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Standing Committee on Finance (National Assembly)

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Dear Hon. J Maswanganyi

2022 DRAFT TAXATION LAWS AMENDMENT BILL: OMISSION TO AMEND COLLATERAL ARRANGEMENT LEGISLATION

We would like to thank the Standing Committee on Finance for the opportunity to submit comments on to the 2022 Draft Taxation Laws Amendment Bill and, in particular, on the omission of any amendments to the collateral arrangement legislation introduced in the Taxation Laws Amendment Act No. 21 of 2021 that are due to become effective on 1 January 2023.

1. CONTEXT

With effect from 1 January 2016 a collateral dispensation was introduced in terms of which certain outright, non-cash collateral was exempted from securities transfer tax (STT) and capital gains tax (CGT) / income tax. To qualify for this dispensation, collateral transfers must meet the 'collateral arrangement' definition in section 1 of the Securities Transfer Tax Act No. 25 of 2007.

The 2021 Taxation Laws Amendment Bill contained an amendment to the collateral arrangement definition in terms of which restrictions were placed on the re-use of collateral that was previously subject to the collateral arrangement dispensation (the 2021 Amendment). In his 2022 Budget Speech, the Minister of Finance announced that, '[a]fter reviewing the public comments on the [2021] bill, government decided to postpone the effective date for these amendments to 1 January 2023 to give both the National Treasury and affected stakeholders more time to consider the impact of the proposed amendments.'

Unfortunately, despite numerous submissions to and meetings with National Treasury, no changes have been made to the 2021 Amendment and thus the 2021 Amendment will become effective on 1 January 2023. Industry and National Treasury are at an impasse, as industry feels strongly that the 2021 Amendment will render the collateral arrangement dispensation unusable, which will result in potential devastating impact on market liquidity and the effectiveness of South African participation in the global markets.

2. RATIONALE FOR THE COLLATERAL ARRANGEMENT DISPENSATION

The rationale for the collateral arrangement dispensation was to place outright, non-cash collateral on par with pledged collateral insofar as tax-neutrality is concerned, which is in line with global best practice. A benefit of outright over pledged collateral is that outright collateral can be re-used. This re-use is essential in

ensuring market liquidity as well as providing a viable way for counterparties to comply with the various regulations that require collateral to be provided to reduce systemic risk.

These risks are highlighted in the recently released 'FSCA Regulation Plan: 1 April 2022–31 March 2025' and 'FSCA Joint Discussion Document: Expansion of Eligible Collateral Types and Regulatory Reporting Requirements'. The former provides insight into the FSCA's regulatory strategy to ensure, *inter alia*, the integrity and efficiency of the financial markets and alignment with international standards. The latter addresses the expansion of eligible collateral for margining purposes to government bonds, liquid shares and liquid corporate bonds, taking into account liquidity risk and international best practice. The ability to place non-cash collateral on an outright, tax-neutral basis is essential to these goals.

3. RATIONALE FOR THE LIMITATION ON RE-USE

According to the Minister of Finance's 2022 Budget Speech, the 2021 Amendment was 'to clarify that the use of collateral for purposes other than subsequent collateral arrangements or proposed limited regulated transactions is against the policy rationale for the introduction of these provisions, and could result in the avoidance of securities transfer tax or capital gains tax.'

While BASA maintains that the current (pre-2021 Amendment) wording of the collateral arrangement definition adequately ensures that any re-use of collateral outside of a further collateral arrangement is subject to normal tax consequences, we are not opposed to National Treasury's proposal to further clarify this so as to leave no doubt. However, as discussed below, the drafting of the 2021 Amendment does not attain this, as it inadvertently goes much further.

4. CONCERNS WITH THE 2021 AMENDMENT

4.1. *Impact of unwinding prior compliant collateral arrangements*

While BASA does not have an in-principal issue with National Treasury's wish to further clarify that any non-compliant re-use of collateral is subject to normal tax consequences, unfortunately the 2021 Amendment does not attain this outcome due to the way in which it has been drafted. Because the limitation on re-use has been drafted as an exception to the definition, it has unintended and far-reaching implications. In this regard, it not only ensures that the non-compliant arrangement is subject to normal tax consequences (as is intended), but also that it undoes the collateral arrangement dispensation for prior compliant collateral arrangements. We submit that this unintended consequence can be avoided by simply framing the re-use limitation as a proviso to the definition instead of an exception.

We submit that the drafting of the 2021 Amendment results in not only the non-compliant arrangement not benefiting from the dispensation and thus being subject to normal tax consequences (as is intended), but also in all prior compliant collateral arrangements not benefiting from the dispensation. It should be noted that outright collateral is often used in subsequent collateral arrangements, where the same security is used in a "chain of collateral" arrangements. This re-use of collateral ensures that there is sufficient collateral to go around as well as market liquidity.

Under the 2021 Amendment, prior compliant collateral arrangements would be adversely affected by a subsequent non-compliant re-use despite the prior arrangements still meeting the collateral arrangement requirements. Thus, a collateral giver who provides shares under a compliant collateral arrangement where the shares are returned to him timeously may nonetheless be subjected to both STT and CGT on such shares if a subsequent collateral taker were to apply the collateral for a non-complaint purpose. This could include re-use in the event of default.

Collateral givers cannot risk tax disposals and STT being triggered in respect of their compliant collateral arrangements by a later non-compliant use of the collateral. Thus, placing outright collateral will no longer



be viable and the collateral arrangement dispensation will effectively become unusable. The absence of outright collateral would result in a significant impact on market liquidity and pose systemic risk to the financial markets.

4.2. List of allowable re-uses

The 2021 Amendment furthermore introduces a limited list of allowable re-uses. We submit that a list of allowable re-uses is not required, as any non-compliant re-use is subject to normal tax consequences and there is thus no risk of avoidance of STT or CGT/income tax.

If National Treasury were nonetheless adamant that a list of re-uses were required, we note that the list in the 2021 Amendment is inadequate, as it does not include the main re-uses of collateral that are essential not only to banks, but to the market in general. The most significant omission from the list is the re-use of collateral in the event of default. Given that the point of providing collateral is for use in the event of default, this oversight is intolerable.

5. PROPOSED SOLUTION

As discussed above, BASA is not opposed to the clarification sought by National Treasury that any non-compliant re-use of collateral would not benefit from the collateral arrangement dispensation. We do, however, submit that this should be attained without revoking the dispensation for prior compliant collateral arrangements. To this end, the limitation on re-use could be framed as a proviso to the collateral arrangement definition, instead of as an exception. We further submit that a list of allowable re-uses is not required, as any non-compliant re-use is subject to normal tax principles, thus ensuring no STT or CGT/income tax abuse. For ease of reference, we have included as an Annexure the wording of the collateral arrangement definition subsequent to the 2021 Amendment as well as our proposed proviso.

Yours faithfully



Leon Coetzee
Deputy Chairman: The Banking Association Direct Tax Committee



**COLLATERAL ARRANGEMENT DEFINITION IN S 1 OF THE STT ACT, INCLUDING 2021 AMENDMENT
(EFFECTIVE 1 JANUARY 2023) UNDERLINED**

“collateral arrangement” means any arrangement in terms of which–

- (a) a person (hereafter the transferor) transfers a listed share or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic if that bond is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act to another person (hereafter the transferee) for the purposes of providing security in respect of an amount owed by the transferor to the transferee;
- (b) the transferor can demonstrate that the arrangement was not entered into for the purposes of the avoidance of tax and was not entered into for the purposes of keeping any position open for more than 24 months;
- (c) that transferee in return contractually agrees in writing to deliver an identical share, as defined in section 1 of the Income Tax Act, or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic that is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act to that transferor within a period of 24 months from the date of transfer of that listed share or bond from the transferor to the transferee;
- (d) that transferee is contractually required to compensate that transferor for any distributions in respect of the listed share (or any other share that is substituted for that listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements) or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic that is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act, which that transferor would have been entitled to receive during that period had that arrangement not been entered into; and
- (e) that arrangement does not affect the transferor’s benefits or risks arising from fluctuations in the market value of that listed share (or any other share that is substituted for that listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements) or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic that is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act,



but does not include an arrangement where the transferee—

- (i) has not transferred the identical share or bond contemplated in paragraph (b) to the transferor within the period referred to in that paragraph unless such failure to return such identical share or bond is due to an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange; or
- (ii) has subsequently transferred the listed share or bond contemplated in paragraph (a) in a manner other than a transfer contemplated in paragraphs (a) to (e), unless the listed share or bond is transferred for purposes of—
 - (aa) a repurchase agreement entered into with the South African Reserve Bank as contemplated in section 10(1)(j) of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989);
 - (bb) complying with Regulation 28 of the Pension Funds Act, 1956 (Act No. 24 of 1956); or
 - (cc) securing overnight cash placement in order to comply with the Basel III Supervisory Framework for measuring and controlling large exposures;

BASA'S PROPOSED PROVISIO AS AN ALTERNATIVE TO THE ABOVE

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but does not include an arrangement where the transferee has not transferred the identical share or bond contemplated in paragraph (b) to the transferor within the period referred to in that paragraph unless such failure to return such identical share or bond is due to an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange;

Provided that where the listed share or bond contemplated in paragraph (a) is subsequently transferred in a manner other than a transfer contemplated in paragraphs (a) to (e), such subsequent transfer shall not qualify as a "collateral arrangement";

