JA Transaction Solutions (Pty) Limited

National Treasury and the South African Revenue Service

By email: 2019AnnexCProp@treasury.gov.za and acollins@sars.gov.za

15 August 2019

Dear Sirs / Madams

Submissions in respect of the Draft Taxation Laws Amendment Bill, 2019 and draft Tax Administration Laws Amendment Bill, 2019

1. Introduction

1.1. We refer to the draft Taxation Laws Amendment Bill, 2019 ("**TLAB**") and draft Tax Administration Laws Amendment Bill, 2019 ("**TALAB**"), together with their respective accompanying draft explanatory memoranda (each an "**EM**") and media statement released for public comment on Sunday 21st July, as read with the 2019 Budget Review of 20 February 2019.

1.2. Detailed below for your consideration is our commentary thereon, separated into the following categories:

1.2.1. substantive comments, including commentary on the relevant EM (refer section 2 below);

1.2.2. minor aspects, e.g. typos, incorrect references etc (refer section 3 below); and

1.2.3. other matters not currently addressed in the Draft Bills (refer section 4 below).

2. Substantive matters

2.1. Addressing abusive arrangements aimed at avoiding the anti-dividend stripping provisions

2.1.1. Whilst we refer below to the changes proposed to paragraph 43A of the Eighth Schedule, our comments apply equally to the equivalent proposed changes to section 22B.

2.1.2. We first highlight certain aspects as regards the principles underpinning the anti-dividend stripping legislation.

2.1.2.1. Paragraph 43A applies in respect of dividends from one resident company to another, i.e. it applies to the distribution of profits which have already been subject to tax in the hands of the distributing company and seeks to levy another layer of tax to the same profits (which in any event would be subject to yet another level of tax upon ultimate distribution outside of the, resident, corporate net).

2.1.2.2. Whilst acknowledging that South Africa cannot, at this time, afford to forego any potential tax revenue, we note that the above (undesirable) multiple levels of taxation in respect of the same underlying profits are avoided in other jurisdictions through group / consolidated tax or, for example, in the UK through a "substantial shareholding exemption" (i.e. these reliefs do not apply to portfolio or passive holdings). We submit that, whichever route is pursued, this is the ultimate destination that South Africa must aim for in the long term to promote business development.

2.1.2.3. If one considers the illustrative scenarios set out below it would appear that the anti-avoidance provisions of paragraph 43A unduly penalise either those who seek to retain their funds in a business to promote the growth thereof (Example 1) or those who are unaware of the basic steps that can be taken on an ongoing basis to mitigate any exposure to such provisions (such steps being illustrated in Example 3).

2.1.2.3.1. Example 1: a new company ("Target") is established by its parent company. All profits (over a number of years) are retained in Target to grow the business until the parent company eventually looks to exit. Under this scenario a pre-sale distribution would afford the parent company an exemption of only 15% of the market value of Target.

2.1.2.3.2. Example 2: a new company ("Target") is established by its parent company. All profits are distributed each year to the parent company who retains these at the expense of limiting Target's ability to utilise those funds and further grow its business (and the South African economy). Under this scenario paragraph 43A would be limited in its application to only dividends in the 18 months preceding a sale.

2.1.2.3.3. Example 3: a new company ("Target") is established by its parent company. All profits are distributed each year to the parent company who can then re-introduce these sums to Target by way of loan funding (whether interest free or interest bearing) or by way of share capital (whether equity or preference). Under this scenario the impact of paragraph 43A would be reduced as additional funds can then subsequently be returned to the parent company outside the ambit or effect of paragraph 43A by way of either repaying loans advanced or by reason of the additional base cost arising from further subscriptions.

2.1.2.4. The provisions of paragraph 43A promote either the course outlined in Example 2 which we consider could be prejudicial to the long-term growth prospects of the economy or that outlined in Example 3 which mitigates against the effectiveness of the provisions and brings their need into question.

2.1.3. We turn now to the detail of the proposed changes.

2.1.4. From the EM (TLAB) and the feedback from National Treasury during the interim public consultation process following the release of an initial draft of the proposed changes on 10 June 2019, it appears that the proposed legislation is targeted at transactions which could potentially otherwise have been structured as sales (irrespective of the level of dilution that the current shareholder experiences).

2.1.4.1. Whilst we acknowledge and accept that the deemed disposal triggered by the proposed provisions of paragraph 43A(3A) only has consequence where other requirements or conditions are first present, e.g. that the current (corporate) shareholder holds a qualifying interest and that an extraordinary dividend exists, there are a number of transactions which we believe should not be subject to these provisions even where such other conditions are present and are followed by an issue of shares that dilutes the current holders' effective interest, for example:

2.1.4.1.1. where a new shareholder is introduced with the related subscription price left in the company to grow the business and no distribution of any of such proceeds (or amounts related thereto);

2.1.4.1.2. in the context of a rights issue offered to all shareholders where a particular shareholder opts not to exercise their related subscription rights and dilutes as a result of other shareholders exercising their rights;

2.1.4.1.3. shares issued in terms of a share incentive scheme for employees;

2.1.4.1.4. where the issue of new shares is as a result of regulatory requirements, e.g. capital adequacy requirements in either the banking or insurance industries; or

2.1.4.1.5. shares issued to new investors in terms of a black economic empowerment transaction, i.e. again by reason of compliance with regulatory requirements.

2.1.5. Referring again to the basis that the provisions are targeted at transactions which could otherwise have been structured as sales and are aimed at placing the dilutionary transactions on a par with such sales the provisions, as drafted are in fact more draconian in that no relief is given for the base cost in the shares deemed to be disposed of. This we consider to be highly inequitable and adjustment in that regard should be made.

2.1.6. The provisions bring in a concept of ‘effective interest’. Whilst the term is commercially understood we question whether it is the best one to be used in the circumstances as it could be open to interpretation. We question whether the concept of ‘participation rights’ as defined and used in section 9D (and whose usage was in 2018 extended to section 12J also – refer paragraph (g) of the definition of “qualifying company” in section 12J(1)) may not be a more appropriate measure here, i.e. the deemed disposal could then be by reference to any decrease in the % of participation rights held.

2.1.7. In determining whether a “qualifying interest” is held, per the preamble to that definition, regard must be had to the holdings of a company “whether alone or together with any connected person in relation to that company”. Paragraph (a)(ii) of the definition of “qualifying interest” adopts a similar approach in determining whether other persons hold the majority of equity shares or voting rights.

2.1.7.1. However, in determining whether there has been a reduction in the “effective interest” of the relevant taxpayer the test as proposed is on a stand-alone basis. This we submit is wholly inequitable and unjustified. One must maintain consistency. If one can be brought into the provisions by reason of the holdings of connected persons the carve-out must be with reference to the same test.

2.1.7.2. If there is no change in the ultimate effective interest (participation rights) of the underlying asset(s) / business(s), i.e. there is no third party introduced and the ownership by a company together with its connected persons is unaltered there should be no deemed disposal (whether any related share issue is inside or outside the reliefs afforded by Part III of the Act).

2.1.8. ***In summary, we submit that the following points should be addressed / catered for in finalising the relevant provisions:***

2.1.8.1. ***exemption for certain transactions such that they fall outside the scope of the provisions, e.g. those listed in paragraph 2.1.4.1 above (whether the mechanics of achieving the same are a motive test or otherwise);***

2.1.8.2. ***relief for the base cost attributable to the shares deemed to have been disposed of;***

2.1.8.3. ***consideration to be given to the use of the defined concept of ‘participation rights’ rather than ‘effective interest’; and***

2.1.8.4. ***consistency in determining whether the provisions can and do apply vis a vis the holdings of a corporate taxpayer, both in determining whether a ‘qualifying interest’ exists and in quantifying any reduction in effective interest, regard must be had to the holdings of the taxpayer “whether alone or together with any connected person”.***

2.1.9. **_Longer term, once the economy can accommodate same, consideration should be given to granting the equivalent of the UK's substantial shareholding exemption, thus mitigating the need for these provisions (and their repeated amendment)._**

2.2. Clarifying the effect of deferred tax on the application of value-shifting rules (section 24BA)

2.2.1. Whilst the principle expressed in the EM (TLAB) in this regard and the related proposed change to section 24BA(3)(a) are welcomed, it is considered that the proposed wording may not achieve the result sought.

2.2.2. Where an acquisition of assets takes place in exchange for the issue of shares such that section 24BA requires to be considered, it is not always the case that a deferred tax liability will be recognised in the accounts of the company issuing the shares.

2.2.3. In any event the test applied in section 24BA is with reference to the difference between the market value of the asset and the market value of the shares issued. Whilst the market value of the shares will be impacted by any deferred tax taken on by the company such impact will apply irrespective of whether or not such deferred tax position is recognised in the financial statements. Even where deferred tax is recognised in the financial records the related impact on the market value of the shares is unlikely to equal such provision, for example the impact on the market value will also take into account factors such as the time value of money based on the expected point at which the deferred tax is expected to crystallise.

2.2.4. **_Accordingly, we believe that the wording "determined in terms of International Accounting Standard 12 of IFRS" should be removed._**

2.3. Refining the interaction between the anti-avoidance provisions for intra-group transactions (section 45)

2.3.1. It was stated in the 2019 Budget Review (Annexure C, page 131 "*Refining the interaction between the anti-avoidance provisions for intra-group transactions*") that instances giving rise to potential double taxation would be addressed.

2.3.2. We include below two such examples of where double taxation can arise due to the "multiple" anti-avoidance provisions within section 45 referred to in the Budget Review. Unfortunately, the TLAB does not yet contain the amendments necessary in this regard and these should now be included.

Example 1: De-grouping and settlement of consideration – sections 45(3A) and 45(4)

2.3.2.1. Section 45(3A), combined with the de-grouping charge in section 45(4) gives rise to the potential for an unwarranted double tax charge. This is illustrated by the following simple example:

2.3.2.2. CoA transfers a capital asset, with market value R100 and base cost R20, to its sister subsidiary CoB for R100 left outstanding on loan account (the sale is undertaken at market value and not book value so as not to prejudice minority shareholders in CoA).

2.3.2.3. CoA's base cost in the loan receivable is, in terms of section 45(3A), nil. Of itself this is not problematic as, provided CoA and CoB are still members of the same group of companies at the time the loan is settled, the resultant gain is disregarded.

2.3.2.4. However, if one considers what happens in the instance where CoA and CoB cease to be members of the same group of companies prior to the loan being settled, the following then occurs:

i) CoB suffers a de-grouping charge in terms of section 45(4)(b)(i) and triggers a capital gain of R80;

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ii) Upon CoB subsequently settling its loan with CoA, CoA has a disposal of its loan (with nil base cost) and also realises a further capital gain of R80

2.3.2.5. The aggregate effect is that taxable capital gains are triggered totalling R160, double the economic gain and in excess of the total market value of the asset originally transferred.

2.3.2.6. This is clearly an untenable position. Where a de-grouping charge arises, no further charge by reason of the nil base cost applied in terms of section 45(3A) should arise.

2.3.2.7. ***Section 45(3A) should be disapplied where a de-grouping charge in terms of section 45(4) arises.***

Example 2: Interaction between de-grouping and ring-fencing – sections 45(4) and 45(5)

2.3.2.8. In certain instances the ring-fencing provisions of section 45(5) would appear to apply where this should not be the case. We have again sought to illustrate this below by means of a simple example.

2.3.2.9. CoA transfers a capital asset to its sister subsidiary, CoB, in terms of section 45. The asset has a base cost of R50 and a market value of R400.

2.3.2.10. Within a year of the original transfer a de-grouping event occurs with the result that, in terms of section 45(4)(b)(i), CoB has a deemed capital gain of R350 and its base cost in the asset transferred increases by a matching amount (i.e. by R350 to R400).

2.3.2.11. At the start of the next year of assessment the asset is sold by CoB to a third party for its, then, reduced market value of R300. Such disposal is still within 18 months of the original acquisition of the asset by CoB.

2.3.2.12. It appears as if, notwithstanding the triggering of the de-grouping charge, the resultant capital loss of R100 (proceeds of R300 less the increased base cost of R400 following the de-grouping charge) will be ring-fenced in terms of section 45(5)(a)(ii) as there is no carve-out for instances where a de-grouping charge has previously arisen.

2.3.2.13. Whilst the above is not a common occurrence, we have seen it a number of times in practice, particularly where the underlying asset is subject to significant price volatility (e.g. listed shares and / or commodities).

2.3.2.14. This cannot be correct or justified. Had the initial transfer from CoA to CoB been effected outside of section 45, CoA would have paid tax on the gain of R350 (as occurs above by CoB) and CoB would not have been subject to any ring-fencing of any loss (or gain) arising in respect of a subsequent disposal to a third party. It cannot be that where Co B pays tax on the same R350 gain by reason of a de-grouping charge that it is then also subject to the ring-fencing provisions as this would result in the 'relieving' roll over provisions placing taxpayers in a worse position than had such reliefs not applied.

2.3.2.15. It is submitted that the ring-fencing provisions in section 45(5) should not apply in respect of disposals of assets that have been subject to a de-grouping charge in terms of section 45(4).

2.4. Withholding taxes (TALAB)

2.4.1. The TALAB proposes various amendments to each of Part IVA (withholding tax on royalties), Part IVB (withholding tax on interest) and Part VIII (withholding tax on dividends) including the alignment of the provisions dealing with:

2.4.1.1. the written undertakings to be provided by the recipient of the relevant payment to the payor thereof to inform the payor of any change in circumstance affecting any exemption or reduced rate applicable in terms of a double taxation agreement through the introduction of related provisions to each of sections 49E and 50E, mirroring those already existing in sections 64G and 64H; and

2.4.1.2. the proposed addition of new provisions (sections 49E(4), 50E(4), 64G(4) and 64H(4)) stipulating that the written undertakings are only valid for a period of two years.

2.4.2. With regard to the proposed limitation on the time the undertakings are to be valid for, we question the need for such limitation given the existing undertakings provided for in Part III (where the wording is stipulated by the Commissioner) are open ended and without time limitation. To increase the administrative burden needlessly simply adds to the level of red tape that taxpayers already have to deal with for no apparent benefit to either taxpayer or fiscus.

2.4.3. For example, again in the context of dividends tax in particular, to require companies to submit a new form every two year to regulated intermediaries in respect of their listed share investments in order to benefit from the exemption in section 64F(1)(a) seems pointless, especially against a back-drop of already having given a written undertaking to notify of any relevant changes in circumstances.

2.4.4. ***We submit that the proposed 2 year limitation on the validity of the written undertakings to be proposed by the relevant beneficial owner of a royalty, interest or dividend payment should be abandoned.***

3. Minor matters

3.1. Clause 2(1)(i) of the TLAB amends the definition of ‘permanent establishment’ and refers to the update of the Model Tax Convention during “2017”. However, per section 5.3 of the EM (TLAB), this reference should be to “2018”.

3.2. Clause 8(1)(c) of the TLAB amends paragraph (e) of the definition of ‘hybrid equity instrument’ in line with other changes in the TLAB such that the revised wording will read as follows:

> *‘…. is subject to a right or <u>arrangement</u> that would have constituted a right or <u>security arrangement</u> contemplated in paragraph (a), (b) or (c) …”*

it is submitted that the word ‘security’ should also be removed as (i) the prior reference in the paragraph is to an ‘arrangement’ and (ii), whilst paragraph (c)(i) contemplates security, neither paragraphs (a) or (b) of the definition do.

3.3. With regard to clause 17(1)(c):

3.3.1. this proposes the insertion of a new subsection (3C) to be inserted “after subsection (3C)”, such latter reference should be to “after subsection (3B)”; and

3.3.2. whilst the principle of the inclusion of such a clause is itself a substantive matter and the topic of much debate in the press of late, we would suggest that, should the proposed limitation be retained (on which we express no view), the wording needs to be amended so as to provide clarity as to whether the proposed R2.5 million limitation is (i) an aggregate limitation per investing taxpayer per year of assessment, or (ii) per investing taxpayer per venture capital company per year of assessment.

3.4. There is a typo in clause 32(a), ".. definition of 'short term polic'y …" should read "… definition of 'short term policy' …"

3.5. Each of clauses 80(1), 81(1) and 82(1) amend certain effective dates to "1 January 2021". However, the EM (TLAB) in relation to these clauses states the amendment should be to 1 January 2020. The TLAB and the EM (TLAB) need to be aligned to whichever of the two dates mentioned is the one intended.

3.6. In the table of contents of the EM (TLAB):

3.6.1. section 3.3 "Consequential Amendments to the Tax treatment of foreign reinsurance business operating a branch in South Africa" is incorrectly included under the heading "Reviewing the real estate investment trust (REIT) tax regime".

3.6.2. section 4.3 "Reviewing the allowable deduction for investors investing in a venture capital company" is incorrectly included under the heading "Reviewing the special economic zone (SEZ) regime".

3.7. In the first paragraph under the background at section 2.1 (page 10) the wording " … in the case of a resident dividend that declares and pays a dividend to another resident company .." is incorrect, the first reference to "dividend" should be to "company".

3.8. In the clause by clause section of the EM (TLAB), with regard to clause 2, the cross-references to the actual clauses in the TLAB require to be updated as they do not currently align.

3.9. With regard to the explanation re Clause 30(c), "TOP" should read "TO"

3.10. Clause 36(b) of the TALAB proposes to substitute section 191(4) of the TAA, 28 of 2011. However, neither in the hard copy of the Act, nor on the online version from sars.mylexisnexis.co.za accessed through SARS website on 9 August 2019, is there an existing section 191(4) to be substituted.

4. Matters not addressed in Draft Bill (each pertaining to 'Income tax – domestic business')

4.1. REIT definition (section 1)

4.1.1. The Taxation Laws Amendment Act, 23 of 2018 ("**TLAA 2018**") amended the definition of "REIT" in section 1 so as to cater for the additional stock exchange licensees who had been granted licenses.

4.1.2. The amended definition requires, *inter alia*, that –

> *"… as shares in a REIT as defined in the listing requirements of an exchange approved in consultation with the Minister and published by the Prudential Authority …."*

4.1.3. However, we believe that the wording adopted is deficient in a number of regards:

4.1.3.1. firstly, we understand that it is the Financial Sector Conduct Authority ("**FCSA**") that publishes the listing requirements of the various exchanges and not the Prudential Authority ("**PA**") as envisaged in the revised definition;

4.1.3.2. secondly, both the FCSA and PA were only established on 21 August 2017 on the coming into force of the Financial Sector Regulation Act and thus it would seem that companies listed as REITs on any exchange approved by the Financial Services Board prior to that date (including the JSE) would no longer qualify as a REIT as the requirement as regards the publishing of the listing requirements of the relevant exchanges by either of the new FCSA or PA would not be met; and

4.1.3.3. whilst the EM to the TLAA 2018 states that there is an additional approval required in that the REIT listing requirements of an exchange's overall listing requirements must be specifically approved this is not necessarily borne out by the wording in the legislation which can be interpreted as the approval requirement applying to the overall requirements. We have experienced both views in the market.

4.1.4. ***We suggest that the above issues be addressed by an amendment to section 1(u) of the Taxation Laws Amendment Act, 23 of 2018, with retrospective effect to its date of promulgation on 17 January 2019.***

4.2. Section 42(8)

4.2.1. We note at the outset that in terms of this particular submission we fully understand the motivation and the principles behind the recapture in terms of section 42(8) of the face value of debts assumed and agree therewith.

4.2.2. The difficulty we have however is that, unlike the other, fixed, time-based tests found in Part III (18 months, 24 months or, in the case of de-grouping events in section 45, 6 years), the recapture contemplated in section 42(8) is a 'forever after' test.

4.2.3. This becomes problematic for, we submit, both taxpayers and SARS alike in terms of tracking same.

4.2.4. It is worth bearing in mind that the de-grouping time-frame in section 45 was also originally a 'forever after' test but that the fiscus subsequently accepted that this was impractical (for both taxpayers and SARS) to monitor and reduced this to a six-year period.

4.2.5. The EM to the Revenue Laws Amendment Act 35 of 2007 (which reduced the original 'forever after' test in section 45(4) to the six-year limit stated the following:

> "*The proposal eases the de-grouping charge by adding a time limit. Under the new rule, the de-grouping charge applies only if the transferor and transferee companies involved in the intra-group transfer become severed from one another (i.e. no longer form part of the same group) within six years after the intra-group transfer. Group*

separations after the six-year period are ignored. This time limit is consistent with the U.K. de-grouping charge and is sufficient to protect against normal third party sales being disguised in intra-group form. It is also roughly consistent with the record-keeping rules of sections 73A and 73B. …..."

4.2.6. ***We submit therefore that consideration should be given to limiting the recapture in section 42(8) to subsequent disposals within 6 years of the acquisition to align with the de-grouping period and assist in the monitoring thereof by both taxpayers and SARS alike.***

4.3. Section 45(4B) trigger of deemed de-grouping where consideration distributed outside group

4.3.1. Section 45(4B)(b) provides a safe harbour limit in terms of which up to 10 per cent of any amount derived directly or indirectly from the consideration resulting from an intra-group transaction in terms of section 45 may be distributed outside the group within a period of two years from the date of such intra-group transaction without giving rise to a deemed de-grouping event / charge.

4.3.2. Section 45(4B)(a) however triggers a deemed de-grouping event / charge where any of the actual consideration received is so distributed, i.e. without an equivalent de-minimus safe harbour limit of 10 per cent.

4.3.3. Assume a group consists of Parent and its two wholly owned subsidiaries, CoA and CoB.

4.3.3.1. In transaction 1 CoA transfers an asset in terms of section 45 to CoB. CoA then distributes the proceeds therefrom by way of dividend to Parent. By virtue of section 45(4B)(b), Parent can then distribute up to 10% of such proceeds to its (non-group) shareholders without triggering a de-grouping.

4.3.3.2. In transaction 2, Parent transfers an asset in terms of section 45 to CoB. In this instance Parent cannot distribute any of the proceeds therefrom as s45(4B)(a) contains no equivalent 10% de-minimus exclusion.

4.3.4. We can think of no reason why such a difference exists and why it would be acceptable for 10 per cent of any consideration to be first distributed within a group and then onwards outside of the group without triggering a de-grouping whereas a direct distribution of 10 per cent of the proceeds outside the group would trigger a de-grouping.

4.3.5. ***Accordingly we submit that section 45(4B)(a) should also provide for the 10 per cent safe harbour.***

4.4. Section 45(5) application of ring-fencing

4.4.1. The manner in which the ring-fencing provisions of section 45(5) apply appears to be the subject of debate, with conflicting views having been expressed by major law firms. It is submitted that such uncertainty should be removed through a change of the language used in the legislation so as to ensure that the legislation accords with the intent expressed in the explanatory memorandum accompanying the introduction of the relevant provisions.

4.4.2. Once again, we have sought to illustrate the issue identified through a simple example. For these purposes the example contemplates the ring-fencing of capital losses in terms of section 45(5)(a)(ii), though similar principles would apply also in respect of gains (section 45(5)(a)(i));

i) Base cost at time of original intra-group transaction – R400

ii) Market value at time of original intra-group transaction – R600

iii) Sales price (and market value) at time of subsequent disposal by transferee – R300

4.4.3. The explanatory memorandum which accompanied the Revenue Laws Amendment Act, 74 of 2002 (the "**2002 EM**"), section 34 of which introduced section 45(5)(a)(ii) in its current form, included the following explanation as to the operation thereof:

> *"… <u>so much of a capital loss</u> determined on disposal of a capital asset within 18 months after it was acquired in terms of an intra-group transaction, <u>as was rolled over</u> to the transferee company, must be disregarded … "*[1] *(underlining is our emphasis)*

4.4.4. Upon a disposal of the asset by the transferee company within 18 months of its acquisition a capital loss of R100 will arise (R300 sales price less the, rolled over, base cost of R400).

4.4.5. Section 45(5)(a)(ii) should not find application as, had the asset been disposed of at the start of the 18 month period, no capital loss would have arisen to which the ring-fencing provisions would apply as, at that time, a capital gain would have arisen.

4.4.6. The reference to "that amount" in section 45(5)(a)(ii) must be read, in the context of the 2002 EM and the opening wording of the sub-section 'so much of any capital loss' as "that amount [of any capital loss]".

4.4.6.1. The Oxford English dictionary includes as a meaning of "that", 'referring to a specific thing previously mentioned, known or understood'[2]. In the context of section 45(5)(a)(ii) such 'thing' is the capital loss referred to in the opening words.

4.4.6.2. It is submitted that had the fiscus intended (contrary to 2002 EM) to ring-fence an amount irrespective of whether the comparative figure gave rise to a gain or loss,

[1] Page 41 of the 2002 EM

[2] www.lexico.com/en/definition/that (accessed 11 August 2019)

then the more appropriate language to have used would have been to replace “that” with “any”,

4.4.6.3. Such an interpretation would be in line with the 2002 EM which provided the rationale for section 45(5)(a)(ii).

4.4.6.4. In the context of the anti-avoidance provisions contain in Part III of Chapter II, it would make no sense to ring-fence an actual loss where no loss was rolled over.

4.4.7. Notwithstanding the above, we have seen a contrary interpretation put forward that which, in applying section 45(5)(a)(ii), holds that the amount to be determined for purposes of any ring-fencing is R200 (R600 market value less R400 base cost, calculated by reference to the market value and base cost at the time of the intra-group transaction). Thus, on the disposal contemplated within 18 months, any capital loss that does not exceed R200 would be ring-fenced, in the current example the full R100 capital loss would thus be ring-fenced.

4.4.7.1. This contrary view appears to be wholly at odds to the policy as set out in the 2002 EM as referred to in 4.4.3 above.

4.4.8. Whilst it is accepted that the differing views set out above could be settled by the courts, being related to a matter of interpretation, we submit that it is preferable for the legislation to be clear and unequivocal and, wherever possible, to avoid the need for litigation. In this regard we submit that the reference in section 45(5)(a)(ii) to “that amount” be replaced with “… that amount of any capital loss ….” (and the reference in section 45(5)(a)(i) to “… the amount” be replaced with “the amount of any capital gain …”).

4.5. Provisional tax for Companies (returns and payment)

4.5.1. Section 27 of the Companies Act, 2008 explicitly limits the financial year of a company to a maximum of 15 months, and, implicitly for financial years after the first year, a minimum of 9 months. However, the first financial year from the date of incorporation can be less than 6 months.

4.5.2. Paragraph 23 of the Fourth Schedule provides for the payment of provisional tax by companies (and thus implicitly therefore also the submission of the related returns) with the first payment due within 6 months after the commencement of a year of assessment and the second payment due by the end of the relevant year of assessment.

4.5.3. No provision is currently made for instances where a company has either a long or a short year of assessment, whether by reason of it being its initial year of assessment from its date of incorporation or where it has a change in its year of assessment, e.g. following a takeover and alignment with a common group year-end.

4.5.4. ***Having regard to the above we submit that, as a minimum, paragraph 23 should provide that where a company has a year of assessment of six months or less that no first payment (and return) is required.***

4.6. Interaction between paragraphs 39 and 42 of the Eighth Schedule

4.6.1. There is a lack of clarity in the legislation as to which of paragraphs 39 and 42 of the Eighth Schedule takes precedence in the case of a disposal and acquisition of identical financial instruments from one person to a connected person in relation thereto. We have experienced different views being taken on this in the market.

4.6.2. We recently raised this matter with SARS and unfortunately there are also differing views on this matter within SARS. We have been informed by SARS that they have raised this matter with the legislative team.

4.6.3. R***ather than awaiting resolution through the courts (which in any event could require subsequent legislative amendment should a court find against whichever view SARS puts forward at that time on behalf of the fiscus) we would suggest the fiscus decide from a policy perspective which provision they intend to take precedence and then provide for this accordingly, e.g. through making one of these paragraphs subject to the other.***

4.7. Rules introduced in 2018 addressing the use of trusts to defer tax or recharacterise the nature of income – sections 7(8) and 25B and paragraphs 64B, 72(b) and 80(3) of the Eighth Schedule

4.7.1. The TLAA 2018 introduced provisions which effectively 'turn-off' the participation exemption in section 10B(2)(a) in certain circumstances.

4.7.2. Whilst the motivation for this in, for example, section 25B(2B) is understood, we submit that the provisions as introduced are overly broad and require the addition of exemptions therefrom.

4.7.3. So as to avoid economic double taxation, provision needs to be made for where the relevant foreign dividend received by the trust is sourced, indirectly, from South African dividends which have been subject to dividends tax.

4.7.4. For example, where a foreign trust (with South African beneficiaries) holds shares in a foreign company which in turn holds shares in a South African company[3] a combined effective tax rate of just under 54% can arise, with the profits generated by the underlying South African company being subject to each of (i) normal tax on taxable income, (ii)

[3] This can occur either in the context of permitted loop structures approved by the FinSurv, or indeed where the foreign jurisdiction is within the common monetary area such that the holding structure does not constitute a loop for exchange control purposes.

dividends tax on any distribution to the foreign shareholder (prior to any reduction in terms of any applicable double taxation agreement) and then (iii) normal tax in the hands of a South African beneficiary when distributed by the foreign trust from an on-declaration by the foreign company.

4.7.5. In the context of the secondary tax on companies (since replaced with the dividends tax), section 64B(3A)(d)(ii) catered for the above holding structure (including a ranking of dividends).

4.7.6. We submit that:

4.7.6.1. the concept and approach adopted in the previous section 64B(3A)(d)(ii) should likewise be adopted in conjunction with the turning off of section 10B(2)(a) in section 25B(2B); and

4.7.6.2. such amendment should also be extended to the other equivalent provisions introduced in the TLAA 2018, e.g. the proposed amendments to section 7(8)(aA).

Should you wish to discuss any aspect of this document further, please contact me directly.

Yours faithfully

James Aitchison
james@jats.co.za
082 781 6269 / 021 403 6317