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# FEEDBACK SUMMARY

## 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 4 SEPTEMBER 2017

### BUSINESS TAX - LOCAL

**Share buy backs**

A concern was raised regarding the difficulty to link to previously taxed proceeds.

NT noted that the 18 months period is aimed at addressing a deferral of tax, which became apparent through disclosures made through the reportable arrangements (RAs) system. The intention is to extend current funding arrangements but also to look at some of the structured transactions that NT has seen but NT confirmed that they would look to extend the current paradigm.

A number of practical difficulties were discussed and concerns raised with cash distributions from current reserves with the purpose of narrowing down on elements of unfairness around these distributions from cash proceeds. NT advised that it may be relatively easy to look at appropriate carve outs.

Stakeholders proposed that NT must look at a reduced period and to build in some flexibility whilst reducing the 18 month period. NT acknowledged that it will need to focus the proposed amendments around extraordinary dividends.

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS PO Box 59875, Kengray, Johannesburg, 2100
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za
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*Tainting of other classes of shares*

NT confirmed that it had considered submissions to exclude dividends paid with reference to interest or preference shares, mentioning that in some instances preference shares could be abused. NT is looking at the measure of tainting and having regard to whether they should have rules that apply to each class of shares, subject to an extraordinary dividend rule.

Stakeholders noted that there would be an issue regarding redeemable preference shares, where payment occurs at the end of the period concerned. NT acknowledged that this is an issue and that it would be addressed. Stakeholders also noted that the Companies Act provisions around distributions within 120 days must be taken into account by NT.

Stakeholders were of the view that there continued to be a lack of clarity regarding the purpose of the proposed amendments.

*Shareholding threshold*

NT is giving consideration to the number of layers that should be considered. Stakeholders pointed out that unconnected persons can be caught in the net of connectedness and that this has no relation to the level of influence that can be exercised. The unintended consequences for resident to resident distributions were discussed. NT confirmed that they would look at structured changes in shareholdings, i.e. the issues around the connected person issue as currently passive shareholders are brought in via the connected person rule and NT therefore will need to consider the real influence and also reconsider the connectedness test for trusts.

Stakeholders considered the “connected person” test to be overbroad, and it believed that “manage and control” may be a better test.

*Indirect shareholding reference*

NT confirmed that it would reconsider the threshold for listed companies.

*In specie distribution*

A policy concern was raised around the stripping of value through cash, and it was questioned by stakeholders where the concern was with *in specie* distributions. It was stated that NT is dealing with a number of layers of taxation and that they would need to model it out where the double taxation issues arise and where the avoidance was identified, considering that the purpose was that NT should only catch profits that were never subject to taxation. It was therefore apparent that NT should more specifically target the mischief and only address that.

*Retrospectivity issue*

NT advised that they would consider targeting only the extraordinary dividend but that there was also an issue raised by stakeholders around retrospectivity.

The issue was discussed at some length and the fact that the *Pienaar Bros* case heard in the High Court is currently on appeal.

It was noted that taxpayers must be in a position to prepare themselves and cannot be expected to be taxed differently with retroactive effect on commercial transactions that were completed years before. The expectation is furthermore that NT should target transactions that have a connection with the actual disposal and to give due consideration to a fair and equitable process. It was noted that even by the time this workshop was held, there was still no clarity in respect of the eventual provisions, whilst dividends would be taxed from 19 July 2017.

NT responded that retrospectivity is not unexpected given the potentially significant loss to the fiscus and that these proposals were foreshadowed in the budget. However, NT has considered that it would need to alleviate unintended consequences.

Stakeholders emphasised again that legal certainty is important for the economy. It was stated that taxation laws should not act as an entrapment of taxpayers. The concerns around the policy regarding the use of retrospectivity and retroactivity of tax laws therefore remain.

**Addressing abuse of CTC**

The concern was raised as to why NT should target residents if the issue lies with non-residents.

*Acquisition of target companies*

The proposed amendments should have been aimed at resident companies and not non-resident companies. NT acknowledged that this would be addressed in future legislative cycles. A number of further concerns were raised including the question why the amendments could not form part of the current legislative process.

NT conceded that there was an issue around the CTC rebasing, but considers this to be too complex in nature to address now and it will have to stand over to a future legislative cycle.

*Section 42 and section 8G*

NT commented on the fact that section 42 undisputedly overrides section 8G.

*Drafting issues*

NT advised that difficulties were experienced with the drafting process and that unintended consequences would be reconsidered. Consideration would be given to the CFC definition instead of the new section 8G, whilst the timing and impact of future contributions to be considered in the next legislative cycle, although NT would not commit to delaying the introduction of section 8G. Considerable issues arose around the introduction of section 24B.

*Concern around disguised sale*

NT confirmed that the EM needs to be corrected.

**Group debt relief**

NT advised that the purpose of the proposed amendments was to assist companies that are in distress.

There appears to be concerns in respect of the proposed amendments for mining companies and the interaction with the rest of the Income Tax Act, more specifically the debt relief provisions.

Stakeholders submitted that it was unclear what kind of financing, i.e. direct or indirect funding was referred to. Under section 19A it specifically covers direct and indirect funding and expenses of assets subsequently forgiven.

With regard to the capital expenditure under section 36, NT did not consider it necessary to specify whether this referred to direct or indirect funding and it was considered that it should be relatively easy to make the link. It was noted that it was clear that section 19A deals with both direct and indirect but that the same cannot be said for section 37. Clarification would therefore be required in this regard with reference to financing.

*Exclusions*

NT confirmed that the exclusions will need to be looked at and that the comments from stakeholders were noted.

*Ring-fencing*

NT advised that the aim was to link the capital expenditure to the mining operation being funded and that it will consider drafting the ring-fencing in that manner.

*Notional amounts*

NT advised that it did not consider it desirable to define a carve-out but that clarity would be provided going forward.

**Dormant company group relief and business rescue**

The proposed amendments are considered to be too onerous, for example around the trade requirement.

NT advised that the intention was to only cater for “dead” dormant companies, but in looking at stakeholder submissions it is apparent that certain cash flows are required even for dormant companies, for example, for the realisation of assets and other ancillary payments to CIPC. NT will therefore relook the dormancy tests including the group debt required to be in existence for four years, no amount to have been received, and no assets to have been received to from the entity.

On the basis that circumstances can vary considerably it is required that the wording should be fairly broad in scope.

The trade test for a dormant company where interest accrues on a bank account or refund amounts due from SARS is still problematic. It was submitted that a rule similar to reorganisation rules whereby company allowed to retain assets that need for settlement of liabilities that will arise should be considered by NT. It was also submitted that requiring that there be no trade would address concerns rather than requiring no receipts or accruals.

*Type of debt allowable*

Currently debt is assumed in the group to facilitate rolled over organisations but NT doesn't want to allow for this because concerned that those debts are not necessarily incurred and therefore additional threshold must be removed.

Stakeholders note concerns that the proposal would make it more complex and it was unclear what the mischief or tax avoidance was to justify such complicated rules.

Move asset worth less than what owe then have a debt reduction immediately excluded from relief in these circumstances-why should that be the case

Stakeholders noted that the dormant company relief which proposes to substitute existing group relief represents a reduction in the benefits of group relief.

NT undertook that it would subsequent to the workshop refine the exclusion to ensure that the provisions target what was intended, namely to target specific relief for dormant companies.

*Exclusion for non-resident companies*

There currently appears to be no debt relief under the CFC rules which causes some issues. NT proposed that the provisions of sections 19A and 19B would be revisited based on further comments by the various stakeholders and specifically target the areas that are considered problematic. Stakeholders submitted that the position of the debtor and the creditor warrants due consideration. The role of the value of shares must also be considered.

Mention was made of the fact that a problem arises relating to the capitalisation of group debt in the case of a business rescue. The real purpose is to provide relieve for debt obligations. NT was requested to address this in the current legislative cycle given it was noted in the 2017 Budget Review.

NT stated that it was considered undesirable to retain para 12A of the Eighth Schedule. Whilst they did not seek an upfront tax, what is required is to put the subsidiary in the same position that it would have been in had the debt been an equity injection in the first place. This was considered by stakeholders to be a case of the tax tail wags the commercial dog, and the question was raised what was the policy purpose of having group relief if not to provide the exact relief NT is seeking to repeal. NT commented that the proposed mechanism is not aimed denying companies the opportunity to do debt equity conversions but there is concern around the interest element

The need was expressed to provide taxpayers with a simpler route. In a group context it is considered that there has to be hybrid debt equity rules and this is according to NT the area where most of the issues arise. NT commented that one would not normally, in the absence of these specific rules, advance debt to a subsidiary in distress though NT remained unclear as to the assistance that a company should provide in these circumstances.

It was mentioned that the subsidiary would already have been subject to tax in terms of section 23M or the thin capitalisation rules and it was questioned whether there was accordingly any mischief and whether NT was forcing everyone to subordinate loans instead of capitalising loans, and therefore in circumstances where a company is in distress it is being forced to pay more tax. The concern was also expressed that withholding tax would already have been paid.

The question was raised why there was a need for new legislation considering that the debt equity conversions provisions were currently working well. NT confirmed that this would be considered and that they wanted to have specific legislative provisions in place to reduce the need for taxpayers to apply for advance rulings.

NT admitted that it will need to clarify the position around indirect capitalisation to be put within scope for purposes of section 19.

**<u>In duplum</u>**

The concerns raised in respect of the *in duplum* rule will be considered by the state law advisors.

**<u>Rehabilitation funds</u>**

NT has considered the comments that they are being too punitive insofar the deeming provision is concerned. NT has, however, seen the anti-avoidance occurring and without addressing this appropriately, it is considered that government will have to make a budget allocation where a company got the tax deduction. There are a number of issues still being considered by NT including what is meant by closure of the mine and there could be an ongoing closure process for a duration of two years. Consideration is given to look at the time of withdrawal from the trust fund. NT is currently in discussions with the DEA and is in the process of discussing further changes.

**<u>REITS allowance assets</u>**

NT advised that the proposals made are not currently being considered but that it should probably fall within sections 45 and 47 of the Act.

**BUSINESS TAX- FINANCIAL**

**<u>Impairment adjustments in section 24JB</u>**

NT noted the comment made that the starting point should be the regulator and that IFRS should follow that. The question was raised why banks are impacted and other financial institutions not. It was also stated that the industry needs one reference point and does not want to land up with a new dispensation and then ten years later SARS claims yet another new test must be introduced.

Various issues were discussed around how to interpret the retail exposure of secured lending versus unsecured lending as normal banks also have unsecured lending.

NT advised that the reference to regulation 67 would remain intact but that further clarity will be provided.

**BUSINESS TAX - INTERNATIONAL**

**Extending CFC rules to foreign companies held via foreign trusts**

NT confirmed that the foreign tax credit calculation will be discussed in the workshops going forward and that the intention was to replicate what is contained in section 9D. NT also mentioned that the issues raised around a change in policy will be addressed and that the problem was that there is no international benchmark.

*Section 9D*

It is considered that the proposed amendments go too far and create further issues on the drafting of the amendment, for example the reference of holding interest in offshore trust and offshore foundations. NT confirmed that these comments are accepted. Consideration will be given as to what is being targeted in terms of trust structures.

*Section 25BC*

It was questioned whether this section, which is aimed at individuals, is subject to section 9D. A number of issues were identified and which remain unresolved, such as what needs to be imputed in terms of section 9D, and what is specifically being targeted by section 25BC as the scenarios possibly envisaged by NT do not seem to be prevalent. The issues around how to determine an indirect participation will require further consideration. It must also be considered that beneficiaries may not have access to information or funds. Consideration must also be given to scenarios where the beneficiaries would not all be South African residents, as this occurs often in practice.

It was suggested that the provisions may need to be aligned with the BEPS proposals.

NT agreed that the interaction between the various sections mentioned by stakeholders in their submissions must be considered in greater depth. This includes the interaction with section 7 of the Act.

NT advised that the reason for their reliance on IFRS10 was directly as a result of the BEPS recommendations. It was mentioned by stakeholders that this may work as a general proposition, but that there may be a need for carve outs where there is no need in the particular circumstances to consolidate and IFRS 10 is therefore not applicable to such entity, resulting in a very complex deemed application merely for tax purposes.