SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
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FEEDBACK SUMMARY – 25 January 2017

GENERAL

SAICA attends various discussions and meetings on behalf of members with National Treasury (NT), South African Revenue Service (SARS) and other stakeholders (internal and external). These meetings represent an opportunity for NT and SARS to obtain further information on any tax matter from the public and discussions and views expressed do not represent policy or decisions. Furthermore, these discussions do not represent an undertaking by SARS, NT or other stakeholders, but merely statements of their understanding or how they perceive or anticipate a particular matter to be addressed.

The below Feedback Summary should be seen in the above context, as it merely attempts to inform SAICA members of the discussions and of any proposals that were made during such discussions.

SARS/NATIONAL TREASURY (NT) ENGAGEMENTS ON 9 January 2018

- SAICA and other stakeholders met with SARS and NT on 9 January 2018 to discuss legislative and operational issues around the strict application of the VDP provisions contained in the Tax Administration Act, 2011. SARS advised that it will engage in further internal meetings to decide the way forward to ensure consistency and fairness.

- SAICA also met with SARS and NT to discuss legislative and operational issues regarding the effectiveness and sustainability of the current RCB model with a view to facilitating future engagement in this regard.

NT WORKSHOP ON 5 December 2017

The NT workshop held on 5 December 2017 discussed the below matters. This followed after NT and SARS received the Annexure C submissions for 2018 from the public on 24 November 2017.

This workshop was noted as constituting a public consultation process.

Debt forgiveness rules

Following on from prior workshops, NT scrapped the initial draft proposals in sections 19A and 19B of the Income Tax Act , 58 of 1962 (the Act) and requested counterproposals to make it workable. Numerous comments were received on the “debt” definition and accordingly amendments were included in the final 2017 Taxation Laws Amendment Bill (2017 TLAB).

It was submitted that in the case of a debt conversion, exchanging debt for a shareholder loan it makes sense to refer to market value. However, for a pure debt waiver/reduction the reference to market value is an alien concept, adding to complexity, the tax compliance burden and administrative cost. Several issues remain, including the following:

- The policy intent of taxing unrealised positions;
- The interaction with the recoupment provisions;
- Connected and third party debt (the provision should be narrowed down);
- Secured versus unsecured lending;
- A distinction to be drawn between material and non-material terms;
- Lack of clarity around NT's concerns regarding material terms, such as covenants and security;
- Issues around interest rate changes, a change in terms, repayment term and multiple concessions;
- The interplay with the hybrid debt provisions;
- The issues around provisional tax for implementation, since the new rules are effective from 1 January 2018;
- No distinction is made between temporary and permanent changes in the terms of a loan; and
- The reversal issue must be considered (there are no claw back provisions when a temporary change in the term of a loan, which triggers tax in terms of the new rules, reverts back).

NT was urged to consider the specific issues of concern from a policy perspective instead of adopting a blanket approach. The commencement date of 1 January 2018 was requested to be postponed until at least 1 January 2019 further clarity is provided (however it appeared that NT was not amenable to this request).

Hybrid debt rules

The interplay between the hybrid debt provisions and the normal recoupment provisions were discussed in detail and NT agreed that these provisions require further consideration. The situation where an instrument goes in and out of the hybrid debt rules also needs consideration. Stakeholders urged NT to consider the revenue impact of introducing the rules, as well as the significant uncertainty around their application.

Ring-fencing to individual mines

The legislation does not currently deal with a reduction in unredeemed capital expenditure and must be addressed.

Share buy backs and dividend stripping

Stakeholders submitted that it is unclear whether foreign dividends fall within the ambit of the new rules, and that a distinction should be drawn between exempt and extraordinary dividends. The definition of preference share was discussed, as well as the uncertainty around how the 15% 'trigger' is calculated. The interplay with the group rules was raised as a serious concern and NT expressed concern about a dividend stripping followed by a reorganisation and rolling over devalued shares.

Stakeholders requested consistency in the manner in which policies are applied, for example, to decide whether share buy backs are considered to be dividends and to apply this policy consistently, also considering the underlying economics and whether different rules apply for different shareholders. NT could not commit on when amendments to the rules will come into effect.

Section 24O practical issues applying rules

Stakeholders submitted that the definition of an operating company requires revisiting.

Interest limitation rules

NT will be issuing a paper for public comment in due course. The paper will address issues such as the level of control, taking into account prior assessed losses, as well as circular references.

Hybrid debt

Various issues were discussed around the interaction of the hybrid debt provisions, reorganisations rules and the recoupment provisions, taking into account anomalies in the case of reorganisations and in certain leasing transactions.

Stakeholders urged NT to address broader issues around the design of the reorganisation rules. Currently, we have a rigid rule based system and the question remains whether a principle based regime for reorganisation relief, similar to the old reorganisation rules must be considered, albeit that this will involve a significant project.

The interaction between section 42 and other reorganisation provisions

Concerns were raised that there may be a lack of clarity whether roll over relief applies to a second transaction and may give rise to issues for multiple consecutive roll overs transactions. The carve outs in section 42 therefore need clarification whilst the Companies Act provisions must be taken into account. It was debated whether taxpayers may be caught unaware when selling an asset at a marked up price, but for tax purposes needed to have elected out of section 45 of the Act. Something more practical and manageable is required for intercompany transfers within a group. Stakeholders proposed that for the regular and continuous transfer of trading stock, section 42 should not apply automatically. Stakeholders requested NT to consider thresholds and de-grouping provisions. NT noted that the EM will be considered and updated.

CTC

Stakeholders identified anomalies around the definition of contributed tax capital (CTC) and questioned the policy in the case of share buybacks in tranches.

This was identified as having a possible anti-avoidance angle, as the legislation only caters for the outright sale of shares and not for a sale in tranches.

NT mentioned that it was a policy decision not to match CTC to the specific shares, as there were difficulties in tracking this but that the issues raised will be considered.

Third party backed shares

Stakeholders asked NT to consider the policy issues around the impact of the "qualifying purpose" definition on working capital and how such a narrow definition impacts start up companies, which appears to be too narrowly defined, the reasoning behind the restriction around preference shares, and a possible revisiting of the available options.

Disallowed expenditure section 23(o)

NT mentioned that a request was received to disallow the deduction of wasteful expenditure, as defined in the PFMA, and that this should be extended to SOE's. Stakeholders debated this aspect and concluded that there are other ways to deal with this issue. Stakeholders requested clarity and legal certainty around the taxation of professional sportsmen.

FINANCIAL INSTITUTIONS

Section 11(jA)

The question was raised why a securitisation vehicle is not covered taking into account that assets were bank originated although ring-fenced. Stakeholders also raised concerns around suspended interest not being recognised for reporting purposes in the case of a client default, but the legal obligation remaining intact. Clarity is required that suspended interest will form part of bad and doubtful debts. The policy issue around the ruling applying to banks only also re requires clarity, considering that other moneylenders are also subject to similar provisions as banks, for example IFRS9. Stakeholders raised going concern issues.

NT responded that other moneylenders are not subject to SARB regulation. Stakeholders insisted that the policy should at least extend to insurers, as they are moving in the same direction of twin peaks, and whilst not there yet, this should be the direction in which to move. A phasing-in was requested.

Various issues were discussed around Islamic financing and understood that NT will address certain double taxation issues.

Insurance

A number of issues affecting insurance companies were considered around the anomalies impacting on the policyholder fund. With regard to IFRS17 coming into effect in 2021, it is

understood that NT will host an industry workshop and that the policy around paragraph 43 of the Eighth Schedule with be clarified.

REITS

Stakeholders questioned the policy considerations around promoting the JSE as the preferred stock exchange and merely referencing other stock exchanges. It was proposed that a submission should be made to the Minister of Finance to the effect that the JSE should not be allowed to benefit alone, as there were no policy reasons why others should not be allowed to benefit as they also go through the same rigorous processes as the JSE. It was discussed that other exchanges' fees are generally cheaper, whilst mention was made that migration issues need to be considered. NT mentioned that a change was first required to the Act before an application for a REIT could be made and that the appropriate process would be "twin peaks" which would regulate prudential and market conduct.

INCENTIVES

Section 12J

NT commented that section 12J dealing with the qualifying company 20% rule on start up in the RDP industry will be considered. Stakeholders requested clarity on the policy insofar that the book value limitation is considered a hindrance to investors.

Section 12L

Stakeholders raised concerns about the uncertainty around the limitations contained in this section. It is understood that SARS issued an Interpretation Note on its meeting with SANEDI. Alignment is needed of the law and practice since the issuing of tax certificates is problematic (since SANEDI issue the certificates but the baseline is required before a claim is allowed). Taxpayers furthermore experienced challenges around the concept of baseline periods, especially where more than one year is required for implementation.

SEZ- section 12R

The DTI has introduced legislation to transition IDZs to be transferred to SEZ but qualifying for section 12I. NT commented that the Minister will issue regulations and that the issue around start-up businesses will be considered, as well as the uncertainty on section 12R relief.

Section 11F

Stakeholders requested NT to revise the policy on the basis that the average contract duration is 10 years and not 15 years. NT noted that two years previously stakeholders submitted that the contract period is 15 years. Having regard to further discussions NT undertook to consider the change in period.

Mining

A policy change is required based on two recent cases, the one being the Marula case and another on contract manufacturers. The issues include the distinction to be considered between mining and beneficiation and the royalties relating thereto.

Tax relief and infrastructure spend

Stakeholders submitted that the legislation requires clarity and NT noted that this will be considered.

Research & Development

NT noted that a task team is currently busy considering the R&D policy and that a paper will be issued for public comment.

Section 18A

NT advised that in the prior year changes certain were made but a policy decision will be considered around outbound situations.

INTERNATIONAL TAX

Transfer pricing deemed dividend

Stakeholders questioned how section 31(3) of the Act relating to deemed dividends must be read. NT commented that taxpayers are not supposed to benefit from the reduced rate under the double taxation agreement (DTA) and that the DTAs have their own definitions of a dividend which mostly relate to shareholding with the exception perhaps of the France/SA DTA. With regards to section 64E, the comment was made that this involved a deemed dividend and therefore no dividend declaration could be made as there were no shares involved. The issue is therefore to assist taxpayers to comply with the provision and not about obtaining DTA relief. Stakeholders made several proposals around the definition of a dividend and deemed dividend which NT will consider. Some issues were raised around potential double penalties including understatement penalties (USP).

CFC section 9D

Numerous submissions were discussed, including where stakeholders proposed that a pre-gateway test should be applied, similar to the UK test.

High tax exemption threshold

The high tax threshold in section 9D is considered to be too high (at 75%) and an ideal threshold of 65% was proposed. Furthermore, proposals were made for NT to consider the onerous tax consequences for outbound investment, the tax compliance burden on taxpayers as well as the relative unattractiveness of the head quarter company regime.

Section 42 and its use in a CFC group

Stakeholders requested NT to revise section 42 and for NT to host a separate meeting to discuss the issues.

Excess funds in a CFC group

The Banking Association of South Africa raised an issue around CFCs in a banking group, with excess funds, not being able to invest the cash back into South Africa within their group, as the same exemptions applicable to foreign bank interest do not apply. A double taxation issue arises in circumstances where the economy could instead benefit from such local placement, in effect penalising local investment. NT noted that the issue had been raised previously.

IFRS10 consolidation of foreign entities

Stakeholders raised issued around unintended consequences when consolidating CFCs, and that clarity is required for associates.

Headquarter company regime

A request to extend the CFC carve out for headquarter companies to apply to intermediate holding companies was discussed. NT informed stakeholders that the OECD had sent correspondence to NT in this regard, as the headquarter company regime was being considered by the OECD to determine if it constitutes a harmful tax practice. NT confirmed that no further changes would be made to the regime, pending the outcome of the OECD's review.

Foreign currency issue section 24I

The application of section 24I(4) of the Act for loan liability waivers was discussed and the anomalies around imputed forex gains with relief available only to the debtor and not the CFC. NT noted that issues around hedge accounting resulting in significant differences between tax and accounting as well as the associated compliance burden will be considered.

Definition of resident

Stakeholders raised various concerns around the definition of a resident and the application of the rules relating to the place of effective management (POEM) and requested NT to request SARS to align the interpretation note with the OECD approach.

Other

NT advised that a final response document and updated EM will be issued in due course.