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TAX ALERT

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FINALITY OF ADVANCE PAYMENTS BY NON-RESIDENTS DISPOSING OF IMMOVABLE PROPERTY

As a general principle, s35A of the Act imposes a duty on the purchaser of immovable property situated in South Africa, owned by a non-resident seller, to withhold a percentage of the purchase price and pay the same over to SARS.

The proposed amendment to s35A(3) of the Act is, according to Treasury, to resolve an impasse where the non-resident seller does not submit a tax return, but an amount has been paid over to SARS in respect of the disposal of the immovable property situated in South Africa.

The 2015 Taxation Laws Amendment Bill (TLAB) proposes an amendment to s35A of the Income Tax Act, No 58 of 1962 (Act), dealing with the withholding of amounts from payments due to non-resident sellers of immovable property situated in South Africa.

The proposed amendment raises an interesting point regarding administrative compliance with a country's tax laws through the submission of returns for assessment versus a final withholding tax.

As a general principle, s35A of the Act imposes a duty on the purchaser of immovable property situated in South Africa, owned by a non-resident seller, to withhold a percentage of the purchase price and pay the same over to the South African Revenue Service (SARS). The withholding percentage differs according to the nature of the seller:

- in the case of a natural person, 5% of the amount payable;
- in the case of a company, 7.5% of the amount payable; and
- in the case of a trust, 10% of the amount payable.

There is a general misconception, most likely based on weak advice being given to the seller, that s35A of the Act imposes a final 'capital gains' withholding tax. This is clearly incorrect as the relevant provision states that the amount withheld "is an advance in respect of that seller's liability for normal tax". A good example would be to compare the aforementioned to the employees' tax regime, where the monthly amount withheld by an employer is not a final tax, but merely an advance payment towards the normal tax liability of the employee, which is assessed annually. Section 35A of the Act looks to apply the same principle – the purchaser withholds and pays the amount over to SARS on behalf of the seller as a provisional payment. This provisional payment is then set-off against the normal tax liability of the seller once assessed by SARS, which implies the submission of a tax return. On assessment, over or under payments of tax could arise, as would be the case with any other taxpayer submitting a return to SARS.

Although the process behind s35A of the Act is simple in theory, it is not an exact science *per se* and a number of practical issues could arise. One of those practical issues forms the subject of the proposed amendment under the TLAB. The proposed amendment to s35A(3) of the Act is, according to National Treasury (Treasury), to resolve an impasse where the non-resident seller *does not* submit a tax return, but an amount has been paid over to SARS in respect of the disposal of the immovable property situated in South Africa. Under the proposal, SARS would be permitted to regard the advance payment, which would lie on the seller's provisional tax account, as a final payment of the assessed tax due.

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In a normal withholding tax context (such a dividends tax, royalties and interest) specific refund mechanisms have been built into the legislation, which is absent from the proposed amendments to s35A of the Act.

Treasury further states that the provision deeming the advance payment to be a final tax, will occur by operation of law, one year after the due date of the relevant tax return has passed. This extended period is intended to afford the non-resident seller an opportunity to still submit a tax return.

At first glance, the proposal is geared at overcoming a real administrative issue in complying with s35A of the Act. The proposal would work well for non-residents who have made an accurate calculation of their capital gains tax liabilities on the basis that the advance payment will exactly cover the amount that would in any event have been assessed by SARS on submission of a tax return. It must be noted that the withholding percentages under s35A of the Act will, in most cases, be much more than the ultimate tax liability of the seller on assessment, which is generally reduced to a more accurate amount by way of a directive application. In the absence of a directive application, it could be that the advance payment is more than what the assessed liability would have been, thereby triggering the refund provisions. However, in the absence of a return being submitted, the non-resident would not be able to claim any valid refund due.

The finality of the advance payment, where no return is submitted, brings with it a few consequential problems. It must be borne in mind that it is still an offence under s234(d) of the Tax Administration Act, No 28 of 2011 (TAA) not to submit a return wilfully or without just cause. It is uncertain whether the proposed amendment to s35A of the Act will qualify as a 'just cause' for purposes of s234(d) of the TAA, notwithstanding, no consequential amendments have been made to essentially 'de-criminalise' the non-submission of a return by the non-resident seller. Further, if the amount is deemed final after the prescribed period for submitting a return, would the non-resident still be able to submit a return and claim a potential refund? The proposal does not seem to prevent the non-resident from doing so, having regard to the general prescription timeframes. In a normal withholding tax context (such as dividends tax, royalties and interest) specific refund mechanisms have been built into the legislation, which is absent from the proposed amendments to s35A of the Act. On this basis one could potentially still utilise the TAA provisions to seek a refund, despite the deemed finality of the advance payment.

Non-resident sellers should tread cautiously in merely choosing not to submit a return to SARS for administrative ease. It would still be advisable to utilise the directive provisions in s35A of the Act to obtain clarity on the ultimate tax liability before doing so and not merely accept the prescribed withholding percentages, which could potentially result in substantial overpayments to SARS.

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ANOTHER RULING ON THE CAPITALISATION OF SHAREHOLDER LOANS

SARS ruled that debt reduction rules contained in s19 of the Act and paragraph 12A of the Eighth Schedule to the Act would not be applicable to the proposed transaction.

The South African Revenue Service (SARS) released Binding Private Ruling 208 (Ruling) on 8 October 2015. The Ruling concerned the use of subscription proceeds to repay a shareholder loan.

Company A and Company B each held 50% of the issued shares in Company C. Company A wanted to acquire Company B's shares (Shares) in Company C.

Company B had a loan claim against Company C, which was used to finance operational expenditure of Company C.

Company A only wanted to acquire the Shares and not the loan claim.

It was proposed that the loan claim be settled before Company A bought the Shares.

The proposed transaction would be achieved as follows:

- Company A would subscribe for a single share in Company C at a nominal value of R1 only;
- Company B would subscribe for a single share in Company C at a premium equal to the loan claim; and
- Company C would use the subscription proceeds to settle the loan claim in full.

Effectively, Company B would first capitalise its loan claim against Company C, and then sell the Shares to Company A.

As is generally the case with the capitalisation of shareholder loans, there is a risk that the parties could trigger the debt reduction rules contained in s19 of the Income Tax Act, No 58 of 1962 (Act), or paragraph 12A of the Eighth Schedule to the Act. This was clearly also the concern for the parties in this particular Ruling.

However, SARS ruled that debt reduction rules contained in s19 of the Act and paragraph 12A of the Eighth Schedule to the Act would not be applicable to the proposed transaction.

The Ruling did not make any mention as to whether actual funds would flow between Company B and Company C, or whether the obligation of Company B to pay the subscription proceeds to Company C, and Company C's obligation to pay Company B in terms of the loan claim, would be extinguished by way of set-off.

SARS has now issued a number of rulings indicating that the capitalisation of shareholder loans would not trigger the debt reduction provisions.

SARS has now issued a number of rulings indicating that the capitalisation of shareholder loans would not trigger the debt reduction provisions. However, taxpayers should take note that these rulings only apply to the specific parties who applied for those rulings and were dependant on the relevant facts of each case. In this particular Ruling, the parties made it a condition precedent of the sale agreement relating to the Shares that an advance tax ruling would first be obtained from SARS in respect of the capitalisation of the loan claim.

Taxpayers are advised to adopt a prudent approach, as there is no guarantee that SARS would not argue that the capitalisation of a shareholder loan would trigger the debt reduction provisions in the absence of an advance tax ruling by the specific parties.

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