DLA CLIFFE DEKKER HOFMEYR

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TAX ALERT

LARGE CORPORATES AND THEIR TAX ADVISERS IN THE CROSS-HAIRS?

"Above all things, a tax attorney must be an indefatigable sceptic; he must discount everything he hears and reads. The market place abounds with unsound avoidance schemes which will not stand the test of objective analysis and litigation. The escaped tax, a favourite topic of conversation at the best clubs and the most sumptuous pleasure resorts, expands with repetition into fantastic legends. But clients want opinions with happy endings, and he smiles best who smiles last. It is wiser to state misgivings at the beginning than to have to acknowledge them ungracefully at the end. The tax adviser has, therefore, to spend a large part of his time advising against schemes of this character. I sometimes think that the most important word in his vocabulary is 'No'."
Randolp Paul: The Lawyer as Tax Adviser

Looking at press reports over the last couple of months, it would seem that the issue with South African tax practitioners is that they are not saying "NO" often (or loudly) enough according to the Minister of Finance and the SARS Commissioner.

Opening the debate on the Tax Administration Bill in the National Assembly in November 2011, the Minister is reported to have said: "The aggressive undermining of the fiscus that some pursue – obviously at the receipt of a fee, even at a time of extreme fiscal stress – is extremely dangerous." The Minister suggested that tax practitioners and their clients should "... pause for reflection, as we must also, on the damage they can do to the tax system, and South Africa more broadly, as a result of their practices."

In February 2012, the Minister mentioned that 34 000 tax practitioners owed in excess of R260 million in tax and that they had 18 000 tax returns outstanding in their personal capacities. The SARS Commissioner joined the fray by alleging wide-spread unethical practices on their part. Strict tax practitioner regulation was therefore needed. The SA Institute of Tax Practitioners and the SA Institute of Professional Accountants countered and made reference to deficiencies in SARS' own administrative systems.

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Come 1 April 2012, SARS announced that it had comfortably exceeded the revenue target by collecting R742,7 billion. Again the tax practitioners were not spared. The Minister's media statement indicated that "SARS will develop a rigorous risk profiling system to identify high risk practitioners." In future, tax practitioners would have to be of "good standing and members of a professional body."

The latest salvo in the direction of tax practitioners and their clients was fired on 8 May 2012. Mr Bob Head (recently appointed from the UK as special adviser to the Commissioner), told Parliament's Finance Committee that "There are some people in the business of trying to help companies not pay tax and they will keep on inventing new schemes."

The above was said in the context of the Commissioner's statement that there had been "an increase in the use of cross-border structuring and transfer pricing manipulations by business to unfairly and illegally reduce their local tax liabilities." According to him, especially African countries were vulnerable to revenue loss because they lacked the capability to detect and prosecute sophisticated tax evasion tactics. (It is noteworthy that at the announcement of the revenue result, it was stated that transfer pricing would come under the spotlight, SARS would up-skill its staff and there would be greater cooperation with other revenue authorities.)

The focus by revenue authorities, and developmental agencies, on the impact that the tax conduct of multi-nationals has on African economies is nothing new. During 2010, the UK development agency ActionAid published a report alleging that SABMiller's subsidiary Accra Brewery in Ghana had made a loss for the last two years and had paid corporate tax in only one of the last four years. That was despite Accra Brewery having produced $45 million worth of beer annually. While ActionAid was careful not to allege that SABMiller was guilty of tax evasion, it questioned the morality of tax avoidance where developing countries were losing more through tax revenue compared to what they received in aid.

Clearly a corporate's tax conduct and tax risk appetite has now become a reputational issue. And revenue authorities (and non-governmental organisations) are keen to exploit any vulnerability. In the recent past multinationals like IHG (hotel group), Unilever (consumer goods), Tui (travel company) and Vodafone (mobile phone group) were all caught up in negative publicity following a campaign by Christian Aid. Hence the Financial Times (9 November 2010) carried a lengthy article titled "Tax claims hit at reputations as well as the coffers."

There you have it. The tax conduct of corporates and the company they keep (read "tax practitioners") is in the cross-hairs. Many South African corporates are branching out into Africa. It appears that they should not only read the tax books but brush up on their morals as well.

Johan van der Walt

SALE OF ASSET FOR LESS THAN MARKET VALUE: A DIVIDEND?

The new dividends tax regime, which replaced Secondary Tax on Companies (STC), came into operation on 1 April 2012 and applies in respect of dividends declared and paid on or after the said date. The relevant provisions dealing with dividends tax are contained in Part VIII of Chapter II to the Income Tax Act, No 58 of 1962 (Act).

Shortly before its anticipated implementation, it was decided not to introduce the draft Value-Extraction Tax (VET) provisions which were intended to partially replace the deemed dividend rules under the STC regime contained in s64C of the Act. The VET provisions (like the former deemed dividend rules), it was considered, assumed that certain forms of value extraction automatically resulted in a deemed dividend without regard to the facts and circumstances of the particular case. It was mentioned, for instance, that when a company pays or settles debts of a third party creditor owed by an indebted shareholder, the automatic result is to treat the payment as a deemed dividend when the value shift could, in fact, stem from some other cause, for example a suretyship obligation undertaken by the company or as payment for services rendered.

To what extent then has the abandonment of the VET provisions and the absence of certain deeming provisions narrowed the dividends tax base?

Consider the following example: On 1 April 2012, Company X sells its immovable property to its sole and beneficial shareholder, A, for a purchase price of R100. The market value of the property at the time of disposal is R250. The question that arises is whether the difference between the market value and the sale price can be regarded as a dividend.

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It should be appreciated that the draft VET provisions did not provide for the scenario in which a company sells an asset to a shareholder (or a connected person in relation to the shareholder) for an amount below market value. Instead, the draft VET provisions dealt essentially with four scenarios, being where a company provides financial assistance to a connected person, releases or relieves a connected person from an obligation measurable in money owed to the company, pays or settles a debt owed by a connected person to a third party and a scenario where the company ceases to be a resident.

Under the former STC regime, the scenario mentioned in the example was specifically dealt with in s64C(2)(a) read with s64C(4)(bA) of the Act. Section 64C(2)(a) provided that an amount shall be deemed to be a dividend declared by a company to a shareholder where any cash or asset is distributed or transferred by that company to or for the benefit of that shareholder or any connected person in relation to that shareholder. Section 64C(4)(bA) stated that ss(2) shall not apply to the extent of any consideration received by that company in exchange for the cash or asset distributed or transferred. Applied to the above example, the effect of the two sections is to trigger a deemed dividend in an amount equal to R150, that is the difference between the market value of the property and the consideration paid for it.

Under the dividends tax regime the position is not as straight forward. In the absence of an applicable deeming provision, it becomes necessary to consider as a point of departure the definition of 'dividend' in s1 of the Act. Insofar as is relevant to the above example, 'dividend' means:

> "any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company, whether that amount is transferred or applied - (a) by way of a distribution made by; or (b)…, that company, but does not include…".

'Amount' has been judicially considered albeit in relation to the 'gross income' definition in s1 of the Act. In *WJ Lategan v CIR (2 SATC 16)*, Watermeyer J stated that the word 'amount' must be given a wider meaning and must include not only money but also value of every form of property earned by the taxpayer whether corporeal or incorporeal that has a money value. In *C:SARS v Brummeria Renaissance (Pty) Ltd and others (69 SATC 205)*, the court held that the right to use loan capital interest free as quid pro quo for granting certain life-rights constituted an 'amount' for the purposes of the gross income definition. The question of whether the right could be turned into money was only one of the ways of determining whether the right had a monetary value. The test, according to the court, is objective and not subjective.

If one applies the said dicta to the meaning of 'amount' in the definition of 'dividend', then the distribution of a cash amount or an asset (whether corporeal or incorporeal) which has, objectively speaking, an ascertainable money value, will constitute an 'amount' for purposes of the definition of dividend. In commercial parlance, the distribution of an amount in cash is referred to as a dividend otherwise than *in specie* whereas the distribution of an asset (corporeal or incorporeal) other than cash is regarded either as a dividend *in specie* or the distribution of an asset *in specie*.

The phrase 'for the benefit or on behalf of any person in respect of any share' is couched very broadly. To appreciate its full ambit, it is instructive to have regard to the corresponding phrase in the definition of 'dividend' that prevailed from 1 January 2011 until the introduction of the new definition on 1 April 2012. The relevant part read as follows:

> 'any amount transferred or applied by a company for the benefit of any shareholder in relation to that company by virtue of any share held by that shareholder in that company…'.

Compared, the new definition is not limited to an amount transferred or applied for the benefit of a shareholder but rather applies to an amount transferred or applied for the benefit or on behalf of any person in respect of any share in the company. The following changes are noticeable:

- The phrase 'or on behalf of' has been added;
- the phrase 'of any shareholder' now reads 'of any person' and
- the phrase 'in respect of' replaces 'by virtue of'.

The addition of the words 'or on behalf of' as an alternative to 'for the benefit of' operates to broaden the definition. Consider a scenario where the directors of a company resolve to distribute a cash dividend to its sole shareholder A. Motivated out of pure gratuitousness, A authorises and instructs the company to pay the cash amount directly to his friend C. In this instance, it can be said that the payment is made on behalf of shareholder A (thereby constituting a dividend) while not necessarily being for A's benefit. But who then is the beneficial owner of this dividend, more specifically who is the person who is entitled to the benefit of the dividend attaching to a share

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in the company and accordingly liable for the dividends tax? The answer is not entirely clear but arguably it is shareholder A who is entitled to the benefit; the fact that he is entitled to direct that the amount be paid directly to C does not detract from the amount (at least initially) being for his benefit. Incidentally, the payment to C could also trigger donations tax in terms of s57 of the Act, being a payment made by a company at the instance of A (who is deemed to be the donor).

The substitution of 'shareholder' for 'any person' is in line with the transition to render the beneficial owner of the dividend liable for dividends tax, at least in so far as dividends other than dividends *in specie* are concerned. Under the dividends tax regime, the focus is on the person who is entitled to the benefit of the dividend attaching to a share rather than on the shareholder registered as such in the company's share register. The determination of the beneficial owner of the dividend remains relevant even in the context of dividends *in specie* as where the beneficial owner is for example a resident company or a public benefit organisation, the dividend will be exempt from dividends tax provided the requisite declaration and undertaking are submitted.

While the current phrase 'in respect of' and the phrase 'by virtue of' that it replaced denote that there be a connection between the amount which is transferred or applied by the company and a share in the company, 'by virtue of' seems to indicate specifically a reference to the rights and corresponding obligations attaching to a share whilst 'in respect of' indicates a wider, more general nexus between the amount transferred or applied and a share. It is noteworthy that the phrase 'by virtue of' is used in s64E(4)(a), despite the seemingly wider phrase 'in respect of' which is now found in the definition of 'dividend'. Furthermore, it was noted above that the beneficial owner of a dividend is the person who is entitled to the benefit of the dividend 'attaching to a share'. Overall then, to constitute a dividend the distribution must be in respect of a share in the company and when determining liability in respect of the dividend one must look to the person who is entitled to the benefit of the dividend attaching to a share in the company.

Despite the said differences, the current and former definition of 'dividend' are substantially similar, the changes being motivated primarily by the shift in emphasis under the dividends tax regime to the beneficial owner of the dividend. The current definition of dividend, and for that matter the definition that prevailed immediately prior to that, seems wide enough to constitute a dividend in the above example. It is submitted that the sale of the property at less than market value represents an amount transferred by the company for the benefit of any person (in this case shareholder A) in respect of a share in the company.

It should be appreciated that s64C(4) stated that the deemed dividend provisions contained in s64C(2) did not apply where the amount constituted a dividend, in other words if it constituted a dividend under the provisions contained in s64B dealing with actual dividends. The inference is that the deeming provisions in s64C applied over and above the general provisions in s64B and that there was a degree of overlap between s64B and s64C. Arguably then, the (or at least certain of the) deeming provisions contained in s64C were inserted for the purposes of providing certainty in the characterisation of certain transactions as dividends rather than on the premise that such transactions were otherwise not dividends.

It is submitted, in light of the foregoing, that under the STC regime SARS could have relied either on s64B or s64C when levying STC in respect of the sale of an asset by a company to its shareholder at less than market value.

Consider a change to the facts in the example above: On 1 April 2012, the immovable property is sold for below market value not to shareholder A but rather to his son B. Under the former STC regime, s64C(2)(a) would have been applicable as B is a connected person in relation to A, a scenario specifically catered for in the said section.

What is the position under the dividends tax regime? Given that A and B are related to each other, the inference is that the amount transferred or applied is for the benefit of or on behalf of shareholder A in respect of the shares beneficially held by him in the company. It would then be incumbent on A to motivate on the facts and circumstances that the reduced purchase price was not determined for his benefit nor on his behalf but rather in fulfilment of some or other obligation to which he does not have an interest. The sale at below market value could, for example, be on account of a debt owed by the company to B or perhaps arise out of some or other obligation owed by the company to B for example payment for services rendered or compensation for damages. However, if A owes his son B an amount equal to the difference between the market value and the purchase price and causes the company to sell the property to B for a price reduced by such debt, then the transfer of the asset will generally constitute a dividend. In this instance, the distribution will be for the benefit of (or at least on behalf of) shareholder A.

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If in return for the immovable property, A (in the first example) or B (in the second example) is liable to pay a market related purchase price, then arguably the transfer is not for the 'benefit' of any person in respect of any share in the company, that is no benefit so to speak is conferred because the consideration is market related. Yet the transfer could still qualify as being 'on behalf of' any person in respect of any share in the company, that it could have been transferred on shareholder A's behalf and at his instance. For example, the property may have some intrinsic or sentimental value to A. However, in this case, it is submitted that the distribution will not constitute an 'amount' for reason that it does not have an objectively ascertainable money value and accordingly will not be regarded as a dividend.

Once it is established that a dividend has been paid or has become payable, the value of the dividend particularly in the case of a dividend *in specie* needs to be determined. Section 64E(3) states that in respect of a dividend that consists of the distribution of an asset *in specie* the amount of the dividend must be deemed to be equal to the market value of the asset on the date that the dividend is paid or becomes payable. As mentioned above, there is currently no equivalent to the former s64C(4)(bA) effectively reducing the value of the dividend by the amount of any consideration received by the company in exchange for the asset distributed.

In the context of the sale of immovable property for less than market value, one should establish what the 'asset *in specie*' is, that is being distributed. If it is the immovable property itself, then in the above examples dividends tax would be payable on the amount of R250 despite an amount of R100 being paid by A or B, respectively. If this is the case, then there would appear to be a legislative oversight in that no regard is had to the consideration paid in return.

However, if the 'asset *in specie*' is rather the right to or benefit of obtaining transfer of the asset for a price below market value then it is the market value of that right or benefit (as opposed to the property itself) that has to be determined. A reasonable method of determining such value, it is submitted, would be to deduct the purchase price paid or payable for the asset from its market value determined at the date the asset is transferred or becomes transferable. Applied to the above examples, the amount of the dividend would be R100. The result is more equitable and brings about a similar tax liability to that which prevailed under deeming provisions in the former STC regime.

It is significant that the new dividends tax regime is not without any deeming provisions. Section 64E(4)(a) expressly deems a dividend to have been paid if, in certain specific circumstances, a loan or advance is provided by a company by virtue of any share held in that company. Section 64E(4)(b), in turn, expressly provides for the amount of such dividend to be quantified as the difference between the market related interest as defined in the Seventh Schedule and the actual interest (if any) that is payable to the company in respect of the loan.

The question that arises is: why did the legislator expressly deem as a dividend the interest free element of a so-called soft loan made by the company but omit to mention a sale of an asset at less than market value, especially when it was deemed prudent to expressly mention the transfer of an asset in the former s64C? As mentioned above, even the draft but abandoned VET provisions did not specifically deal with below market value sales by companies to shareholders. It was also mentioned above that in enacting s64C(4)(a), the legislator contemplated that there might be an overlap between s64B and s64C. Accordingly, it could be inferred that the legislator is of the view that the definition of dividend is wide enough to cater for a sale at less than market value by a company to its shareholder or a connected person in relation to the shareholder.

In summary, taxpayers should not assume that in the absence of an express or separate deeming provision, dividends tax will not arise in the context of the sale of an asset to a shareholder (or a connected person in relation to the shareholder) at less than market value. There is a risk that the current definition of 'dividend' is wide enough to include such a sale and therefore it is recommended that companies and shareholders stay alert to the potential resultant dividends tax.

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