DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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IN THIS ISSUE

- **Legislature keeps plodding along on carbon tax**
- **Ruling on dividends tax on shares held by local branches**

LEGISLATURE KEEPS PLODDING ALONG ON CARBON TAX

In May 2013 National Treasury released the long-awaited carbon tax policy paper, which serves as an update to the carbon tax discussion paper on the introduction of a carbon-pricing mechanism in South Africa that the government released in December 2010.

The carbon tax discussion paper was preceded by an announcement in 2009 that the government is committed to reducing greenhouse gas emissions by 34% by 2020.

The underlying rationale for reducing the emission of greenhouse gases is to "facilitate an environmentally sustainable economic development and growth path for South Africa." This would be achieved by pricing carbon emissions in a way that affects producer and consumer behaviour and addresses climate change.

The updated policy paper aims to refine the specific features of carbon tax that were discussed in the 2012 Budget Review. This article highlights some of the issues raised in the policy paper:

Carbon tax or an emissions trading scheme?

A significant issue addressed in the policy paper is the mechanism that would be used to price carbon. In principle there are two main market-based mechanisms that could be used to price carbon, namely, carbon taxes and emissions trading schemes. Carbon taxes work by pricing the emissions directly, whereas emissions trading schemes operate by limiting the amount of greenhouse gases that are allowed to be emitted.

The policy paper makes it clear that in South Africa the most appropriate pricing mechanism, in the short to medium term, would be a carbon tax rather than an emissions trading scheme. This had already been established in the 2010 discussion paper.

The main reason given for preferring a carbon tax over and emissions trading scheme is that an emissions trading scheme mechanism will require a sufficient number of entities participating and adequate trading volumes to generate an appropriate carbon price. As the energy sector is dominated by a relatively small number of suppliers and South Africa is a developing country, it may fail to meet these requirements.

Designing a carbon tax

The 2010 carbon tax discussion paper proposed three options for establishing a base for a carbon tax:

(i) direct measure of greenhouse gas emissions;

(ii) quantity of fossil fuel input for coal, crude oil and natural gas; and

(iii) energy outputs (electricity and transport fuels).

The policy paper proposes that the best option would be to impose a levy directly on the emissions of actual greenhouse gases or carbon dioxide equivalents. However, such a tax on actual emissions would constitute an administrative burden.

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Accordingly, the policy paper proposes that the most preferred option is for a fuel input tax. The carbon tax will only cover direct emissions, also known as scope 1 emissions, in the tax base. These are emissions that result directly from fuel combustion and gasification and from non-energy industrial processes.

Tax-free thresholds for certain sectors

Certain sectors that are vulnerable or exposed in respect of competitiveness in trade and carbon-intensive sectors will enjoy relief in the form of a variable tax-free percentage-based threshold for the first five years. It is anticipated that there will be a move towards absolute thresholds after that period.

Additional offset incentives will also be available to companies that introduce certain measures to curb carbon emissions.

The agricultural, forestry and land, and waste sectors will enjoy a 100% threshold for the first five years. The steel, cement and chemical sectors will enjoy a maximum threshold of 80%, the petroleum sector 70% and the electricity sector 60%.

Proposed carbon tax rate

In theory, the aim of the proposed carbon tax is to correct the existing prices of goods and services that generate excessive greenhouse gas emissions so that they reflect the social costs of such emissions.

The policy paper proposes that as of 1 January 2015, a carbon tax is introduced at R120 per ton of carbon dioxide equivalent.

If the tax free thresholds are taken into account, the effective tax rate will be substantially below the rate of R120 per ton of carbon dioxide equivalent during the first five year period.

It is also proposed that the carbon tax rate of R120 per ton of carbon dioxide equivalent will be increased at a rate of 10% per year until 31 December 2019.

Conclusion

In light of the above, it is clear that the arguments presented in the 2010 discussion paper and the recently updated policy paper are on par with each other. Significantly, both the discussion paper and the policy paper are strongly in favour of the carbon tax option as opposed to the emissions trading option. It would appear that the issue is no longer open for debate and South Africa will see a carbon tax, sooner or later. It remains to be seen whether the carbon tax legislation will be ready for implementation by 1 January 2015.

From a socio-economic perspective, the policy paper appears to underplay the potential effect that a carbon tax might have on the economy in terms of inflation and the spending power of economic participants who are already over-taxed. These issues still need to be adequately addressed.

Perhaps the most concerning issue relating to the proposed carbon tax is whether the tax collected by government will genuinely be put to use in respect of renewable energy and other measures to create a clean and sustainable environment, and not simply be seen as another revenue source for funding unrelated projects.

The public is invited to comment on the carbon tax policy paper by 2 August 2013.

Nicole Paulsen and Heinrich Louw

RULING ON DIVIDENDS TAX ON SHARES HELD BY LOCAL BRANCHES

The South African Revenue Service (SARS) published Binding Private Ruling 148 (ruling) on 19 June 2013.

The ruling deals with whether the dividends tax rate applicable to dividends paid on shares held by a local branch of a foreign company can be reduced by a relevant double taxation agreement. The facts are briefly as follows:

The applicant is a company that is part of a global group with headquarters in Japan. The applicant has a local branch through which it operates in South Africa. The branch mainly acts as agent for the applicant in respect of purchasing and selling commodities. Where the branch acts as buying agent, it earns commission based on the value of the commodities procured.

The applicant (together with the branch) holds a 49% equity stake in a local private company. Of the 49%, 2% is held by the branch. The branch has a right to dividends and capital gains in respect of its 2% shareholding in the local company. The branch also shares in the funding obligations relating to its 2% shareholding. The local company in turn holds a significant interest in a major supplier of commodities to the applicant (presumably through the branch).

From time to time the branch therefore receives dividends in respect of its 2% shareholding in the local company, and in principle, dividends tax needs to be withheld on such dividends.

Section 64G(3) of the Income Tax Act No 58 of 1962 (Act) provides that a company paying a dividend may reduce the rate at which dividends tax is withheld in accordance with an applicable double taxation agreement, provided that the beneficial owner of the dividend submits the relevant declaration and undertaking to the company paying the dividend.

Article 10(2) of the double taxation agreement between South Africa and Japan (DTA) provides for such a reduction of the dividends tax rate to 5% in circumstances where the beneficial owner (being a company) holds at least 25% of the voting shares in the company paying the dividend.

However, in terms of Article 10(4) of the DTA, this reduced rate does not apply to a beneficial owner that carries on business in South Africa through a permanent establishment and the shareholding in respect of which the dividends are paid 'is effectively connected with such permanent establishment'.

The question that arises is therefore whether the 2% shareholding of the local branch of the applicant is 'effectively connected' to its permanent establishment in South Africa.

SARS ruled that, based on the particular facts, the branch’s 2% shareholding in the local private company is not effectively connected to the branch and Article 10(4) does therefore not apply. The applicant (and the branch) may therefore rely on the provisions of s64G(3) of the Act and Article 10(2) of the DTA in order to the reduce the rate of dividends tax in respect of dividends paid on the full 49% shareholding, inclusive of the 2% held by the branch.

Unfortunately the ruling is not entirely clear as to SARS’s reasoning, but it appears that, since the 2% shareholding of the branch related to the procurement or purchasing of goods in South Africa from the local supplier company, Article 5(4) of the DTA excluded or disconnected the 2% shareholding from any permanent establishment of the applicant.

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