

TAX AND EXCHANGE CONTROL ALERT

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SET-OFF OF CUSTOMS DEBT AGAINST AMOUNTS REFUNDABLE

South African Revenue Service (SARS): Customs (Customs) sets off amounts owed to Customs against amounts refundable to clients.

OVERRULED: SARS EXPRESSES AN INTERESTING VIEW ON AN AMALGAMATION TRANSACTION

The South African Revenue Service (SARS) has traditionally adopted a conservative approach in issuing rulings which approve a tenuous interpretation of provisions of the Income Tax Act, No 58 of 1962 (Act), in favour of the taxpayer. However, in Binding Private Ruling 231 (Ruling), which was issued by SARS on 10 May 2016, SARS adopted an interesting interpretation of the corporate roll-over relief provisions in s44 of the Act, which raises a number of questions. The Ruling is quite long and therefore we will only discuss the manner in which SARS applied the provisions of s44, relating to corporate roll-over relief in the case of so-called amalgamation transactions (s44 transaction).

SET-OFF OF CUSTOMS DEBT AGAINST AMOUNTS REFUNDABLE

Customs may set off any amount due by a person against any amount of duty refundable and due to such a person.

In certain circumstances that Customs may not set-off amounts due by a certain importer against amounts refundable to another.



South African Revenue Service (SARS): Customs (Customs) sets off amounts owed to Customs against amounts refundable to clients.

Section 76C of the Customs and Excise Act, No 91 of 1964 (Act) provides for set-off as follows:

“Set-off of refund against amounts owing - Where any refund of duty is in terms of this Act due to any person who has failed to pay any amount of tax, additional tax, duty, levy, charge, interest or penalty levied or imposed under any other law administered by the Commissioner within the period prescribed for payment of the amount, the Commissioner may set off against the amount which the person has failed to pay, any amount which has become refundable to the person in terms of this Act”.

The provision has the effect that Customs may set off any amount due by a person against any amount of duty refundable and due to such a person.

There are cases where Customs also sets off amounts in, for example, the following circumstances:

- An amount for a customs penalty or other provisional payment (Amount A) is paid by client A to a customs clearing agent. The clearing agent pays the amount to Customs on behalf of client A.

- Client B of the same clearing agent instructs the clearing agent to make clearance for imported cargo, but once cleared, client B is not in a position to make payment to the clearing agent for the import duties and/or VAT due (Amount B). Amount B is due and payable to Customs.
- In the interim, client A mitigates his penalty and/or the provisional payment for amount A becomes refundable to client A.
- The SARS system can automatically set-off the amount due to client A against the (due) debt of client B as Amount B is due by, and Amount A payable to, the same clearing agent on the system.

Section 99(2) of the Act provides that agents appointed by importers may be held liable for the payment for duty and charges of the importer, except if certain pre-requisites are present.

However, it may be argued in certain circumstances that Customs may not set-off amounts due by a certain importer against amounts refundable to another.

SET-OFF OF CUSTOMS DEBT AGAINST AMOUNTS REFUNDABLE

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It may be argued in certain circumstances that Customs could potentially be forced by a court to repay the amount refundable to client A in cash, instead of crediting the clearing agent's deferment account.



Another example is the following:

- A customs clearing agent has a deferment account (which is in general terms an account to pay duties and VAT on a monthly basis) with Customs. Duty and VAT for client A of the clearing agent is paid by way of the deferment for a period of two years for a specific product upon importation.
- Client A obtains a tariff determination for the product to the effect that it is free of duty. The duty paid for a period of two years retrospectively from the date of the determination now becomes refundable to client A.
- SARS now credits the deferment account of the clearing agent and refuses to repay the amount refundable direct to client A. The clearing agent now has a credit on his deferment, but cannot necessarily repay the amount to client A.

It may be argued in certain circumstances that Customs could potentially be forced by a court to repay the amount refundable to client A in cash, instead of crediting the clearing agent's deferment account.

In closing, we remind readers of the following:

- SARS advised the following regarding the new customs legislation (The Customs Duty Act, No 30 of 2014 (assented to 9 July 2014) and the Customs Control Act, No 31 of 2014 (assented to on 21 July 2014), but not yet effective):

"Please take note that we intend to temporarily halt any further amendments to the Rules after the comments during this round of public participation have been considered. This decision has been taken to facilitate the process of systems development in preparation for the first phase of implementation, which is expected to start before the end of the 2016/17 financial year".

- Sections 931 and 933 of the Control Act provide that existing registrations and licenses (under the Act, ie the current legislation) will lapse after 30 days from the effective date of the New Acts, except if such registrants and/or licensees re-apply for new registrations and/or licenses under the new Acts. It is notable that the registration or license need not be approved within the 30 day period – the application must merely be made within the period.

Petr Erasmus

OVERRULED: SARS EXPRESSES AN INTERESTING VIEW ON AN AMALGAMATION TRANSACTION

In Binding Private Ruling 231 (Ruling), SARS adopted an interesting interpretation of the corporate roll-over relief provisions in s44 of the Act, which raises a number of questions.

The Applicant in this case is a South African resident company that is held 74% by a foreign company (ForeignCo) and 26% by black economic empowerment (BEE) shareholders.



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Facts

The Applicant in this case is a South African resident company that is held 74% by a foreign company (ForeignCo) and 26% by black economic empowerment (BEE) shareholders. ForeignCo is a wholly owned subsidiary of another foreign company (HoldCo). There are also a number of Co-Applicants, including three companies that are majority-owned by BEE shareholders (BeeCo1, BeeCo2 and BeeCo3). BeeCo2 is a wholly owned subsidiary of BeeCo1. BeeCo2 and BeeCo3 also each participate in two separate unincorporated joint ventures (UJV's).

The relevant legal framework

In terms of s44(2) of the Act, a company will qualify for certain corporate roll-over relief, in that the transfer of capital assets or trading stock will not trigger the inherent tax gain, if the transaction constitutes a s44 transaction in terms of s44(1)(a) or (b).

Section 44(1)(a) defines an amalgamation transaction as a transaction where:

1. any resident company (amalgamated company);

2. disposes of all of its assets (other than assets it elects to use to settle any debts by it incurred in the ordinary course of its trade, and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up); or
3. to another resident company, which is a SA resident (resultant company) in terms of an amalgamation, conversion or merger.

Section 44(1)(b) contains the exact same wording, the only difference being that the amalgamated company is a foreign company and that the shares in the amalgamated company are held as capital assets. Section 44(2)(a) contains a further requirement for the corporate roll-over relief in that the shares must be acquired by the resultant company as capital assets or as trading stock, as the case may be.

Description and purpose of the transaction

The Applicant and the relevant subsidiary Co-Applicants intend to rationalise and simplify its South African group structure

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It is possible that ForeignCo and HoldCo might be liable to pay capital gains tax (CGT) if it disposed of its shares outside of the ambit of the corporate roll-over relief provisions in the Act.



by entering into four separate transactions which will eliminate the unincorporated joint ventures (UJV's) and unnecessary companies in its structure. Transactions 1, 2 and 4 entail s44 transactions, whereas Transaction 3 constitutes an asset-for-share transaction in terms of s42 of the Act.

We will only discuss SARS's Ruling with respect to Transactions 1 and 2.

In Transaction 1, the group wishes to eliminate the intermediate holding of the Applicant's shares by ForeignCo. To do this, ForeignCo will dispose of its shares in the Applicant in terms of a s44 transaction. The new shares in the Applicant will be distributed by ForeignCo to its sole shareholder, HoldCo, in terms of the relevant amalgamation agreement. ForeignCo will then be liquidated in terms of that amalgamation agreement. In Transaction 2, a similar approach will be followed. BeeCo1 will dispose of its shares in BeeCo2 for a new issue of shares in BeeCo2 in terms of a s44 transaction. The new shares in BeeCo2 will be distributed by BeeCo1 to its shareholders in terms of the relevant amalgamation agreement and BeeCo1 will then be liquidated in terms of that amalgamation agreement.

SARS's Ruling

With respect to Transaction 1, SARS ruled that the transfer by ForeignCo of its shares to the Applicant under the amalgamation agreement will constitute a s44 transaction in terms of s44(1)(b) of the Act and will be qualify for the corporate roll-over relief and that the repurchased shares of the Applicant will also be cancelled upon repurchase.

There will also be no dividends tax payable on the distribution of the newly-acquired shares of the Applicant to HoldCo.

With respect to Transaction 2, SARS ruled that the transfer of assets by BeeCo1 to BeeCo2 under the amalgamation agreement between them, will constitute a s44 transaction terms of s44(1)(a) of the Act and will qualify for the corporate roll-over relief. The repurchased shares of BeeCo2 will also be cancelled upon repurchase. No dividends tax will be payable on the distribution of the newly-acquired BeeCo2 shares by BeeCo1 to its shareholders.

Comments

Although SARS rulings often do not include all the facts provided to it by the applicants, it is possible that ForeignCo and HoldCo might be liable to pay capital gains tax (CGT) in terms of paragraph 2(1)(b)(i) of the Eighth Schedule to the Act, if it disposed of its shares outside of the ambit of the corporate roll-over relief provisions in the Act. Paragraph 2 of the Eighth Schedule states that a non-resident company will be liable for CGT in South Africa if on disposal, it holds more than 20% of the shares in a South Africa resident company and 80% of the market value of the South Africa resident company's shares are directly or indirectly attributable to immovable property. This might explain why the parties wish to make use of the roll-over relief in s44. Upon closer scrutiny, it appears that some of the requirements of s44 might not have been met.

Section 44(2)(a)(i) states that where an amalgamated company disposes of a capital asset, the resultant company will only qualify for the roll over relief if the

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This argument is supported by the fact that a company cannot acquire rights against itself.



resultant company "...acquires it as a capital asset..." In Transaction 1, ForeignCo concludes a s44 transaction in exchange for the Applicant issuing new shares to it. It is the subsequent cancellation of these repurchased shares which raises issues. The cancellation is an unavoidable outcome and therefore, regardless of the intention of the Applicant, it could never have held the shares as capital assets. Should s44(2) or (3) of the Act not apply, the repurchase might constitute a 'dividend' and potentially trigger a dividend withholding tax charge. A further consequence of s44(2) or (3) not applying is that the distribution of shares by the amalgamated company will not be income tax and dividends tax neutral.

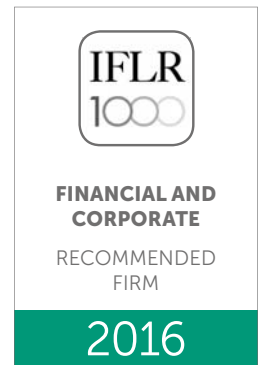
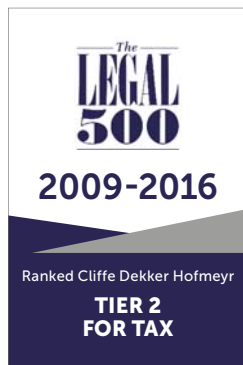
Section 41 of the Act defines a capital asset as any asset as defined in the 8th Schedule, except an asset that constitutes trading stock. The 8th Schedule defines an asset essentially as any property or any right in such property. The definitions of trading stock in s1 and s41 of the Act essentially state that trading stock is anything acquired by the taxpayer for the purposes of sale or the proceeds of which would form part of the taxpayer's gross income upon disposal. The shares of the Applicant and the shares of BeeCo2 that are bought back in terms

of Transactions 1 and 2 are therefore not acquired as capital assets or as trading stock in terms of the repurchase transactions. In terms of s44(6)(c) of the Act, the transfer of capital assets or trading stock to the shareholders of the amalgamated company will only qualify for the roll-over relief, if the requirements of s44(2)(a) are met. As it appears that these requirements have not been met, a capital gain will potentially be triggered when ForeignCo disposes of the newly issued shares of the Applicant to HoldCo.

This argument is supported by the fact that a company cannot acquire rights against itself and by s35(5) of the Companies Act, No 71 of 2008, which states that once shares have been repurchased by a company, they no longer have the status of issued shares, but have the same status as authorised unissued shares. In commercial terms, these shares are thus not reflected on the balance sheet of a company as assets.

The same comments apply to Transaction 2, in terms of which BeeCo1, the amalgamated company, disposes of its shares in BeeCo2, the resultant company, in exchange for the issue of new shares in BeeCo2.

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