South African Institute of Tax Professionals

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Dear Ms. Mputa and Ms. Collins

RE: ANNEXURE C PROPOSALS 2015

Thank you for the opportunity to contribute proposals for the inclusion in Annexure C of the Budget Review 2015.

Set out below, is the consolidated commentary on **Corporate Tax matters only**, developed from both an internal review of the provisions as well as from consultations with members, stakeholders and industry. The commentary reflects the collective view of members, stakeholders and industry role players consulted.

1. Sale of contingent liabilities

Problem statement

In *Ackermans Ltd v Commissioner for South African Revenue Service, Pep Store (SA) Ltd v Commissioner for South African Revenue Service* (441/09) [2010] ZASCA 131; 2011 (1) SA 1 (SCA) ; [2011] 2 All SA 125 (SCA) (1 October 2010) the court found that the seller cannot deduct the price reduction on transfer of contingent liabilities. Initially this problematic matter was to be settled by legislative amendments and then by an interpretation note which was also never finalised. SARS released a discussion paper on the matter in December 2013 which at pg. 9-10 still does not clarify the matter by merely concluding that it is a facts and circumstances test. At pg. 10-11 the position for the purchaser is discussed in respect of contingent liabilities realising after the sale. Though SARS' position has not been finalised, an anomaly has been identified in

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section 7B of the Income Tax Act (No. 58 of 1962) (hereinafter "ITA") which is not addressed in the discussion.

Section 7B of the ITA was inserted from 1 March 2013 and defers the deduction of variable remuneration where the amount is to be paid after accrual. The income tax deduction for the employer is then also deferred until the date of payment. This deferral is problematic when applied to the already complicated sale of a going concern and transfer of contingent liabilities. The problem is that the amount for which the seller has incurred an unconditional legal obligation prior to the sale, but which will only be paid after the sale, will not be deductible. It is also unclear if the prohibition in section 7B constitutes a contingency, though we do not think so, which would entitle the purchaser to deduct the amount that was paid as the amount does not seem to meet either the "in the production of income" or the "in the course of trade" requirement. This will result in neither the seller nor the purchaser becoming entitled to a tax deduction for the amount.

In addition, leave pay is also problematic as paragraph (c) of the definition of "variable remuneration" in section 7B refers to leave pay which has in respect of leave accrued during that year. The leave accrual of the employee that must be paid and the employer's assessment year of obligation must be the same year. The purchaser and seller may not have the same tax years and it is unclear how the transferred leave pay obligation that becomes payable by the purchaser should be treated.

Proposed solution / recommendation

Though SARS are still to issue the final interpretation note following the discussion paper, which has been outstanding since 2011, it does not seem that it will be able to address the problems created by section 7B of the ITA. In this regard it is submitted that section 7B(2) should be amended to exclude its operation where the contingent or realised liability has been transferred or sold.

It is further requested that the Interpretation Note or Binding Ruling in respect of the transfer of contingent liabilities be finalised as a matter of urgency.

2. Withholding tax on interest on retirement interest

Problem statement

Where a member of a pension, provident or retirement fund emigrates or is an expat returning to his or her home country, such person may become entitled to end his or her membership of that fund and have a lump sum become payable on termination. Such lump sum may, however, only be actually paid months after termination and the person leaving SA may by then may be a non-resident from a tax perspective. In terms of the Pension Funds Act (No.24 of 1956) and the rules of these funds, such accrued but not paid retirement amount will carry interest. Though there is an exclusion in section 50D(3) of the ITA where such person was in SA for 183 days in the 12 months prior to the payment, this may not necessarily apply as the person could have been on leave in the months before termination or could have rendered services to the SA employer outside SA. The payment of the interest is from a regulated person, i.e. a pension, provident or retirement annuity fund.

Proposed solution / recommendation

It is proposed that section 50D(1)(a)(i) should be amended by the insertion of the following item (dd):

"(dd) payable by a pension, provident or retirement annuity fund on any lump sum amount payable on termination of membership of such fund."

3. Translation of interest and the section 24J calculation

Problem statement

Section 25D of the ITA states that an amount received, accrued or incurred by a company should be translated at the spot rate. However, when it comes to interest, section 24J of the ITA requires that the interest should be, as a general rule, calculated based on the yield to maturity throughout the period.

Where a foreign currency denominated loan exists between a resident and non-resident, it is unclear for the purposes of section 24J whether the interest is calculated in foreign currency per the legal obligation and then translated at spot rate on payment date (with the exchange gains then included in the yield to maturity calculation in section 24J) or whether the loan is translated to Rands at year end in terms of section 25D and then the yield to maturity calculation is applied to the loan. In the latter instance this will result in the forex gains and losses being dealt with separately under section 24I (i.e. the forex difference between the foreign currency interest payable and the SA Rand interest calculated on the translated loan amount).

Proposed solution / recommendation

It is submitted that section 24J should be amended to contain a translation rule which determines how interest accrued or incurred on foreign currency denominated debt should be calculated.

4. **Related finance charges**

Problem statement

The definition of "interest" in section 24J includes in paragraph (a) "related finance charges". In respect of many commercial lending arrangements, fees are payable to a person other than to the holder of the instrument.

In *CSARS v South African Custodial Services (Pty) Ltd* 74 SATC 61 (SCA) (30 Nov 2011) the court, for the purposes of section 11(bA), held that related finance charges included guarantees fees, introduction fees, administration and legal fees that are causally linked to obtaining the loans. These fees were also payable to third parties and not to the person advancing the finance.

It is submitted that these words have the same meaning as used in section 24J in the definition of "interest". In the definition of "adjusted initial amount", for the purposes of calculating the deductible or receivable amount in terms of section 24J(2) & (3), it requires that the amount paid or received *in terms of such instrument*.

In this regard it can be interpreted that "in terms of such instrument" means that it must be expressly stated in such instrument (i.e. part of the loan terms) or that it must be causally linked to such instrument. It is submitted that in context to the grammatical wording it should merely be causally linked.

Proposed solution / recommendation

It is submitted that to clarify the causality requirement, section 24J should be amended as follows in the definition of "adjusted initial amount".

"a*)…less any payments received by such holder during all such previous accrual periods,* ***[in terms of]*** *in respect of such income instrument; or*

"(b)…less any payments made by such issuer during all such previous accrual periods, ***[in terms of]*** *in respect of such instrument..."*

5. Nature of interest deemed to be dividend

Problem statement

Section 8F and 8FA deem certain amounts of interest to constitute a dividend. Where the amount of interest paid or received is subject to the provisions of a DTA, it seems that SARS' interpretation is it that the amount should be dealt with under general OECD article 10 for dividends. It is submitted that this approach is incorrect as the provisions of the DTA will supersede the local law, including section 8F & 8FA and that the amounts should be correctly classified under the relevant provisions of the DTA. In this respect, legal interest should fall under article 11.

Proposed solution / recommendation

Though it is conceded that this is a DTA problem to a large extent, the correct application in our view should either be clarified in an Interpretation Note or section 8F and 8FA should be amended to be subject to an amount determined as interest in terms of a DTA.

6. Deduction of unapproved research and development ("R&D")

Problem statement

Monies expended on capital expenses on research and development as defined in section 11D(1)(a) of the ITA but which is not approved by the Department of Science and Technology in terms of section 11D(2)(a)(iv) should in principle still be deductible as they remain R&D expenses as defined within the framework and do in fact contribute to the economy. However, as the current section 11D has been changed from the 100/50 per cent regime to a merely qualifying 150 per cent, these costs will only be deductible under the accelerated allowances provided by section 12C over a 3 year period if it relates to a depreciable asset. As section 11(a) disallows expenses of a capital nature, the taxpayer will not be entitled to a deduction for unapproved R&D that falls within the definition.

<u>Proposed solution / recommendation</u>

It is submitted that a 100 per cent deduction should be available in section 11D where no other section provides a deduction or allowance in respect of amounts expended on R&D as defined in section 11D.

7. Technical reference – Employment Tax Incentive Act

<u>Problem statement</u>

Section 5(2)(a) of the Employment Tax Incentive Act (No. 26 of 2013) (hereinafter "ETI") refers to section 187(f) of the Labour Relations Act (No. 66 of 1995) and it should in fact refer to section 187(1)(f) of the said Act.

<u>Proposed solution / recommendation</u>

Section 5(2)(a) of the ETI should be amended as follows:

(2) For the purposes of subsection (1), an employer is deemed to have displaced an employee if—

> *the resolution of a dispute, whether by agreement, order of court or otherwise, reveals that the dismissal of that employee constitutes an automatically unfair dismissal in terms of section 187<u>(1)</u>(f) of the Labour Relations Act*

8. Industrial policy projects - Extension discretion

<u>Problem statement</u>

Section 12I(19)(a) of the ITA provides the Minister of Trade and Industry the power to extend a period in subsection (2) and (6)(b) by 12 months. Though subsection (2) has the same "brought into use 4 years after approval" requirement as subsection 7(c), no discretion is afforded in respect of this time period which is the qualifying criteria for the industrial policy project requirements and affords the allowance in subsection (2). Extending the period in subsection (2) therefore does not assist if the policy project will the day after the 4 year period not be an industrial policy project as per subsection (7).

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Proposed solution / recommendation

Section 12I(19)(a) should be amended as follows:

(a) May after taking into account the recommendations of the adjudication committee, extend the periods contemplated in subsection (2) ***[and]****, (6)(b) and (7)(c).*

9. PBO investment assets

Problem statement

The Draft Taxation Laws Amendment Bill, 2014 (hereinafter "TLAB") proposed that section 18A be amended by the insertion of subsection (2D) which lists the "qualifying instruments" that a PBO may hold and requires the distribution of the resulting investment returns.

The final TLAB, however, replaced this requirement with the wider term of "investment asset". The question is whether "investment asset" only applies to monies deposited for investment purposes or to all monies deposited whether for investment purposes or not, such as deposits into a bank account for use in normal activities? If the latter also applies then the interest earned on the day to day account also becomes subject to a distribution requirement.

Proposed solution / recommendation

The term "investment asset" should be clarified by Interpretation Note or in the legislation.

10. Section 64F(m) of the Income Tax Act – Uncertainty regarding dividends tax exemption

Problem statement

Certain loans by companies to shareholders or connected persons in relation to shareholders were subject to STC under section 64C(2)(g) when the loan or advance was granted or made available to such a person. The granting or making available of the loan or advance constituted a deemed dividend under that section.

Such loans could be outstanding at 1 April 2012 when dividends tax replaced STC. In order to prevent a loan that does not bear interest at the official rate to be subject to both STC (under section 64(2)(g)) and dividends tax (under section 64E(4)), an explicit exemption was included in section 64E(4)(e) to state that such a loan would not be subject to the deemed dividend provisions should it not bear interest at the official rate if the debt was subject to STC. It is submitted that this provision allows a company to leave such a loan outstanding without attracting further dividends tax.

Some companies however wish to extinguish the loan by writing it off, thereby turning the value transferred by way of loan (and deemed dividend for STC purposes) into a real dividend. In principle, the provisions of section 64E(4) and section 64F(m) would suggest that this write off should not be subject to dividends tax as the underlying amount has already been subject to STC. It is, however, difficult to read this in the wording of section 64F(m) which states that a divided is exempt from dividends tax "…*to the extent that the dividend was subject to the secondary tax on companies*". In this case, the dividend that was subject to STC was arguably the granting or making available of the amount (deemed dividend under sction 64C(2)(g)) while the dividend at the time of write off is the company giving up its right to be paid. Even though these events relate to the same loan, the dividend event that may be subject to dividends tax is not the same dividend event that was subject to STC. Uncertainty therefore exists whether the dividend arising from the write off of such a loan would be exempt from dividends tax.

Proposed solution / recommendation

A specific exemption can be included in section 64F to exempt any dividend which arises as a result of the writing off of a loan that was subject to STC. In addition, the exemption should make provision to exempt any dividend paid by way of reduction of the amount owing in terms of such a loan (i.e. if a dividend is declared, but the shareholder loan asset is reduced and utilised to pay the dividend rather than another asset or cash).

Should you have any enquiries or wish to discuss the submissions made please do not hesitate to contact me.

Yours sincerely,

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