TAX

IN THIS ISSUE

WHO IS OBLIGED TO REPORT A REPORTABLE ARRANGEMENT?

REDUCING TAX BY USING ARBITRAGE

WHO IS OBLIGED TO REPORT A REPORTABLE ARRANGEMENT?

The list of reportable arrangements was extended by the South African Revenue Service in a notice (SARS Notice) published on 16 March 2015 in terms of s35(2) and s36(4) of the Tax Administration Act, No 28 of 2011 (TAA).

The SARS Notice has caused some consternation. However, if one considers the obligation to notify SARS of reportable arrangements, the effect of the SARS Notice is perhaps not as far-reaching as first appears.

In terms of s35(1) of the TAA an arrangement is a reportable arrangement if:

- a person is a participant in an arrangement and the arrangement has certain characteristics; or
- SARS has listed it in terms of a public notice under s35(2) of the TAA (the SARS Notice being the first and, so far, only such notice).

Notably, in the case of a reportable arrangement listed in a SARS notice under s35(2) of the TAA, it is not a requirement that a tax benefit is or will be derived or is assumed to be derived by a participant; it is merely a requirement that the transaction be listed in the public notice. Nevertheless, in many cases, while the relevant arrangement may technically be a reportable arrangement in terms of a notice, practically there will be no obligation on any person to actually report the arrangement.

The person who must report a reportable arrangement is a 'participant'. A 'participant' is defined in s34 of the TAA to mean, in relation to an arrangement:

- a promoter; or
- a person who directly or indirectly will derive or assumes that the person will derive a tax benefit or financial benefit by virtue of an arrangement.

A 'promoter', in relation to an arrangement, is a person who is 'principally responsible for organising, designing, selling, financing or managing the arrangement'.

'Tax benefit' is defined in s34 of the TAA to mean 'avoidance, postponement or reduction of a liability for tax'.

In terms of s34 of the TAA, 'financial benefit' means 'a reduction in the cost of finance, including interest, finance charges, costs, fees and discounts on a redemption amount'.

In terms of s37 of the TAA, the person who must report a reportable arrangement is the participant, that is, either the promoter or the person who derives a tax benefit.

In terms of paragraph 2.4 of the SARS Notice the following arrangement has been identified as a reportable arrangement:

"Any arrangement in terms of which one or more persons acquire the controlling interest in a company on or after the date of publication of this notice, including by means of acquiring shares, voting rights or a combination of both, that:

(a) (i) has carried forward or reasonably expects to carry forward a balance of assessed loss exceeding R50 million from the year of assessment immediately preceding the year of assessment in which the controlling interest is acquired; or

(ii) has or reasonably expects to have an assessed loss exceeding R50 million in respect of the year of assessment during which the controlling interest is acquired; or

(b) directly or indirectly holds a controlling interest in a company referred to in paragraph (a)"

Presumably, the provision is aimed at giving SARS early warning of arrangements that constitute the 'trafficking' in companies that have assessed losses.

Now, daily, shareholders sell shares in companies that have assessed losses, in some cases significant assessed losses. No doubt in most of these transactions, the intention of a person acquiring the shares in a company is, in good faith, to invest in a company that, for example, operates a viable business and that, coincidentally, has an assessed loss.

Consider the example where X is interested in acquiring a controlling stake in Company Y from shareholder Z. Company Y owns valuable intellectual property but has been battling to realise it to best effect. It has incurred actual losses and also has an assessed tax loss of R60 million. X pays cash for the shares. X identified the opportunity himself and, accordingly, there was no one who is 'principally responsible for organising, designing, selling, financing or managing the arrangement' between X and Z. Accordingly, there was no 'promoter' as defined in s34 of the TAA.

Clearly, the transaction falls within the provisions of paragraph 2.4 of the SARS Notice. But who is obliged to report the arrangement to SARS? As there is no promoter,

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the only person who in principle is obliged to report the arrangement is one who will directly or indirectly derive a tax benefit or financial benefit.

It is not apparent whether X, Company Y or Z is obtaining any financial benefit, that is, a 'reduction in the cost of finance'.

Is X, Company Y or Z a 'participant'? That is, is any of them directly or indirectly avoiding, postponing or reducing a liability for tax?

Conceivably, Z could be selling the shares at a loss and, in so doing, realise a capital loss which it may be able to set off against future capital gains for capital gains tax purposes and, accordingly, be reducing a liability for tax. But let's assume that there is no capital loss.

Is X realising a tax benefit? Company Y has an assessed loss and, if it keeps on operating, may be able to set off future taxable income against the assessed loss. Clearly, it may reduce tax in future. However, the reduction does not arise by *virtue of* the transaction between X and Z; it arose because of the losses it realised in the past.

Is X a 'participant'? In other words, is X directly or indirectly deriving or assuming that it will derive a tax benefit by virtue of the arrangement? X derives no direct tax benefit as a result of the assessed loss; the benefit (if any) accrues for the benefit of Company Y, as noted above. In other words, X is not avoiding, postponing or reducing X's liability for tax. Is X *indirectly* deriving a tax benefit? Again, while X may be deriving a benefit in the sense that it will hold a share in a company that has an assessed loss, it will not be deriving a tax benefit; the tax benefit is that of the company.

So, in the example above, the transaction may constitute a reportable arrangement, however, there is no promoter and, apparently, there is no one realising a tax benefit and thus none of the parties involved is obliged to report the arrangement.

What I have sought to point out is that while an arrangement may technically constitute a reportable arrangement, in the case where there is no 'promoter', there must be at least one party to the transaction who derives a tax benefit, otherwise there is no obligation on any one to report the arrangement. Before notifying SARS of an arrangement that, on the face of it, is reportable, parties should first determine whether there is actually an obligation on any one of them to report the arrangement.

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REDUCING TAX BY USING ARBITRAGE

With effect from 1 March 2015, the highest marginal income tax rate for individuals was increased from 40% to 41%. It appears likely that the rate may increase in future, which means individuals should try to minimise their personal income tax as far as possible.

The highest marginal rate takes effect on taxable income above the amount of R701,301.

There is an opportunity for owners of closely held companies and close corporations to reduce their personal taxes by using the arbitrage between the highest marginal rate, on the one hand, and the corporate income tax rate and the dividends tax rate, on the other hand.

Consider, for example, the case of Ms X who holds 100% of the shares in Company Y and who is employed by Company Y. For the 2015 tax year, Ms X wishes to realise a pre-tax income of R1,5 million.

Now, if Company Y pays Ms X a salary of R1,5 million, she will realise a net, after-tax income as follows:

Salary	R1,500,000
Less: Income tax	R536,324
Net after-tax income of Ms X	**R963,676**

However, if, instead of paying Ms X a salary only, the company pays Ms X a salary and a dividend, she will realise a net, after-tax income as follows:

Salary	R701,301
Less: Income tax	R205,587
Net income after income tax on salary	R495,714
Profit in company (after deduction of Ms X's salary)	R798,699
Less: corporate income tax (at 28%)	R223,636
Profit in company after tax	R575,063
Less: dividends tax (at 15%)	R86,259
Net after-tax dividend received by shareholder	R488,804
Total net after-tax income of Ms X	**R984,518**

It is apparent that Ms X realises a higher net, after-tax return in the case where the company pays a salary and a dividend. In fact, she receives R20,842 more.

Naturally, as the amount available for payment as a salary and dividend increases, the saving becomes more significant.

Does the above course of action constitute impermissible tax avoidance? No. It is trite that a person is allowed to arrange her affairs to minimise her taxes. It is normal for a company to pay a salary and dividend to a shareholder who is also an employee of the company.

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