DLA CLIFFE DEKKER HOFMEYR

TAX

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VALUE SHIFTING ARRANGEMENTS STILL APPLICABLE TO COMPANIES AND TRIGGERING ADVERSE TAX IMPLICATIONS

The Eighth Schedule to the Income Tax Act, No 58 of 1962 (Act) contains particular anti-avoidance provisions dealing with so called value-shifting arrangements. The South African Revenue Service (SARS) Comprehensive Guide to Capital Gains Tax (Issue 4) (CGT Guide) indicates that value shifting involves the effective transfer of value from one entity to another without constituting an ordinary disposal for capital gains tax purposes. Without these specific provisions, the concern is that entities could manipulate the value of assets in order to obtain a capital gains tax benefit.

In the Taxation Laws Amendment Act, 2012 (TLA 2012) a new s24BA of the Act was introduced to ensure that asset-for-share transactions take place for equal value. In other words, the market value of the asset acquired by the company must equal the market value of the shares issued in exchange, otherwise it will trigger the attendant tax implications for the person receiving the benefit.

As a result of the new anti-avoidance provisions in s24BA of the Act the value shifting arrangement definition was to be amended such that it would no longer be applicable to companies and only apply to trusts and partnerships. However, this amendment was only to be effective from 1 January 2014 as National Treasury required further time to ensure that the change did not give rise to anti-avoidance.

In the initial Draft Taxation Laws Amendment Bill, 2013 no mention was made of the potential repeal of s102 of the TLA 2012, which provision was to exclude companies from the value shifting arrangement provisions. However, in the final Taxation Laws Amendment Act, 2013 (TLA 2013), it was announced that the proposed amendment to the value shifting arrangement provisions would be repealed and has been repealed with effect from 1 February 2013.

The Explanatory Memorandum (EM) on the TLA 2013 simply states that as a consequence of the repeal of s24B of the Act, the value shifting arrangement rules are necessary to counter transactions that shift value by the issue of shares between connected persons. However, this statement appears to be at odds with the fact that s24BA of the Act, the provision introduced to deal with these value mismatches, is still applicable. In addition, National Treasury indicated in the EM on the TLA 2012 that value shifting provisions have proved to be ineffective in respect of companies and that the formal 'connected persons' relationship (being one of the requirements for the application of the value shifting arrangement provisions) is often lacking in many anti-avoidance transactions. If the value shifting arrangement provisions were 'ineffective' in the case of companies, why then simply reinstate the old provisions?

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To appreciate the adverse tax implications that may be triggered as a result of the concurrent application of s24BA of the Act and the value shifting arrangement rules it is helpful to refer to the following example in Chapter 21.3.6 of the CGT Guide:

"Example – Value shifting by issuing shares at a discount

Facts:

Bongo is the sole shareholder of Why (Pty) Ltd in which he holds 2 shares of R1 each. The retained income in the company amounts to R99 998. The market value of the shares on 1 October 2005 is R100 000. The base cost of Bongo's 2 shares on valuation date is R50 000. On 1 October 2005, Why (Pty) Ltd issues a further share of R1 to Bongo's daughter, Cynthia, at a cost of R1.

Result:

[For detailed workings of the value shifting arrangement provisions refer to Chapter 21.3.6 of the CGT Guide]

Bongo's Capital Gain - R16 833

Cynthia's Base Cost - R33 334"

Section 24BA of the Act only applies to the disposal of an asset in exchange for the issue of shares (as opposed to cash in exchange for the issue of shares). Therefore, if the same transaction were implemented under the current legislation but Cynthia disposed of an asset worth R1 to Why (Pty) Ltd (ie as opposed to subscribing for shares for cash in the company), the difference between the market value of the share immediately after the issue (say, R33 334) and the market value of the assets immediately before the disposal (say, R1) would be deemed to be a dividend in terms of s24BA(3)(b) of the Act. Not only will the value shifting arrangement provisions contained in the Eighth Schedule to the Act be triggered but there will be an additional dividend withholding tax liability on Cynthia of R5 000.

In light of National Treasury's late decision to repeal the exclusion of companies from the value shifting arrangement provisions it is not clear whether it was their intention that both the value shifting arrangement provisions and s24BA of the Act may be triggered in the same transaction. However, the CGT Guide does indicate that the donations tax and dividends tax implications of these types of value shifting transactions should not be lost sight of.

Taxpayers entering into asset-for-share transactions should therefore carefully consider these provisions to fully understand the potential tax implications. Importantly, s24BA of the Act and the value shifting arrangement provisions contain a number of specific requirements and exclusions that must be considered to determine the attendant tax consequences, which will depend on the facts and circumstances of the particular transaction concerned.

Andrew Lewis

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TAX ALLOWANCES FOR TRI-GENERATION

The South African energy landscape has undergone significant changes over the last few years with the introduction of a number of private and public sector funded renewable energy projects, aimed at feeding power into the national grid and reducing reliance on coal-fired power stations for generating electricity. Further initiatives for energy efficiency (and not necessarily energy generation) have also been introduced to further assist taxpayers in reducing their energy footprint.

The generation of electricity from renewable resources such as wind, solar, biomass or hydro is not only directed at feeding power into the national grid, but is also utilised by a wide array of corporate taxpayers for their own use. Corporate taxpayers are also investing in innovative technologies to reduce energy consumption. All of the aforementioned could be combined into a so-called 'tri-generation' or a Combined Cooling and Heating Power (CCHP) plant, which generates electricity from a renewable resource and, as a secondary process, captures heat and produces chilled water for energy reduction. It may be more beneficial for a corporate taxpayer, in a typical office environment, to implement a type of CCHP plant, given its relatively compact nature as opposed to solar, wind and hydro energy generation, which generally require enormous expanses of land.

In its basic form, a CCHP plant utilises a fuel source in the form of a gas, which has been derived from biomass to ignite an engine which, in turn, will generate electricity through a generator. As a secondary energy efficiency process, heat from the CCHP plant will be captured and processed through absorption chilling technology to produce chilled water for use, for example, in cooling computer equipment (as opposed to using an air conditioning unit powered by electricity from the national grid). The CCHP plant therefore generates electricity from a renewable resource (eg biogas extracted from biomass such as plant material) and reduces energy consumption through absorption chilling technology. A crucial aspect to understand is that the fuel used to ignite the engine in a CCHP plant (eg biogas) needs to be extracted through a complex process utilising specialised machinery, as logic dictates that biomass in its raw form (ie leaves, wood chips, manure etc.) is fairly useless from a renewable energy and energy efficiency perspective.

As investment costs into CCHP plants are substantial, it is essential that taxpayers claim relevant and qualifying tax allowances to ensure the commercial viability of a renewable energy or energy efficiency program. In broad strokes, the most relevant tax considerations when it comes to renewable energy and energy efficiency fall under s12B and 12L of the Income Tax Act, No 58 of 1962. The main difference between s12B and s12L is that s12B is specifically directed towards the investment in assets which are to be used in the generation of electricity from renewable resources (ie solar, wind, biomass or hydro) as opposed to s12L, which is directed at the investment in technology that reduces energy consumption.

Provided the requirements of s12B are met, a taxpayer is permitted to deduct the cost of qualifying assets (including structures of a permanent nature), used in the generation of electricity from renewable resources, on a 50/30/20 basis (ie three years). The aforementioned accelerated capital allowance under s12B provides a substantial incentive to invest in renewable energy programs – the often difficult question that arises is which assets are in fact used in the 'generation of electricity' and where does the process start, which must be determined based on the objective facts of each case and is very much dependent on the type of renewable energy utilised and the technology adopted.

As stated previously in this article, in the case of biomass in its raw form, it is fairly useless and needs to be processed to extract a fuel (in this case biogas), which is used to ignite an engine situated within a CCHP plant. Taxpayers would need to pay careful attention and take appropriate tax advice in determining where the process of electricity generation from a renewable resource actually starts, as significant capital investments would likely be made at the front-end of a 'tri-generation' process, through the setting up of biomass processing facilities, as an example.

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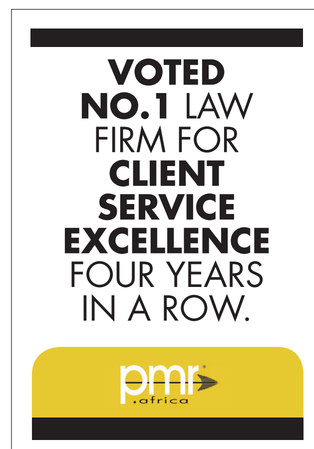
As a secondary process, a CCHP plant is used to produce chilled water through a process known as absorption chilling, which in turn brings energy efficiency (as opposed to electricity generation) allowances into play. Section 12L provides a qualifying taxpayer with an allowance for implementing technology resulting in measured and verified energy efficiency savings. Subject to certain compliance and registration requirements being met (not forming the subject matter of this article), the allowance under s12L is calculated at 45 cents per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.

The difficulty with s12L is potentially two-fold in that a taxpayer would essentially only receive a once-off benefit in its first year of assessment, unless continuous energy efficiency processes are put in place year-on-year. The costs incurred could possibly outweigh any benefits under s12L after the first year of assessment in which the allowance is claimed, which is mainly due to the calculation of the baseline from which energy efficient savings are measured. Secondly, there is a debate as to whether s12B and s12L are concurrent benefits, in other words, a taxpayer may not be able to simultaneously claim both allowances in relation to the CCHP plant and would possibly need to 'make a call' on which allowance is more beneficial from a tax perspective.

There is no doubt that, through proper planning and expert advice, renewable energy and energy efficiency programs adopted by taxpayers could be extremely tax efficient. National Treasury has recognised the need for stimulating the aforementioned sectors of the economy, but one senses even more could be done to assist in offsetting the enormous capital investments that must be made.

As the renewable energy and energy efficiency landscape grows, more and more taxpayers will be utilising technology to reduce reliance on the national grid and further reduce their energy footprint (especially in an office environment). Tax allowances will no doubt play a crucial role in determining whether the South African renewable energy and energy efficiency landscape will be sustainable in the long term.

Ruaan van Eeden



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