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THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
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FEEDBACK SUMMARY – 10 May 2018

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 them 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 merely attempts to inform SAICA members of the discussions and of any proposals that were made during such discussions.

NATIONAL TREASURY (NT) WORKSHOP ON 13 APRIL 2018

The NT workshop held on 13 April 2018 discussed the below matters. NT noted that the draft Bill will be issued by June 2018 in view of the lengthy 75 day parliamentary recess ahead of the national elections in 2019.

Debt reduction rules

Background

NT noted that the scope of the debt reduction rules needed to be narrowed down based on the prior year discussions.

Definition of concession or compromise

The definition proposed last year is not considered to adequately list concessions and NT therefore proposes an expanded list of factors to be included with the policy intent being to recover an expense previously granted to the taxpayer, and also not to create a special dispensation for specific parties such as parastatals.

Stakeholder concerns raised previously, and again at this workshop, include the following:

- debt forgiven is not realised expenditure incurred;
- unintended consequences prevail around liquidations, such as compelling taxpayers to follow more cumbersome liquidation court proceedings to not fall within the scope of the proposed provisions;

- in relation to the intercompany debt provisions, there is some difficulty in looking at how such debt is made up, which is not being considered by NT;
- non-trading rules should not be restricted to residents and should be addressed in a way to still address NT's concerns, and that the "trading test" issue should be considered further; and
- non-residents should be able to get rid of dormant subsidiaries in the same way as a resident company.

It was proposed that NT could have made a change for dormant companies to possibly be a non-resident or to align the provisions of section 19 and para 12A. In this regard, NT explained that the definition was to apply only to debt between connected persons and that changes relating to future interest to be incurred will not be subject to this rule.

SARS expressed concerns around the extinction of debt in a merger situation, whilst a stakeholder was of the view that not all debts will be extinguished by a merger. NT will go back to reconsider the types of debts that should be covered when there would be a clawback, whilst at the same time considering the three year carry forward recoupment in terms of prior proposals, although the prior drafts were rejected. It was stated that a capitalisation of debt always has an element of a debt benefit and therefore there should be a reversal where the taxpayer realises the value of the shares.

A stakeholder pointed out that there is a concern where a subsidiary is capitalised with an equity loan where the loan is later capitalised.

NT concluded that they will need to be prescriptive regarding what debt is allowed to be converted, looking at for example loans that are more equity in nature, but NT does not want to prescribe a period. Stakeholders acknowledged the recoupment in a situation where an interest bearing loan is capitalised, but raised a concern where a portion of capital is also recouped. Further concerns were raised around interest withholding tax implications, the position in relation to companies in distress, how the various definitions interrelate and the actual mischief that needs to be addressed.

The concerns around the subordination of loans was discussed at length at the hand of a commercial lending example, stating that a company may be forced to subordinate debt, but that the debt is still not realised, and NT is therefore seeking to tax a debt benefit in an unrealised situation, whereas the subordination only impacts on the priority of claims, and this applied in general and in distress situations. It was noted that trying to create a tax event in these circumstances will cause chaos in the debt capital markets.

Consistent with the prior NT workshops, stakeholders insisted that the rules should only apply on a realised basis that has a commercial effect, and should not affect positions that do not change the economic impact. Stakeholders proposed that if a concession has an effect on the market value, then the rules could apply. It was noted that in a scenario of an upfront (hard-coded) subordination, this would not fall within the ambit of the provisions except where there was a subsequent change to the terms and at that later stage subordinated. The current proposals by NT is driving the wrong behaviour, as the taxing of unrealised situations remains the main issue. The question was asked whether NT wants to discourage the capitalisation of

loans in a group context, as this will also drive the wrong behaviour, namely maxing out the security requirements upfront and ensuring upfront that shareholders rank last.

A stakeholder noted that credit risk has no direct benefit for the company and that the subordination of liabilities of companies is not equivalent to a conversion of debt. The concept of taxing economic benefit on the basis of time value of money (TVM), which NT is leaning towards in terms of the proposals does not sit comfortably in a tax context, is not seen anywhere else in the tax Acts and the Peoples Stores case specifically rejected this. It was also proposed that NT should consider giving the capital loss to the lender, but ideally only actual realisations should be considered.

Stakeholders agreed that the additional list added by NT would exacerbate the problem as these are also looking at events that can result in taxing the non-realisation of debt, and submitted that the actual debt forgiveness should be taxed and that if there are specific concerns with simulations, NT needs to specifically address these concerns

NT proposed that they will re-look at: the scope of the proposed rules, the reversal rule, consider to what extent to limit the concessions to specific events, market value versus face value for debt, the policy design aspects, realised versus unrealised positions, and what should be included in the definition of interest. NT did not commit on the proposed effective date other than to say that it will be practical. NT mentioned that they will call for another workshop on the matter.

Anti-dividend stripping rule

NT proposed that the 15% threshold would be retained but that for purposes of preference shares, for an extraordinary dividend an interest rate of 15% is applied for the period that the dividend is received. Stakeholders requested that NT issue the draft bill so that the actual wording could be considered.

In a BEE context, NT proposed that they will look at the connection in relation to the investment, for example the private equity connected person definition will be considered

NT mentioned the blanket override of the roll-over rules by the anti-dividend stripping rules, and referred to the Explanatory Memorandum example, and to the delaying effect of anti-avoidance provisions in re-organisation transactions and liquidations. NT will consider the unbundling transactions and why there should not be an override.

In relation to section 44, NT mentioned that it did not want dividends to be declared, and stated that the shares distributed is not a dividend, but in a statutory merger there will be a dividend. Sections 42, 45, 46 and 47 were mentioned and that there were concerns around the interpretation and application of the roll over relief rules.

NT mentioned that they would re-look at section 45, section 42, and section 46 and they will consider the real mischief being targeted.