1. The legal nature of the problem**

- 3.1.1. The provisions of section 45(4)(b) of the Act are too broad in their application and can result in a de-grouping charge being triggered in situations where a company that was not originally part of the group of companies required to qualify for the relief, ceases to form part of the same group of companies.
- 3.1.2. It was stated in Annexure C of the 2024 budget:

*“ It is proposed that the scope of the de-grouping charge be narrowed to avoid the de-grouping charge being triggered when there is a change in shareholding affecting a group of companies, while the companies involved in the original intra-group transaction are still part of another group of companies.”*

### **3.2. A detailed factual description**

- 3.2.1. Company A holds 100% of the equity shares in Company B and Company B holds 100% of the equity shares in Company C. The shareholders of Company A are D (holding 55% of the equity shares) and E (holding 45% of the equity shares).
- 3.2.2. In FY01 Company C disposes of a part of its business as a going concern to Company B in terms of section 45 of the Income Tax Act. In FY01, D and E dispose of their shares in Company A for Company F with the result that Company F holds 100% of the equity shares in Company A.
- 3.2.3. In FY04 Company F sells all its shares in Company A to an independent third party outside of roll-over relief i.e., tax is triggered. In this example, the transferee (Company C) ceases to form part of the same group of companies as Company F (a controlling group company in relation to Company C) and the de-grouping

charge is triggered in Company B.

- 3.2.4. The latter position is not equitable as the relief in terms of section 45 of the Income Tax Act would have been granted originally notwithstanding the fact that Company F ceased to form part of the group i.e. All that was required for section 45 to apply was the existence of a group in the form of Company B and Company C.

### **3.3. The nature of the business / persons impacted**

- 3.3.1. This provision has a negative impact on any group where there are new entrants after the original section 45 transaction and these entrants are considered as controlling companies in relation to a transferor company in the original section 45 transaction.

### **3.4. Proposal**

- 3.4.1. Consideration to be given to removing the strict reference to a controlling group company in general terms and referring, instead to any controlling group company in relation to the transferor company at the time of entering into the section 45 transaction.
- 3.4.2. The latter amendment and any risk associated with this is protected by subsection (3A) and subsection (4B).

## **4. Reduction of 6 year timeframe in respect of the de-grouping charge**

[Applicable provision: Sections 45(4)(b) and (bA)]

### **4.1. Legal nature of the problem**

- 4.1.1. The provisions of section 45(4)(b) and (bA) of the Income Tax Act contain the anti-avoidance measures whereby 2 companies enter into an intra group transaction and cease to form part of the same group of companies ("de-grouping charge") within a period of 6 years. We agree with the policy rationale that the "roll-over" relief should be triggered on de-grouping as that was the basis upon which the relief was granted concern is raised as to the significant period of 6 years being impractical.

### **4.2. A detailed factual description**

- 4.2.1. Whilst a period of 6 years may have been reasonable upon the introduction of section 45 on 6 November 2002, we must take cognizance of the rapid pace in which the corporate environment has changed in the last 2 decades.
- 4.2.2. Mergers and acquisitions which generally took years to negotiate in the early 2000s due to directors, lawyers and business advisers having to travel across the country or world to attend multiple meetings to negotiate the deal and again to sign the relevant documents to "close a deal" no longer do business this way.
- 4.2.3. Using technology, businesses are now able to do all/most of electronically, by way of virtual meetings etc, real time video streaming of the factories, work sites etc., and the ease of securely signing documents electronically without any travel and unnecessary delays.
- 4.2.4. The pace of business has increased rapidly over recent years whereby deals can

be negotiated and closed within a year or 2, or even quicker. Hence it is difficult for taxpayers to practically use the relief provided in this provision due to the de-grouping charge being 6 years. Business owners and management are unable to determine how the business dynamics or economic environment may change in the next 3 to 6 years and accordingly are unable to utilise this provision due to the uncertainty of triggering the de-grouping charge.

### **4.3. The nature of the businesses impacted**

4.3.1. This provision affects all corporate taxpayers

### **4.4. Proposal**

4.4.1. The de-grouping charge to be reduced from 6 years to 3 years (36 months) which is more reasonable and practical given the current business environment corporates operate in which has evolved drastically in the last 2 decades. A 3 year de-group charge also aligns to the anti-avoidance provisions contained in sections 44(13) which deals with amalgamation transactions and 47(6) which deals with liquidation transactions, both of which are also included under the corporate restructure rules (sections 41 to 47).

## **5. Contributed tax capital restriction**

[Applicable provisions: Section 45(4)(B) of the Act]

### **5.1. The legal nature of the problem**

5.1.1. Section 8G of the Income Tax Act restricts the ability of a group of companies to step up their contributed tax capital to the market value of the shares in a subsidiary company by the transferor (a non-resident) transferring the shares in a transferee company (a resident) to a Newco (a resident) in return for shares. The latter (prior to section 8G) had the effect of establishing CTC equal to the market value of the shares in the transferee company to the Newco. The transferee company would then pay dividends to the Newco which would be tax exempt and dividends tax exempt and the Newco would return CTC to its shareholder (the non-resident) free of dividends tax or STC.

5.1.2. The wording of the provisions is too broad and has unintended consequences. It was stated in Annexure C of the 2024 budget:

*"The taxation consequences of this anti-avoidance measure may affect legitimate corporate finance practices and limit South Africa's attractiveness as an investment destination. Government proposes that further refinements be considered to minimise any inadvertent tax consequences."*

### **5.2. A detailed factual description**

5.2.1. For example, Company A (non-resident) holds 100% of the equity shares in Company B (a resident) and Company B in turn holds 70% of Company C a resident. Assume Company B has no CTC. If Company A were to subscribe for shares in Company B and Company B uses the funds derived on the subscription to acquire the 3% minority stake in Company C from a BEE shareholder, then no additional CTC will be established in Company B for the following reasons:

- Company B issues shares to a non-resident (Company A);
- After the transaction Company A and Company B form part of the same

- group of companies;
- The funds are used to acquire shares in another company (Company C) that forms part of the same group of companies as Company A.

### **5.3. The nature of the business / persons impacted**

5.3.1. Section 8G was not intended to catch the type of transaction as suggested above. The non-resident could have advanced a loan to Company B to acquire the shares in Company C. The repayment of the latter loan would not have attracted any tax and it is difficult to see why the creation of CTC in such a circumstance would not be allowed. The issue with loans is that the non-resident home country would more likely than not insist on interest being charged from a transfer pricing perspective and that will also result in additional costs for the South African subsidiary.

### **5.4. Proposal**

5.4.1. The legislation be amended to apply only to transactions that result in the transfer by the subscribing company (a non-resident company) of shares held within the group in a resident company (the target company) forming part of the same group of companies as the subscribing company to another resident company forming part of the same group of companies as the subscribing company, where shares are issued directly or indirectly to facilitate such a transaction.

5.4.2. The amendment should then ensure that normal financing transactions are not adversely impacted.

## **6. Clarification of Tax Implications for Distributions from South African Trusts to Non-Resident Beneficiaries under Section 7(8)**

### **6.1. Background and legal nature of the problem**

6.1.1. As it is now possible (for exchange control purposes) for a SA trust to distribute amounts to a non-resident trust the question arises whether such distribution could constitute a 'donation, settlement or other disposition' for purposes of section 7(8), with the result that income earned on the amount by the beneficiary could be attributed back to the local trust.

6.1.2. Such an outcome appears illogical but since section 56(1)(l) exempts from donations tax a donation 'if such property is disposed of under and in pursuance of any trust', the impression is created that a distribution could be viewed as a donation settlement or other disposition (a pure donation has to be gratuitous which is not the case with a distribution where there is an obligation on the trustees to distribute in circumstances set out in the trust deed, but a settlement or other disposition could be construed as qualifying.)

6.1.3. There appears to be confusion in the tax industry on this point.

### **6.2. Proposal**

6.2.1. A sub-section be added to section 7 to the effect that a distribution to a beneficiary from a trust in terms of a trust deed does not constitute a donation settlement or other disposition.

## 7. Reword of the carve out for hybrid-debt instruments

[Applicable provision: Section 8F(3)(f)]

### 7.1. Legal nature of the problem

7.1.1. Since initial introduction of this “carve out” contained in section 8F(3)(f) concerns have been raised as to the practical difficulty that “registered auditors” face in complying with this provision as it does not align with the auditing standards framework and IRBA has expressed their views that a registered auditor may be subject to a disciplinary hearing should such person issue the certificate required for this section to find application.

### 7.2. A detailed factual description

7.2.1. Whilst various requests were made to IRBA to assist proposing an alternative that would satisfy SARS and IRBA no progress has been made in this regard. Additionally with effect from 1 April 2023 IRBA is no longer a recognised controlling body with SARS in terms of section 240A of the Tax Administration Act.

7.2.2. However, the issue remains that should a registered auditor issue such a certificate in terms of the carve out contained in section 8F(3)(f), such tax practitioner/registered cannot be reported to IRBA as a recognised controlling body to administer disciplinary action. We therefore hold the view that the reference to the “registered auditor as contemplated in the Auditing Profession Act”, is superfluous from 1 April 2023 and results in the provision remaining impractical.

### 7.3. The nature of the businesses impacted

7.3.1. We note that the “carve-out” in terms of section 8F(3)(f) is not only applicable to entities that are subject to an audit hence the carve-out should apply to ALL corporate taxpayers in the event that a subordination agreement is entered into for the purposes of satisfying the going concern requirement as mentioned above.

### 7.4. Proposal

7.4.1. Based on the above we request that the legislation be reworded as follows:

**Insertion of a definition** under section 8F(1) for “subordination agreement” as follows:

*“**subordination agreement**’ means a written agreement that is entered into in relation to an instrument which agreement defers the obligation to pay an amount so owed on a date or dates falling within or subsequent to that year of assessment by reason of that obligation being conditional upon the market value of the assets of that company not being less than the amount of the liabilities of that company.”*

The proposed **reword of the carve out** for section 8F(3)(f) is as follows:

*“(f) that constitutes a hybrid debt instrument:*

- (i) solely in terms of paragraph (b) of the definition of hybrid debt instrument;*
- (ii) is subject to a subordination agreement; and*

- (iii) *the taxpayer was in possession of a written confirmation issued by an independent registered tax practitioner as defined in the Tax Administration Act, 2011 (Act No. 8 of- 2011), that –*
- (aa) was issued by no later than the date the annual financial statements in respect of that year of assessment were signed;*
  - (bb) confirms the existence and enforceability of the subordination agreement in relation to that year of assessment; and*
  - (cc) confirms that the subordination agreement came into existence subsequent to the end of that year of assessment or the end of any prior year of assessment.”*

End.