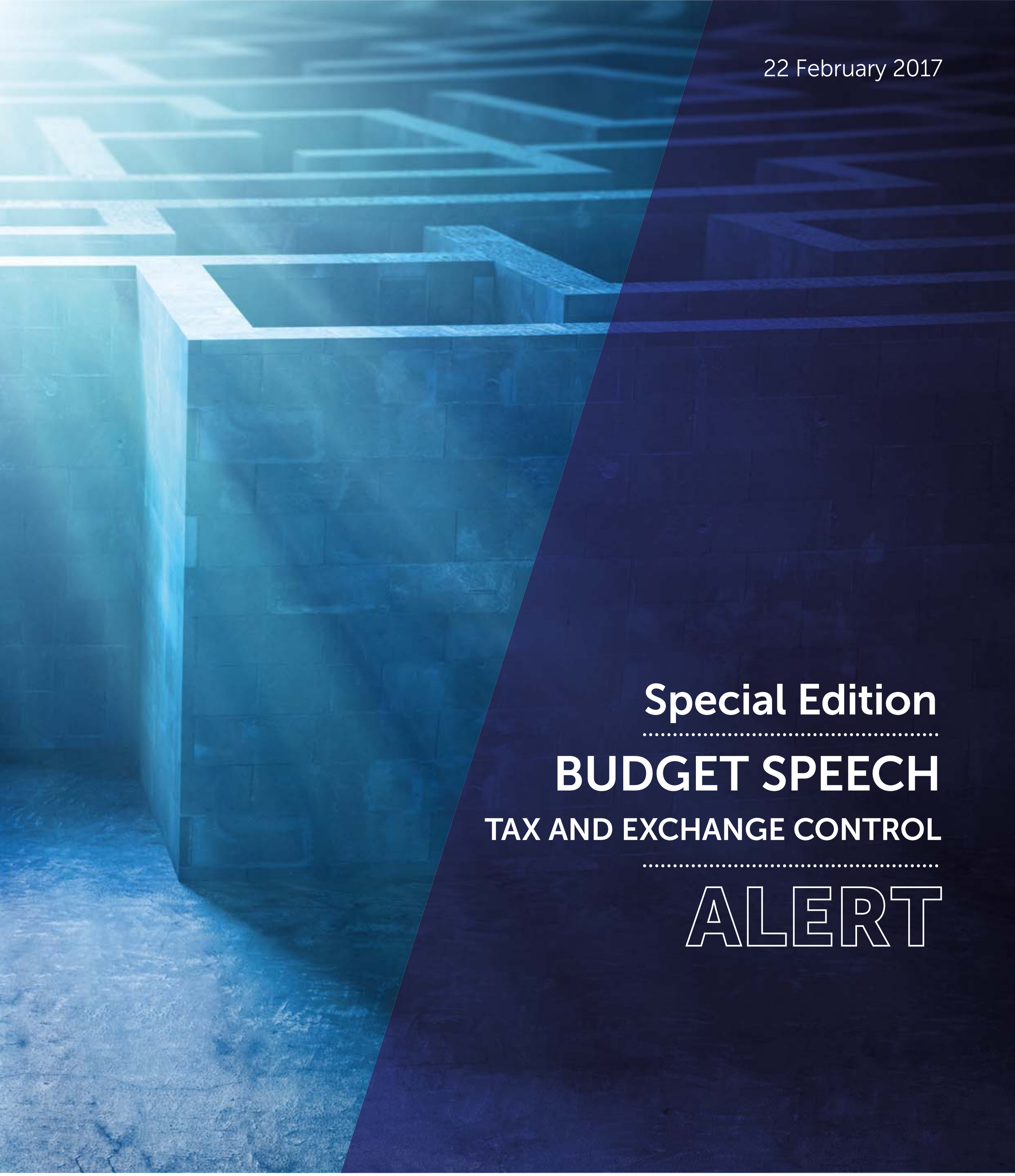

22 February 2017

Special Edition

BUDGET SPEECH

TAX AND EXCHANGE CONTROL

ALERT

CDH
CLIFFE DEKKER HOFMEYR

CLARITY

FROM POWERFUL PARTNERSHIPS COME POWERFUL SOLUTIONS

CDH
CLIFFE DEKKER HOFMEYR

ASSUMPTION OF CONTINGENT LIABILITIES

INTRODUCTION

The assumption of contingent liabilities by a purchaser has been the subject matter of much debate over the years from a tax perspective.

This issue has especially arisen given the fact that the South African courts indicated that:

- the issue of shares does not constitute an expense for tax purposes, resulting in the purchaser not being able to claim an allowance should an asset be funded by means of the issue of shares; and
- the seller cannot claim a deduction in circumstances where the purchaser is paid to assume the contingent liabilities;

The South African Revenue Service (SARS) recently issued Interpretation Note 94 dealing with the assumption of contingent liabilities. It was indicated that, in the case of a seller:

- it must include the agreed value of the freestanding contingent liability assumed by the purchaser in gross income where the purchase price is partly settled by the purchaser assuming such contingent liability; and
- it does not incur expenditure in relation to the assumption of the contingent liability by the purchaser.

It was also indicated that the purchaser will incur expenditure only if the contingent liability materialises, and not if any amount is paid by the purchaser to the seller. If an amount is paid by the purchaser to the seller, it is allocated towards the relevant asset that is acquired.

Notwithstanding the clarity that was given in the Interpretation Note, the issue was still how to deal with the assumption of contingent liabilities making use of the corporate reorganisation rules. Recently it was indicated in Binding Private Ruling 266 that, even if the assumption of the contingent liabilities forms part of the purchase price, the purchaser is still entitled to a deduction of leave pay and bonus contingent liabilities. A similar result followed pertaining to the assumption of post-retirement medical aid contingent liabilities.

In order to clarify the issue, it was indicated in the Budget that the assumption of future contingent liabilities will be considered as an acceptable consideration under the corporate reorganisation rules. It would thus follow that the seller is not taxed on such assumption by the purchaser and the purchaser will be entitled to claim a deduction thereof as and when incurred.

Emil Brincker

CLIFFE DEKKER HOFMEYR

THE SUBSCRIPTION OF SHARES BY SETTLING THE SUBSCRIPTION PRICE BY WAY OF AN EXISTING DEBT OWING TO THE ISSUER

INTRODUCTION

For years SARS has argued that the issue of shares by a company does not constitute an expenditure and would thus not enable the issuer of shares to a deduction of expenses to the extent that the subscription price is not settled in cash, but by way of the transfer of assets or the reduction of debt owing by the issuer to the creditor/shareholder.

This approach was based on the judgment of the Supreme Court of Appeal in *CSARS v Labat Africa Limited* 74 SATC 1 where it was indicated that expenditure requires a diminution, even if only temporary, of assets of the person who expensed the expenditure. It was held that the taxpayer did not incur any expenditure in circumstances where the seller assigned a trademark as consideration for the issue of shares.

This principle also applied in circumstances where the subscriber of the shares did not settle the subscription price in cash, but for instance used a debt owing by the issuer of the shares in settlement of the subscription price. This was especially relevant in the context of the provisions of s19 and paragraph 12A of the Eighth Schedule to the Act dealing with the waiver or reduction of debt.

Recently, however, SARS issued a number of rulings that acknowledged the fact that there will be no reduction in debt in circumstances where set off applies in relation to this type of scenario. In other words, the debt is used as the subscription price and the subscription price is settled by the reduction or settlement of the debt.

In the Budget it was now indicated that the use of set off is recognised from a legal perspective. In such instance:

1. both amounts must be due and payable;
2. both amounts must be payable in the same currency; and
3. both amounts are then set off on the same date, being the date that the debt is settled and the date that the subscription price is settled.

It is thus now recognised that the conversion of debt into equity is allowed without negative consequences. However, specific provision will now be made if the debt that is settled includes capitalised interests, ie interest that accrued but was never paid by the issuer/debtor. In such event there will still be a recoupment of the capitalised interest in the hands of the issuer of the shares in circumstances where the interest was previously claimed as a deduction. It is not clear whether these recoupment provisions will extend to other assets in respect of which the debtor/issuer may have claimed a deduction. At this point in time the recoupment provisions seem to be limited to capitalised interest that formed part of the debt that is converted into equity.

Emil Brincker

CHANGES TO THE DEFINITION OF CONTRIBUTED TAX CAPITAL

INTRODUCTION

It has come to the attention of Treasury that companies with foreign shareholders can increase their contributed tax capital and thereby arguably avoid the payment of dividends tax through capital distributions. Distributions to foreign shareholders are not subject to capital gains tax to the extent that the share investment falls outside the ambit of the Eighth Schedule to the Act.

The mechanisms potentially targeted by Treasury involve the imposition of a new South African holding company between the foreign shareholders and the South African investment. The new holding company acquires the share investments held by the non-resident shareholders and settles the purchase consideration through the issue of shares in itself. The share issuance by this new holding company will create a contributed tax capital balance equal to the market value of the share investments acquired. This mechanism therefore enables foreign shareholders to extract profits equal to the market value of their investment in a dividend tax neutral manner.

The proposed amendment should therefore result in duplication of the existing contributed tax capital balance attributable to the foreign shareholders.

Dries Hoek

INTERACTION BETWEEN SECTION 8F AND SECTION 24JB OF THE ACT

INTRODUCTION

Treasury identified a potential conflict in the application of s8F of the Act in instances where the borrower is taxed in accordance with s24JB of the Act.

Section 8F(2)(a) provides that interest incurred in respect of a "hybrid debt instrument" will be deemed a dividend in specie declared and paid by the borrower and that the borrower will not be entitled to an income tax deduction in respect of such interest. However, if the borrower is a bank or financial institution contemplated in s24JB(1), it is argued that the borrower falls outside the ambit of s8F on the basis that s24JB(3) overrides the application of s8F. This potentially opens the door for the borrower to claim the interest in respect of the borrowings as an income tax deduction in terms of s24JB(2).

In order to avoid a situation where the holder of a "hybrid equity instrument" receives an income tax exempt dividend and the borrower claims the interest as an income tax deduction, it is proposed that the legislation be amended to clarify the position that provisions of s8F override those of s24JB.

Dries Hoek

CLIFFE DEKKER HOFMEYR

DIVIDENDS TAX RATE INCREASED TO 20%

INTRODUCTION

In terms of s64E of the Act, dividends tax is levied on the payment of any dividend by a company. Dividends paid to resident companies are generally exempt, and it is mainly individuals, trusts and non-residents (including non-resident companies) that are affected.

Dividends tax was levied at a rate of 15%. However, it was announced by the Minister that the dividends tax rate will be increased to 20% with effect from 22 February 2017.

While resident individuals and trusts will be affected by this change, it should be kept in mind that non-residents may claim a reduction in the dividends tax rate in terms of an applicable international treaty for the avoidance of double taxation.

For example, in terms of the treaty between South Africa and the United Kingdom, dividends paid by a South African resident company to a resident of the United Kingdom may not be taxed at a rate higher than 5% if the beneficial owner is a company holding at least 10% of the capital in the South African company paying the dividend. Where, for example, the beneficial owner is an individual and resident in the United Kingdom, the rate may not exceed 10%.

The reduction in the rate in respect of cash dividends must be claimed in terms of s64G(3) of the Act.

Heinrich Louw

WITHHOLDING TAX ON DISPOSAL OF IMMOVABLE PROPERTY BY NON-RESIDENTS

INTRODUCTION

In terms of s35A of the Income Tax Act, the purchaser of immovable property situated in South Africa from a non-resident seller, must withhold a portion of the purchase price payable, and pay it over to SARS.

The amount so withheld and paid to SARS will stand to the credit of the non-resident in respect of any capital gains tax payable by that non-resident in respect of the disposal. The applicable rates were 5% for individual sellers, 7.5% for companies and 10% for trusts.

However, the Minister has announced that the applicable rates will increase to 7.5% for individuals, 10% for companies, and 15% for trusts.

The reason proffered was that the withholding tax should be brought in line with the increased effective capital gains tax payable.

Heinrich Louw

TAXATION OF EMPLOYEE SHARE-BASED SCHEMES

INTRODUCTION

The tax treatment of employee share trusts and their employee beneficiaries have recently been the subject matter of debate, specifically in relation to capital gains tax.

Paragraph 80(2) of the Eighth Schedule provides that, where a trust realises a capital gain on the disposal of an asset, and a beneficiary has a vested interest in the capital gain but not in the asset, the trust must disregard the capital gain, and the beneficiary must account for it.

Paragraph 80(2A) of the Eighth Schedule applies where a beneficiary of a trust holds an equity instrument in terms of s8C of the Act. In such a case, the flow through mechanism as provided for in paragraph 80(2) of the Eighth Schedule will not apply if the trust vests a capital gain in the beneficiary by reason of the vesting of the equity instrument.

The issue that arises is whether the capital gain will be "trapped" in the trust and taxed at trust rates, the gain will flow through to the beneficiary, or whether there will not be any gain at all. This is particularly important when considering that the employee will pay income tax as and when the equity instrument vests.

SARS has briefly touched on some of these issues in Binding Private Rulings 259 and 261, but the position is still not entirely clear. In addition, advance tax rulings only apply to the specific applicant.

The Minister has announced that amendments will be introduced that deal with the interaction between s8C of the Act and the Eighth Schedule to the Act.

Heinrich Louw

VAT AND LEASEHOLD IMPROVEMENTS

INTRODUCTION

The Act deals quite extensively with the income tax treatment of leasehold improvements ie where a lessee effects improvements to land belonging to a lessor.

Specifically, paragraph (g) of the definition of "gross income" in s1 of the Act, s11(g) of the Act and s11(h) of the Act contain the relevant rules governing the treatment by the lessee and the lessor.

However, the Value-added Tax Act, No 89 of 1991 (VAT Act) does not contain any similar rules governing any supplies made, the timing of such supplies, and the value thereof.

It is now proposed that rules will be introduced into the VAT Act dealing with these issues.

Heinrich Louw

VAT AND CLOUD SERVICES

INTRODUCTION

Changes were introduced in the VAT Act in 2014 dealing with the supply of electronic services from a place outside of South Africa to persons resident in South Africa.

Essentially, such suppliers will be seen as conducting an enterprise and will be required to register as vendors where certain turnover thresholds are met.

Electronic services are described in a regulation issued by the Minister. However, these services mainly focus on the supply of education, games, auction services, e-books, audio-visual content, music and other subscription services.

However, the supply of software applications and many cloud-based services such as on-line storage or virtual servers do not fall within the confines of the prescribed electronic services.

It has now been indicated that provision will be made for these type of services, and specifically cloud-based services.

Heinrich Louw

CARBON TAX IS NOT COMING INTO EFFECT JUST YET

INTRODUCTION

In November 2015 the Draft Carbon Tax Bill (Draft Bill) was published.

In terms of s4 of the Draft Bill, carbon tax would be levied in respect of greenhouse gas (GHG) emissions resulting from:

- the combustion of fossil fuels;
- fugitive emissions in respect of commodities, fuel or technology; and
- industrial processes, and product use.

On 20 June 2016, the Draft Regulations: Carbon Offsets (Draft Regulations) were published in terms of s20(b) of the Draft Bill, which sets out the requirements that have to be met in order to qualify for a carbon offset allowance, which can reduce a taxpayer's liability by either 5% or 10%. The Draft Bill also makes provision for other allowances for which taxpayers may qualify and which will reduce a taxpayer's carbon tax liability.

Following public hearings on the Draft Bill and the Draft Regulations as well the release of a carbon tax modelling report by National Treasury in November 2016, the Minister announced in the Budget that a revised Carbon Tax Bill will be published for public consultation and tabled in Parliament by mid-2017. The latest developments include the following:

- during the first phase of the tax (until 2020), there will be no impact on the price of electricity; and
- a revised regulation for the carbon offset allowance, enabling firms to reduce their carbon tax liability, will be published by mid-2017.

Government also expects to provide clarity on the alignment of the carbon tax and carbon budget after 2020.

Louis Botha

PROJECTIONS VS COLLECTIONS FOR CUSTOMS AND EXCISE

INTRODUCTION

The actual collections in customs duties as compared to projections in the 2016 budget speech were down to R6.5 billion. There has also been a decline in import VAT partially offset by strong domestic VAT collection, but higher VAT refunds reducing net income.

It is expected that tax proposals relating to fuel levy and excise duties on tobacco and alcohol products will contribute around 18.3% of the overall increase of around R28 billion.

Fuel, alcohol and tobacco

As is the case each year, the Minister proposes an increase in duties and levies for fuel, alcohol and tobacco products.

General fuel levy will increase by 30c/litre and the Road Accident Fund levy will increase by 9c/litre.

Excise duties to increase by between 6.1 and 9.5%. For alcoholic beverages, the increase is between 6.1 and 9%. For tobacco products, the increase is between 8 and 9.5%.

Certain traditional African beers and brandy appear to not be affected (tariff items 104.01.10, 104.10.10, 104.17.05, 104.23.01 and 104.23.03).

General Customs and Excise Proposals

Zero rating on fuel is proposed to be removed, but in order to mitigate the effect on transport costs, consideration may be given to combining this with either a freeze or decrease in fuel levy.

Certain amendments to the Customs Control and Duty Acts (2014) are considered following comments received from external stakeholders. The amendments are expected to facilitate systems development. It is further expected that the new legislation will be phased in over a two year period, starting with the registration, licensing and accreditation process.

The current legal authorisation for the sharing of trade statistics with organs of state will be reviewed and potentially amended. Section 4 of the Customs and Excise Act, No 91 of 1964 currently makes provision for sharing of information to certain organs of state under specific circumstances.

Amendments is considered relating to the marking, tracking and tracing of imported and locally produced tobacco products. The Customs and Excise Act, No 91 of 1964 currently makes provision for a diamond stamp impression in this regard.

The diesel refund scheme is in the process of being reviewed. Proposed reforms include: interim diesel refund amendments, qualifying primary production activities rather than users, Inclusion of contractors, standalone diesel refund administration system and linking qualifying activities to physical location. The potential reforms appear interesting and hopefully beneficial to industry.

Petr Erasmus

CLIFFE DEKKER HOFMEYR

INTRODUCTION OF A NEW TOP PERSONAL INCOME TAX BRACKET

INTRODUCTION

Even though this may not come as a surprise, the Budget introduced a new top personal income tax bracket of 45% for taxable income in excess of R1.5 million per tax year. For the 2017 tax year the top bracket was 41% of taxable income above R701,301. The Minister announced in the Budget that approximately 100,000 taxpayers are to be affected by the new tax bracket. This forms part of Government's proposal to raise an additional R28 billion in taxes and will strengthen the progress of the personal income tax system.

The Minister further indicated that increasing the top marginal rate without concurrently raising the dividend withholding tax rate would increase the arbitrage opportunity for individuals to pay themselves with dividends instead of salaries. The Minister accordingly proposes to increase the dividend withholding tax rate from its current rate of 15%, to 20%.

The Budget proposes to provide partial relief for bracket creep, which occurs when personal income tax tables are not fully adjusted for inflation. The effect of bracket creep is that inflationary salary adjustments increase the effective tax rate for individuals, thereby reducing their real income. The bracket creep adjustment for 2017/2018 amounts to R2.5 billion in relief.

The primary, secondary and tertiary rebates and the levels of all taxable income brackets will further be increased by 1% from 1 March 2017. The primary rebate will be increased to R13,635. The secondary rebate will be increased to R7,479 and the tertiary rebate will be increased to R2,493. The tax threshold for individuals below the age of 65 will increase from R75,000 to R75,750. The tax threshold for individuals aged 65 and over will increase to R117,300 and the tax threshold for individuals aged 75 and over will increase to R131,150.

Mareli Treurnicht

DISGUISED SALE OF SHARES USING SHARE BUYBACKS

INTRODUCTION

The 2016 Budget highlighted tax avoidance schemes involving share buybacks for review. These schemes typically involve a company buying back shares from its existing shareholders (the sellers) and issuing new shares to the purchasers, instead of the sellers selling their shares directly to the purchasers.

By making use of a share buyback and the issue of shares instead of a direct sale of shares, the seller avoids the payment of capital gains tax (CGT) on the disposal of the shares to the purchaser. The seller receives payment from the company in the form of a dividend, which may be exempt from income tax in terms of s10(1)(k) of the Act, and which may be exempt from dividends tax in terms of s64F of the Act if the beneficial owner falls into one of the listed categories, for example if the beneficial owner is a resident company.

Alternatively, if the board of directors of the company so elects, the consideration paid to the seller will constitute a return of capital in its hands and a reduction in the contributed tax capital (CTC) of the company. When the new purchaser subscribes for shares in the company, the consideration paid by the purchaser to the company is regarded as CTC in the hands of the company and no CGT liability will arise in respect of the issue of the shares to the purchaser.

Following the 2016 Budget, no specific countermeasures were introduced to address the abuse of share buybacks. The Budget therefore proposes that specific countermeasures be introduced to curb the use of share buyback schemes. One can therefore expect that the Government will introduce changes to address this issue in the near future. It is worth mentioning that the increase in dividend withholding tax from 15% to 20%, as proposed in the Budget, may make share buybacks less attractive.

Mareli Treurnicht

CLIFFE DEKKER HOFMEYR

TAX ON SUGAR SWEETENED BEVERAGES

INTRODUCTION

In 2016 the Government announced its proposal to introduce a tax on sugar sweetened beverages (SSB). Obesity stemming from overconsumption of sugar has been raised as a global concern. Many countries such as Denmark, Finland, France, and Mexico have levied taxes on SSB. The Department of Health also published a policy paper on the growing concern of obesity in South Africa.

Treasury published a policy paper in 2016 in terms of which it set out its proposals in relation to the taxation of SSB (Policy Paper). The aim of the proposed tax is to reduce excessive sugar intake. The proposed tax will be administered through the Customs and Excise Act.

Treasury called for written comments on the Policy Paper and consulted with industry associations and interested parties in relation to the proposed tax. Following this process, the design of the tax on SSB has been revised as follows:

- a broader World Health Organisation definition will be applied to cover both intrinsic and added sugars in SSB;
- the sugar content will remain the base on which the tax will be applied as it is well-suited to public health goals;
- the proposed tax rate will be 2.1c/gram for sugar content in excess of 4g/100ml; and
- of the proposed rate, 50% will apply to concentrated beverages.

The Government has indicated that a portion of the revenue received in respect of SSB will be used to support health promotion interventions as part of a strategy to fight non-communicable diseases.

Mareli Treurnicht

TRUSTS – UNFORTUNATELY, THERE'S MORE...

INTRODUCTION

On 1 March 2017, s7C of the Act will come into effect, which will bring about important changes to the tax dispensation applicable to trusts. These amendments have received widespread media attention, but it appears that there might be more changes in the pipeline. From the 2017 Budget it appears that further measures will be taken to prevent tax avoidance through the use of trusts.

Prior to the introduction of s7C, it was common for persons to sell an asset to a trust, and for the trust to then create a loan account in their favour which they would then reduce by making use of the annual donations tax exemption of R100,000. This was an effective method to avoid estate duty by reducing the asset base of the lender for estate duty purposes. To address this, s7C(2) states that no deduction or loss will be allowed in respect of the disposal or reduction of certain such loans.

Section 7C(3) further states that where the loan is made by a connected person as contemplated in s7C(2), and if it bears no interest or bears interest at less than the official rate, a the amount of interest below the official rate not charged will be treated as a donation.

This principle is not entirely new. In *Commissioner for South African Revenue Services v Woulidge* [2002] 2 All SA 199 (A), it was held that where a person makes a tax-free loan to a trust, the interest forgone and which remains unpaid represents a continuing donation. Section 7C(3) is therefore merely a codification of this principle, but is beneficial in the sense that it will not apply in those situations and to those trusts listed in s7C(5).

It was indicated in the Budget that in response to s7C, some taxpayers have already attempted to circumvent the anti-avoidance measure by making low-interest or interest-free loans to companies owned by a trust. This could be done if the trust and the company in question conclude an asset-for-share transaction in terms of s42 of the Income Tax Act. In terms of such an asset-for-share transaction, the company would issue all its shares to the trust in exchange for some or all of the assets of the trust. The shares and assets transferred in terms of this transaction will not trigger the payment of capital gains tax in the hands of either party and will be rolled-over until either the shares or the assets are disposed of at a later stage. Once the asset-for-share transaction has been effected, it would be possible for a beneficiary of the trust to then make an interest-free loan to the company without s7C being applicable, as the section only applies in the case where a natural person or a company makes a loan to a trust. Furthermore, as the beneficiary is not a shareholder of the company, it is not a connected person and therefore no adverse tax consequences would arise where the beneficiary sells an asset to the company and the company creates a loan account in favour of that beneficiary. Such loan account could then be extinguished by making use of the R100,000 annual donations tax exemption.

It was indicated that to counter this abuse, it is proposed that the scope of the anti-avoidance measure in s7C be extended to cover these avoidance schemes. In addition, the Minister proposed in the Budget that the anti-avoidance rule should not apply to trusts that are not used for estate planning, for example, employee share scheme trusts and certain trading trusts.

In the Budget it was also announced that trusts, except special trusts, will in future be taxed on their income at a rate of 45%. This is a substantial increase from the rate of 41% that applies in the 2017 year of assessment.

Louis Botha

CLIFFE DEKKER HOFMEYR

TAX IMPLICATIONS OF DEBT FOREGONE

INTRODUCTION

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.

Section 19 and paragraph 12A of the Eighth Schedule of the Act find general application where a debt has been reduced or cancelled. More specifically, s19 of the Act applies where:

a) a debt that is owed by a person or company is reduced;

b) the amount of the debt was used to fund deductible expenditure, acquire allowance assets or trading stock; and

c) there is a difference between the amount advanced under the loan and the amount repaid in terms of the loan.

Generally, where there is a reduction of debt that has been used to fund deductible expenditure or allowance assets, a recoupment could arise in the hands of the debtor in terms of s19 of the Act.

Paragraph 12A, which represents the capital gains tax equivalent of s19, provides, *inter alia*, that a debtor must reduce the base cost of an asset with the amount of any debt that is reduced for no consideration, and/or reduce assessed losses.

However, paragraph 12A excludes the reduction of debt owed between companies within the same group. This relief does not extend to s19 which deals with debt used to finance tax-deductible operating expenditure. As a result, companies that used intra-group debt to finance tax-deductible operating expenses are required to account for recoupments upon the reduction of debt.

It was indicated in the Budget that Treasury recognises that dormant group companies or companies under business rescue would not have the resources to pay tax on the reduction of debt. It was proposed that the current relief for group companies available in paragraph 12A be extended to s19.

Gigi Nyanin

SOUTH AFRICA DECLARES ITS SUSTAINED COMMITMENT TO THE OECD BEPS PROJECT IN THE BUDGET

INTRODUCTION

In the preface to the Organisation for Economic Co-operation and Development's (OECD's) handbook, OECD Work on Taxation, OECD Secretary-General, Angel Gurría, comments as follows:

"Tax is at the heart of our societies. A well-functioning tax system is the foundation stone of the citizen-state relationship, establishing powerful links based on accountability and responsibility. It is also critical for inclusive growth, sustainable development, and well-being, providing governments with the resources needed to invest in infrastructure, education and health, and support social protection systems."

He goes on to observe that as the world becomes increasingly globalised and cross-border activities become the norm, it is imperative for tax authorities to work together to ensure that taxpayers pay the right amount of tax in the right jurisdiction.

New economic opportunities and challenges presented by globalisation, changing business models and shifting geopolitics, have rendered the international tax rules, which were originally formulated in the 1920s, either defunct or inadequate to the task at hand.

Consequently, in September 2013, G20 leaders unanimously endorsed the OECD's ambitious and comprehensive 15-point Base Erosion and Profit Shifting (BEPS) Action Plan, which aims to ensure that the international tax rules do not facilitate the shifting of corporate profits away from where the real economic activity and value creation is taking place. More specifically, the objectives of the BEPS project are to improve the coherence of inter-jurisdictional tax rules; reinforce substance requirements; and enhance transparency and certainty.

In just two years, OECD and G20 countries have delivered a comprehensive package of policy tools with the objective of enabling governments to address the gaps in the international tax system. The implementation of the OECD BEPS project is progressing rapidly and pulling the international tax regime up by its bootstraps in the process.

South Africa joined the OECD to assist in the prevention of BEPS perpetrated by multinational enterprises (MNEs) attempting to evade tax in their primary jurisdictions of operation; and National Treasury has already introduced domestic provisions to address BEPS practices that it considers prejudicial to the South African fiscus. The Minister observed in the Budget that MNEs continue to exploit inconsistencies in global tax rules to their advantage and to avoid tax liabilities.

The OECD has maintained a rigorous schedule since September 2013. The following brief time line illustrating the industry of the OECD from our 2016 Budget to date, should leave readers in no doubt as to the OECD's commitment to this endeavour. The time line simultaneously records South Africa's commitment to attaining BEPS objectives; indication that South Africa is keeping pace satisfactorily, and in some instances, is leading the onslaught on BEPS.

In March 2016, the OECD continued its effort to boost transparency in international tax matters by releasing its standardised electronic format for the exchange of Country-by-Country (CbC) Reports between jurisdictions. CbC reports form part of the OECD's work aimed at ensuring the expeditious and efficient implementation of the BEPS measures. They are required to be completed by MNEs with annual consolidated revenue for the immediately preceding fiscal year of EUR 750 million or more.

CLIFFE DEKKER HOFMEYR

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CbC reports are to be electronically transmitted between Competent Authorities with the objective of assisting tax administrations to acquire a comprehensive understanding of the manner in which MNEs structure their operations, by annually providing tax authorities with information on the global allocation of income and taxes paid; together with other indicators as to the location of economic activity within the MNE. CbC reports will also cover information about which entities of an MNE do business in a particular jurisdiction and the specific business activities conducted by each entity.

The information to be disclosed in the CbC report is to be collected by the country of residence of the Reporting Entity for the MNE, and must then be exchanged under the relevant international exchange of information agreement. First exchanges of CbC reports are scheduled to commence in 2018, with information on the 2016 year.

In South Africa, the Tax Administration Act (TAA) provides the legal basis for CbC reporting. For MNEs with fiscal years commencing on or after 1 January 2016, the first CbC reports must be filed with SARS from 31 December 2017 onwards.

Further, as regards, CbC reporting, in June 2016 the OECD released its Guidance on the Implementation of CbC Reporting.

One of the pillars of the BEPS project focusses on ensuring transparency while simultaneously promoting certainty and predictability. The adoption of CbC reporting is a significant outcome of that work. The guidance sets out:

- transitional filing options for MNEs that voluntarily file in the Parent jurisdiction;
- guidance on the application of CbC reporting to investment funds;
- guidance on the application of CbC reporting to partnerships; and
- the impact of exchange rate fluctuations on the agreed EUR 750 million filing threshold for MNEs.

Who could possibly forget the leak of the Panama papers in April 2016? The event constituted the biggest data leak in history, exposing millions of documents and hundreds of thousands of offshore entities created by the Panama based law firm, Mossack Fonseca, dating back to 1977. The papers uncovered the secret dealings of prominent figures; and serious crimes including bribery, arms deals, tax evasion, financial fraud, drug trafficking, and sanction busting.

The OECD responded to the leak immediately, with a statement from Angel Gurría, to the effect that the OECD "had constantly and consistently warned of the risks of countries like Panama failing to comply with the international tax transparency standards" through the Global Forum on Transparency and Exchange of Information.

The Global Forum on Transparency and Exchange of Information for Tax Purposes monitors the standards on tax transparency and the exchange of tax information, namely the exchange of information on request (EOIR); and the automatic exchange of information (AEOI).

On 14 April 2016, the OECD submitted new proposals to the G20 with a view to the advancement of global transparency, including the extended and accelerated implementation of the OECD standard on AEOI; and requiring substantial compliance by all Global Forum member countries with the standards of transparency required for EOIR. The OECD simultaneously proposed intensifying cooperation on transparency with regard

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to beneficial ownership – the opacity of which lay at the core of the revelations contained in the Panama papers.

The AEOI between tax authorities comes into operation in September 2017. MNEs will be required to file additional information with SARS on cross-border activities from the end of 2017. In this regard, the Minister affirmed South Africa's commitment to work actively with the international tax community to combat inter-jurisdictional revenue leakages, money laundering and harmful tax practices.

April 2016 was a busy month! On 19 April 2016, four international organisations, the International Monetary Fund; the OECD; the United Nations (UN); and the World Bank Group, made a giant stride to bolster global co-operation in tax matters by announcing their collaborative endeavour: the Platform for Collaboration on Tax. The Platform is to formalise regular discussions amongst themselves on the design and implementation of standards for international tax matters; strengthen their capacity-building support; deliver jointly developed guidance; and share information on operational and knowledge activities.

Further, given the escalating importance of taxation in the debate to achieve the UN Sustainable Development Goals, a major aim of the Platform will be to better frame technical advice to developing countries as they seek both more capacity support and greater influence in designing international rules.

Among the Platform's first obligations will be the delivery of toolkits designed to assist developing jurisdictions to implement the measures developed in terms of the BEPS Project.

On 31 May 2016, a discussion draft was released on Action 15 (Development of a Multilateral Instrument to Implement the Tax Treaty related Measures) of the BEPS Action Plan. South Africa was one of over 100 jurisdictions that contributed to the discursive process.

This was followed in November 2016 by the adoption of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, with the objective of swiftly implementing a series of tax treaty measures to update international tax rules and reduce opportunities for tax avoidance by MNEs through the imposition of minimum standards to counter treaty abuse; and improve dispute resolution mechanisms while providing sufficient flexibility to accommodate specific tax treaty policies. The multilateral instrument will also enable governments to strengthen their tax treaties with other tax treaty measures developed in the BEPS project and in so doing, transpose the BEPS project deliverables into more than 2,000 tax treaties worldwide.

Angel Gurría commented that "the adoption of (the) multilateral instrument marks a turning point in tax treaty history. It will save countries from multiple bilateral negotiations and renegotiations to implement the tax treaty changes in the BEPS project. More importantly, having more than 100 jurisdictions on board will help ensure consistency in the implementation of the BEPS project, which will result in more certainty and predictability for businesses, and a better functioning international tax system for the benefit of citizens (worldwide)."

The conclusion of negotiations on the multilateral instrument is a monumental achievement and a first high-level signing ceremony is scheduled to take place in

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Paris in the week commencing 5 June 2017. The Minister confirmed that South Africa intends signing the multilateral instrument this year in a bid to curb aggressive tax avoidance activities.

On 30 June 2016, representatives from more than 80 countries, including South Africa, gathered in Kyoto, Japan, to drive ongoing efforts to update international tax rules and render them suitable for the 21st century. This meeting marked a new era in international tax co-operation. It was the first occasion on which a broad range of countries, representing varying levels of development, gathered on equal footing in the OECD's Committee on Fiscal Affairs, and inaugurated the New Inclusive Framework on BEPS implementation, with a view to ensuring a level global playing field.

In Kyoto, participants commenced work on setting standards on the remaining BEPS issues including transfer pricing and interest deductibility; as well as developing practical guidance to support consistent, global implementation of their commitments to the BEPS project. In particular, the New Inclusive Framework will focus on implementation of the four minimum standards arising from the BEPS project pertaining to harmful tax practices; tax treaty abuse; CbC reporting; and dispute resolution mechanisms.

Further, in Kyoto, a framework was agreed covering all tax rulings that could give rise to BEPS concerns in the absence of compulsory AEOI. The framework came about in consequence of the work done on BEPS Action 5 (Harmful Tax Practices), and deals with six categories of rulings: rulings related to preferential regimes; cross-border unilateral advance pricing arrangements, or other unilateral transfer pricing rulings; rulings authorising a downward adjustment to profits; permanent establishment rulings; conduit rulings; and any other type of ruling, which the OECD's Forum on Harmful Tax Practices, considers may potentially give rise to BEPS concerns in the absence of information exchange.

South Africa participated in the Forum on Harmful Tax Practices and recently completed its self-review of preferential regimes, bringing it into alignment with OECD member countries.

In July 2016, the OECD released a discussion draft dealing with the design and operation of the group ratio rule under Action 4 (Interest Deductions and Other Financial Payments) of the BEPS Action Plan.

This was followed in December 2016, with the release of an updated version of the BEPS Action 4 Report, which includes additional guidance on two main areas:

- the design and operation of the group ratio rule; and
- approaches to deal with risks posed by the banking and insurance sectors.

With reference to the group ratio rule, the 2015 Action 4 Report set out a common approach to address BEPS involving interest and payments economically equivalent to interest. The common approach included a 'fixed ratio rule', which limits an entity's net interest deductions to a specific percentage of its tax-EBITDA; and a 'group ratio rule' to allow an entity to claim higher net interest deductions, based on a relevant financial ratio of its worldwide group. The updated report provides a further tier of technical detail to assist jurisdictions in implementing the group ratio rule in line with the common approach.

As regards the banking and insurance sectors, the 2015 report identified factors which indicated that the common approach may not be suitable to deal with the risks posed by banks and

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insurances companies. The updated report concludes, in the main, that regulatory and commercial considerations reduce the risk of the use of interest for BEPS purposes in these sectors.

With reference to Action 4, South Africa has significant concerns around interest deductibility; the four primary areas of concern in this regard, as identified by SARS, being hybrid debt, connected person debt, transfer pricing and acquisition debt. While efforts to curb excessive debt financing, which erodes the tax base, continue unabated, Nation Treasury has undertaken to review the current interest deductibility limitation in light of OECD recommendations.

On 20 October 2016, the OECD released documents approved by the New Inclusive Framework on BEPS, that form the basis of the Mutual Agreement Procedure (MAP) peer review and monitoring process under Action 14 (Making Dispute Resolution Mechanisms More Effective) of the BEPS Action Plan.

Recognising that the actions to counter BEPS must be complemented by actions that ensure certainty and predictability for business, Action 14 requires effective dispute resolution mechanisms to resolve tax treaty-related disputes. Action 14 outlines the minimum standards and best practices for resolving treaty-related disputes under the MAP.

The documents released include the translation of the minimum standard approved in the final Action 14 Report, into the foundation for peer review; the assessment methodology for the peer review and monitoring process; and the MAP statistics reporting framework which reflects the collaborative approach Competent Authorities are to apply in the resolution of MAP cases. Hopefully the procedures detailed in these documents will facilitate enhanced transparency on statistical information relating to the inventory, types and outcome of MAP cases through common reporting of MAP cases going forward; and provide guidance on information and documentation to be submitted with a MAP request.

Through rigorous peer reviews and the continual collection of data, the Action 14 BEPS deliverables seek to eliminate taxation not in accordance with treaty provisions; and help resolve any tax-treaty related disputes in a timeous and efficient manner. The involvement of the New Inclusive Framework throughout the peer review process ensured that the effort to streamline MAP incorporated the experience of both developing and developed countries.

South Africa has undertaken to update its current model treaty to incorporate the minimum standards but like other developing countries participating in the BEPS project, South Africa has not committed to mandatory binding MAP arbitration.

In February 2017, the OECD released documents, approved by the New Inclusive Framework on BEPS, which form the basis of the peer review of Action 13 CbC reporting and for the peer review of the Action 5 transparency framework.

The Action 13 standard on CbC reporting and the Action 5 standard for the AEOI on tax rulings constitute two of the four BEPS minimum standards. Each of the four BEPS minimum standards is subject to peer review in order to ensure timeous and accurate implementation and consequently protect the level playing field. All members of the New Inclusive Framework on BEPS have committed to implementing the minimum standards and participating in the peer reviews.

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South Africa's stance on the other BEPS actions is as follows:

Action 1 (Addressing the Tax Challenges of the Digital Economy)

Foreign businesses supplying digital services in South Africa are required to register as VAT vendors; and South Africa is a member of the new Task Force for the Digital Economy, which is looking at direct taxes.

Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements)

Recommendations on transparent entities are being incorporated into the multilateral instrument, which South Africa will sign this year. South African domestic law already contains measures to counter double deductions; income exclusions in the absence of a corresponding deduction; and deductions with no inclusions.

Action 3 (Designing Effective Controlled Foreign Company (CFC) Rules)

South Africa's CFC rules have been internationally acknowledged as well designed rules and were recommended as one of three options for other countries to implement.

Action 6 (Preventing the Granting of Treaty Benefits in Appropriate Circumstances)

New treaties concluded by South Africa will comply with the OECD BEPS project minimum standards, while the multilateral instrument will deal with existing treaties. As regards treaty shopping, South Africa has elected to apply the principal purpose test because it corresponds with its domestic general anti-tax avoidance rule.

The principal purpose test operates to deny treaty benefits if it is reasonable to conclude that obtaining the treaty benefit was one of the principal purposes of entering the arrangement or transaction.

Action 7 (Preventing the Artificial Avoidance of Permanent Establishment (PE) Status)

In future, South Africa's tax treaty negotiations will take cognizance of the OECD recommendations addressing fragmentation of activities and the avoidance of PE status through specific activity exemptions; the objective being to prevent entities from artificially avoiding PE status by dividing up their cohesive business into smaller operations.

Actions 8 – 10 (Aligning Transfer Pricing Outcomes with Value Creation)

SARS is in the process of updating its Transfer Pricing Practice Note to align with the OECD Transfer Pricing Guidelines. The update will include new guidance on the arm's length principle and an agreed approach to ensure the appropriate pricing of intangibles that are difficult to value.

Action 11 (Measuring and Monitoring BEPS)

South Africa agrees with the view that effective measuring and monitoring through improved statistics and evaluation is essential for curbing BEPS and has undertaken to continue work in this regard with other countries.

Action 12 (Mandatory Disclosure Rules)

The TAA embodies provisions dealing with reportable arrangements. Taxpayers who have embarked on such arrangements

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are required to report them to SARS in accordance with the provisions of the TAA. The South African reportable arrangement rules have been employed as a bench mark in the final BEPS Action 12 recommendations.

It remains to note that a parallel may be drawn between the BEPS project in the international tax domain and the work of the Davis Tax Committee (DTC) on the domestic tax front. The DTC has been mandated to "inquire into the role of the (South African) tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability." In fulfilling its mandate, the DTC is required to "take into account recent domestic and international developments and, particularly, the long term objectives of the National Development Plan."

While it is indubitable that National Treasury; SARS; and the DTC are up to the task; we can only hope that domestically South Africa will be able emulate the international strides being made through the BEPS project – a task made exceedingly difficult by the lack of accountability, responsibility and integrity on the part of government; the absence of which continues to weaken the citizen-state relationship.

Lisa Brunton

AMENDING FOREIGN EMPLOYMENT INCOME TAX EXEMPTION IN RESPECT OF SOUTH AFRICAN RESIDENTS

INTRODUCTION

South African tax resident individuals are generally taxed on a worldwide basis of taxation such that income earned by a resident from the rendering of services anywhere in the world will be included in "gross income", as defined in s1 of the Act. However, subject to certain exclusions, s10(1)(o)(ii) of the Act essentially exempts from normal tax certain types of remuneration in respect of services rendered by way of employment outside the Republic during specified qualifying periods. Many South African tax resident individuals seconded by South African resident employers to work in offshore jurisdictions for certain periods, successfully utilise this exemption.

In essence the exemption provided under s10(1)(o)(ii) of the Act applies in respect of services rendered outside South Africa for or on behalf of any employer, to the extent that the individual is outside South Africa for a period or periods exceeding 183 full days (calendar, not working days) in aggregate, during any 12 month period commencing or ending during a tax year. In addition, the exemption will only apply if, during the 183-day period, there was at least a 60-day continuous period of absence from South Africa.

As a result of various interpretational and practical issues arising in respect of the application of s10(1)(o)(ii), SARS reviewed its guidance note by recently issuing a revised Interpretation Note No. 16 on 2 February 2017 (Note). One of the main issues the new Note cleared up was the common misconception that all remuneration received or accrued during the qualifying period of 12 months is exempt and confirmed to the contrary, that only the remuneration received or accrued in respect of services rendered outside the Republic during the qualifying period of 12 months is in fact exempt. Interestingly, the Note specifically stated that the terms of tax treaties vary from treaty to treaty, and so the possible effects of tax treaties on the application of the foreign employment income exemption was excluded from the guidance in the Note.

However, one of the issues which arises in respect of the application of s10(1)(o)(ii) of the Act, is where a resident works in a foreign country for more than 183 days with no tax payable in the foreign country, that foreign employment income will benefit from double non-taxation. The view is that this exemption on foreign employment income appears excessively generous and it is therefore proposed that this exemption be adjusted so that foreign employment income will only be exempt from tax if it is subject to tax in the foreign country.

Jerome Brink

CLIFFE DEKKER HOFMEYR

INTERACTION BETWEEN THE *"IN DUPLUM"* RULE AND STATUTORY TAX LEGISLATION

INTRODUCTION

The *in duplum* rule is a well-established common law rule confirmed by our courts which essentially aims to protect creditors by limiting the amount of the total interest a creditor can charge.

The effect of the rule is that interest on a debt ceases to accrue where the total amount of the interest equals the outstanding principal debt. In *Woulidge*, the Supreme Court of Appeal, *inter alia*, held that the *in duplum* rule does not apply in determining the amount of interest to be attributed to a donor under the attribution rules.

It was thus held:

> "It is clear that the in duplum rule can only be applied in the real world of commerce and economic activity where it serves considerations of public policy in the protection of borrowers against exploitation by lenders."

As illustrated in the *Woulidge* case, various anti-avoidance provisions in the Act may be undermined should the in duplum rule apply. In particular, some taxpayers may be relying on this rule to distort the quantification of the tax benefit derived from low-interest or interest-free loans. These taxpayers aim to avoid income tax determined on the difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. It is proposed that the tax rules dealing with low-interest or interest-free loans be amended to explicitly exclude the application of the in duplum rule to ensure their efficacy.

Jerome Brink

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ONGOING REFINEMENTS OF THE VENTURE CAPITAL COMPANY REGIME

INTRODUCTION

The Venture Capital Company (VCC) regime was introduced in order to increase access to equity finance by small and medium-sized businesses and junior mining exploration companies thereby increasing the growth in these important sectors of the economy. Without providing a detailed analysis of the mechanics of the relevant s12J of the Act, in essence qualifying investors are able to invest in approved VCCs in exchange for the issue of venture capital shares and investor certificates. Importantly, investors can claim an upfront tax deduction in respect of their investments in an approved VCC. The approved VCC will, in turn, invest in qualifying investee companies in exchange for qualifying shares.

While the initial uptake in the regime was slow, we have seen a steady increase in registered VCC companies over the last few years, with the latest list of approved VCCs published on the SARS website numbering 44, with two withdrawn. However, some commentators express the view that while the upfront tax deduction is a very attractive incentive there are no incentives in respect of investment returns during the lifetime of the VCC. Ordinarily, investors envisage making a return on their investments into the VCC either through dividends which are declared by the underlying qualifying companies to the VCC or by way of dividends being declared by the VCC itself to the investors as a result of a disposal of the shares in the underlying companies.

However, dividends received by the VCC investors in respect of their VCC shares are currently subject to dividends tax, which was recently announced by the Minister to have been increased to a rate of 20%. Only where the VCC investor qualifies for an existing dividend tax exemption such as the South African resident company exemption, could such a VCC investor attract a benefit in respect of its returns. It has therefore been announced that further changes be made to the VCC regime to remove impediments to investment such as rules relating to investment returns. While this announcement is very generic it may well be focused on the extraction of returns by way of dividends during the lifetime of the VCC. In addition, it would be most welcome if there was some sort of relief regarding the ultimate sale of VCC shares after a certain period once the investment has been realised.

Further to this, the underlying qualifying companies which a VCC may invest in is restricted in various manners, and in particular such companies cannot conduct an "impermissible trade" as defined. Impermissible trades, amongst others, include any trade carried on in respect of immoveable property, except trade as a hotel keeper (includes bed and breakfast establishments); financial service activities such as banking, insurance, money-lending and hire-purchase financing; provision of financial or advisory services, including legal, tax advisory, stock broking, management consulting, auditing, or accounting; operating casinos or other gambling related activities including any other games of chance; manufacturing, buying or selling liquor, tobacco products or arms or ammunition; or any trade carried on mainly outside the Republic. Again, while the announcement in the Budget is very general, the proposal is that the rules relating to qualifying companies are currently being considered.

The VCC regime is clearly a work in progress as refinements to the regime continue, notwithstanding the fact it is subject to a 12 year sunset clause in that it is proposed to end on 30 June 2021. Nevertheless, it still provides a very attractive tool within which to invest in various small and medium-sized businesses and it will be interesting to monitor the further enhancements.

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BBBEE STATUS: LEVEL THREE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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