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The Select Committee on Finance

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Dear Madam

COMMENTS ON 2020 DRAFT TAXATION LAWS AMENDMENT BILL ("DTLAB") AND DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL ("DTALAB").

"Loop structures" for foreign direct investment purposes

1. Introduction

1.1 Currently, South African resident individuals are permitted to own up to 40% of the shares in a foreign company that invests back into South Africa. The DTLAB proposes for the 40% restriction to be lifted to encourage inward investments into South Africa, subject to reporting the investment to the Financial Surveillance Department of the South African Reserve Bank ("**FinSurv**") as and when the transaction is finalised. It has been proposed that this reform will be effective from 1 January 2021 for companies, including private equity funds, provided that the entity is a tax resident in South Africa (i.e. "loop structures" will be permitted provided that the entity (we assume that this relates to an offshore entity) is tax resident in South Africa).

1.2 There is currently no proviso in the South African Exchange Control regulations stipulating that the offshore entity needs to be “tax resident in South Africa”. We assume that the "tax resident in South Africa" requirement will only apply where South

Africans own over 50% of the shares or voting rights of the offshore entity and that "loop structures" in respect of which South Africans own less than 50% of the shares or voting rights of the offshore entity will be permitted even where the offshore entity is not tax resident in South Africa.

2. **Impact**

2.1 If our assumption, as discussed in paragraph 1.2 is incorrect, we foresee the following negative economic consequences of the "tax resident in South Africa" requirement:

2.1.1 rather than encouraging investment into South Africa, the requirement will materially curtail investment opportunities. This would essentially be a step backwards rather than a phasing out of exchange controls; and

2.1.2 unintended consequences when implemented against the backdrop of the various Double Tax Agreements that South Africa has with various countries, essentially blocking investment back into South Africa even where South Africans are minority shareholders.

3. **Recommendation**

3.1.1 We recommend that it should be clarified that the "tax resident in South Africa" requirement applies to the South African company into which a foreign investment is made (i.e. the South African company is not only resident in South Africa for exchange control purposes but also tax resident in South Africa).

3.1.2 Alternatively, we recommend that it should be clarified that the "tax resident in South Africa" requirement only applies where South Africans own over 50% of the shares or voting rights of the offshore entity, as discussed further in paragraph 1.2.

Income Tax: Comments in respect of International Tax Amendments in Taxation Laws Amendment Bill

4. **Introduction**

4.1 As requested, we have set out our comments in respect of the Taxation Laws Amendment Bill below.

5. Introducing an anti-avoidance provision regarding change of residence

5.1 Section

5.1.1 Section 9H of the Act.

5.2 The legal nature of the problem

5.2.1 The income tax legislation currently contains provisions to ensure that the fiscus is not out of pocket when the tax residence of a South African company is migrated to another jurisdiction. It was pointed out in the Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill, 2020 that Government has noticed that the South African tax base is eroded in instances where a South African tax resident company changes its tax residence to another jurisdiction and shares in that company are subsequently sold by South African shareholders which qualify for a participation exemption. Allowing South African resident shareholders to benefit from a participation exemption on disposal of the shares in a non-resident company that was a resident company when the shares were acquired is against the intended purpose of the participation exemption, and it has been proposed that changes be made in section 9H to deem a South African tax resident shareholder who holds shares in a South African tax resident company that changes its tax residence to another jurisdiction to be deemed to have disposed of its shares in that company.

5.2.2 However, it appears to us that due consideration has not been paid to how this amendment will interact with the existing legislation. The absence of a holistic approach creates multiple layers of taxation on the same economic gain, which we have illustrated below.

5.2.3 When a South African tax resident company changes its tax residence to another jurisdiction, the company ceases to be tax resident in South Africa and is deemed to dispose of its assets. The disposal is subject to South African capital gains tax.

5.2.4 In addition, in terms of section 9H(3)(c)(iii), the company must, on the date immediately before the day on which the company so ceased to be a resident,

and for the purposes of section 64EA(b), be deemed to have declared and paid a dividend that consists solely of a distribution of an asset *in specie*:

5.2.4.1 the amount of which must be deemed to be equal to the sum of the market values of all the shares in that company on that date less the sum of contributed tax capital of all the classes of shares in the company as at that date; and

5.2.4.2 to the person or persons holding shares in that company in accordance with the effective interest of that person or those persons in the shares in the company as at that date.

5.2.5 Section 64EA(b) provides that a company that is a resident that declares and pays a dividend which consists of the distribution of an asset *in specie*, is liable for the dividends tax in respect of that dividend.

5.2.6 Accordingly, the company would be subject to capital gains tax on a deemed disposal of its assets, as well as South African dividends tax on the deemed dividend *in specie* declared by the company.

5.2.7 We also note that, in terms of section 9H(3)(e), where a South African company ceases to be a resident, the amount of any capital gain disregarded in terms of paragraph 64B of the Eighth Schedule in respect of the disposal of an equity share by that company within three years immediately preceding the date on which the company ceases to be a resident, will be deemed to be taxable in the company's hands.

5.2.8 In addition, in terms of section 9H(3)(f), where a South African company ceases to be a resident, the amount of any foreign dividend that was exempt from normal tax in terms of section 10B(2)(a) within the three years immediately preceding the date on which that company ceased to be a resident, will be deemed to be a foreign dividend received by or accrued to that company, that is not exempt.

5.2.9 Accordingly, on ceasing to be a South African resident, the company will be subject to four tax events, namely, on a deemed disposal of its assets, on the deemed dividend *in specie* (unless an exemption applies), on the recoupment

of previously exempt capital gains and on the recoupment of previously exempt foreign dividends.

5.2.10 The amendment to section 9H, effected by way of the introduction of section 9H(3A), provides that a South African tax resident shareholder which holds at least 10% of the equity shares and voting rights in a South African tax resident company must, where that company ceases to be a resident and where section 64FA exempts or reduces the amount of tax payable in respect of the deemed dividend *in specie,* be treated as having:

5.2.10.1 disposed of the shares in the South African tax resident company to a person which is a South African tax resident on the day immediately before the day on which the company ceased to be a resident; and

5.2.10.2 reacquired each of the shares on the day on which the company ceased to be a resident

for an amount equal to the market value of those shares.

5.2.11 Accordingly, both the company itself (under current law), as well as the company's shareholder (under the proposed amendment), will be subject to South African tax where the company ceases to be a South African tax resident. In many cases this will result in effective economic double taxation in that the increase in value of the shares (on which the shareholder will now be taxed) results directly from an increase in the value of the company's assets (on which the company itself will be taxed).

5.3 **Impact**

5.3.1 If the proposed amendment to section 9H is passed, this may result in numerous layers of taxation on the same amount.

5.3.2 To give an example, assume that:

5.3.2.1 a South African company, ("**Company A**"), holds 100% of the shares in another company, "**Company B**" which is SA tax resident initially but then moves its tax residence to the UK.

5.3.2.2 Company B's sole asset is 100% of the shares in a UK company, Company C.

5.3.2.3 Company A set up Company B with an equity contribution of R100 million.

5.3.2.4 In turn Company B used the R100 million to acquire the shares in Company C.

5.3.2.5 Company B received foreign dividends of R5 million per year for the last three years, which were exempt in Company B's hands.

5.3.2.6 Company C's value (and consequently also Company B's value) has now increased by R50 million to R150 million.

5.3.3 When Company B migrates its tax residence to the UK, it will be taxable at an effective rate of 22.4% on the capital gain of R50 million. Assuming that the section 64FA exemption from tax in respect of dividends *in specie* applies, no dividends tax will be levied on the deemed dividend *in specie* of R50 million. However, Company B will also be taxable at a rate of 20% on the (previously exempt) foreign dividends of R15 million received by it in the preceding three years. If the amendment proposed is introduced, Company A will in addition have to pay capital gains tax on its deemed gain of R50 million at an effective rate of 22.4%. Overall, the South African tax triggered as a result of the R50 million growth in value of the Company C shares will be approximately R22.4 million, and the taxation in Company B's hands on the previously exempt foreign dividends will be R3 million. This translates into an effective tax rate of approximately 50%. These multiple layers of taxation as a result of a single transaction are clearly very draconian.

5.4 **Recommendation**

5.4.1 We recommend that the proposed amendment to section 9H be deleted, given the fact that there are already a number of significant taxing provisions in place dealing with the scenario in which a company migrates its tax residence.

6. Limiting the application of dividend and capital gain exemptions in loop structures

6.1 The recent amendments contained in the Taxation Laws Amendment Bill were intended to prevent the fiscus from losing tax on transactions which ordinarily would have been taxable where a loop structure did not exist. However, the amendments, in some instances, actually result in additional tax being imposed where ordinarily (i.e. in the absence of a loop structure) the transaction would not have been taxable.

6.2 Dividend exemption

6.2.1 Section

6.2.1.1 Section 9D(2A)(d) of the Act.

6.2.2 The legal nature of the problem

6.2.2.1 Where a South African individual holds shares in a South African company directly, the individual would be subject to South African dividends tax a rate of 20% on dividends paid by the South African company to the individual. However, where the South African individual holds shares in a South African company via a CFC in terms of a so-called "loop structure", the rate of dividends tax on dividends paid to the CFC by the South African company may be reduced in terms of South Africa's tax treaties. Furthermore, foreign dividends received by the individual from the CFC may qualify for an exemption from South African tax in terms of section 10B of the Act. Accordingly, the existence of the loop structure would reduce the amount of tax which would ordinarily be payable.

6.2.2.2 Therefore, it has been proposed that section 9D be amended, ostensibly to ensure that the South African fiscus does not lose out on dividends tax as a result of a loop structure. The 2020 Budget Review proposed that the amendment would only apply to individuals and trusts who or which hold shares in a CFC on the basis that an individual or trust would have been subject to dividends tax had such individual or trust directly held shares in the underlying South African company.

6.2.2.3 However, the proposed amendment goes far beyond this and also applies to South African companies which are shareholders in a CFC. These

companies would be exempt from income and dividends tax on dividends received from a South African resident company. Therefore, in many instances the proposed amendment will in fact result in SARS getting more tax rather than the same amount of tax that would arise where the South African company is held directly by South African shareholders.

6.2.2.4 For example, if a South African company ("**SA Co 1**") holds shares directly in another South African company ("**SA Co 2**"), dividends received by SA Co 1 from SA Co 2 would be exempt from South African dividends tax. Accordingly, where SA Co 1 holds shares directly in SA Co 2, no tax would be payable in respect of dividends paid by SA Co 1 to SA Co 2.

6.2.2.5 However, where a CFC is interposed between SA Co 1 and SA Co 2, dividends paid by SA Co 2 to the CFC would be subject to South African dividends tax (albeit potentially at a reduced rate in terms of South Africa's treaties in certain cases). Accordingly, the existence of the loop structure would result in an <u>increased</u> amount of tax being payable.

6.2.2.6 In addition, the proposed amendment to section 9D(2A)(d) proposes that in determining the net income of a CFC, any exemption from normal tax in respect of dividends received or accrued as contemplated in section 10(1)(k) must not apply in respect of the portion of an amount of the aggregate amount of dividends received by or accrued to that CFC during any foreign tax year, determined in accordance with the following formula:

A = B x (C - D)

where:

6.2.2.6.1 "A" represents the amount of the dividend to be determined which is not exempt from income tax in the hands of the CFC's South African shareholder;

6.2.2.6.2 "B" represents the ratio of the number 20 to the number 28;

6.2.2.6.3 "C" represents the aggregate of dividends received by or accrued to the CFC during its foreign tax year; and

6.2.2.6.4 "D represents:

6.2.2.6.4.1 100% of the amount of any dividend received in respect of which dividends tax has been paid at a rate of 20%;

6.2.2.6.4.2 50% of the amount of any dividend received in respect of which dividends tax was paid at a rate of 10%;

6.2.2.6.4.3 40% of the amount of any dividend received in respect of which dividends tax was paid at a rate of 8%;

6.2.2.6.4.4 37.5% of the amount of any dividend received in respect of which dividends tax was paid at a rate of 7.5%; and

6.2.2.6.4.5 25% of the amount of any dividend received in respect of which dividends tax was paid at a rate of 5%.

6.2.2.7 We note that variable "D" in the Taxation Laws Amendment Bill, 2020 refers to "any dividend paid by that controlled foreign company". We submit that this is an error in the drafting and the phrase in variable "D" should rather refer to "any dividend paid by a South African company to a controlled foreign company". For purposes of this submission, we have assumed that the drafting is incorrect and have relied on the construction as suggested in this 3.2.2.7 of this submission.

6.2.2.8 Where dividends tax of less than 20% is imposed, the problem arises because income tax will then be imposed in accordance with the formula, arriving at an effective aggregate South African tax rate of 20% in all instances. While we accept that a South African company held by a CFC may be required to pay dividends tax on its dividends paid to that CFC, we see no justifiable basis for also imposing income tax on the dividend amount under the CFC rules. As mentioned above, where a South African company holds shares directly in another South African company, no income tax would be payable on dividends paid between the two companies. This should not be any different simply because a CFC is interposed between the two South African companies.

6.2.2.9 In contrast, where a South African company is held by a South African individual, ordinarily there would be a tax liability where dividends are paid by the South African company to the South African individual shareholder. A South African individual who holds shares directly in a South African company would ordinarily suffer dividends tax at a rate of 20% on dividends received by him or her from the South African company.

6.2.2.10 Accordingly, if a CFC is interposed between the South African company and a South African individual, the tax payable on a dividend paid by CFC in a loop structure should not exceed 20%, i.e. the tax liability which would ordinarily be suffered if the individual were to hold the shares in the South African company directly. This is not the case though, where dividends tax is imposed at a rate of less than 20%. We have illustrated this by means of the following example.

6.2.2.11 Assume that South African individual ("**Individual**") holds shares in CFC, which in turn holds shares in SA Co. SA Co declares a dividend of R100, on which dividends tax of 8% is withheld.

6.2.2.12 According to the formula in section 9D(2A)(d), the exemption from normal tax in calculating the net income of the CFC (which may be imputed to and taxed in the hands of the Individual) would not apply to the following amount:

A = B x (C - D)

A = 20/28 x (R100 - (40% x R100))

A = 20/28 x (R100 - R40)

A = 20/28 x R60

A = R42.86

6.2.2.13 The non-exempt portion of the dividend is R42.86. Accordingly, assuming that Individual is subject to tax at the highest marginal rate, the South African income tax payable on the non-exempt potion of the dividend in Individual's hands would be R42.86 x 45% = R19.29.

6.2.2.14 The total tax payable in respect of the dividend is:

R8 dividends tax + R19.29 income tax = R27.29 total tax

6.2.2.15 The inclusion rate of 20 to 28 which is contained in the formula in section 9D(2A)(d) results in an effective tax rate of greater than 20% where the net income of the CFC is imputed to the individual shareholder, as illustrated by the above example. The effective tax rate in this example is approximately 27%, as opposed to 20% (which it otherwise should be).

6.2.2.16 We submit that the inclusion rate which should be used in respect of individuals is 20 to 45. Where this inclusion rate is used, the effective rate of tax is 20%. Using the facts set out in the above example, the exemption from income tax in Individual's hands in respect of the dividend would not apply to the following amount:

A = B x (C - D)

A = 20/45 x (R100 - (40% x R100))

A = 20/45 x (R100 - R40)

A = 20/45 x R60

A = R26.67

6.2.2.17 The non-exempt portion of the dividend is R26.67. Accordingly, assuming that Individual is subject to tax at the highest marginal rate, the South African income tax payable on the non-exempt portion of the dividend in Individual's hands would be R26.67 x 45% = R12.

6.2.2.18 The total tax payable in respect of the dividend is:

R8 dividends tax + R12 income tax = R20 total tax

6.2.2.19 The total tax payable of R20 is equal to the amount of tax which would be suffered if an individual were to hold shares in a South African company directly, and is therefore correct.

6.2.3 **Impact**

6.2.3.1 The proposed amendment to section 9D(2A)(d) would subject the dividend received by a CFC (which is held by a South African company) to tax at an effective rate of up to 20%, even though, in the absence of a loop structure, no income tax would have been payable on the dividend paid between two South African companies.

6.2.3.2 In addition, the inclusion rate of 20 to 28 results in an effective tax rate which is greater than 20% where the shareholder of the CFC is an individual or trust.

6.2.4 **Recommendation**

6.2.4.1 We recommend that it should be clarified that the section 9D(2A)(d) amendment would not apply in circumstances where the shareholder of a CFC is a South African tax resident company.

6.2.4.2 We also recommend that the inclusion rate of 20 to 28 in section 9D(2A)(d) be adjusted to ensure that shareholders of the CFC which are not South African tax resident companies are subject to tax at the appropriate effective tax rate.

6.3 **Capital gains tax exemption - paragraph 64B (6) of the Eighth Schedule to the Act**

6.3.1 **Section**

6.3.1.1 Paragraph 64B (6) of the Eighth Schedule to the Act.

6.3.2 **The legal nature of the problem**

6.3.2.1 The participation exemption in paragraph 64B(1) of the Eighth Schedule provides for an exemption from capital gains tax in respect of capital gains realised by a taxpayer on the disposal of shares in a foreign company where the taxpayer, *inter alia*, holds an interest of at least 10% of the equity shares and voting rights in the foreign company.

6.3.2.2 However, the proposed new paragraph 64B(6) of the Eighth Schedule to the Act provides that paragraph 64B would not apply in respect of any capital gain or capital loss determined in respect of the disposal of any share in a CFC to the extent that the value of the CFC's assets are attributable to South African assets.

6.3.2.3 We understand that, in terms of the amendment, if for example, 60% of the value of the CFC is attributable to South African assets, then the participation exemption would only apply to 40% of the capital gain realised on disposal of the shares in the CFC. The amendment, therefore, only denies the participation exemption to the extent that value is attributable to South African assets. We submit, however, that the amendment may be interpreted as denying the participation exemption in its entirety where a CFC has South African assets. Accordingly, we suggest that the correct interpretation be confirmed in the Explanatory Memorandum and the wording of the amendment be modified to clarify that the participation exemption would only be denied in respect of the portion of the gain which relates to South African assets.

6.3.3 **Impact**

6.3.3.1 We foresee that it is unlikely that South African tax residents will deliberately interpose a CFC company to hold the shares in a South African company simply to take advantage of a future potentially tax-free disposal of the CFC. Rather, it is more likely that a South African resident will be given the opportunity to invest in a foreign company, which happens to hold South African investments, where the South African resident was not involved in setting up the structure which acquired the South African assets.

6.3.3.2 Regardless of this, though, paragraph 64B(6) would preclude the South African tax resident from accessing the participation exemption on disposal of its shares in the CFC (which the resident may otherwise have qualified for), simply because the foreign company happens to have a South African investment, which may be fairly minor.

6.3.3.3 South African tax residents would be penalised for investing in a foreign company which may have held South African assets for many years prior to the South African tax resident's investment in the foreign company. Discouraging investment in this manner appears to be short-sighted and potentially detrimental to economic activity.

6.3.4 **Recommendation**

6.3.4.1 We recommend that paragraph 64B(6) should be deleted, for the reasons given above. Alternatively, if it is retained, it should be amended to penalise situations where the South African assets which are held by the CFC were originally owned directly by South African tax residents, as opposed to situations in which the South African assets have been held by the foreign company itself for a certain length of time.

6.3.4.2 Paragraph 64B(6) should be limited to situations where South African assets were previously held directly by South African tax residents, either wholly or in part, in the preceding three years. In other words, where the CFC has held the South African assets for at least three years, the disposal of shares in the CFC by a South African tax resident should still qualify for exemption.

6.3.4.3 We also recommend that paragraph 64B(6) should be amended to reflect a minimum percentage of South African assets that should be held by the CFC in order for paragraph 64B(6) to apply, with insignificant percentages being ignored.

7. **Expansion of scope of reorganisation rules in sections 41 - 47 in context of relaxation of loop structure provisions**

7.1 **Sections**

7.1.1 Sections 41 - 47 of the Act.

7.2 **Legal nature of the problem**

7.2.1 The loop structure provisions are anticipated to be relaxed, which may allow for a South African company to be held by a CFC. However, the reorganisation

rules in sections 41 to 47 have not been expanded to include transactions where a South African company held by a CFC is (for example) liquidated or unbundled, or a CFC disposes of shares in a South African company to another CFC or to an SA resident. Other instances where such relief is needed may also apply.

7.3 **Impact**

7.3.1 Whilst the restrictions on loop structures are expected to be relaxed, related amendments to tax legislation should not be limited to simply introducing measures to protect the tax base. We suggest that the tax legislation should be expanded to also facilitate genuine business transactions which are now permitted in the loop structure environment.

7.3.2 Currently it is inequitable if no relief is granted in terms of the reorganisation rules in the context of loop structures, even where all parties to the relevant transaction are either directly (or indirectly through the CFC rules) within the scope of South African tax.

7.4 **Recommendation**

7.4.1 We recommend that appropriate amendments be proposed to the reorganisation rules to provide relief for reorganisation transactions where a South African company is held by a CFC.

7.4.2 Whilst not exhaustive, areas where such amendments could be made include:

7.4.2.1 section 42 should be amended to include transactions where a person disposes of an asset, or shares in a South African company, to a CFC, in exchange for shares in the CFC;

7.4.2.2 section 44 should be amended to include transactions where a resident disposes of its assets to a CFC by means of an amalgamation, conversion or merger;

7.4.2.3 section 45 should be amended to include the disposal of an asset, or shares in a South African company, by a company to a CFC, in terms of an intra-group transaction;

7.4.2.4 section 46 should be amended to include transactions where the equity shares in resident company that are held by a CFC, are distributed in terms of an unbundling transaction; and

7.4.2.5 section 47 should be amended to include transactions where a South African resident company disposes of its assets to its holding company which is a CFC, in terms of a liquidation distribution.

8. Deletion of words "a natural person" and "special trust" in section 9D(2A)(f) of the Act

8.1.1 Section

8.1.1.1 Section 9D(2A)(f) of the Act.

8.1.2 Legal nature of the problem

8.1.2.1 Prior to the amendment in the Taxation Laws Amendment Bill, section 9D(2A)(f) determined the inclusion rate for capital gains tax purposes for the shareholder of a CFC which was an individual, special trust or an insurer in respect of its individual policyholder fund. It provided that, where a South African tax resident was a natural person, special trust or an insurer in respect of its individual policyholder fund, the taxable capital gain of the CFC would, for purposes of calculating the net income to be imputed to the SA tax resident natural person, special trust or insurer, be 40% of the CFC's net capital gain (as opposed to 80% of the taxable capital gain which would apply to companies).

8.1.2.2 However, the words "a natural person" and "special trust" have been deleted in section 9D(2A)(f) of the Taxation Laws Amendment Bill. This is problematic in that it results in a higher capital gains tax effective rate for natural persons and special trusts which hold participation rights in a CFC than those taxpayers should ordinarily be subject to.

8.1.2.3 Companies are subject to South African capital gains tax at an effective rate of 22,4%, i.e. 80% of the gain is taxed at a rate of 28%. In respect of individuals, special trusts, and insurers in respect of their individual policyholder funds, however, only 40% of the gain is taxed at the

individual's marginal tax rate. Accordingly, the inclusion rate of 80% for companies is higher than the inclusion rate of 40% for individuals, special trusts and insurers in respect of their individual policyholder funds.

8.1.2.4 Initially, the Draft Taxation Laws Amendment Bill proposed to delete section 9D(2A)(f), which originally referred to individuals, special trusts, and "an insurer in respect of its individual policyholder fund", in its entirety. Submissions were made to SARS and National Treasury in respect of the problematic impact that the deletion of this section would have on individuals, special trusts and insurers in respect of individual policyholder funds.

8.1.2.5 The Response Document states that "… the deletion of the 'look-through' rule in paragraph (f) of the proviso to section 9D(2A) to create an equal treatment of residents holding South African assets directly or indirectly has an impact that an Individual Policyholder Fund (IPF) would be taxed at an inclusion rate of 80% instead of 40% where the capital gain is generated from a CFC which will impact unity pricing of policyholder investments that contain non-loop foreign investments".

8.1.2.6 Whilst SARS and National Treasury have taken account of comments regarding the problematic higher rate for insurers in respect of individual policyholder funds, the excessive effective capital gains tax rate to which individuals and special trusts will now be subject has not been corrected.

8.1.3 **Impact**

8.1.3.1 The deletion of the words "natural person" and "special trust" in section 9D(2A)(f) results in a South African tax resident individual and special trust which hold participation rights in a CFC becoming subject to capital gains tax on imputable capital gains from the CFC at a higher effective tax rate, i.e. 80% of the CFC's net capital gain would be imputable to the individual and special trust. This would result in an effective tax rate of 36% in respect of individuals and special trusts which are subject to tax at the highest marginal rate of 45%.

8.1.3.2 Ordinarily, however, 40% of the CFC's net capital gain would be attributable to the individual and special trust, which would result in an effective tax rate of 18% for individuals and special trusts.

8.1.3.3 The difference between 36% and 18% in respect of individuals and special trusts would be very detrimental for these taxpayers.

8.1.4 **Recommendation**

8.1.4.1 We recommend that the words "a natural person" and "special trust" be reinstated in section 9D(2A)(f), for the reason given above.

9. **Taxation of the transfer of listed securities to an offshore exchange**

9.1 **Section**

9.1.1 Section 9K of the Act.

9.2 **Legal nature of the problem**

9.2.1 When a domestic listed security is removed from the JSE register and is listed on an exchange that is outside South Africa, section 9K provides that the resident natural person or trust which holds that security is deemed to dispose of, and reacquire, that security.

9.2.2 If a South African tax resident natural person or trust ceases to be resident in South Africa, the taxpayer is deemed to dispose of his/her/its assets, which would include securities, whether or not listed on the JSE or on a foreign exchange (excluding, *inter alia*, South African immovable property). Accordingly, the holder would be subject to South African tax on ceasing to be a South African tax resident natural person or trust under section 9H, and it is unclear why it is necessary to introduce the new section 9K which would have the same effect.

9.2.3 It is also unclear why a South African tax resident natural person or trust (who does not cease to be South African tax resident) would be subjected to two tax events, i.e. where a listed security is transferred to a foreign exchange, and again when the resident disposes of the foreign-listed security in due course. In addition, the South African tax resident may be negatively affected from a cash

flow point of view, as the resident would not receive cash proceeds on a deemed disposal of its security, and may not have the cash available to pay any tax due to SARS.

9.2.4 It appears to be unduly onerous for a South African tax resident natural person or trust to be subject to two tax events, i.e. when the listed security is transferred to a foreign exchange, and when the security is disposed of, rather than being subject to one tax event (which would occur on actual disposal of the security).

9.3 **Impact**

9.3.1 Section 9K results in taxation in the hands of holders of securities which are transferred from the JSE to a foreign exchange. However, such holders would already be taxable where:

9.3.1.1 a South African tax resident holder ceases to be a South African tax resident; or

9.3.1.2 a South African tax resident holder actually disposes of the foreign-listed security in due course.

9.4 **Recommendation**

9.4.1 We recommend that section 9K should be deleted, for the reasons given above.

<u>Value-Added Tax</u>

10. **Section 1 of the VAT Act - amendment to the definition of "enterprise"**

10.1 **Legal nature of the problem**

10.1.1 The proposed amendment states that the activity of the supply of the use or right of use of ships, aircraft and rolling stock shall be deemed not to be the carrying on of an enterprise.

10.1.2 In this regard, it is uncertain whether the activity of the supply of the use or right of use of engines are included in the proposed amendment and thus whether the supply of the use or right of use of engines is also deemed not be the carrying on of an enterprise as contemplated in the proposed amendment.

10.2 **Impact**

10.2.1 The proposed amendment seems to suggest that the proviso will not apply in instances where the supply relates to the use or right of use engines.

10.3 **Recommendation**

10.3.1 That clarity is provided regarding whether the activity of the supply of the use or right of use of engines would be included in the proposed amendment.

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