Draft Taxation Laws Amendment Bill, 2019; and Draft Tax Administration Laws Amendment Bill, 2019

Presentation to Joint meeting of Standing Committee on Finance and Select Committee on Finance

10 September 2019

Introduction

General

- JATS
- Complexity
- Timing

To be covered

1: Anti-dividend stripping provisions

2: Value shifting (deferred tax impact)

3: Double tax from interaction between anti-avoidance provisions

4: Withholding tax administrative burden

1: Anti-dividend stripping (1 of 4)

- Background / rationale
  - Extension of existing provisions which target pre-sale dividends (treating dividends to sale proceeds);
  - Seeking to tax ‘dilutionary’ transactions that are argued to be an alternative to a sale;
  - Policy aspects;
    - Short term;
    - Long term.
- Pre-requisites

  Primary
  - Qualifying interest (combined holdings); and
  - Extraordinary dividend.

  Secondary
  - Issue of shares to new shareholder.

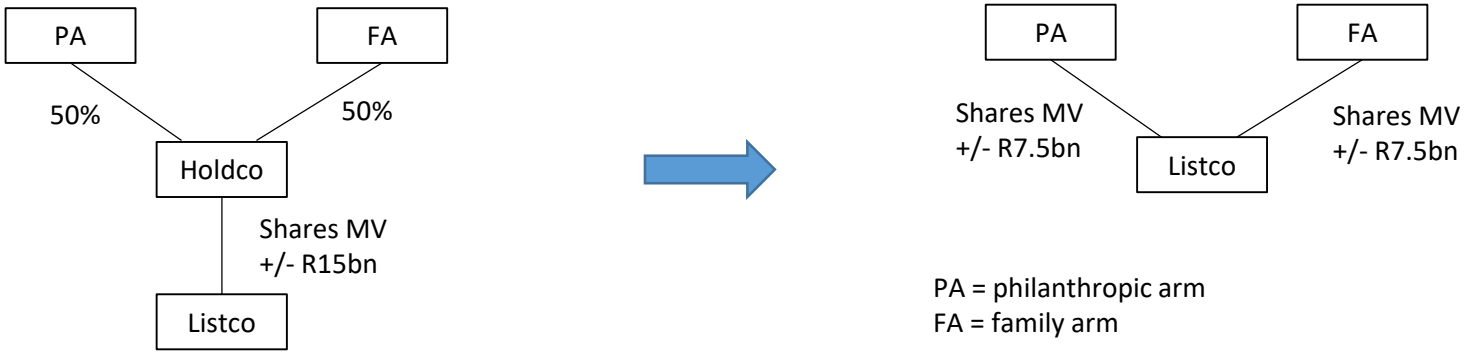
1: Anti-dividend stripping (2 of 4)

- Unwarranted adverse impact on legitimate transactions, e.g.:
  - Introduction of funding to grow business (ordinary co-investor and/ or preference share funding – cost of equity considerations);
  - Share schemes;
  - Compliance with regulatory requirements;
    - Capital adequacy;
    - BEE;
  - Rights issues;
  - Restructures; and
  - Other.

1: Anti-dividend stripping (3 of 4)

- Live transaction:
  - Brief history;
  - Regulatory approvals;
  - Structural issue and proposed restructure;
  - No change in ultimate beneficial ownership;
  - Historical distributions;
  - Availability of capital for future deployment.

- Simplified schematic:



1: Anti-dividend stripping (4 of 4)

- Other issues
  - No parity with actual sales
    - No base cost offset
    - Contrast to application of the general anti-avoidance rule (“GAAR”)
  - Mismatch in tests
    - Use of combined holdings in determining whether a qualifying interest exists
    - Use of isolated holdings for purposes of dilution
  - No linkage (direct or indirect) between incoming shareholder and distribution
  - No de-minimus provision
    - Original draft of 10 June referred to current shareholder ending up “with a negligible effective interest”
  - Effective date
    - Transactions concluded prior to Budget Day (approach in 2017)

2: Value shifting (1 of 2)

- Illustrative example
  - Mr and Mrs X jointly own an asset with market value of R500 and base cost of R150
  - Asset is transferred to a company, Co Y, in return for issue of shares
- Envisaged outcome – rollover relief in terms of section 42 (asset for share)
  - Co Y holds the asset with a base cost of R150 and a market value of R500
  - Mr and Mrs X hold shares in Co Y with a base cost of R150 and a market value of R[500]
- Issue
  - The value of the Co Y shares may not be R500 due to the deferred tax liability taken on by Co Y by reason of the roll-over treatment granted in terms of section 42 (gross deferred tax liability of some R78)
  - Section 24BA overrides the reorganisation relief where the value of the asset given (before transfer) does not equal the value of the shares issued (post issue) and triggers deemed capital gain or dividends

2: Value shifting (2 of 2)

- Proposal in draft bill
    - To ignore value mismatches attributable to deferred tax determined in accordance with IFRS
- Issue with draft proposal
    - The reference to deferred tax liability determined in accordance with IFRS is problematic as there may be no deferred tax recognised in the books in connection with the transfer, e.g. where predecessor accounting is applied
- Recommendation
    - Whilst the amendment should be retained (this addresses a common transaction / potential issue, the reference to IFRS should be removed

3: Interaction of anti-avoidance provisions (1 of 2)

- Recap / starting point
  - Section 45 provides for roll-over relief for transfer of assets between group members
  - Mandatory application (though can elect out)
  - is a statutory deferral mechanism, gain or loss only triggered when assets disposed of outside group
  - On a subsequent ‘real’ disposal of asset rolled over gains and losses (together with any subsequent growth or reduction in value) triggered
  - Anti avoidance trigger where transferee and transferor companies cease to form part of same group of companies within 6 years of transfer of asset – in this case rolled over gains or losses are triggered
  - Additional anti-avoidance provision where assets are transferred on loan account, loan receivable deemed to have a nil base cost (but gain on repayment ignored if the payor and holder form part of the same group of companies at time of payment)

3: Interaction of anti-avoidance provisions (2 of 2)

- Issue through way of an illustrative example
    - Co A transfers an asset with market value R100 and base cost R20 to its sister subsidiary, Co B, for its market value of R100, which is left outstanding on loan account
    - Co A's base cost in the loan receivable from Co B is nil
    - Co A and Co B then, within 6 years and prior to the loan being repaid, cease to form part of the same group of companies
    - Co B subsequently settles the loan to Co A
    - Outcome in terms of current legislation
        - Co B triggers a de-grouping charge and the rolled over gain of R80 will be taxable in Co B; AND
        - The repayment of the loan to Co A triggers a gain in Co A of R100
        - Overall gains taxed of R180, in excess of the both the gain rolled over (R80) and the market value of the asset (R100)
- Proposal
    - Where a de-grouping charge arises the nil base cost in any related loan should be switched off
    - Aside from the deferral aspect, the de-grouping should place the erstwhile group, and the fiscus, in the same position as had the transfer not qualified for the relief, i.e. only the rolled over gain (or loss) should be triggered

4: Withholding taxes – administrative burden

- Proposals
    - Suggested in the draft explanatory memorandum that, for interest withholding tax and royalty withholding tax, a separate declaration is required in advance of each payment, thus amendment is required to clarify this is not the case.
    - Proposed that declarations only be valid for a period of two years, for each of interest withholding tax, royalty withholding tax and dividend withholding tax.
- Commentary/ recommendations
    - We do not believe that under current legislation, section 49E (royalty withholding tax) or section 50E (interest withholding tax), separate declarations are required in advance of each payment.
        - That being said, to the extent that any ambiguity is seen to exist we would support changes in the wording to clarify this.
    - However, we do not support any tie limitation on the
    - The existing declarations (forms WTRD, WTID, DTD(EX) and DTD (RR) in the formats prescribed by SARS contain open-ended undertakings by the relevant beneficial owner to inform the paying party of relevant changes in their circumstances impacting on the relevant exemption or reduced rate.
    - To add needless administrative burden is not supported and we recommend that the proposed two year limitation be removed.

Closing

- Questions /points of clarity
- Thank you