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TAX AND EXCHANGE CONTROL ALERT

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A TAXPAYER'S UNFORTUNATE EXPERIENCE WITH SARS

On 21 October 2016 judgment was handed down by the High Court (Gauteng Division, Pretoria) in the matter of *BMW South Africa (Pty) Ltd v The Commissioner of the South African Revenue Service* (as yet unreported).

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TAX CONSEQUENCES OF THE PART WAIVER OF A LOAN AND THE REDUCTION OF THE INTEREST RATE

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On 10 October 2016, the South African Revenue Service (SARS) issued binding private ruling 252 (Ruling) which determines the donations tax and capital gains tax (CGT) consequences of the waiver of a portion of a loan and the reduction of interest on the remaining balance of the loan to 0%.

By way of background, debt relief in South Africa has become somewhat of a norm due to the current stressed economic climate. One of the most common means of debt relief by creditors has been the waiver of the whole or part of a debt. For the years of assessment commencing before 1 January 2013, the reduction of debt was subject to income tax, donations tax and/or CGT, which had the result of effectively undermining the economic benefit of the debt relief.

As a result, SARS introduced a uniform system that provides relief to persons under financial distress in certain circumstances in the form of s19 (which deals with the income tax implications of debt reduction) and paragraph 12A of the Eighth Schedule (which addresses the CGT consequences) of the Income Tax Act, No 58 of 1962 (Act).

In the Ruling, SARS had to determine the donations tax and CGT consequences of the part waiver of a loan and the reduction of the interest rate on the remaining balance of the loan to 0% (Proposed Transaction). The parties to the Proposed Transaction are a South African resident company (Applicant) and a South African resident trust (Trust), the beneficiaries of which are employees of the Applicant who are historically disadvantaged persons as contemplated in the broad-based socio-economic empowerment Charter for the South African Mining and Minerals Industry.

The Applicant is in the business of processing mining residues and waste material in order to extract precious metals which are sold to third parties. In order to conduct the processing activities, the Applicant had a precious metals refining licence (Licence) as required in terms of the Precious Metals Act, No 37 of 2005 (Precious Metals Act).

Against this backdrop, the Applicant established the Trust in order to meet its Black Economic Empowerment (BEE) objectives. Upon the creation of the Trust, the Applicant issued some of its ordinary shares to the Trust at market value. The subscription price for such shares was financed by the Applicant on loan account and the interest thereon was to be levied at the "official rate of interest" as prescribed by the Seventh Schedule to the Act. More specifically, paragraph 2(f) of the Seventh Schedule states that where a loan has been granted to an employee by his employer and (i) no interest is payable, or (ii) interest is payable at a rate lower than the official rate of interest, the difference between the official rate of interest and the interest paid by the employee is a fringe benefit.

The loan balance had not significantly reduced due to the capitalisation of interest and the Applicant was of the view that the outstanding balance of the loan exceeded the market value of the shares held by the Trust. Furthermore, based on current forecasts, it would take the Trust approximately 41 years to repay the full loan amount.

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TAX CONSEQUENCES OF THE PART WAIVER OF A LOAN AND THE REDUCTION OF THE INTEREST RATE

CONTINUED

SARS ruled that donations tax will not be levied under s54 of the Act in respect of the part waiver of the loan and the amendment of the loan agreement to reduce the interest rate to 0%.

The regulations published under the Precious Metal Act require the Applicant to provide "meaningful economic participation" to the beneficiaries of the Trust, in order to maintain the Licence. In light of the anticipated repayment period, two empowerment agencies confirmed that the Trust might not be able to provide the required meaningful economic participation and accordingly, the Applicant was at risk of losing the License.

As a result, the Applicant proposed to waive approximately one third of the loan (which includes capitalised interest) and reduce the interest rate on the balance remaining to 0%.

SARS ruled that:

- donations tax will not be levied under s54 of the Act in respect of the part waiver of the loan and the amendment of the loan agreement to reduce the interest rate to 0%;
- the part waiver of the loan and the amendment of the loan agreement to reduce the interest rate to 0%, will not be deemed to be a donation in terms of s58 of the Act; and
- the Trust will be required, under paragraph 12A read with paragraph 20 of the Eighth Schedule of the Act, to reduce its base cost for the shares to the extent that the original loan capital is to be waived.

The Proposed Transaction would be entered into for purposes of meeting both the Applicant's BEE objectives and statutory requirements for maintaining the Licence. Accordingly, it could arguably not have constituted a donation for purposes of s54 of the Act. However, it is particularly interesting to note that the reduction of the debt would not be seen as the disposal of property for inadequate consideration in terms of s58 of the Act. Presumably the argument was that adequate consideration would be received in the form of the benefit of maintaining the Licence. It was not indicated whether the Trust claimed any deductions in respect of the interest on the loan (to the extent that it may have qualified).

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A TAXPAYER'S UNFORTUNATE EXPERIENCE WITH SARS

The Applicant presented proof of payment to SARS, but SARS still insisted that the penalties and interest should be paid.

On 21 October 2016 judgment was handed down by the High Court (Gauteng Division, Pretoria) in the matter of *BMW South Africa (Pty) Ltd v The Commissioner of the South African Revenue Service* (as yet unreported).

Briefly, the applicant (Applicant) was a vendor for purposes of Value-added Tax (VAT). The respondent, being the South African Revenue Service (SARS), had made a finding that the Applicant did not pay certain amounts of VAT due in respect of the October 2011 to February 2012 VAT periods.

As a result, SARS levied penalties and interest in respect of the amounts not paid.

However, on the facts, it appeared that the Applicant had made payment as required, but for some unknown reason SARS had not correctly allocated the amount paid.

The Applicant presented proof of payment to SARS, but SARS still insisted that the penalties and interest should be paid. The Applicant paid the amounts under protest, and proceeded to bring an application in the High Court.

SARS did not at first indicate any intention to oppose the application, and eventually consented to an order setting aside the finding of non-payment and that the penalties and interest be remitted. SARS also consented to costs on an attorney-client scale, and costs of senior counsel.

SARS was represented by counsel who sought only to oppose a limited issue: whether the Applicant should be entitled to interest in respect of the amounts that it had paid under protest and which should now be remitted.

However, the matter did come to be heard, and SARS was represented by counsel who sought only to oppose a limited issue: whether the Applicant should be entitled to interest in respect of the amounts that it had paid under protest and which should now be remitted.

Based on the decision in *Shuttleworth v South African Reserve Bank* 2015 (1) SA 586 (SCA), the court held that the Applicant was entitled to interest.

In the *Shuttleworth* case the court confirmed that amounts paid under protest can be recovered under the *condictio indebiti*, together with interest.

The court also cited s187, s188 and s190 of the Tax Administration Act, No 28 of 2011, which provides for interest to run on refundable amounts.

Accordingly, the court granted an order to the effect that SARS must pay interest *a tempore morae* on the amounts paid by the Applicant under protest.

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