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National Treasury
Private Bag X923
Pretoria
0001

BY E-MAIL: 2019AnnexCProp@treasury.gov.za

mmule.majola@treasury.gov.za

acollins@sars.gov.za

Dear Ms Majola and Ms Collins

Dear Madams

**COMMENTS ON THE INITIAL BATCH OF THE DRAFT TAXATION LAWS AMENDMENT BILL 2019**

1. We herewith take the opportunity to present our comments on behalf of the South African Institute of Chartered Accountants' (SAICA) National Tax Committee on the draft 2019 initial batch of the Taxation Laws Amendment Bills.

2. Our submission includes a discussion of some of the most pertinent legislative matters, which we believe require the most urgent attention.

3. As always, we would like to thank the NT and SARS for the opportunity to provide constructive inputs in relation to the Bill. SAICA believes that a collaborative approach is best suited in seeking actual solutions to legislative concerns.

Should you wish to clarify any of the matters discussed below, please do not hesitate to contact us.

Yours sincerely

**Pieter Faber**

**Senior Executive: Tax**

**SAICA**

**David Warneke**

**Chairperson: National Tax Committee**

**SAICA**

**ALIGNING THE EFFECTIVE DATE OF TAX NEUTRAL TRANSFERS BETWEEN RETIREMENT FUNDS WITH THE EFFECTIVE DATE OF ALL RETIREMENT REFORMS**

4. We agree with the proposed changes to align the effective date of the tax neutral transfers from pension to provident or provident preservation funds with the effective date of retirement reform amendments of 1 March 2021.

5. Submission: The amendment is supported to ensure the overall alignment of retirement reform which will take place from 1 March 2021.

**CLARIFICATION OF THE INTERACTION BETWEEN THE ANTI-AVOIDANCE RULES DEALING WITH DIVIDEND STRIPPING AND CORPORATE RE-ORGANISATION RULES**

***Interaction between dividend stripping and corporate re-organisation rules***

6. The Draft Explanatory Memorandum heading at paragraph 2.1 refers to the interaction between dividend stripping and the corporate re-organisation rules. The draft legislation, however, does not include anything related to the re-organisation rules.

7. Submission: It is uncertain why the corporate re-organisation rules are mentioned in the heading and we suggest this be clarified or it should be made clear that more amendments in this regard are to be expected in the second batch of legislative amendments. If the latter, it is concerning that these provisions were not included in the initial batch of amendments and it is hoped that adequate reasons for this will be provided.

8. The carve-out for deferral transactions in section 22B(2) and paragraph 43A(2) should also extend to the new provisions as the proposed re-wording of section 22B(2) and paragraph 43A(2) creates uncertainty in this respect. The words in section 22B(2) "*or is treated in terms of subsection (3A) as having disposed of any of those shares*" should be moved to earlier in the wording as is the case for paragraph 43A(2) as well.

9. Submission: Subsection 22B(2) should read as follows:

10. "*Subject to subsection (3), where a company holds shares in another company and disposes of any of those shares or is treated in terms of subsection (3A) as having disposed of any of those shares, in terms of a transaction that is not a deferral transaction*…"

11. Similarly the word order in paragraph 43A(2) should be amended so that the subparagraph reads:

12. "*Subject to subparagraph (3), where a company holds shares in another company and disposes of any of those shares or is treated in terms of subparagraph (3A) as having disposed of any of those shares, in terms of a transaction that is not a deferral transaction*".

***Wording pertaining to the reduction in shareholder value***

13. Both the *Draft Explanatory Memorandum* and the *draft legislation* refer to a situation where a target company issues shares to another party and the market value of the shares held by the shareholder company in the target company *is reduced by reason of the shares issued by the target company*.

14. Technically, it is not the issue of shares that results in the reduction of the market value of the shares held by the shareholder company, but rather *the pre-subscription dividend that is declared prior to the issue of new shares*. For example, assume a company has 100 shares in issue, with a total market value of R1 000 (R10 per share). If a dividend of R500 is declared, the shares will (all things being equal) drop in value to R5 per share. If thereafter shares are issued to a new shareholder who contributes R5 per share, the reduction in the market value of the shares "by reason of the new shares issued by the target company", is nil. Immediately prior to the issue of the new shares the market value of the shares was R5 and it remains so after the issue of the new shares.

15. The wording in both the Draft Explanatory Memorandum and the draft legislation needs to be amended to provide clarification on this matter.

***Qualifying interest in a target company***

16. The revised wording in subsection (3) seems to imply that the new subsection (3A) will only apply when a company holds a qualifying interest in a target company, but the wording in (3A) only refers to "when a company *holds shares in another company*…".

17. Submission: The wording in subsection (3A) should also refer to holding of a 'qualifying interest'. For the purposes of the anti-avoidance rule, the qualifying threshold for listed companies should be increased or listed companies should be excluded from the anti-avoidance rule – it is not practical to test if a deemed disposal has taken place every time a listed company issues shares.

***Further unintended application of the anti-avoidance sections***

18. Whilst we appreciate the attempt by the National Treasury to combat abusive tax schemes aimed at circumventing the current anti-avoidance rules dealing with dividend stripping arrangements, the wording of the proposed changes in subsection (3A) (…when share are issued to *a person other than that company*….") is so wide that almost all new issue of shares will trigger a disposal in the hands of the existing shareholders.

19. According to the proposed changes, a disposal (in the hands of say Company A) will be triggered where a target company issues new shares to a person other than Company A and the market value of company A's shares is reduced by reason of the new shares being issued by the target company. These changes will result in negative unintended consequences for a number of *bona fide* share issue transactions. The following transactions will, amongst others, be negatively impacted:

    **A) Right issues of shares:** Right issues of shares is one of the ways in which a company raises additional capital. Companies invite their existing shareholders to take up new shares in proportion to their existing shareholding. A failure by a shareholder to subscribe

for a rights issue results in the dilution of the shareholding and potential reduction in the market value of the shares held. Applying the proposed changes, a shareholder who is unable to participate in the right issues will be treated as having disposed of its shares and a potential capital gains tax amount will become payable depending on the extent of the exempt dividend received or accrued.

**B) Black Economic Empowerment (BEE) transactions:** BEE structures depend on a reduction in value of shares in a company, so as to facilitate the introduction of BEE shareholders. By comparison, an outright disposal of shares by current shareholders to BEE shareholders for nominal value in these circumstances (assuming that the shares were held on capital account) would give rise to capital gains tax determined at market value in terms of paragraph 38, as well as donations tax. The proposed amendment, which would have the effect that one could no longer reduce the value of shares in a company on a tax-neutral basis prior to the introduction of new shareholders, would therefore have a severe impact on the viability of BEE transactions. The proposed changes will therefore inadvertently target shareholders in companies that are seeking to comply with the BEE ownership rules in the sectors that they operate in.

**C) Bona fide share issue transactions:** Companies raise additional capital by issuing new shares to new shareholders. With the proposed changes, the deemed disposals will be triggered in the hands of the existing shareholders even where a company issues shares to any person, including the general public, which will result in the reduction of the market value of the shares held by existing shareholders. The proposed changes will negatively affect the company's ability to raise funding without triggering negative tax implications to its existing shareholders.

20. **D) Non-taxable transactions:** The proposed amendments could have the effect of triggering taxation in circumstances in which an outright disposal of shares would not have, for example, if shares are issued to a company that forms part of the same group of companies as the current shareholders.

21. Submission: The proposed changes create a legal fiction in that the current shareholders have not disposed of their shares in the target company: shares that were held by the current shareholders continue to be held by them. Except in very unusual circumstances, this is counter-intuitive and undesirable from a policy perspective. It is not why a normal transaction such as the declaration of dividends (even if large in amount) by a company, which, after all, are established for this very purpose, should be viewed as 'abusive'.

22. Despite the conceptual basis underpinning section 22B and paragraph 43A still being open to question, we submit that the proposed deemed disposal, as described in subsection 22B(3A) and subparagraph 43A(3A) of the Eighth Schedule, should be amended to exclude *bona fide* right issues, ensure that the shareholders of companies that are entering into *bona fide* BEE transactions are not affected by these amendments and that the anti-avoidance provisions are only trigger where the issue of shares is done with the sole or main purposes of assisting the existing shareholders to avoid income tax or CGT. Thus the anti-avoidance provisions should be limited to situations where shares are issued by the target company to connected persons in relation to the shareholder for tax avoidance purposes and in respect of which taxation would have been payable in an outright disposal of the shares.

***Value of exempt dividend***

23. In the event that a transaction meets the requirements of the proposed amendments, the company is deemed to have disposed of the percentage of the shares it holds equal to the percentage by which the market value of those shares has been reduced. Any exempt dividend in respect of the shares disposed of is then, to the extent that the exempt dividend is an "extraordinary dividend", included in the proceeds. If one applies this to the example in point 14 above, 50% of the shares would be deemed to be disposed of, since the market value of the target company decreased by 50%, from R1 000 to R500. The exempt dividend in respect of the shares disposed of, that is, 50% of the shares held, is R250, not R500.

24. Submission: Presumably it was intended that the R500 be the "exempt dividend", rather than the R250. The full "exempt dividend" should be included in proceeds, and not just the exempt dividend in respect of the shares disposed of.

***Effective date***

25. There appears to be contradictory wording in relation to the effective date for these proposed amendments.

26. The *Draft Explanatory Memorandum*, on page 5 at paragraph III dealing with the **Proposal**, provides the following: "This means that the proposed amendments to the legislation on anti-avoidance rules dealing with dividend stripping will come into effect from 20 February 2019 and apply to dividend stripping schemes entered into on or after 20 February 2019.These legislative interventions will not apply in respect of dividend stripping schemes entered into before 20 February 2019."

27. However, further down on page 5 of the *Draft Explanatory Memorandum*, paragraph IV, which deals with the **Effective Date**, provides that: "The proposed amendments will be deemed to have come into operation on 20 February 2019 and apply in respect of shares held by a company in another company if the market value of those shares is reduced by reason of shares issued by that other company, on or after 20 February 2019 to a person other than that company."

28. The *Draft Taxation Laws Amendment Bill (draft legislation)* provides that: "Subsection (1) is deemed to have come into operation on 20 February 2019 and applies in respect of shares held by a company in a target company if the market value of those shares is reduced by reason of shares issued by that target company, on or after 20 February 2019, to a person other than that company."

29. The wording in the **Proposal** clause of the *Draft Explanatory Memorandum* contradicts the wording in the **Effective Date** clause of the same document. *The draft legislation* is aligned with the **Effective Date** clause of the Draft Explanatory Memorandum.

30. In this regard, should a transaction have been concluded during 2018, (well before the announcement of this proposed amendment), but was subject to suspensive conditions, for instance Competition Commission approval – which resulted in the delay of the issue of the shares in the target company to a date after 20 February 2019 – this transaction would fall foul of the proposed amendments based on the wording of the draft legislation read with the Effective Date clause of the Draft Explanatory Memorandum.

31. This does not appear to be equitable as companies should not be placed in a situation where the tax implications of a transaction change after a transaction has been concluded in the interim period between signature of a transaction and the conditions precedent being fulfilled. This is especially important given that the companies have no control over, for example, the Competition Commission approval.

32. Submission: The effective date of the amendment should be amended to provide that it will be effective in respect of **transactions entered into** on or after 20 February 2019 as indicated in the Proposal clause of the Draft Explanatory Memorandum.

***Overlap with 'value shifting arrangement' provisions and/or section 24BA***

33. The amendments could possibly overlap with the value shifting provisions in the Eighth Schedule and/or section 24BA (Transactions where assets are acquired as consideration for shares issued) in circumstances where full value is not introduced to the target company by incoming shareholders. This means that more than one taxing provision could apply to the same transaction.

34. Submission: There should be a carve-out from section 22B and paragraph 43A in these circumstances.