SAIT | Summit Place Business Park | Building 3, Ground Floor
221 Garsfontein Road | Menlyn | South Africa | 0081

www.thesait.org.za

31 August 2024

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS
299 Bronkhorst Street
Nieuw Muckleneuk
Pretoria
0181

Via email: National Treasury (2024AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2024: INTERNATIONAL BUSINESS TAX

Dear Colleagues,

We attach the comments from the SAIT International Business Tax Technical Work Group (**the WG**) on the proposals contained in the draft Taxation Laws Amendment Bill, 2024, as it pertains to International Business Tax and related matters.

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 International Tax Technical Work Group

All references to the legislation are to the Income Tax Act, No. 58 of 1962 (the Act), and proposals contained in the draft Taxation Laws Amendment Bill, 2024 (DTLAB).

1. Preamble

We have read and analysed the proposed amendments relating to:

- Clarifying Translation for Hyperinflationary Currencies;
- Clarifying the 18-Month Shareholding Period;
- Clarifying Foreign Tax Rebates on Capital Gains; and
- Aligning Section 6quat Rebate and CFC Income Rules.

We are not opposed to the proposed amendments and welcome the clarity and correction provided.

We proceed to set out below our commentary relating to the proposed amendments to section 24I of the Act.

2. Refining the definition of "exchange item" for determining exchange differences

[Applicable provision: Section 24I of the Act]

2.1 Government proposal

2.1.1 To address the tax leakage associated with financial arrangements that involve cross-currency swaps where interest payments and a principal amount in one currency are exchanged for principal amount and interest payments in a different currency, it proposed that the definition of "exchange item" be extended to include shares that are disclosed as financial assets for purposes of financial reporting in terms of IFRS.

2.2 WG response

2.2.1 The proposed amendment appears to align, to some extent, with the international hybrid treatment approach. The proposed amendment seemingly suggests treating "exchange items" as debt for foreign purposes, and similarly, as debt for exchange difference calculations domestically. The result of this: while exchange losses may be claimable as a deduction exchange gains would be taxable.

2.2.2 Unlike other countries, such as the USA, our domestic rules pertaining to hybrid instruments do not involve reclassification of the instrument from debt to equity or vice versa. Instead, we treat interest as a dividend or dividends as taxable income without changing the classification of the instrument itself.

2.2.3 Generally, where the South African specific anti-avoidance provisions, which deal with the equivalent of 'hybrid' type arrangements (such as those under sections 8E or 8EA) apply, one would still need to account for foreign exchange gains or losses. It seems logical that one should only need to account for current exchange gains or losses if the instruments are such that sections 8E or 8EA apply.

2.3 Proposal

2.3.1 Redeemable preference shares are treated as debt for accounting purposes, but this does not necessarily align with the income tax treatment. This discrepancy

highlights the need for consistency. Therefore, it is imperative to ensure that the application of sections 8E and 8EA remains consistent with their original intent. Although there might be justification for treating instruments differently in certain circumstances, it would pose a significant issue if the legislation were to abruptly categorise a wide array of instruments as hybrid without providing clear and substantiated justification.

2.3.2 In summary, maintaining consistency is crucial. Treating income from shares and debt instruments uniformly under the 24I rule should align with the principles set out in sections 8E, 8EA, 8F, and 8FA. We should address any inconsistencies to avoid disparate treatments for similar financial instruments.

2.3.3 Recommendation

2.3.3.1 Therefore, to maintain consistency, we recommend that the inclusion should apply only if sections 8E and 8EA are also relevant.

3. Reviewing the interaction of the set-off of assessed loss rules and rules on exchange differences on foreign exchange transactions

[Applicable provision: Section 24I of the Act]

3.1 Government proposal

3.1.1 It is proposed that the section 24I foreign exchange rules be amended to allow for the ring-fencing and carry-forward of foreign exchange losses incurred by a company during any year of assessment that it is not trading and for offsetting against foreign exchange gains in the current and future years of assessment.

3.2 WG response

3.2.1 The proposed amendment achieves its stated objective but goes far beyond that. It effectively limits the ability to offset exchange gains against losses in a normal trading environment. This proposed amendment effectively states that exchange losses can only be utilised if there are corresponding exchange gains to offset them. This approach is similar to the treatment of deductions for en commandite partnerships or mining, where losses are carried forward within the section itself and can only be deducted against future gains.

3.2.2 Thus, the proposed amendments permit the carry forward of exchange losses but restricts their use in the current year if there are no corresponding exchange gains to offset. This would pose no problem for non-trading companies that cannot utilise these losses within the current year. However, it presents a challenge for trading companies with net exchange losses but no assessed losses, as they are unable to offset these net exchange losses against ordinary income.

3.2.3 Furthermore, the proposed ring-fencing applies to both realised and unrealised gains and losses. Previously, submissions were put forward requesting and recommending that this ring-fencing treatment should be on a “per-exchange-item” basis. However, the present proposed amendment seems to suggest an approach contrary to our previous suggestions.

3.2.4 The proposed amendment should rather have considered treating non-trading companies separately within the 24I framework or, alternatively dealing with the

issue under section 20. Instead, the proposed amendment now seeks to apply broadly to most companies, which complicates the situation to address relatively minor issues specific to non-trading entities.

3.2.5 The objective of section 24I is to inter alia ensure that gains and losses on an exchange item are taxed such that over the entire holding period the overall gain or loss on the exchange item is recognised. However, as indicated above, the proposed amendment falls short of this objective and it appears to be a deviation from the original objective and may potentially lead to the taxation of unrealised gains even where there has been an overall loss on the exchange item.

3.2.6 Another point to consider in relation to the achievement of the stated objective (i.e with loan flow through entities) is the need for transitional provisions. For example, if a company had losses before the proposed amendment take effect, but starts making gains afterward, how will these previous losses be treated? Specifically, will the company be able to deduct its earlier net losses against future gains - the company could not utilise those losses before due to not being in trade? Essentially the transitional approach should ensure that companies can effectively manage and offset losses from before effective date of the proposed amendment against subsequent gains.

3.3 Proposal/Recommendation

3.3.1 The core issue appears to be in the legislative drafting, which fails to account for pre-existing losses associated with existing exchange items. Additionally, the provisions seem to apply over-broadly, affecting even trading companies, rather than providing only the intended concession. What was initially meant to be a concession has, in practice, become a penal provision.

3.3.2 We recommend that section 24I be left as is and that Section 20 be amended to refer to exchange losses per 24I, the assessed loss which arises pertaining to which, may then, without limitation, be carried forward despite no trade and set off only against future exchange gains as contemplated in section 24I. We note that a similar approach is already being taken in amending section 20 to deal with companies being wound up, so that a further concession along the lines mentioned above would be easy to introduce

4. Miscellaneous

4.1.1 We set out below drafting errors that appear to be typographical in nature for your attention:

"Section 24I(3)(b)(i) – any premium or like consideration received by, reduced by -," appears to be incorrect. The intention appears to be to reduce the premium received by premiums paid, but the current wording does not convey this accurately.

End.