DLA CLIFFE DEKKER HOFMEYR

TAX

ALERT

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TAXATION OF HEDGE FUNDS

Following the release on 12 September 2012 of a proposed framework for the regulation of hedge funds, the National Treasury and the Financial Services Board released draft regulations (Draft Regulations), together with an explanatory memorandum (Memorandum), on 16 April 2014.

The Memorandum cites two factors that influenced Government's decision to regulate hedge funds, not only at manager level, but also at portfolio level:

- the global financial crisis of 2008; and
- South Africa's commitments as member of the G20.

Hedge funds are to be regulated in terms of the existing legislative framework provided by the Collective Investment Schemes Control Act, No. 45 of 2002 (CISCA) and specifically as a scheme declared by the Minister of Finance under s63 of CISCA.

The Draft Regulations define a 'hedge fund' as:

"…a collective investment scheme which uses any strategy or takes any position which could result in the portfolio incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include, but are not limited to –

(a) leverage; or

(b) net short positions".

While the Draft Regulations make provision for the registration of hedge fund managers, and set out various prudential and reporting requirements for financial regulatory purposes, it is important to appreciate the significance of bringing hedge funds under the framework of collective investment schemes for tax purposes.

Provisional amendments have already been introduced into the Income Tax Act, No. 58 of 1962 (Act) in 2013 to cater for the taxation of hedge funds as collective investment schemes, and these amendments will take effect as soon as the Minister of Finance declares hedge funds to be collective investment schemes under s63 of CISCA.

Essentially, hedge funds are to be taxed on a flow-through basis similar to that of traditional collective investment schemes. S25BA of the Act provides that amounts received by or accrued to a portfolio of a collective investment scheme (other than property schemes) are deemed to have accrued to the participant if such income is distributed to the participant within 12 months of accrual to the portfolio. In these circumstances the portfolio is exempt. However, if no distribution is made within the 12 month period, the amounts are deemed to have accrued to the portfolio, and the

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portfolio will be taxed accordingly. Also, dividend income will then not be exempt in the hands of the portfolio. Collective investment schemes (other than property schemes) are however exempt from capital gains tax in terms of paragraph 61 of the Eighth Schedule to the Act.

This treatment will apply whether the hedge fund is a 'qualified investor' or a retail fund, and irrespective of whether the hedge fund is structured as a company, trust or partnership.

In respect of the disposal by a participant of a participatory interest in a hedge fund, s9C of the Act has been amended to include such participatory interest in the definition of an 'equity share' and the disposal of the interest will be deemed to be on capital account where the participant has held the interest for more than three years (as is the case with 'equity shares' as defined). In other circumstances the ordinary rules will apply in respect of determining whether the disposal of the participatory interest should be treated as being on capital or revenue account.

Managers of hedge funds as well as investors should take note of the Draft Regulations and understand the tax consequences that will arise when final regulations are published and the Minister of Finance declares hedge funds to be collective investment schemes.

Heinrich Louw

NEW REGULATIONS FOR THE ZERO RATING OF INDIRECT EXPORTS

Background

The Value-Added Tax (VAT) rules relating to the exportation of goods are rather complex and intricate. Many vendors do not always appreciate the issues that arise in circumstances where goods are exported, either by the vendor or the purchaser of the goods.

The South African VAT system is essentially destination based, which means that the supply of goods or services are to be taxed in the country where such goods or services are consumed. In other words, where goods are exported from South Africa, the goods will be consumed outside of South Africa, and the supply of such goods should therefore not attract VAT in South Africa. Section 11(1)(a) of the Value-Added Tax Act, No. 89 of 1991 (VAT Act) gives effect to this general rule by providing that movable goods that are 'exported' from South Africa in terms of a sale or instalment credit agreement will attract VAT at the rate of 0%, as opposed to the standard rate of 14% - provided that sufficient documentary proof relating to such exportation is in place (s11(3) of the VAT Act).

"Exported" is defined in s1(1) of the VAT Act as meaning:

"*(a) consigned or delivered by the vendor to the recipient at an address in an export country as evidenced by documentary proof acceptable to the Commissioner;*

(b) …

(c) …

(d) ***removed from the Republic by the recipient for conveyance to an export country, in accordance with the provisions of an export incentive scheme approved by the Minister***".

Paragraph (d) was amended in 2013 to read as follows:

"*(d) removed from the Republic by the recipient or the recipient's agent for conveyance to an export country in accordance with any regulation made by the Minister in terms of this Act*".

An export as contemplated in paragraph (a) is generally referred to as a 'direct export', while an export as contemplated in paragraph (d) is generally referred to as an 'indirect export'.

The 'Export Incentive Scheme' contemplated in paragraph (d) of the definition of 'exported' was originally published as Notice No. 2761 in Government Gazette No. 19471 of 13 November 1998 (Scheme).

In the 2012 Budget the Minister of Finance announced that, *inter alia*, the VAT treatment of indirect exports (specifically by road or rail) would be reviewed, and new draft regulations were subsequently published.

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Final regulations (Regulations) were published as Regulation No. 316 in Government Gazette No. 37580 of 2 May 2014.

Zero rating of indirect exports under the Scheme

In terms of the Scheme, the vendor was required, in the first instance, to account for output tax at the standard rate where the recipient of the supply took possession of the goods in South Africa. The recipient was however entitled to apply to the VAT Refund Administrator for a VAT refund under Part One of the Scheme, provided that the recipient was a 'qualifying purchaser' as defined and the required documentary proof was retained.

The Scheme made provision for the vendor to elect to apply the zero rate in circumstances where the goods were supplied to a 'qualifying purchaser' as defined and the goods were subsequently transported by ship or by air to an export country by such purchaser. Specifically, the Scheme permitted zero rating where the goods were delivered by the vendor to a local harbour or airport for subsequent exportation by the foreign purchaser. In these circumstances, the supplier assumed the obligation to obtain proof that the goods were in fact subsequently exported, and bore the risk of having to account for VAT at the standard rate if the required documentation could not be obtained within the prescribed time periods.

The vendor could not elect to zero rate a supply where the purchaser would export the goods by way of road or rail.

Zero rating of indirect exports under the Regulations

Under the Regulations, some substantial changes have been made.

In terms of Part 2, Section A, a vendor may elect to zero rate the supply of goods where:

- the goods are delivered to certain harbours or airports;
- the goods are exported by means of a pipeline or electrical transmission line;
- the vendor supplies the goods to a qualifying purchaser on a flash title basis;
- the vendor supplies the goods to a qualifying purchaser, but the goods are first delivered to another local vendor for purposes of processing, repair, improvement, manufacture, assembly or alteration, and the goods are subsequently delivered by the latter vendor to certain harbours or airports; or
- the vendor supplies goods to a qualifying purchaser or registered vendor and the goods are situated at the designated harbour or airport, the goods are delivered to either the port authority, master of the ship, a container operator, the pilot of an aircraft or are brought within the control area of the airport authority, and the goods are destined to be exported from South Africa.

Various procedural and documentary requirements must be met where a vendor elects to zero rate such a supply.

Where the vendor does not elect to zero rate the supply, the vendor must levy VAT at the standard rate and the qualifying purchaser can apply for a VAT refund under Part 1 of the Regulations.

In terms of Part 2, Section B, a vendor may elect to zero rate the supply of goods where the goods are supplied to a qualifying purchaser and those goods are to be exported by the qualifying purchaser's agent.

Various requirements need to be met by the parties involved, but, essentially, the vendor must consign or deliver the goods to the purchaser's agent's premises (or otherwise ensure that the goods are delivered to the agent's premises).

The vendor must also ensure that the goods are exported from South Africa within a period of 90 days from the earlier of the time of invoice or payment.

An 'agent' is defined as any registered vendor:

- located in South Africa who is the nominated agent of a qualifying purchaser and registered as prescribed in the rules of s59A of the Customs and Excise Act, No. 91 of 1964;
- that has been appointed by a qualifying purchaser to collect, consolidate and deliver movable goods to such qualifying purchaser at an address in an export country; and

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- is licensed as a remover of goods in bond as contemplated in 64D of the Customs and Excise Act.

The agent must conclude an agreement with the qualifying purchaser to be appointed as its South African representative for customs purposes as well as its agent in respect of all supplies made to that qualifying purchaser by vendors in terms of this Part 2 of the Regulations.

The agent must actually export the goods within 90 days from the earlier of the time of invoice or payment.

The actual transport of the goods must be done by a 'cartage contractor', which is defined as a person whose activities include the transportation of goods, and includes couriers and freight forwarders. For purposes of exports by road or rail, the cartage contractor must be a licensed remover of goods in bond as contemplated in s64D of the Customs and Excise Act. The agent may also be the cartage contractor. The cartage contractor can be contractually bound to the vendor, the qualifying purchaser or the qualifying purchaser's agent.

The qualifying purchaser must register as an 'exporter' as prescribed in rule 59A.03(1) to the Customs and Excise Act. They must appoint an agent as their South African representative for customs purposes and enter into an agreement with their agent in South Africa for purposes of complying with the Regulations.

There are many technical and documentary requirements that a vendor, agent and cartage contractor must meet relating to such a transaction and, accordingly, there are various pitfalls. If any of the requirements are not met, the vendor will have to account for VAT at the standard rate.

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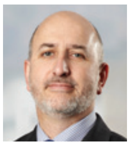

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