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TAX

Tax amendments – 2015

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INTRODUCTION

The Taxation Laws Amendment Act, 2015 and the Tax Administration Laws Amendment Act, 2015 have now both been passed by Parliament, but await signature by the President.

Once again, and for the second year running, the number and scope of the changes to the various fiscal Acts (mainly the Income Tax Act, 1962 (the Act) and the Value-Added Tax Act, 1991) are relatively limited. In a way, given the plethora of amendments in the preceding years, this is not unwelcome. Again, those amendments that have been made are mainly of a highly technical nature and are more of interest to tax professionals than to business people in general.

That said, there are a number of controversial amendments, particularly as regards the administrative aspects of the law.

But what the future may hold is probably more interesting (in the Chinese curse sense) when The Davis Tax Committee reports gets turned into legislation, particularly as regards recommendations in relation to base erosion and profit shifting (BEPS) and the taxation of offshore trusts, together with possibly expanded rules in relation to the controlled foreign company rules. But that will be a story for another day.

INDIVIDUALS

As has been widely published in the press, the most controversial aspect relates to annuitisation of provident fund credits, such that, subject to *de minimis* limits and payments of the full amount on death, a maximum of one-third may be paid as a capital sum on retirement, and the balance must be utilised to purchase an annuity, just as in the case of a pension fund.

However, to maintain vested rights, the definition of "provident fund" makes it clear that the portion to be paid as an annuity does not include the following:

- In the case of a member of a fund who is 55 years or older on 1 March 2016, all contributions to that fund plus other amounts credited prior to that date and fund returns; or
- In the case of any other member, the contributions prior to that date plus other credits and fund returns,

and in either case, less any permitted reductions.

Thus these amounts will be ring-fenced and vested. Clearly, any contributions after 1 March 2016 by a person under 55 will be the subject of a compulsory two-thirds annuity.

CORPORATES AND BUSINESSES

Commissioner's discretions

The Act is replete with discretions given to the Commissioner for SARS, most of which are subject to objection and appeal (and those which are not, are only subject to review in the High Court). Some of these discretions have been exercised in the form of interpretation notes or published general rulings, while others are left to be exercised on a case-by-case basis, and often these are never exercised at all (usually

because the Commissioner is never put in a position to exercise his discretion in the first place, often through the innocent lack of knowledge by the taxpayer that the latter is supposed to request the Commissioner to do so).

Most of these discretions have now been removed, which is probably a good thing given the fact that they were not being exercised in practice anyway, and even if taxpayers were to request the Commissioner to do so, SARS would probably not have sufficient resources to do so efficiently. In some cases, however, as will be seen below, the removal of the discretion is largely cosmetic.

Legally, where the Commissioner is given a discretion and the taxpayer is dissatisfied with the manner in which he exercises it, the taxpayer's remedy is to object against the decision (where the decision is subject to objection and appeal), though often this is done in the form of objecting to the assessment which embodies the decision. Where the discretion has been removed and the test is then objective, it then becomes a case for the court to decide on what the correct interpretation of the relevant section of the Act is. For example, if previously the section referred to a value of an asset which the Commissioner considered to be fair, and this is now substituted with market value, the test then becomes objective as to what the market value of an asset might be.

The following are those of the discretions which have been removed that are likely to have more general interest, as they are likely to affect taxpayers on a day-to-day basis:

- The rates of depreciation or wear and tear of capital assets have always been at the discretion of the Commissioner, but subject to objection and appeal. This discretion in section 11(e) of the Act has now been removed. Instead, however, the section states that the rates must be "on the basis of periods of use listed in a public notice issued by the Commissioner, or a shorter period of use approved by the Commissioner on application in the prescribed form and manner by the taxpayer". Frankly we cannot see that anything has changed – this is still effectively at the Commissioner's discretion. It is a case of a rose by any other name smelling as sweet. Fortunately this subsection remains subject to objection and appeal.
- The allowance for doubtful debts under section 11(j) of the Act is similarly ostensibly no longer subject to the Commissioner's discretion but, again, the subsection now states that the allowance may be claimed "according to criteria set out ... in a public notice issued by the Commissioner". This could be even worse than before as it might not take into account unique circumstances in relation to a particular taxpayer, unless the public notice allows the taxpayer and the Commissioner to engage in relation to the taxpayer's unique circumstances.
- Much the same applies in relation to stock provisions under section 22 of the Act, which are supposedly no longer discretionary, but criteria will be "listed in a public notice issued by the Commissioner" – again this could leave the taxpayer in a worse position unless unique circumstances can be catered for.
- The Commissioner's determination of what the value of an asset is at the end of a finance lease is now substituted with the market value.
- The Commissioner had a discretion as to whether certain plant and machinery and buildings were used in a process similar to manufacture, and thus could be eligible for depreciation allowances. The Commissioner's discretion is no longer required, and the test will be objective.
- Under section 24 of the Act the so-called hire purchase debtors allowance is granted for suspensive sales. The extent of the allowance is no longer at the Commissioner's discretion, but will be such as is "set out in a public notice issued by the Commissioner".
- The allowance for future expenditure under contracts under section 24C of the Act has had the discretion removed as to the extent which will be deductible, so that now it is fully objective.
- There are numerous discretions contained in the Seventh Schedule to the Act, which quantify the taxable fringe benefits for employees.

Acquisition of shares in operating companies

With effect from 1 January 2013, and contrary to general principles, interest became deductible in relation to debt used to acquire shares, when section 24O of the Act became effective. But this section applied only where, shortly stated, the debt was used to finance the acquisition of at least 70% of the equity shares in an operating company, or a controlling group company in relation to an operating company. An operating company was one which carries on business continuously and in the course or furtherance of which it provides goods or services for consideration.

Problems were identified with this section, particularly in regard to the situation where a holding company was purchased, and when one traced the situation to the operating companies further down the chain, technically the tests were met, but the extent to which the real operating business could be attributed to the purchase price was not sufficiently significant. In this regard it must be remembered that

section 24O was introduced as a concession to obviate the need to undertake the debt push-down restructures to obtain interest deductions on debt used to finance the acquisitions of businesses.

In what cannot be described as a model of drafting clarity, section 24O has been redrafted in toto, to apply with effect from 1 January 2016. In effect what it seeks to do is "look through" the chain of companies and attribute the **value** of the operating companies acquired to the cost of the shares acquired, and the interest will be allowed as a deduction only to the extent attributable to that value.

Additionally, it is not enough that, to be an operating company, it must carry on a business continuously in the course of which it provides goods or services for consideration – at least 80% of its receipts and accruals must also constitute income for tax purposes (i.e. gross income less exempt income).

If a controlling group company ceases to be such in relation to an operating company, or an operating company ceases to be such, the interest deduction will cease to apply if the loan has not yet been discharged.

CGT and cancellation of agreements

The Eighth Schedule to the Act was amended to clarify the treatment of cancellations of agreements where the parties are restored to the position that they were in, prior to the agreement being entered into.

The person originally disposing of the asset will effectively be deemed to reacquire the asset for his or her original base cost (plus the cost of any improvements incurred by the new owner in the interim).

If the cancellation took place in the same tax year then the original seller will be deemed not to have disposed of the asset in the first place. The new rules will apply only if cancellation took place in a later tax year.

On cancellation the original seller will now be entitled to claim a capital loss equal to the capital gain that he or she "enjoyed" in the year of sale; or will be subject to a capital gain in respect of the capital loss that he or she originally suffered in the year of disposal. The latter is not all that serious since if there was no other transaction, that loss would have been carried forward and can shelter this gain. But if there was a capital gain in the prior year which was taxed, the taxpayer could now be left with this loss which could take many years to utilise. This is not a satisfactory compensation.

INTERNATIONAL TAX

Foreign tax credit

Double tax agreements between countries regulate what each country (the source country and the residence country) is and is not entitled to tax, the agreement also regulates the maximum amount that the source country may tax.

It is an unfortunate state of affairs that many African countries with which South Africa has concluded such agreements ignore the fact that the agreements effectively prohibit or minimise the extent to which a number of withholding taxes imposed by those countries' domestic laws may be deducted, and they deduct large withholding taxes in total disregard of their obligations under those agreements.

Some years ago, and uniquely in the world, South Africa introduced section 6quin of the Act to allow South African companies facing this problem to claim these incorrectly withheld taxes on fees (and only on fees) as tax credits, though latterly the claim was only valid if a special return was submitted to SARS (the purpose of the return was to give SARS information so as to engage with the relevant country concerned as to why it was disregarding the treaty).

It has now been decided to repeal section 6quin. This caused something of an outcry, particularly by those who seek to promote South Africa as a gateway to Africa and as a headquarter company jurisdiction. There can be no doubt that, technically, repealing is the correct thing to do, and that if treaty partners are not respecting the treaties, there are other ways of dealing with them, and those other ways should aggressively be pursued.

But Treasury and SARS did make some concession, and that was to enable these withholding taxes to be claimed as a deduction instead under section 6quat(1C) of the Act instead. But this is possible only where there is no mutual agreement procedure available under a relevant double tax agreement. In essence this is likely to exclude a goodly number of deductions anyway.

Participation exemption

South Africa enjoys a limited participation exemption in relation to holdings in foreign shares, both as regards dividends and as regards CGT.

As regards the latter, it is available if at least 10% of the equity shares and voting rights are held, the shares have been held for at least eighteen months, and they are disposed of to a non-resident for proceeds equal to not less than their market value.

With effect from 5 June 2015 a further criterion has been introduced, namely, that the non-resident purchaser may not be a connected person in relation to the seller.

Controlled foreign companies

Prior to 2011 the controlled foreign company (CFC) rules contained in section 9D of the Act contained the so-called diversionary income rules, which are actually anti-diversionary income rules, and are designed to prevent income being diverted from the South African company to the CFC, where it is taxed at a lower rate. (These days this falls under the well-known heading of base erosion and profit shifting or BEPS.)

In 2011 it was decided to simplify section 9D by removing some of these rules and instead relying on the transfer pricing rules, and including instead a high-tax exemption and permanent establishment exemption in section 9D. But it is now felt that this is not adequate, no doubt prodded by the whole BEPS movement, and section 9D has now been amended to reinstate the diversionary income rules as they were in 2011, so as to apply in respect of foreign tax years applicable to the CFC ending during tax years commencing or after 1 January 2016.

In very brief terms these rules seek to bring within the South African tax net profits of CFCs, even if they have qualifying foreign business establishments, where goods are purchased or sold or manufactured, but the CFC is essentially dealing more with connected persons or residents of South Africa than with foreigners, or its activities in manufacturing are minor rather than significant (obviously the legislation is more detailed than this).

Corporate migrations

In 2014, in an effort to stop effective corporate migrations or changes in control, a simplistic amendment, with extraordinary consequences, was introduced with inadequate thought. That stated that if assets were transferred by a non-resident to a South African company in exchange for shares in the company issued by the non-resident, the company itself suffered a capital gain equal to the market value of the shares it issued. This applied irrespective of the percentage of shares held by the non-resident, so that it would necessarily apply to the situation where there was not a change in control, let alone the transfer of residence of the company from South Africa to a foreign jurisdiction.

Fortunately sanity has prevailed and the amendment has been reversed, and the status quo ante has been reinstated, with effect from 2014. An alternative measure to deal with corporate migrations has been brought in, in the form of an amendment to section 9H of the Act, which deals with the so-called exit charge when persons cease to be residents of South Africa.

As indicated above, South African residents enjoy a participation exemption on both foreign dividends and capital gains. What this new rule states is that if a company ceases to be a resident:

- Any capital gain which was disregarded in the previous three years as a result of the participation exemption will now be deemed to be a capital gain derived by the company, so that it will be subject to CGT; and
- Any foreign dividend that was exempt from tax by reason of the participation exemption during the previous three years will be deemed to be a foreign dividend that is not exempt, so that it will be taxable at the rate of 28%.

TAX ADMINISTRATION

The most controversial aspect relates to the issue of so-called prescription of assessments in terms of the Tax Administration Act, 2011 (the TAA).

The general rule is that income tax assessments prescribe three years after the date on which they were issued, while taxes that operate on a self-assessment system, such as PAYE and VAT, have a five-year prescription period, ie SARS may not raise an assessment in respect of a tax period if more than five years have elapsed after the relevant return has been submitted. In any case, however, the relevant period may be ignored if the relevant amount of tax has not been paid by reason of fraud, or misrepresentation or non-disclosure of material facts.

There is already a provision in the TAA which states that, prior to the expiry of any three- or five-year period, the taxpayer and SARS may agree to extend the period. This would typically occur if SARS is in the process of undertaking an audit, which is not yet complete, and rather than raise a premature assessment, SARS will typically approach the taxpayer and request that they agree to this extension.

Despite vociferous objections raised, the TAA has now been amended to give SARS unilateral power to extend the prescription period in certain circumstances as follows:

- SARS complains that taxpayers do not always provide the relevant material requested within the required time periods or the extended periods granted, and sometimes taxpayers unnecessarily delay proceedings by taking procedural points and litigating them. On this basis, after giving at least thirty days' notice to the taxpayer, SARS has the right to extend the period (even an extended period agreed upon) by a period approximate to the delayed period arising from the aforegoing.
- On giving sixty days' notice the said periods can be extended for up to three years (two years in the case of self-assessment) in the case of an audit relating to (i) the application of the doctrine of substance over form, (ii) the application of the general anti-avoidance rule, ie the GAAR, (iii) the taxation of hybrid entities or hybrid instruments, or (iv) the transfer pricing rules under the Act.

Unfortunately what the TAA does not provide for is offsetting remedies to the taxpayer where SARS itself is at fault. For example, what happens where (as has happened in practice), the relevant SARS official decides to commence his or her audit of the return a mere month or two prior to the end of the three-year period? Why should the law then allow SARS unilaterally to extend the prescription period by a further three years merely because one of the queries happens to involve, say, a hybrid instrument? Or if the query happened to involve information that was now nearly three years old and the taxpayer required more time to extract it from archives, why should SARS be entitled to delay prescription in the circumstances, when SARS could easily have commenced their audit earlier?

There is one subtle point of interest here and that is that, although it is the Commissioner of SARS that is responsible for administering the tax Acts, he is authorised to delegate the powers and duties and, as a result, the TAA, when something is to be done, refers to these things being done by "SARS", or "a SARS official", or "a senior SARS official", but in regard to this particular provision, it refers specifically to "the Commissioner". Presumably this must be interpreted to read that it is the Commissioner personally that must make the decision to extend the prescription period, and not anyone else at SARS.

While this might give some level of comfort that the provision will not be abused, it would still be preferable if the law provided for the taxpayer to respond to the Commissioner with a submission before a final decision was to be taken. (In any event, the Commissioner's action is subject to review in the High Court, but that is not necessarily a satisfactory remedy from a practical perspective.)

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