2017

Draft Taxation Laws Amendment Bill and Draft Tax Administration Laws Amendment Bill

TAX ALERT

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2017 DRAFT TAXATION LAWS AMENDMENT BILL AND DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL

The 2017 draft Taxation Laws Amendment Bill (DTLAB) and draft Tax Administration Laws Amendment Bill (DTALAB) were released for comment on 19 July 2017. In our latest newsletter, we focus on some of the core amendments proposed in the draft legislation relating to direct and indirect taxes as well as tax administration.

Our previous Tax Alert considering the proposals announced in the 2017 Budget can be found here.

Brian Dennehy

BRIAN DENNEHY
Director, Head of Tax
Tel: +27 11 530 5998
E: brian.dennehy@webberwentzel.com

CORPORATE TAX

Debt-reductions
Authors: Brian Dennehy and Donald Fisher-Jeffes

Debt reductions - mining companies
Ordinarily, where funding which is subject to a debt reduction was used to fund expenditure incurred in respect of an allowance asset and any excess remains after applying paragraph 12A of the Eighth Schedule to reduce the base cost of the asset, the excess will be deemed, for the purposes of section 8(4)(a) of the Income Tax Act, 1962 (ITA) to be an income amount recovered or recouped for the year of assessment in which the debt is reduced.

Mining companies are afforded a 100% deduction for capital expenditure incurred, to the extent it is derived from mining operations. The result thereof is that mining companies are immediately subject to recoupment equal to the amount by which a debt was reduced, which places mining companies at a disadvantage when compared to other persons who are able, upon the reduction of debt, to first reduce the base cost of their allowance assets.

The DTLAB proposes that for any debt that was used to fund the capital expenditure of mining operations which is reduced, cancelled, waived, forgiven or discharged during a year of assessment be now used to first reduce the balance of any unredeemed capital expenditure, and the balance thereafter included in the gross income of the mining company in terms of paragraph (j) of the definition of 'gross income'.

Debt reductions - dormant companies
Paragraph 12A(6)(d) exempts debt from the waiver provisions in paragraph 12A to the extent such debt is reduced, cancelled, waived, forgiven or discharged between South African group companies. There is however no equivalent in section 19. This has led to numerous difficulties, in particular for cash-strapped companies wishing to wind up their operations, but who cannot afford to trigger and pay cash tax.
The DTLAB hence proposes that the ambit of the exemption in paragraph 12A(6)(d) be extended to section 19. Unfortunately, both the section 19 group exemption and the current paragraph 12A(6) exemption, which is not currently subject to limitation, are to be limited only to apply to scenarios where the debtor is a dormant group company, where such dormant group company has not traded or received assets or other amounts in the past three years. In addition, the exemption will not apply to debt which arose in respect of assets disposed of in terms of corporate rules.

Debt reductions - conversion of debt into equity
The underlying commercial purpose for converting the debt of financially distressed companies to equity in most instances is so that the financially distressed companies may be recapitalised and placed into a solvent position. Issuing shares for an amount payable in cash and setting off the subscription price owed by the subscriber against an amount owed by the company has become one of a number of fairly common mechanisms for settling existing loans in a tax efficient manner, without triggering any debt reduction rules. Such arrangements have even been recognised by SARS, in certain instances, as a valid means of settling a debt (see SARS Interpretation Note 91). Concern has however been raised about the abuse of such capitalisations of debt, given that deductions may have been claimed by the debtor company, without the creditor in all instances including such amounts in its income.

As such, the DTLAB proposes that intra-group debt which is exchanged or converted into shares be 'carved out' of section 19 and that no recoupments arise under such scenario, provided that:

- the creditor and the debtor be required to continue to form part of that same group of companies for at least five years from the date of conversion, otherwise a deemed reduction will be triggered;
- interest previously deducted by the debtor should be treated as a recoupment in the hands of the debtor to the extent the interest was not subject to normal tax in the hands of the lender; and
- any recoupment must first be used to reduce any assessed loss of that debtor company in the year of assessment that the debt to equity conversion takes place. A third of any balance exceeding that assessed loss must be treated as a recoupment in each of the three immediately succeeding years of assessment.

The proposed amendments will come into effect on 1 January 2018.

Share buy-backs and dividend stripping
Authors: Graham Viljoen and Donald Fisher-Jeffes

In the 2017 Budget, delivered by the Minister of Finance, it was proposed that additional measures will be considered to circumvent transactions where investors choose to realise their share investments by means of having the shares they hold in a company bought back and characterised as a dividend, while being paid for by means of a new investor subscribing for shares in the same company. This followed on the back of a similar announcement in 2016, whereafter no specific countermeasures were introduced. The primary concern throughout this period being the structuring in and perceived abuse of the local resident company-to-company dividend exemption to facilitate tax neutral disposals of investments, without incurring either dividends tax or capital gains tax.

Further to the above, concern has been raised that the local resident company-to-company dividend exemption additionally presents taxpayers with arbitrage opportunities through dividend stripping. The arbitrage is achieved through the declaration of extraordinary pre-sale dividends to a resident shareholder, which are exempt from tax. The effect thereof is to reduce the capital gains proceeds, which would otherwise have arisen upon disposal of the shares. Section 22B and paragraph 43A of the Eighth Schedule were previously introduced into the ITA to mitigate this behaviour and already deem a pre-sale dividend to be as an amount of income or proceeds. These sections are however subject to a number of limitations, which focus on the manner in which the pre-sale dividends were funded, and in many instances these limitations are ineffective or circumnavigated.

To mitigate the perceived abuse of share buy-back schemes as well as the limitations of the dividend stripping rules, the DTLAB proposes that any dividends received within 18 months must be included in income; or included as proceeds for capital gains tax purposes, where a person disposes of shares in another company and that company held a ‘qualifying interest’ in that other company, with such qualifying interest being defined to mean a direct or indirect interest held by a company in another company, whether alone or together with any connected persons in relation to that company, that constitutes at least 50%of the equity shares or voting rights in that other company; or 20% of the equity shares or voting rights in that other company if no other person holds the majority of the equity shares or voting rights in that other company.

The amendments are currently very widely drafted and would appear to unintentionally deem a number of ordinary course transactions to be proceeds in the hands of the recipients.
For example, the redemption of preference shares held by large shareholders and the distribution of in specie distributions, which would have already been subject to capital gains tax in the hands of the company. The deeming provisions also currently apply to shares and not only equity shares, as would be anticipated, which stretches its application far beyond the mischief which the legislation is intended to curb. The section is deemed to have come into operation on 19 July 2017, and applies in respect of any disposal on or after that date. While we anticipate the wide ambit of the amendments to be refined and narrow, it is not anticipated that the date of operation will
be deferred.

Contributed Tax Capital (CTC) and its application in respect of non-resident shareholders
Author: Darren Roy

The DTLAB proposes a new section 8G in the ITA to address the abuse of the CTC provisions through certain structures where foreign shareholders increase their CTC and avoid dividends tax through capital distributions.

The CTC of a company is determined separately in relation to each class of share and equals the consideration received or accrued for the issue of such shares, less any determined returns of CTC by the company on or after 1 January 2011. Upon a distribution by a company, this will constitute a “dividend” unless the board of directors elects to return CTC in which case the distribution will represent a “return of capital” for tax purposes. This results in a reduction of the base cost of the relevant shares in the shareholders’ hands by the amount of the “return of capital”.

Two structures have been identified where the concept of CTC is exploited. The first involves a non-resident disposing of its shares in a South African subsidiary (SA SubCo) to a newly interposed South African company (SA HoldCo) in exchange for the issue of new shares by SA HoldCo. This could be done free of any tax (provided that the shares are not “land rich”), and results in the creation of CTC in SA HoldCo equal to the value to the SA SubCo shares acquired.

The second structure involves a non-resident subscribing for shares in a resident company (SA HoldCo) whereafter SA HoldCo applies the subscription proceeds to purchase the shares in SA SubCo from a disposing shareholder. The subscription by the non-resident creates CTC in SA HoldCo whereas a direct sale of shares from the disposing shareholder to the non-resident would not. In both instances, CTC could arguably be distributed to the non-resident shareholder in due course free of dividends tax. (It is useful to note that the Explanatory Memorandum states that the second structure envisages SA HoldCo applying the proceeds of the subscription made by a non-resident to repurchase shares in SA HoldCo. The wording in the proposed section does not seem to support this conclusion.)

An anti-avoidance measure has been proposed to deal with both structures, which adjusts the amount of CTC arising in SA HoldCo. More specifically, where the consideration received by a company (SA HoldCo) consists of, or is used directly or indirectly to acquire, shares in another company (SA SubCo) that forms part of the same "group of companies" as that company, the CTC in that company is deemed to equal the shareholder's previous share of CTC in the other company adjusted for the percentage shareholding in SA SubCo. (The percentage threshold for a "group of companies" in this provision is reduced to 50% as opposed to the 70% threshold which applies in the definition contained in section 1.)

This section is proposed to come into operation on 19 July 2017, and applies to any shares issued on or after that date.

Tax implications of the assumption of contingent liabilities under the corporate reorganisation rules
Authors: Bianca Bates, Kyle Beilings and Craig Miller

It is common practice in South Africa for companies to restructure their groups and businesses. To ensure that sections 41 to 47 of the ITA (Corporate Rules) are not misused when facilitating the sale or transfer of assets inside or outside of a group of companies, these rules prescribe the types of consideration to be received by the seller on the sale of its assets to the purchaser in order to qualify for the tax roll over relief contemplated by the Corporate Rules. Specifically relevant as a form of consideration, in this instance, is the assumption of debt. The Corporate Rules provide for tax roll over relief where the purchaser assumes debt from a particular company (being the seller), but only to the extent that the debt was:

- incurred more than 18 months before the disposal of an asset secured by such debt;
- if the debt was incurred within 18 months of the disposal of an asset secured by the debt, to the extent that such debt was used to refinance debt incurred more than 18 months before the disposal of that asset; or
- any debt that arose in the ordinary course of undertaking the relevant business.
 (collectively, the 18 Month Rules)

The 18 Month Rules set out above find its application in section 42 (which deals with "asset-for-share transactions"), section 44 (which deals with "amalgamation transactions") and section 47 (which deals with "transactions relating to liquidation, winding-up and deregistration").

In thinking about debt, and its potential different forms, there has always been uncertainty around the application of the Corporate Rules to contingent liabilities. According to the Explanatory Memorandum, the concept of "debt" for purposes of the Corporate Rules requires the seller to have an existing and real obligation to pay a third party and that third party must have a legal right to receive payment. As a result, given the uncertainty that a contingent liability may never materialise, it would differ from the notion of "debt". In SARS' Interpretation Note 94, published on 19 December 2016 (IN 94), although dealing only with the concept of free-standing contingent liabilities, IN 94 provided that contingent liabilities *"represent potential debt which may or may not arise depending on the occurrenceor non-occurrence of one or more uncertain future events".*

In addition, IN 94 confirmed that when transferring a business as a going concern, the assumption by the purchaser of free-standing contingent liabilities which are assumed as consideration, should form part of "debt" in terms of the 18 Month Rules.

The DTLAB proposes that a new definition of "debt" be inserted into section 41, which will include contingent liabilities, i.e. this will legislate the position noted in IN 94. The proposed amendment does not refer to the notion of "free-standing contingent liabilities" as is referenced in IN 94. The remaining requirements for the application of the 18 Month Rules will apply equally to contingent liabilities.

The proposed amendment will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2017.

Third-party backed shares: amendment of the provisions to cover certain qualifying purposes
Authors: Lisa Lumley, Kyle Beilings and Graham Viljoen

Section 8EA of the ITA contains certain anti-avoidance provisions that reclassify dividends as income where a preference share is subject to an "enforcement right" and / or "enforcement obligation". Where either an "enforcement right" and / or "enforcement obligation" is given by a third party, the dividend in respect of such preference share will be taxed as income in the hands of the holder unless:

- such preference share was issued for a "qualifying purpose" (simplistically, the direct or indirect acquisition of an equity share in an "operating company"); and
- the "enforcement right" and / or "enforcement obligation" is provided by a "permitted third party".

Permitted third parties include, *inter alia*, any person(s) that hold equity shares in the issuer of the preference share if (i) the issuer used the funds from the preference shares solely for the acquisition of equity shares in an "operating company", and (ii) the enforcement right or obligation is limited to that person's rights in and claims against that issuer.

As per the Explanatory Memorandum, the first requirement, namely "solely for the acquisition of equity shares" is overly restrictive and does not cater for situations where the cash raised from the issue of the preference share was used to refinance debt and / or other preference share funding that was used for a "qualifying purpose". The amendment therefore proposes deleting the reference to "solely for the acquisition of equity shares". This will allow for broader application where certain parties provide third party backing.

We welcome this amendment as it provides clarity on this particular point. However, as per the 2017 Budget, we understood that National Treasury and SARS were considering expanding the "qualifying purpose" definition as there are valid concerns that a "qualifying purpose" is too narrowly defined. Consequently, we recommend that the "qualifying purpose" definition be expanded to include the acquisition of income-producing assets and/or a business as a going concern.

This proposed amendment will come into operation on 1 January 2018, and will apply in respect of dividends received or accrued during years of assessment commencing on or after that date.

Securities and collateral lending arrangement extended
Authors: Shirleen Ritchie and Donald Fisher-Jeffes

Securities lending arrangement and collateral lending arrangement are defined for purposes of securities transfer tax and capital gains tax and provide relief in respect of the transfer of listed shares and listed South African government bonds, where such shares or bonds are returned to the borrower by the lender or to the lender by the borrower within a limited period of time.

National Treasury has recognised that the inclusion of foreign government listed bonds may mitigate and diversify risk as a necessary commercial purpose and that no reason for disparate treatment between South African government listed bonds and foreign listed government bonds exists. It is therefore proposed that the current definitions of securities and collateral lending arrangements be expanded to include foreign government listed bonds, subject to the remainder of the requirements. Unlisted securities may still not be used as collateral or for security arrangements.

The proposed amendment will be effective from 1 January 2018, and will apply in respect of securities and collateral lending arrangements entered into on or after that date.

Adjustment to financial services
Author: Shirleen Ritchie

Alignment of section 24JB with IFRS 9
International Financial Reporting Standard 9 (IFRS 9), which deals with the disclosure of financial instruments, is effective for annual reporting periods beginning on or after 1 January 2018. IFRS 9 replaces International Accounting Standard 39 (IAS 39) and deals with three distinct topics, namely the classification and measurement of financial assets and financial liabilities, the general hedging of financial instruments and the impairment of financial instruments.
Section 24JB of the ITA in its current form allows a covered person to include in or deduct from income all amounts in respect of financial assets and financial liabilities that are recognised in profit or loss in the statement of comprehensive income for a particular year of assessment where such instruments are recognised at fair value in terms of IAS 39.

The Explanatory Memorandum highlights the following key differences between IAS 39 and IFRS 9:

- IFRS 9 only allows designation when it eliminates or significantly reduces an accounting mismatch;
- an amount of change in the fair value of a financial liability attributable to changes in the credit risk of that liability should be disclosed in the "other comprehensive income" statement; and
- on the commencement of the application of IFRS 9, certain financial instruments will be reclassified and adjustments will be reflected in the retained earnings as opposed to profit and loss.

The proposed amendment to section 24JB therefore includes an amendment to section 24JB(2) to include financial assets and financial liabilities in profit and loss where the asset or liability is measured at fair value, and to limit the excluded financial assets only to such assets as are held on capital account. Therefore, a specifically excluded asset that is held as trading stock will not be excluded.

The second proposed amendment introduces section 24JB(2A), which specifically includes in or deducts from income any realised gain or realised loss recognised in respect of a financial liability where the gain or loss is attributable to a change in the credit risk of that financial liability.

The third proposed amendment introduces the transitional tax treatment of financial assets and financial liabilities that will cease to be subject to tax in terms of section 24JB and allows a covered person to realise any inclusion in or loss deductible from income as if the asset was disposed of in the year of assessment immediately preceding the year of assessment in which IFRS 9 applies for an amount equal to the market value thereof.

It is proposed that the amendment will apply with effect from any year of assessment commencing on or after 1 January 2018.

Doubtful debt allowances for banks

Currently, banks are entitled to deduct an amount for doubtful debts as determined in accordance with a directive issued by SARS to the Banking Association of South Africa for purposes of section 11(j). The directive applies as long as IAS 39 applies to banks and seeks to align the tax treatment of doubtful debts with the accounting treatment thereof.

Given the revision of impairments as part of the introduction of IFRS 9 as it applies to banks, it is proposed that section 11(jA) be introduced in relation to covered persons as defined in section 24JB, limited to those persons that constitute banks as defined in the Banks Act, 1990, as per paragraph (c) of that definition. It is proposed that the deductible allowance be an amount equal to 25% of loss allowance relating to impairment as contemplated in IFRS 9, 85% of so much of that loss allowance relating to impairment as is equal to the amount that is in default (as determined by applying criteria in paragraph (a)(iii) to (vi) and (b) of the definition of default in Regulation 67 of the regulations to the Banks Act).

Any allowance deducted must be included in the income of the relevant covered person in the subsequent year of assessment. The proposed amendments to section 11(JA) and section 24JB apply with effect from years of assessment commencing on or after 1 January 2018.

Interaction between section 24JB and hybrid debt instruments clarified

In additional alignments with IFRS 9, an amendment has been proposed to section 24JB to clarify the interaction between sections 8F and 8FA, comprising the hybrid debt instrument reclassification provisions, and section 24JB as it relates to covered persons.

The amendment makes it clear that any deduction from income provided for in terms of section 24JB in respect of any financial instrument is subject to the provisions of section 8F and section 8FA. Therefore, to the extent that a covered person issues hybrid debt instruments, that covered person will also be precluded from claiming a deduction in respect of interest paid in respect of that instrument.

This amendment addresses the asymmetry that results from the application of section 24JB to covered persons, which allows a deduction in respect of the relevant financial instrument, and the tax treatment of the interest amount as a dividend in specie in the hands of the recipient. This amendment is specifically targeted at credit linked notes issued by covered persons where the note is dependent on the solvency of the bank. It is proposed that the amendment will apply with effect from any year of assessment commencing on or after 1 January 2018.

Amendments for long-term insurers

Author: Darren Roy

Amendments to the tax valuation method

In 2016, amendments were effected to section 29A of the ITA to cater for the tax treatment of long-term insurers as a result of the introduction of the Solvency Assessment and Management Framework and the new Insurance Act, 2016. These changes included, inter alia, the introduction of the definition of "adjusted IFRS value" and rules dealing with "phasing-in amounts".

There are certain aspects of the 2016 amendments which may cause confusion, and therefore the amendments in the DTLAB are intended to address these concerns.

The definition of "adjusted IFRS value" is inconsistent with regards to the treatment of negative liabilities (being the amount by which the expected present value of future premiums exceeds the expected present value of future claims and expenses). In this regard, the definition of "adjusted IFRS value" has been redrafted in the form of a formula which should make it easier to apply. It also allows for a deduction of negative liabilities, irrespective of whether they are disclosed as a reduction of liabilities or assets for IFRS purposes, and limits the "adjusted IFRS value" to zero, such that it cannot result in a net negative, after the following deductions: reinsurance amount, negative liabilities, phasing-in amount (where applicable) and deferred acquisition costs.

The current definition of "phasing-in amount" is not clear whether the reduction of negative liabilities by any negative liabilities recognised as an asset for IFRS purposes applies if the relevant fund is in a net liability or net asset position. The amendment to the definition clarifies that such reduction of negative liabilities is only applicable where the fund is in a net asset position.

The proposed amendments will come into operation on the date that the Insurance Act, 2016 comes into effect and will apply in respect of years of assessment ending on or after that date.

Amendments to the tax treatment of deferred acquisition costs

Deferred acquisition costs for long-term insurers consist of costs of policies such as commissions which are deferred and only paid at a later date. For example, most insurers only pay such costs when the policyholder pays the first year premium. For accounting purposes such costs are deferred and amortised over a specified period. Currently, section 29A does not prescribe the tax treatment of deferred acquisition costs which has resulted in different interpretations and practices in dealing with such costs for tax purposes.

The DTLAB clarifies the tax treatment of deferred acquisition costs and proposes that (i) the deferred acquisition costs recognised as assets for financial reporting purposes be disregarded as an asset for the purposes of section 29A, and (ii) the deferred acquisition costs should be deducted against the amount of liabilities for purposes of the amended definition of "adjusted IFRS value".

The proposed amendments will come into operation on the date that the Insurance Act, 2016 comes into effect and will apply in respect of years of assessment ending or after that date.

Additional relief for venture capital investors

Authors: Shirleen Ritchie and Donald Fisher-Jeffes

During 2008, an allowance was introduced to incentivise the investment in Venture Capital Companies (VCCs) as part of a regime to encourage the establishment and growth of small, medium and micro-enterprises. Although initial uptake of the regime was slow, amendments over the past few years have resulted in increased attention in the regime.

One of the main advantages of the regime to the investor is that the investor is entitled to a deduction in respect of the initial subscription consideration payable on subscription for VCC shares, subject to certain requirements and limitations. No recoupment of the deduction is required on disposal of the VCC shares by the investor if the shares are held for a period of at least 5 years. However, prior to disposal or as part of the disposal, the VCC may return "contributed tax capital" (generally similar to share capital) to an investor. The current wording of section 12J(9) in the ITA may trigger a recoupment of the deduction previously granted upon a return of contributed tax capital.

The DTLAB seeks to amend section 12J(9) to allow a return of contributed tax capital to an investor without triggering a recoupment, provided that the contributed tax capital is returned after a period of five years.

This is a welcome change and will provide VCC investors with additional flexibility to realise VCC investments. It is proposed that the amendment applies to years of assessment commencing on or after 1 January 2018.

Additional penalties for mining rehabilitation funds

Authors: Kagiso Sephesu, Nirvasha Singh and Joon Chong

Holders of mining rights have certain statutory obligations in terms of the Mineral and Petroleum Resource Development Act of 2002 (MPRDA) and the National Environmental Management Act of 1998 (NEMA) which compel them to make provision for closure rehabilitation.

Section 37A of the ITA allows mining companies to claim a deduction for income tax purposes for their contributions to trusts or companies to provide sufficient cash funds to meet such statutory obligations in the future.

Section 37A currently provides for the following penalties:

- should a rehabilitation fund hold impermissible investments, which are investments outside the prescribed list, the market value of those impermissible assets has to be included as taxable income by the mineral right holder or mining company; and

- should a rehabilitation fund make impermissible withdrawals from the fund, i.e. used for activities not related to rehabilitation or mine closure, the market value of those withdrawals will be included in the taxable income of the rehabilitation fund.

Further, should the Commissioner find that a rehabilitation fund has contravened section 37A, he may include an amount equal to twice the market value of all property held in the rehabilitation fund, in the rehabilitation fund's taxable income, and the amount that the mining company contributed to the rehabilitation fund, in the mining company's income.

In order to be more effective in preventing the withdrawal of funds which is used for purposes other than rehabilitation or mine closure, the DTLAB proposes harsher penalties in section 37A:

- if an impermissible investment is held by the rehabilitation fund, 40% of the market value of the said investment will be deemed to be the amount of tax payable by either the mineral right holder or the mining company;
- if an impermissible withdrawal has been made from the rehabilitation fund, then 40% of the market value of the said withdrawal will be deemed to be the amount of tax payable by the rehabilitation fund; and
- if it is found that there has been a contravention of section 37A, an additional 40% of twice the market value of all the property held by either the rehabilitation fund, the mineral right holder or the mining company shall be the normal tax payable.

Furthermore, with the aim of assisting SARS with verifying whether funds from the rehabilitation fund are withdrawn and utilised to fund activities strictly related to the rehabilitation or mine closure, the DTLAB proposes that the mining rehabilitation trust should provide the Director General of the National Treasury with the following information within three months after the end of any year of assessment:

- the total amount of contributions to the mining rehabilitation fund;
- the total amount of withdrawals from the mining rehabilitation fund; and
- the purpose for which the funds withdrawn were applied.

In addition, should the company or rehabilitation fund receive a request from the Director General of the National Treasury, the said company or fund is obliged to provide such information within seven days of receipt of the request.

As will be noted from the above proposals, the new proposed penalties in section 37A are very harsh and have the effect of immediate payments of tax when triggered.

The proposed amendment will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2017.

TAX ADMINISTRATION AND DISPUTE RESOLUTION

Expansion of banks' power to hold funds on suspicion of a tax offence
Author: Rudi Katzke

Section 190(5A) of the Tax Administration Act, 2011 (TAA) requires a bank to immediately report to SARS if it has a reasonable suspicion that the payment of an amount is related to a tax offence. Then, if instructed to do so by SARS, the bank must hold the funds for two business days pending an investigation by SARS, unless SARS or the High Court directs otherwise.

It appears that members of the financial sector were not satisfied that this provision enabled sufficiently prompt action in cases where a tax offence was suspected. Based on their lobbying efforts, the DTALAB accordingly proposes to do away with the requirement that the bank must first obtain SARS' permission to place the hold on such a transaction. The provision remains otherwise unchanged. The effect is that the funds in question will be secured (held) as soon as the bank reports the transaction to SARS, at which point the two business days will commence.

Whilst swift action is understandably ideal in a case where funds are truly related to a tax offence, banks should arguably be circumspect in exercising this expanded power, and should be certain that their suspicions in this regard are truly reasonable. If a banking client requires a *bona fide*, legitimate transaction to be carried out swiftly, particularly where large amounts are involved, a bank may foreseeably open itself up to liability and reputational damage if it places a hold on a transaction based on ultimately unjustified suspicions of a tax offence in motion.

SARS' goal to align all interest provisions: further or closer to the goal posts?
Authors: Rudi Katzke and Yashika Govind

Previous press releases issued by SARS have highlighted their intention of moving towards a modernised interest system, with the goal of aligning all the interest provisions in the various tax statutes under one section in the TAA. With the exception of certain sections in Chapter 12 of the TAA, the majority of that Chapter did not come into effect on 1 October 2012 along with the rest of this statute. As a result, the provisions of the other tax statutes regulating the accrual of interest remain in force until the President determines, by proclamation, the date when the relevant suspended provisions of Schedule 1 of the TAA will come into operation.

Currently, section 270(6E)(a) provides that until the whole of Chapter 12 and Schedule 1 to the TAA come into operation, interest on understatement penalties must be calculated in the manner in which additional tax is calculated in the relevant tax acts. In addition, section 270(6E)(b) read with section 187(3)(f) provides that interest on understatement penalties will be calculated from the effective date of the tax understated. The "effective date" is deemed to be the date on which the TAA came into operation (1 October 2012).

The DTALAB proposes to amend section 270(6E) to allow SARS to separately implement the interest provisions in respect of value-added tax, estate duty and transfer duty, in different phases. The proposed amendment provides that until the whole of Chapter 12 and Schedule 1 of the TAA come into operation, interest on understatement penalties "in respect of a tax type" will be calculated in the same way in which interest on additional tax penalty was calculated before the TAA was promulgated.

In line with the proposed amendments to section 270(6E), the DTALAB also proposes to amend section 272 of the TAA. The latter proposed amendment will permit the Minister of Finance to determine, by public notice, the date on which the interest provisions relating to a specific tax type will come into operation.

At face value, the proposed amendments above do not have any significant effect. Furthermore, the proposed amendments fail to deal with instances where SARS officials have attempted to levy interest in terms of section 89 quat of the ITA on understatement penalties imposed in terms of the TAA. Taxpayers should note that the definition of "normal tax" in section 89quat(2) of the ITA does not include understatement penalties imposed under the TAA. On a proper reading it is arguable that interest cannot be imposed on understatement penalties in terms of this provision.

Deemed accrual for interest due from SARS
Author: Joon Chong

Generally, amounts are included in a taxpayer's gross income on the earlier of receipt or accrual of such amounts. There have been certain instances in the ITA when it is necessary for this principle to be varied, such as when accounting for variable remuneration both for the employer and employee.

The DTLAB proposes to clarify another situation where the "earlier of receipt or accrual" basis could be impractical. A dispute may be settled or court judgement finalised in one year and the amounts due by SARS in the reduced assessment only paid in the next year of assessment.

An original assessment may also be corrected by SARS after the end of the relevant year of assessment through a reduced assessment. In both these instances, the date of receipt falls in a year of assessment after the year of accrual. It may also be difficult to determine with accuracy before the date of payment the correct amount of interest which is due by SARS. For example, when parties still need to finalise the quantification of amounts after a court has pronounced on a legal principle.

In terms of a new proposed section, section 7D in the ITA, (but see above, where the DTLAB similarly seeks to introduce a new section 7D), any interest payable by SARS is deemed to accrue to the recipient on the date of payment. The new section comes into operation on 1 January 2018 and will apply to any amounts of interest payable by SARS on or after that date.

Decisions by SARS that do not result in assessments
Author: Rudi Katzke

In Annexure C of the 2017 Budget review, the Minister of Finance stated the following under the heading "Tax Administration - Decisions by SARS"

"It is proposed that all decisions of SARS that are not subject to objection and appeal should be subject to the remedies under section 9 of the Tax Administration Act."

No further comments were provided in support of this proposal.

If a taxpayer is aggrieved by a SARS decision, and if the relevant requirements of the Promotion of Administrative Justice Act, 2000 (PAJA) are satisfied, the taxpayer may apply to the High Court for a review of that decision. One of the requirements under PAJA is that the applicant must first have exhausted all internal remedies under the relevant legislation.

Section 9 of the TAA basically provides that a taxpayer may request SARS to withdraw or amend any of its decisions, as long as the decision is not given effect to in an assessment. This is because a taxpayer may still counter an assessment by filing an objection, and if that is unsuccessful, by lodging an appeal to the tax board or tax court under the TAA.

But in some instances an assessment is not subject to objection or appeal. A taxpayer's only remedy to challenge such an assessment is to apply to the High Court for review under PAJA, because no further internal remedy exists. Examples of assessments that are not subject to objection or appeal are where SARS has issued an assessment based on an estimate (section 95 of the TAA), or where SARS has issued an altered assessment pursuant to settlement of a dispute with a taxpayer (section 150 of the TAA).

The DTALAB proposes that only assessments that are subject to objection and appeal (ie where an alternative internal remedy is still available) must be excluded from the operation of section 9.
The effect will be that a taxpayer who is aggrieved by an assessment that is not subject to objection and appeal, such as an altered assessment issued pursuant to settlement, may request SARS to withdraw or amend that assessment in terms of section 9. This change is to be welcomed as it will likely prevent some unnecessary review applications to the High Court, for instance where there is an obvious and easily rectifiable mistake. Even if the grievance is based on more technical grounds, the taxpayer may first apply for such an assessment to be withdrawn under section 9, with the hope of avoiding a costly High Court review application.

Donations to a public benefit organisation (PBO): Who qualifies for the section 18A deduction?
Authors: Rudi Katzke and Yashika Govind

The eligibility to issue tax deductible receipts is dependent on section 18A approval being granted by SARS' tax exemption unit (TEU), and is restricted to specific approved organisations which use the donations to fund specific approved public benefit activities. Currently, section 18A tax deductible status applies inter alia to certain "specialised agencies" defined in section 1 of the Diplomatic Immunities and Privileges Act, 2001 (DIPA). The definition of "specialised agencies" in section 1 of DIPA does not include the United Nations, a body which forms part of the South Africa United Nations Strategic Cooperation Framework 2013 to 2017.

The proposed amendment expands the application of section 18A, allowing tax deductions for tax deductible donations to be made to United Nations agencies operating in South Africa. The proposed amendment will take effect on the date of promulgation of the Taxation Laws Amendment Act, 2017.

PAYE on reimbursement of travel expenses greater than rate or distance set in Gazette
Authors: Nirvasha Singh and Kagiso Sephesu

Currently the reimbursement of a travel allowance is disregarded when calculating an individual's monthly employees' tax deduction.

The DTALAB proposes to amend paragraph (CA) of the definition of "remuneration" in the Fourth Schedule to simplify and facilitate the calculation and administration of employees' tax. The rate per kilometre published in the Government Gazette by the Minister of Finance should be used to determine the amount of remuneration, notwithstanding the actual distance travelled by the employee.

In addition, the proposed insertion of paragraph (cC) in the definition of "remuneration" has the effect that only that portion of the travel expenses which exceeds the published rate or distance should be regarded as remuneration when determining the monthly employees' tax deduction. Should an employer reimburse an employee at a higher rate than that the published rate, the excess will be regarded as remuneration and subject to employees' tax.

As of present date, the published rate per business kilometre using the simplified method for annual business distances of less than 8,000 kilometres is ZAR 3,29. The above amendments apply to the years of assessment commencing on or after 1 March 2018.

INTERNATIONAL TAX

Proposed amendments to the controlled foreign company (CFC) legislation

Authors: Leani Nortjé, Nola Brown and Anne Bennett

As foreshadowed in this year's Budget documentation, changes to the law have been proposed which are aimed at bringing into the South African tax net income derived by foreign companies held directly or indirectly by non-South African tax resident trusts or foundations with South African beneficiaries. The changes proposed are extremely broad in scope and, as a result, likely to be controversial. If implemented, the changes will have the effect of putting SA tax residents with indirect interests in foreign companies through trust structures in a worse tax position than they would have been in had they simply held the foreign shares directly.

The CFC rules in section 9D of the ITA, aimed at preventing South African tax residents from shifting income outside of the South African tax net into lower tax jurisdictions, apply where South African residents hold directly or indirectly more than 50% of the total "participation rights" or exercise more than 50% of the voting rights in a foreign company. "Participation rights" are defined as the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share or any interest of a similar nature in that company, or in the absence of this, the right to exercise any voting rights in that company.

In terms of the current definition of "participation rights", where a foreign discretionary (as opposed to vested) trust or a foundation is interposed between South African residents and a foreign company, that foreign company will typically not constitute a CFC even if the trust/ foundation meets the CFC participation or voting right threshold in the foreign company. This is because the South African resident beneficiaries have no "participation rights" in the foreign company of which the trust/foundation is a shareholder, but merely a spes or a hope which might never be realised that the trustees of the trust/foundation council will vest any income or capital that might be derived from the foreign company in them in the future. The South African resident beneficiaries also have no voting rights in such foreign company.

For some time now, Government has consequently been concerned that trusts or foundations may be deliberately interposed in offshore structures in order to avoid CFC implications. Various proposals have been made in the past to curb this perceived abuse, none of which have been successfully implemented to date.

The final report on Action 3 of the G20/OECD base erosion and profits shifting (BEPS) initiative (Designing Effective Controlled Foreign Company Rules) (Action 3), recommends the introduction of a broad definition of entities that fall within the scope of the CFC rules if these entities earn income that raise BEPS concerns. In addition, it also recommends that non-resident companies which are consolidated in the accounts of a resident company in terms of IFRS should be treated as CFCs. IFRS 10 requires certain companies that control one or more other entities to prepare consolidated financial statements. It defines the principle of control, and establishes control as the basis for consolidation. Control for these purposes will include rights that give the power to direct activities that significantly affect the subsidiary's returns.

As a result of Government's concerns and the recommendations of Action 3 as aforementioned, the following amendments to the CFC rules are being proposed in the DTLAB.

The definition of a CFC in section 9D(1) is to be broadened to deem a foreign company to be a CFC where one or more South African residents hold an interest in a non-resident trust or a foreign foundation and that trust or foundation directly or indirectly holds more than 50% of the total participation rights or voting rights in that foreign company. In addition, a foreign company will be a CFC where the financial results of that foreign company are reflected in the consolidated financial statements as contemplated in IFRS 10 of any company that is a South African tax resident.

To provide for imputation to SA tax resident companies, it is proposed that section 9D(2) be amended so that the percentage of the participation rights of a resident in relation to the CFC is deemed to be equal to the percentage of the financial results of that CFC reflected in the consolidated financial statements, as contemplated in IFRS 10, for the year of assessment of the resident holding company, as defined in the Companies Act.

Accordingly, it is the resident holding company that would need to include any CFC imputation in this regard in its taxable income, calculated on the basis of the "net income" of the foreign company, as determined in accordance with the provisions of section 9D.

Imputation to SA tax resident beneficiaries (other than companies) of foreign trusts or foundations is intended to be achieved by way of the introduction of a new section 25BC and not by expanding section 9D. Section 25BC provides that where any resident (other than a company) is a beneficiary of a non-resident trust or a foreign foundation and that trust or foundation holds a participation right as defined in section 9D(1) in a foreign company and that would have constituted a CFC had that trust or foundation been a resident, any amount received by or accrued to or in favour of that person during any year of assessment from that trust or foundation by reason of that person being a beneficiary of that trust or foundation must be included in the income of that person.

The use of the words "any amount" in section 25BC seems punitive as this prima facie suggests that all amounts vested in a resident beneficiary of a qualifying trust/foundation, whether or not derived from the applicable underlying foreign company, will be taxable as income in that beneficiary's hands. It also suggests that no matter how proportionately small any distribution to the SA tax resident beneficiary may be, relative to distributions to other beneficiaries, and despite the fact that the SA resident beneficiary may have no control of any kind over the foreign company, the SA resident beneficiary will be disadvantaged under the CFC rules. The breadth of the proposed provision means that it is likely to catch many structures which are in no way abusive or tax driven.

The reference to "any amount" also suggests that section 25BC will override section 25B(2A) which currently applies to exempt foreign dividend income in the hands of South African resident beneficiaries of an offshore trust if such dividend income is capitalised in the trust and only vested in the beneficiaries in a subsequent year of assessment.

The proposed amendments will come into effect on 1 January 2018, and apply in respect of years of assessment commencing on or after that date.

Domestic treasury management company criteria
Author: Sean Gilmour

A domestic treasury management company must meet certain residence requirements in order to qualify for a relaxation of the normal rules relating to the taxation of foreign currency gains and losses. The company in question must, in terms of the current definition, be incorporated in South Africa (or be deemed to be incorporated in South Africa) and have its place of effective management in South Africa.

The DTLAB proposes that the requirement that a domestic treasury management company be incorporated in South Africa (or be deemed to be incorporated in South Africa) be removed as a requirement for the company to qualify for the regime. If this change is enacted, a company will accordingly meet the residence requirement for a domestic treasury management company if its place of effective management is in South Africa (notwithstanding its place of incorporation).

This change is to be welcomed as it will provide more flexibility and should facilitate the use of existing foreign entities by South African based multinational groups for group treasury management purposes. It should be noted that if a taxpayer wishes to make use of an existing foreign incorporated company for this purpose, such a company will need to become South African tax resident. While a change in place of effective management is likely in practice, to be a far easier transition than a migration of legal residence, it could trigger tax consequences in the country where the company concerned is currently tax resident.

The change will be effective for years of assessment commencing on or after 1 January 2018.

Intellectual property refinements
Author: Sean Gilmour

The 2017 Budget announced that the regulatory framework regarding cross-border intellectual property transactions is to be relaxed, for both tax and exchange control purposes.

The framework in question comprises a series of anti-avoidance provisions which were introduced to prevent erosion of the South African tax base. The erosion of concern to National Treasury results from the assignment from South Africa of intellectual property developed in South Africa to foreign entities with a lower effective tax rate, followed by the licensing of that intellectual property back to fully taxable South African taxpayers. The royalties would in such a scenario remain fully deductible in South Africa but potentially subject to a low rate of tax in the jurisdiction in which the licensor is tax resident.

The current section 23I of the ITA essentially limits South African taxpayers from claiming a deduction for royalties paid to non-residents in respect of intellectual property which was originally developed in South Africa. The limitation does not apply to payments made to CFCs if the royalty income is fully imputed to a South African resident shareholder under the CFC provisions. The limitation which is in place is also dependent on whether the payment in question is subject to the withholding tax on royalties and if it is, at what rate.

The DTLAB notes concerns which arise as a result of the wide definition of "tainted intellectual property" and various interpretations of the term 'developed' in the context of "tainted intellectual property". These difficulties are noted as having a potential impact on South African based infrastructure in the context of local modifications or improvements of existing intellectual property that was not originally developed by a South African taxpayer. Section 23I may apply in a scenario in which a South African company acquires an intellectual property rich foreign subsidiary and uses South African based expertise within the group to further enhance the intellectual property.

The DTLAB proposes an exemption from the deductibility limitations and will apply if the payments are made to a CFC which is resident in a 'high tax' jurisdiction. The CFC in question must be subject to an aggregate amount of foreign tax which is at least 75 per cent of the amount which would have been payable had the CFC been tax resident in South Africa.

The relevant definition of "tainted intellectual property" which remains unchanged is still very complex and somewhat difficult to interpret, and some refinement or clarification of this would have been welcomed. That being said, the relaxation effectively renders the provisions academic when transacting with a CFC in a high-tax jurisdiction and multinationals with operations in such jurisdictions will benefit from the proposed change.

The amendment is to come into operation on 1 January 2018 and will apply in respect of years of assessment commencing on or after that date.

INDIVIDUALS AND TRUSTS

Repeal of foreign employment income exemption
Author: Nola Brown

It has been proposed that, from 1 March 2019, all South African individual tax residents will be subject to South African income tax on foreign employment income earned in respect of services rendered outside South Africa. Currently, South African tax residents who are outside South Africa rendering services for their employer for a period exceeding 183 days (60 days of which must be continuous) during any period of 12 months, enjoy an exemption from South African income on their foreign employment income (section 10(1)(o)(ii) exemption in the ITA).

However, National Treasury is of the view that this exemption creates opportunities for double non-taxation in cases where the foreign host country does not tax the individual, or it taxes the individual at a significantly reduced rate. An additional reason given by National Treasury for repealing the exemption is that government employees who work outside South Africa do not qualify for the exemption.

In the Budget earlier this year, it was indicated that the exemption would be adjusted, so that the foreign employment income would only be exempt from tax if the income was subject to tax in the foreign country. However, National Treasury has gone a step further and proposed to remove the exemption completely. Any foreign taxes suffered by the employee would be creditable against the South African tax due on the employee's foreign income, provided certain requirements are met, for example, proof of the foreign taxes suffered must be available.

Retirement fund contribution deductions are further harmonised
Author: Joon Chong

The wider retirement reform objectives were harmonised across all retirement funds when section 11(K) of the ITA was replaced with effect from 1 March 2016. From that date, the same deduction regime applies to both employer and employee contributions to pension funds, provident funds and retirement annuity funds. The DTLAB proposes to remove further inconsistencies and anomalies in regard to the deductibility of contributions to retirement funds for employers and employees by deleting section 11(k) and introducing a new section, section 11F, to the ITA as a stand-alone section dealing specifically with these deductions.

While the present deduction limitation provided for in section 11(k) will remain, that is, the lesser of ZAR 350,000 or 27.5% of remuneration or calculated taxable income (see further below), a new limiting criterion is proposed that aims to exclude the use of any taxable capital gains. This is to prevent the anomaly of the retirement fund contribution deduction generating an assessed loss as a result of a higher limit due to the inclusion of taxable capital gains in taxable income. The proposed new criterion (paragraph (c) below) will apply from 1 March 2016, that is, with effect from the 2017 year of assessment. Thus, with effect from the 2017 year of assessment, individuals who contribute to pension funds, provident funds or retirement annuity funds are able to claim deductions limited to the lesser of:

- ZAR 350,000;
- 27.5% of the higher of:
  a) the individual's remuneration (other than retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit);
  b) taxable income (other than retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as determined before this deduction and any section 18A deductions to public benefit organisations; or
  c) the taxable income of that person before -
     (i) allowing any deduction under this section; and
     (ii) the inclusion of any taxable capital gain.

Individuals who have relied on the previous limitations and who have therefore taken capital gains derived by them into account in reducing their employees' tax liability may now find themselves in a position where their employees' tax liability is in excess of what it should have been. It is not clear as to how this should or will be rectified.

When the ZAR 350,000 maximum limit applies from the 2018/2019 year of assessment onwards, the calculation of employees' tax to be withheld for each month is for this limit to apply evenly over the year of assessment. The limit for each month in the year of assessment would thus be ZAR 350,000/12 (Proviso to paragraph 2(4) of Fourth Schedule).

Postponement of annuitisation requirement for provident funds to 1 March 2019
Author: Leani Nortjé

As part of the reforms which are intended to enhance the preservation of retirement fund interests during retirement, amendments have previously been proposed to the tax treatment of provident funds, with the result that as with pension and retirement annuity funds, benefits under a provident fund would be required to be annuitised.

The effective date of the annuitisation requirement for provident funds has been postponed a few times with the last proposed effective date being 1 March 2018. The reason was to allow the Minister of Finance to consult further with interested parties, and particularly the National Economic Development and Labour Council (NEDLAC), after the publication of the comprehensive policy document on social security and to report back to Parliament on the outcome of these consultations by no later than 31 August 2017.

As the discussions on the policy document are still underway with NEDLAC it is proposed that the annuitisation of provident funds be postponed once again until 1 March 2019. Accordingly, the annuitisation requirement will only apply to contributions made to a provident fund in respect of years of assessment commencing on or after 1 March 2019. All contributions made to a provident fund before 1 March 2019 as well as any growth on such contributions may be taken as a lump sum benefit on retirement and will not be subject to annuitisation.

Amendments to section 7C
Author: Joon Chong

Section 7C is an anti-avoidance section targeting zero or low interest loans provided to trusts by natural persons purportedly to facilitate the transfer of wealth and estate planning, resulting in loss of donations tax and estate duty to the fiscus. This provision currently applies to loans provided to a South African trust by (i) a natural person that is a "connected person" in relation to the trust; or (ii) a company, at the instance of that natural person, and that natural person holds at least 20% of the equity shares in the company. The rand difference between the official rate of interest (currently, 7.75%) and the interest on this loan results in a deemed annual donation on the lender on the last day of the year of assessment.

The anti-avoidance measures in section 7C have been rendered less effective by zero or low interest loans made to companies owned by trusts, rather than loans made directly to the trusts. Further, these loans are also transferred by the connected natural person lender to another person who is a connected person to the lender. The purpose of the transfer of the loan claim from the natural person to another connected person in relation to the lender, is to break the link between the lender who is a natural person and the loan to the trust.

The DTLAB proposes to counter these measures by increasing the scope of section 7C to also include zero or low interest loans provided to companies that are connected persons in relation to the trust. Further, where the initial loan claim to the trust is transferred to another natural person, the transferee of the loan claim is deemed to have made a loan to the trust or company on the date the loan claim was acquired from the transferor.

There is, however, recognition that trusts are used for legitimate reasons other than the mischief targeted by section 7C. For instance, the deemed donation in section 7C does not apply to loans made to special trusts solely benefitting disabled persons, loans to trusts that are public benefit organisations, loans to vesting trusts, and loans used to fund the acquisition of the primary residence of the lender.

The DTLAB proposes that this section should also not apply to loans provided to trusts used in employee share schemes that meet the following requirements:

- the trust was created solely to give effect to an employee share scheme;
- the loan was provided by a company to the trust to enable the trust to acquire shares in the lending company or any other company in the same group as the lending company (scheme company);
- section 8C equity instruments that derive their value from shares in a scheme company may be offered by the trust to an individual solely by virtue of the individual's employment or holding of office in a scheme company; and
- natural persons holding at least 20% of the equity or voting interests in any scheme company are not entitled to participate in that scheme.

The proposal in the 2017 Budget to exclude loans provided to trading trusts as they are not used for estate planning has unfortunately not been given effect to in the DTLAB.

It is useful to note at this point that a natural person is entitled to rely on the annual ZAR 100,000 donation exemption in respect of any deemed donation under section 7C. This means that section 7C should not apply to loan amounts of less than ZAR 1 300 000. Any deemed donation not exceeding ZAR 100,000 will accordingly not be subject to donations tax.

In duplum rule will no longer apply in certain circumstances
Authors: Joon Chong and Wesley Grimm

The common law in duplum rule provides that interest ceases to accrue when the aggregate interest due equals the unpaid capital amounts of the related debt. Certain statutory rules provide similar rules that limit the amount of interest that can be incurred in respect of any debt. These statutory rules provide for interest and other finance costs to stop accruing when the total of these amounts equal the capital portions of the related debt. The ITA contains various anti-avoidance provisions which counter the use of zero or low interest loans that result in a loss to the fiscus. These provisions quantify the tax benefit of the zero or low interest loans as the difference between the official rate of interest (currently, 7.75%) and the actual interest, multiplied by the loan amount. The rand difference in interest rates is then treated as:

- a deemed donation for donations tax purposes - for loans to trusts by a connected lender (section 7C);
- remuneration subject to employees' tax - for loans by employers to employees (Seventh Schedule); and
- a deemed dividend for dividends tax purposes - for loans by a company to natural person shareholders (section 64E(4)).

The common law in duplum and statutory interest limitation rules arguably apply in relation to the amounts that are deemed to accrue in relation to zero or low interest loans and that fall to be dealt with as either a donation, remuneration or deemed dividend. The DTLAB introduces a new section 7D in the ITA which provides that the deemed amount must be determined without regard to any in duplum or statutory rules. (The DTALAB also proposes to introduce a section 7D which deals with deemed accrual of interest payable by SARS.) Effectively, the deemed amount which is treated as a donation, remuneration or deemed dividend could therefore continue to increase indefinitely.

The new provision will apply in respect of years of assessment ending on or after 1 January 2018.

The constitutionality of the new section 7D is beyond the scope of this article. We note with interest (pun intended), the policy considerations observed in the Constitutional Court judgment of Paulsen and Another v Slip Knot Investments 777 (Pty) Limited [2015] ZACC 5. Prior to Paulsen, the commencement of litigation against the defaulting debtor resulted in suspension of the in duplum rule.

The Constitutional Court in Paulsen overruled previous authority and held that the rule indiscriminately targets all debtors and that debtors may be entirely drained by the accumulation of interest during the course of litigation. At paragraph 79, the court held that "The possible total financial ruin of debtors by uncapped interest pendente lite is at least as much an important public interest consideration as the interest of finance."

The court unequivocally held that there are strong public policy considerations in favour of maintaining the in duplum rule after litigation has commenced. The effect of the Paulsen judgement is that the in duplum rule still applies during the course of litigation. Interest only starts to accrue anew post judgment from date of judgment if the creditor is successful and the judgment debt is due and payable. Perhaps our courts would find that the same public policy constraints apply to the deemed amounts referred to above.

Clarifying the trust "conduit rules" on the taxation of employee share based schemes
Author: Leani Nortjé

Paragraph 80(2) of the Eighth Schedule provides that where a trust realises a capital gain on the disposal of an asset and a resident beneficiary has or acquires a vested interest to that capital gain, the capital gain so vested is taxable in the hands of the beneficiary and not in the hands of the trust.

With effect from 1 March 2016, paragraph 80(2A) was introduced to clarify that paragraph 80(2) will not apply where an employee share trust vests a gain in a beneficiary that holds an equity instrument to which section 8C applies, and such gain was derived by reason of the vesting of that equity instrument in that beneficiary as contemplated in section 8C, or by reason of the disposal by that beneficiary of a restricted equity instrument for another restricted equity instrument or to his employer, an associated institution or other person by arrangement with the employer for an amount less than market value. Accordingly, any capital gain arising from such disposal will be taxed in the hands of the trust and not in the hands of the employee beneficiary, as any gain realised in relation to such equity instrument will only be taxed in the hands of the beneficiary upon vesting in terms of the provisions of section 8C.

These provisions ensure that a gain is not subject to capital gains tax when it should be subject to income tax. However, in combination, the provisions of section 8C(1A) and paragraph 80(2A) arguably result in a gain realised in respect of a restricted equity instrument being subject to capital gains tax in the trust and income tax in the hands of the individual.

In order to address this anomaly, it is proposed that a new paragraph 64E be inserted in the Act. This provision stated that where a beneficiary of a trust has a vested right to an amount derived by the trust from a capital gain, the trust must disregard:

- so much of that capital gain that is equal to that amount, if that amount is to be included in the beneficiaries income, in terms of section 8C, or
- that amount taken into account in determining the gain/loss in the hands of that trust beneficiary in respect of the vesting of a restricted equity instrument.

Further to the above, paragraph 80(2) of the Eighth Schedule is to be amended to clarify that it is subject to the provisions of paragraph 64E. As a result of these amendments, paragraph 80(2A) will be deleted.

The proposed amendments will be deemed to have come into effect on 1 March 2017, and apply in respect of any amount received or accrued on or after that date.

Proposed amendments to the provisos to the income tax exemption in relation to dividends
Author: Leani Nortjé

Subject to certain exceptions, proviso (dd), (ii) and (jj) to section 10(1)(k)(i) in the ITA excludes certain dividends received by "virtue of employment" or in respect of "restricted equity instruments" with the result that such dividends will be taxed as income in the recipients hands.

In particular, proviso (jj) applies to any dividend in respect of a restricted equity instrument as defined in section 8C that was acquired in the circumstances contemplated in section 8C if that dividend is derived directly or indirectly from, or constitutes an amount transferred or applied for the acquisition or redemption of any share in that company, an amount received or accrued in anticipation or in the course of winding up, liquidation, deregistration or final termination of a company, or as a distribution in specie of an unrestricted equity instrument.

The DTLAB proposes to amend proviso (jj) so as to narrow its application by removing the application of the proviso to dividends derived directly or indirectly from the circumstances listed in (jj) so that the dividend exemption will only be denied if the dividend in question actually constitutes the direct distribution contemplated.

However, a new proviso (kk) is to be introduced to section 10(1)(k)(i) which will apply to deny the dividend exemption if the dividend in question has been derived in terms of a restricted equity instrument as defined in section 8C that was acquired in the circumstances contemplated in section 8C(1) if that dividend is derived directly or indirectly from an amount transferred or applied by a company as consideration for the acquisition or redemption of any share in that company, or an amount received or accrued inanticipation or in the course of the winding up, liquidation, deregistration or final termination of a company. The existing proviso (jj) is therefore in effect simply divided into two separate provisos. Furthermore, it is also proposed that paragraph 11A of the Fourth Schedule be amended to specifically include in "remuneration" any amount received by or accrued to a person by way of a dividend contemplated in provisos (dd), (ii) and (jj) to section 10(1)(k)(i) and will be deemed to be paid by the person by whom that dividend was distributed, which person must withhold employees' tax from such dividend payment. The persons paying these dividends are therefore considered to be employers and must now deduct employee's tax in respect of the dividends paid or payable by that person to the employee. No such similar provision is proposed for dividends received as contemplated in the proposed proviso (kk) to be introduced.

The proposed amendments will come into effect on 1 March 2018.

CUSTOMS AND EXCISE

Overview of significant amendments to customs and excise legislation
Author: Rudi Katzke

Introduction

The Customs and Excise Act 91 of 1964 (C&E Act) is due to be replaced by the Customs Duty Act 30 of 2014 (CDA) and the Customs Control Act 31 of 2014 (CCA). Although the latter two Acts have been formally assented to, their respective commencement dates are yet to be proclaimed. Until then, the C&E Act persists and is still subject to annual amendments. Even though the CDA and CCA are not yet effective, they have been annually refined by legislative amendments since their publication, often with a view to ensuring a smooth transition from the old legislative environment to the new. In line with this trend, the DTALAB proposes further changes to the C&E Act, the CDA and the CCA respectively.

Section 21A of the C&E Act

The DTALAB proposes to amend section 21A of the C&E Act to, inter alia, further clarify the cessation of liability for customs duty on imported goods used by an enterprise operating within a Customs Controlled Area. Under the proposed amendment, liability for duty ceases if that enterprise can prove that it used imported goods to manufacture or produce goods which have been subsequently removed to other licensed or registered premises for manufacture or production of any other goods. In addition to the other existing benefits, this amendment aims to further encourage enterprises to relocate their manufacturing and production capabilities to Customs Controlled Areas.

Section 65A of the CDA

This proposed new section seeks to combat fraud perpetuated with applications for refunds and drawbacks. Under this provision, only the person who is "entitled to" a refund and drawback will be eligible to apply for it. For example, refunds of duty will only be paid to the person who cleared the goods, regardless of whether or not that was the person who actually paid the duty. Refunds of an administrative penalty will only be paid to the person on whom the penalty was imposed. Approved refunds or drawbacks will only be paid into the bank account of the person entitled to it, unless that person has authorised SARS to pay the amount into the bank account of a third party. Based on the stringent administrative requirements applicable to become and remain a registered clearing agent, this new section seeks to combat fraud in respect of refunds or drawbacks.

Section 111 of the CCA

The CCA regulates various "customs procedures" (defined in section 1 to include the national and international transit procedure, the warehousing procedure and the export procedure, amongst others). Section 111 currently requires that permission be obtained from SARS Customs before the transfer of ownership of goods that are subject to any customs procedure. In contrast, the C&E Act only required such permission for the transfer of ownership of warehoused goods. The proposed amendment limits the permission requirement to goods subject to a customs procedure where ownership control is considered to be essential, such as the warehousing, home-use processing and inward processing procedures.

Section 174 of the CCA

In terms of section 174 of the CCA, clearance declarations can be amended if necessary, but only to correct an error or to update or change information on the initial declaration. The proposed amendment allows for a clearance declaration to also be changed by extending a timeframe applicable to goods cleared under a particular customs procedure. The person who cleared the goods may bring such an application, which will be integrated with the electronic clearing system for efficiency and cost saving reasons, instead of by a separate application.

Section 935A of the CCA

Currently, section 928 of the CCA contains a general transition principle in terms of which all approvals, permissions, authorisations, exemptions, rebates, relief and other existing measures granted under the C&E Act will continue when the new legislation takes effect. However, in terms of section 935A of the CCA, deferments granted under the C&E Act will not automatically continue in that manner and will lapse on the date when the CCA takes effect. Existing deferment holders will have an opportunity to apply for deferment benefits under the CDA before its effective date.

Section 942A of the CCA

The proposed new section 942A enables the Commissioner to exercise various powers before the commencement date of the CDA and CCA respectively, to further enable the smooth transition of the legislative dispensation from the C&E Act. These powers include the publishing of rules, appointing of customs officers, and the delegation of powers and duties. The effective date of such actions will only be when the new legislation takes effect. As for the new rules in respect of registration, licensing and deferment benefits, section 942A allows for the submission of applications well before the effective date, given the massive scope of such an undertaking. SARS has indicated that it will actively encourage taxpayers to apply for these registrations long in advance, to ensure that there is no interruption in their ability to continue to trade.

VALUE-ADDED TAX

Clarifying the zero rating of international travel insurance
Author: Chetan Vanmali

Currently, section 11(2)(d) of the Value-Added Tax Act, 1991 (VAT Act) provides for the zero rating of insurance and the arranging of insurance insofar as it relates to international travel (i.e. a journey commencing from a place in South Africa (SA) to a destination outside SA, including stop-overs *en route* to the destination, time spent in the destination country and the return journey). The zero rating however does not extend to the supply of insurance during the period that the insured is:

- transported to and from his/her original point of departure (for example, while en-route to or from the airport); and
- not being transported while on the international journey (for example, while the insured stays in a hotel).

As insurers regard the supply of international travel insurance as a single supply in respect of which a single price or fee is charged, certain difficulties arose in applying the zero rating provisions contemplated in section 11(2)(d). It is apparent that these insurance services are being subject to VAT at the standard rate of 14%. In this regard, SARS issued Binding General Ruling (VAT) 37 (BGR 37) on 12 December 2016 which allows insurers to zero rate travel insurance supplied in respect of an international journey which includes periods during which the insured is:

- outside SA but not being transported while on an international journey; and
- inside SA while en-route to the place of departure from another place in SA as part of the international journey (and *vice versa*).

The purpose of the proposed amendment to section 11(2)(d) is to confirm the zero rating of the supply of travel insurance insofar as it relates to an international journey.

The effective date of the above amendment is 1 April 2018.

Services supplied in connection with certain movable property situated in an export country
Author: Chetan Vanmali

At present, the VAT Act provides for services that are directly supplied in connection with movable property situated outside South Africa (SA) at the time the services are rendered to be zero-rated. The term “movable property” is not defined in the VAT Act. In terms of the Companies Act, movable property is defined to include securities or shares. This implies that any services supplied to a resident of SA that is directly in connection with securities (debt securities, equity securities and participatory securities) in a foreign incorporated company listed on the JSE but which falls under a main register held in a foreign country, could be interpreted to mean the supply of services in a movable property that is situated in an export country.

Consequently, services supplied relating to securities or shares in a foreign incorporated company listed on the JSE, but which falls under a main register that is held in a foreign country, should be zero rated for VAT purposes.

The proposed amendment in the DTLAB seeks to specifically exclude debt securities, equity securities or participatory securities from the zero rating contemplated in section 11(2)(g)(i) of the VAT Act.

The effective date of the amendment is 1 April 2018.

Goods supplied in the course of manufacturing of goods temporarily imported
Author: Chetan Vanmali

Where goods are imported under Item 470 of paragraph 8 of Schedule 1 of the VAT Act (Schedule 1), any services supplied directly in relation to the processing, repair, cleaning, reconditioning or manufacture of those goods may be zero-rated in terms of section 11(2)(g)(ii) of, read together with Schedule 1 to, the VAT Act. In addition, section 11(1)(b) of the VAT Act provides for any goods supplied in the course of carrying out those repairs, cleaning, reconditioning or even modification services to be zero-rated where those goods have been wrought or affixed to or consumed in the course of conducting the repairs, modification, renovation or treatment.

VAT vendor status of municipalities
Author: Kagiso Sephesu

After the local government elections that took place on 3 August 2016, certain municipalities were disestablished, merged, renamed and/or their municipal boundaries altered as a result of a municipal boundary change. In this regard, the legal, practical and other consequences resulting from the area of a municipality being wholly or partially incorporated in or combined with the area of another municipality is dealt with in terms of the Local Government: Municipal Structures Act 117 of 1998 (the Structures Act). Consequently, those affected municipalities have had to either cancel their existing VAT registration or have had to apply for a new VAT registration.

In order to address the unintended VAT consequences as a result of changes to the area of a municipality in terms of the provisions of the Structures Act, SARS issued Binding General Ruling (VAT) 39 (BGR 39) on 27 January 2017 which provides that in the case of the transfer of any assets, liabilities, rights and obligations as a result of a municipal boundary change, the existing municipality and the superseding municipality shall be deemed to be one and the same person.

The purpose of the insertion of section 8(28) is to bring the VAT Act in line with the provisions of BGR 39.

The effective date of the amendment is 1 April 2018.

Leasehold improvements
Author: Des Kruger

The VAT treatment of leasehold improvements has been a contentious issue since the inception of VAT. Unlike the ITA which has specific provisions that deal with leasehold improvements, and the many judicial pronouncements on the interpretation thereof, the VAT Act (and SARS) has been strangely silent. It's anyone's guess what has been happening in practice, but experience suggests the treatment has been anything but consistent.

The DTLAB seeks to remedy this lacuna by introducing specific provisions relating to leasehold improvements. The provisions will be effective from 1 April 2018.

In the first instance, it is proposed to introduce a new section (section 8(29)) that provides that where leasehold improvements are effected by a lessee who is a vendor to fixed property belonging to the lessor, the lessee is deemed to have made a taxable supply to the lessor "to the extent that the leasehold improvements are made for no consideration". The deemed supply of the leasehold improvements is deemed to have been made "at the time the leasehold improvements are completed" (proposed new section 9(12)). The proposed new section 8(29) will however not apply where the leasehold improvements "are wholly for consumption, use or supply in the course of making other than taxable supplies" (emphasis added).

Having deemed the supply of the leasehold improvements to be taxable supply "to the extent that the leasehold improvements are made for no consideration", the DTLAB then proposes (new section 10(28)) that the supply is "deemed to be nil". It will be apparent, therefore, that from the lessee's perspective, the supply by the lessee (a vendor) of leasehold improvements to the lessor will either be a taxable supply for consideration, if any consideration is charged for the improvements, or a taxable supply for no consideration to the extent that no consideration is charged. In both instances, the lessee will be entitled to full input tax relief as the lessee qua vendor has acquired the necessary goods and services for the purpose of making a deemed taxable supply.

Where the lessor is a vendor, however, the lessor will be deemed (new section 18C) to have made a taxable supply to the extent that the lessor will utilise the leasehold improvements for the purpose of making non-taxable supplies or would have been denied an input tax deduction under section 17(2) in respect of the acquisition of the leasehold improvements (where, for example, the leasehold improvements are to be used for "entertainment" purposes). The deemed supply by the lessor is deemed to be made "at the time the leasehold improvements are completed". The tax payable by the lessor is determined in accordance with a formula:

AxBxC

where,
"A" is the tax fraction (14/114);
"B" is the higher of the market value of the leasehold improvements, the actual cost (including VAT) of the leasehold improvements or the "total amount (including any VAT) of leasehold improvements as agreed upon by the lessor and lessee"; and
"C" is the percentage non-taxable use by the lessor of the leasehold improvements "at the time the leasehold improvements are completed".

Example
Company A (a vendor) agrees to effect improvements on land belonging to Company B (a vendor) to the value of ZAR 10 million. Company A in fact incurs ZAR 6 million in carrying out the leasehold improvements. At the time of completion of the leasehold improvements the market value of the leasehold improvements is ZAR 10 million. No consideration is charged by the lessee for the improvements. Company B will utilise the leasehold improvements 60% for the purpose of making non-taxable supplies (but see below as regards the usage by the lessor).

The lessee is deemed to have made a taxable supply of the leasehold improvements to the lessor for consideration of nil (no consideration having been charged), but will be entitled to claim full input tax relief in respect of any VAT incurred on acquiring the goods and services necessary to effect the improvements. The lessor in turn will have to account for output tax in respect of the market value of the leasehold improvements, being the higher of the actual cost of the improvements, the agreed value of the improvements and the actual open market value thereof. The lessor will have to account for output tax of ZAR 736,842 (14/114 x ZAR 10 million x 60%).

Given that section 18C will only be triggered if the lessor is a vendor, it is not clear how the deemed supply of leasehold improvements by a lessee under section 8(29) will be treated where the lessor is not a vendor. While the lessee will still be deemed to have made a taxable supply, the supply is deemed to be a taxable supply for nil to the extent that no consideration is charged. Unlike the provisions relating to "imported services", there is specific provision that would require a lessor who is not a vendor to account for VAT on the leasehold improvements in these circumstances.

Another issue relates to the date of completion, which is the date that the liability to account for output tax by the lessor will be triggered. While the liability of the vendor to also account for income tax under the ITA in these circumstances (assuming there is an obligation of the lessee to effect the improvements) arises in the tax year in which the taxpayer (vendor) acquires the "right to have improvements effected" (paragraph (h) of the definition of "gross income" in section 1(1) of the ITA), it would seem to be SARS' practice to accept that the taxpayer need only account for income tax on the leasehold improvements in the year that the improvements are completed.

Finally, the proposed new leasehold improvement regime is not of application where the leasehold improvements are to be used "wholly" for the purpose of making non-taxable supplies (proviso to proposed new section 8(29)). Does the test apply to the lessee or lessor? The proposed new adjustment provision (section 18C) is triggered if the lessor utilises the leasehold improvements for a non-taxable purpose. The non-application of the new regime as provided for under the proviso to the proposed new section 8(29) must refer to the usage of the improvements by the lessee, as any non-taxable usage by the lessor is covered by the proposed new section 18C. That said, surely a lessor is always using the leasehold improvements for the purpose of making a taxable supply thereof to the lessee, and it is the lessee who then uses the leasehold improvements for a non-taxable or taxable purpose.

The author has always maintained that two supplies are made in a leasehold improvement scenario, a supply by the lessee of the leasehold improvements to the lessor, and a supply by the lessor of the right of use of the fixed property to which the leasehold improvements are to be effected to the lessee, in other words a barter transaction. The consideration derived by the lessee for the supply of the leasehold improvements is the value of the right of use granted by the lessor to the lessee in exchange for the leasehold improvements. The lessor in turn has made a supply of the right of use of the fixed property to the lessee for consideration equal to the value of the leasehold improvements. Both lessor and lessee in the author's opinion should account for VAT on their relative supplies, being of equal value (per the recent Cape Town Jazz Festival case). Whether or not the lessor or lessee will be entitled to claim input tax relief would then depend on their specific usage of the leasehold improvements. This approach would also deal with the position where the lessee or lessor is not a vendor.

TAX TEAM

BRIAN DENNEHY
Director, Head of Tax
Tel: +27 11 530 5998
E: brian.dennehy@webberwentzel.com

NINA KEYSER
Partner
Tel: +27 21 431 7357
E: nina.keyser@webberwentzel.com

NICOLE PAIGE
Partner
Tel: +27 11 530 5857
E: nicole.paige@webberwentzel.com

JOON CHONG
Partner
Tel: +27 21 431 7362
E: joon.chong@webberwentzel.com

SEAN GILMOUR
Partner
Tel: +27 11 530 5094
E: sean.gilmour@webberwentzel.com

NIRVASHA SINGH
Partner
Tel: +27 11 530 5176
E: nirvasha.singh@webberwentzel.com

KAREN MILLER
Consultant
Tel: +27 21 431 7216
E: karen.miller@webberwentzel.com

NOLA BROWN
Associate Director
Tel: +27 11 530 5454
E: nola.brown@webberwentzel.com

ANNE BENNETT
Partner
Tel: +27 11 530 5886
E: anne.bennett@webberwentzel.com

GRAHAM VILJOEN
Director
Tel: +27 11 530 5293
E: graham.viljoen@webberwentzel.com

CRAIG MILLER
Director
Tel: +27 11 530 5551
E: craig.miller@webberwentzel.com

DONALD FISHER-JEFFES
Director
Tel: +27 11 530 5018
E: donald.fisher-jeffes @webberwentzel.com

CHETAN VANMALI
Partner
Tel: +27 11 530 5204
E: chetan.vanmali@webberwentzel.com

DES KRUGER
Consultant
Tel: +27 221 431 7333
E: des.kruger@webberwentzel.com

KEITH VEITCH
Consultant
Tel: +27 11 530 5202
E: keith.veitch@webberwentzel.com

RUDI KATZKE
Senior Associate
Tel: +27 21 431 7363
E: rudi.katzke@webberwentzel.com

KYLE BEILINGS
Senior Associate
Tel: +27 11 530 5211
E: kyle.beilings@webberwentzel.com

SHIRLEEN RITCHIE
Senior Associate
Tel: +27 11 530 5504
E: shirleen.ritchie@webberwentzel.com

ASHFORD NYATSUMBA
Senior Associate
Tel: +27 11 530 5259
E: ashford.nyatsumba@webberwentzel.com

DARREN ROY
Senior Tax Manager
Tel: +27 11 530 5466
E: darren.roy@webberwentzel.com

LEANI NORTJÉ
Senior Associate
Tel: +27 11 530 5580
E: leani.nortje@webberwentzel.com

GITTE TRUTER
Senior Associate
Tel: +27 11 530 5996
E: gitte.truter@webberwentzel.com

YASHIKA GOVIND
Associate
Tel: +27 11 530 5865
E: yashika.govind@webberwentzel.com

CARRYN ALEXANDER
Associate
Tel: +27 21 431 7070
E: carryn.alexander@webberwentzel.com

LISA LUMLEY
Associate
Tel: +27 11 530 5647
E: lisa.lumley@webberwentzel.com

BIANCA BATES
Associate
Tel: +27 11 530 5826
E: bianca.bates@webberwentzel.com

ROBERT NEWHAM
Associate
Tel: +27 11 530 5645
E: robert.newham@webberwentzel.com

KAGISO SEPHESU
Associate
Tel: +27 11 530 5450
E: kagiso.sephesu@webberwentzel.com

ADRIAAN BOOYSEN
Candidate Attorney
Tel: +27 11 530 5508
E: adriaan.booysen@webberwentzel.com

WESLEY GRIMM
Candidate Attorney
Tel: +27 11 530 5124
E: wesley.grimm@webberwentzel.com

JOHANNESBURG OFFICE
90 Rivonia Road, Sandton, 2196, Gauteng.
PO Box 61771, Marshalltown, Johannesburg, 2107, South Africa

t: +27 11 530 5000 f: +27 11 530 5111

CAPE TOWN OFFICE
15th Floor, Convention Tower, Heerengracht, Foreshore,
Cape Town, 8001
PO Box 3667, Cape Town, 8000, South Africa
t: +27 21 431 7000 f: +27 21 431 8000

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