6 OCTOBER 2017

TAX AND EXCHANGE CONTROL ALERT

IN THIS ISSUE

EQUALITY OF A DIFFERENT KIND - PROPOSAL TO AMEND THE DEBT REDUCTION RULES APPLICABLE TO MINING COMPANIES

Section 36 of the Income Tax Act, No 58 of 1962 contains unique provisions which are only applicable to mining operations, and which set out the manner in which redemption allowances and unredeemed capital expenditure are calculated.

TAKING MONEY ABROAD LAWFULLY – JUST USE YOUR SINGLE DISCRETIONARY ALLOWANCE

In our Tax and Exchange Control Alert of 29 September 2017 (South Africans working and living abroad – the Excon considerations), we dealt with the exchange control (Excon) rules applicable to South African residents who work abroad on a temporary basis.

CLIFFE DEKKER HOFMEYR

EQUALITY OF A DIFFERENT KIND - PROPOSAL TO AMEND THE DEBT REDUCTION RULES APPLICABLE TO MINING COMPANIES

When a debt is reduced or waived, i.e. a debt arising in respect of a loan used to obtain a capital asset, paragraph 12A of the Eighth Schedule to the Act contains the tax implications applicable to the amount of debt that is reduced or waived.

The difficulty noted with the current legislative framework, is that both paragraph 12A of the Eighth Schedule and s19 of the Act are not applicable to mining operations.

Section 36 of the Income Tax Act, No 58 of 1962 (Act) contains unique provisions which are only applicable to mining operations, and which set out the manner in which redemption allowances and unredeemed capital expenditure are calculated. The definition of "capital expenditure", as provided for in s36, contains a list of expenditure regarded as capital expenditure for purposes of mining operations, such as expenditure relating to shaft sinking, mine equipment, development and management, amongst others.

Reduced or waived debts

When a debt is reduced or waived, i.e. a debt arising in respect of a loan used to obtain a capital asset, paragraph 12A of the Eighth Schedule to the Act (Eighth Schedule) contains the tax implications applicable to the amount of debt that is reduced or waived (debt reduction amount). In the event that debt was used to acquire a capital asset which qualifies for specific capital allowances in terms of the Act, paragraph 12A makes provision for the debt amount so reduced to be used to reduce the base cost of such capital asset, resulting in an increased capital gain when the capital asset is ultimately disposed of.

On the other hand, where debt funding is utilised for the purpose of financing operating expenses, and is therefore not of a capital nature, but constitutes tax deductible expenditure, s19 of the Act makes provision for a recoupment of the expenditure which has been previously deducted by including these amounts in the taxpayer's income. The difficulty noted with the current legislative framework, is that both paragraph 12A of the Eighth Schedule and s19 of the Act are not applicable to mining operations which are governed under unique provisions in the Act and which fail to deal with the tax treatment of debts reduced or waived in relation to mining operations.

It is evident, following the publication on 19 July 2017 of the draft Taxation Laws Amendment Bill, 2017 (2017 draft TLAB), read together with the Explanatory Memorandum in respect of the TLAB (Memorandum), as well as the Draft Response Document published by National Treasury (Treasury) on 14 September 2017 (Draft Response), that proposals have been made by Treasury and the South African Revenue Service (SARS), to amend s36. This is in order to include specific provisions applicable to mining operations in respect of the tax treatment regarding the reduction or waiver of debts used to fund capital expenditure.

As indicated in the Memorandum, an important reason for the proposed amendment of s36 is due to the fact that mining operations account for their capital expenditure in respect of capital assets and allowance assets differently from companies in other sectors, and these differences result in anomalies when applying the current capital gains tax rules found in paragraph 12A. When debt raised in respect of non-mining operations is used to finance capital expenditure, the debt reduction amount is required to first reduce the base cost of the capital asset or allowance asset if the asset is still held by the taxpayer, thus resulting in a higher capital gain when the asset is ultimately disposed of. Should a situation arise where

CDH
CLIFFE DEKKER HOFMEYR

EQUALITY OF A DIFFERENT KIND - PROPOSAL TO AMEND THE DEBT REDUCTION RULES APPLICABLE TO MINING COMPANIES

CONTINUED

The intention of s36(7EA) is to provide a solution regarding the tax treatment when debt which is used to fund capital expenditure, has been reduced or waived.

the debt is not traceable to the financing of any capital expenditure, or the base cost of the capital asset or allowance asset that was acquired using this debt has been fully reduced to zero, the debt reduction amount will be used to reduce any assessed capital losses the taxpayer may have. Subsequent to this, to the extent that the taxpayer's base cost of its capital asset or allowance asset and assessed losses are fully reduced in accordance with the above, no capital gain will arise.

The same treatment is, however, not applicable in respect of mining operations. For example, as a result of taxpayers conducting mining operations being granted a 100 per cent upfront deduction of capital expenditure claimed against income solely derived from the mining operations, any reduction or waiver of a debt in respect of mining operations cannot be used to first reduce the base cost, as mining companies will be taxed on the recoupment thereof. In other words, the mining company will be taxed on the recoupment of the 100 per cent upfront deduction previously granted in respect of the mining asset and included in the taxable income of the mining company and subject to normal tax. Paragraph 12A, however, fails to take into account whether or not an upfront allowance may have been granted as in the case with mining operations.

Proposed amendment

Section 36(7EA) was included in the 2017 draft TLAB for comment and contains the draft provisions regarding the reduction or waiver of debts in respect of mining operations. The intention of s36(7EA) is to provide a solution regarding the tax treatment when debt which is used to fund capital expenditure, has been reduced or waived. In these circumstances, s36(7EA) provides that the debt reduction amount is required to be applied in order to reduce any amount of capital expenditure incurred in the year of assessment in which the debt reduction amount arose.

Section 36(7EA) contains a proviso that to the extent that the debt reduction amount exceeds the capital expenditure incurred, the debt reduction amount must be treated as an amount which has been received by or accrued to the mining company and included in its gross income.

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

CLIFFE DEKKER HOFMEYR

EQUALITY OF A DIFFERENT KIND - PROPOSAL TO AMEND THE DEBT REDUCTION RULES APPLICABLE TO MINING COMPANIES

CONTINUED

Following the publication of s36(7EA) in the 2017 draft TLAB, submissions were made by interested stakeholders, including the public.

Following the publication of s36(7EA) in the 2017 draft TLAB, submissions were made by interested stakeholders, including the public. These submissions were subsequently addressed by Treasury and SARS and are set out in the Draft Response. In this regard, the following interesting considerations were raised in respect of the proposed s36(7EA):

- Paragraph 12A contains various exceptions in terms of which the reduction of debt provisions do not find application in certain circumstances, however no exceptions have been included in the draft provision. In response to this, Treasury and SARS indicated that the current exceptions included under paragraph 12A will be extended to apply to mining companies;
- In respect of the proviso where a debt reduction amount exceeds the capital expenditure amount, the debt reduction amount must be included in the gross income of a "mining company", as defined. The term "mining company" must be amended in order to align it with paragraph (j) of the definition of gross income, and reference should be made to a taxpayer carrying on mining operations instead. Treasury and SARS accepted this comment and indicated that the 2017 draft TLAB will be amended to refer to a taxpayer carrying on mining operations;
- The draft provisions do not take into account how the reduction of capital expenditure is to be taken into account in respect of ring-fenced mining operations (s36(7F)). Clarity is required in respect of whether the taxpayer must only reduce the capital expenditure of the mine in respect of which the debt was reduced or waived, or whether the capital expenditure of any other mines which the taxpayer operates will also be affected. The response from Treasury and SARS is that only the capital expenditure of the mine which was funded with the debt which was subsequently reduced or waived, should be reduced by the debt reduction amount. Any other mines operated by the taxpayer will not be affected. Changes will therefore be made to the 2017 draft TLAB to clarify this issue.

Process going forward

We now await the publication of the revised 2017 draft TLAB which will incorporate the changes as set out in the Draft Response.

Candice Gibson

CLIFFE DEKKER HOFMEYR

TAKING MONEY ABROAD LAWFULLY – JUST USE YOUR SINGLE DISCRETIONARY ALLOWANCE

The rules regarding the SDA are set out in sB.4(A) of the Currency and Exchanges Manual for Authorised Dealers. The AD Manual must be read with the Exchange Control Regulations, 1961.

In our Tax and Exchange Control Alert of 29 September 2017 (South Africans working and living abroad – the Excon considerations), we dealt with the exchange control (Excon) rules applicable to South African residents who work abroad on a temporary basis. One of the aspects that we briefly touched on, was the single discretionary allowance (SDA), which all South Africans who are 18 years or older can make use of. In this article, we will discuss the SDA in a bit more detail.

The AD Manual further states that the SDA may be transferred abroad in Rand, but that transfers of a capital nature must be converted to foreign currency through an AD.

General principles

The rules regarding the SDA are set out in sB.4(A) of the Currency and Exchanges Manual for Authorised Dealers (AD Manual). The AD Manual must be read with the Exchange Control Regulations, 1961 (Regulations).

As stated in our previous alert, the SDA comprises an amount of R1 million per calendar year, which any resident who is 18 years or older may use for any legal purpose abroad, without obtaining a tax clearance certificate. For example, the SDA may be used for investment purposes or to send gifts to persons abroad, but may not be used to export gold or jewellery. There are a few additional rules that apply.

The AD Manual states that the SDA may be used solely at the discretion of the resident who is entitled to it, without any documentary evidence having to be produced to the Authorised Dealer (AD), such as a bank through which the transfer is made. However, where the SDA is used for travel purposes outside the Common Monetary Area (CMA), which consists of Lesotho, Namibia, South Africa and Swaziland, such persons must produce their passenger ticket(s) to the relevant AD.

The AD Manual further states that the SDA may be transferred abroad in Rand, but that transfers of a capital nature must be converted to foreign currency through an AD. Transfers of a capital nature refers to those transactions listed as such in sJ.(G) of the AD Manual. Section J.(G) of the AD Manual sets out the classification of outward payments and the codes that must be used by AD's when reporting outward payments to the South African Reserve Bank (SARB). In this regard, sJ.(G) refers to a number of transfers by South African resident individuals, which are considered to be of a capital nature, including investments made abroad in respect of shares, bonds, money market instruments and property.

SA resident individuals can also transfer monetary gifts and loans within the SDA limit of R1 million per applicant during a calendar year to non-resident individuals and to resident individuals who are overseas temporarily, but not to those residents who are abroad on holiday or business travel. In addition to monetary gifts, SA resident individuals may export Krugerrand coins or the equivalent in fractional Krugerrand coins up to an amount of R30 000 as gifts to non-residents, subject to the completion of the prescribed SARS Customs Declaration.

It should also be noted that where payments take place for current account transactions dealt with elsewhere in the AD Manual, such payments will not be deducted from an individual's SDA limit. Where such payments are made to settle legitimate foreign obligations, it is necessary to present documentary

TAKING MONEY ABROAD LAWFULLY – JUST USE YOUR SINGLE DISCRETIONARY ALLOWANCE

CONTINUED

The SDA may not be used to disguise transfers for other purposes for which foreign currency would be refused under the appropriate sections of the AD Manual. In this regard, it is also important to take into account of the provisions of Regulation 2(4).

evidence to the AD to prove the purpose of such payment, for example, the relevant invoice, court order or agreement.

Finally, the SDA may not be used to disguise transfers for other purposes for which foreign currency would be refused under the appropriate sections of the AD Manual. In this regard, it is also important to take account of the provisions of Regulation 2(4). It states that persons must use foreign currency acquired from an AD for its stated purpose (the purpose they indicated when they applied for the foreign currency) and may not do anything to cause the foreign currency to not be used for its stated purpose.

Documentary and procedural requirements

In terms of the AD Manual, when SA resident individuals make transfers abroad and make use of their SDA in this regard, they should provide accurate information to the AD assisting them with such transfer, so that the AD can correctly report the purpose of the transaction to the SARB. Where persons made use of their SDA to take funds abroad, AD's must indicate this when reporting the transaction to the SARB.

SA resident individuals transferring funds by making use of their SDA must produce a valid green bar-coded South African identity document or Smart identity document card for identification purposes and the identity number is mandatory when the transaction is reported to the SARB.

Specific rules for importers

Where SA resident importers make import payments under the SDA dispensation, they must have a valid customs client number (CCN) and such CCN must be recorded by the AD when reporting the transaction. Such importers must also comply with the provisions of Regulation 12.

Regulation 12(1) states, amongst other things, that if goods purchased have not been consigned to SA within four months from the date on which payment for the goods was made, such importers must within 14 days from the expiry of the four-month period, report this fact to the SARB or to an AD. The SARB or a person authorised by the SARB, may then order such importers to assign their rights to the goods, to the SARB or to a person authorised by the SARB, in exchange for consideration paid to the importers.

Comment

SA residents wishing to transfer funds abroad for investment or other purposes, should therefore ensure that they adhere to the rules set out above. Importantly, SA residents should keep track of the amount of funds transferred annually by making use of their SDA, to ensure that they do not exceed the R1 million limit. If they wish to make larger investments or wish to take funds in excess of R1 million abroad during a calendar year, they should apply to make use of the foreign investment allowance.

Another important consideration should be kept in mind by persons who take funds abroad in the form of travel allowances. Where persons make use of their SDA to take funds abroad as a travel allowance, they may not deposit the unused portion of the travel allowance into their foreign bank account or use such funds for investment purposes abroad. The funds taken abroad as a travel allowance may only be used for purposes of travel and if not, must be converted back into Rand within 30 days of a person's return to SA.

Louis Botha

CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Tax and Exchange Control practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Mark Linington
Private Equity Sector Head
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

Gerhard Badenhorst
Director
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com

Petr Erasmus
Director
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@cdhlegal.com

Mareli Treurnicht
Director
T +27 (0)11 562 1103
E mareli.treurnicht@cdhlegal.com

Lisa Brunton
Senior Associate
T +27 (0)21 481 6390
E lisa.brunton@cdhlegal.com

Candice Gibson
Senior Associate
T +27 (0)11 562 1602
E candice.gibson@cdhlegal.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Varusha Moodaley
Senior Associate
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com

Louis Botha
Associate
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

Jerome Brink
Associate
T +27 (0)11 562 1484
E jerome.brink@cdhlega.com

Gigi Nyanin
Associate
T +27 (0)11 562 1120
E gigi.nyanin@cdhlegal.com

Nandipha Mzizi
Candidate Attorney
T +27 (0)11 562 1741
E nandipha.mzizi@cdhlegal.com

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

CLIFFE DEKKER HOFMEYR