8 SEPTEMBER 2017

TAX AND EXCHANGE CONTROL ALERT

IN THIS ISSUE

THE BEPS EFFECT - HAS LORD TOMLIN'S FAMOUS 1936 DICTUM BECOME OBSOLETE?

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LIGHTS, CAMERA, ACTION! THE TAX EXEMPTION IN RESPECT OF FILMS

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The last two centuries have seen courts handing down judgments wherein the House of Lords and/or the judiciary have been required to interpret the concept of tax avoidance taking into account the specific facts of each case, as well as the interpretation of what constitutes lawful tax structuring, and what does not.

A popular dictum regarding the structuring of a taxpayer's affairs is that which Lord Tomlin made in 1936 in the well-known case of *IRC v Duke of Westminster* [1936] A.C 1; 19 TC 490 at 520, wherein he stated that:

> Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

The qualification "if he can" is a significant factor which depends on the circumstances of each case. In some instances, a taxpayer may attempt to remain outside a certain charging provision of legislation, and in others he may wish to bring himself within the ambit of a statutory provision with the aim of obtaining a tax benefit. It may also occur that although the intention of the taxpayer may be to remain outside a charging provision, he may bring himself within a charging provision of statutory legislation, which subsequently results in a tax liability.

SARS, as well as forums such as the OECD and the Davis Tax Committee have awakened to issues regarding tax avoidance, and are actively taking steps to address these very issues.

Base erosion and profit shifting: the Action Plans

With the implementation of the Organisation for Economic Cooperation and Development (OECD's) Base Erosion and Profit Shifting (BEPS) Action Plans, which include, among others, Country-by-Country (CbC) Reporting for multinational enterprises (MNEs), taxpayers will no longer be able, or at least not easily be able in any event, to strategically escape taxation by shifting their profits to low or no tax locations. Taxpayers are now faced with the realisation that gone are the days where they were able to arrange their affairs in a way to attract as little tax as possible, but are now faced with the harsh reality that the South African Revenue Service (SARS), as well as forums such as the OECD and the Davis Tax Committee have awakened to issues regarding tax avoidance, and are actively taking steps to address these very issues.

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CONTINUED

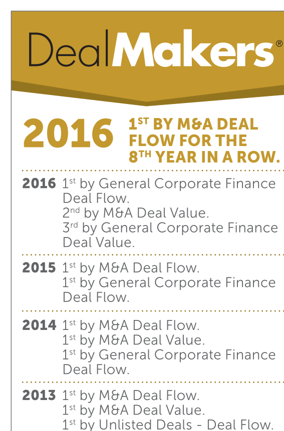
National Treasury will continue to act aggressively against transfer pricing abuse, the misuse of tax treaties and illegal money flows.

Following our former Minister of Finance, Pravin Gordhan's 2016 Budget Speech, Gordhan stated that National Treasury will continue to act aggressively against transfer pricing abuse, the misuse of tax treaties and illegal money flows. Reference was further made to the BEPS Action Plans in order to address revenue losses, and a further reference was made to international agreements in respect of information sharing to enable tax authorities to act more effectively against illicit flows and abusive practices by MNEs and wealthy individuals.

In the 2017 Budget Speech, Gordhan once again reiterated the ongoing problems with specific reference to MNEs making use of inconsistencies in global tax rules to their advantage and in order to avoid tax liabilities. In this regard, Gordhan stated that South Africa intends to sign a multilateral instrument to assist with the updating of treaties and reduce the scope for aggressive tax avoidance activities, which to date, has been signed along with various countries. Gordhan further stated that the automatic exchange of information between tax authorities will come into operation in September 2017, whereas multinationals will be required to file certain information regarding their cross-border activities by the end of 2017. BEPS Action 13 specifically deals with guidance on the implementation of transfer pricing documentation and CbC Reporting by MNEs.

South Africa's legal framework in respect of CbC Reporting

In terms of the CbC Reporting, the draft CbC regulations were published in April 2016, and finalised in December 2016 and apply to the years of assessment beginning 1 January 2016. Before the draft regulations were promulgated, South Africa signed a multilateral competent authority agreement (MCAA), which sets out the rules and procedures which may be necessary for those jurisdictions implementing BEPS Action 13 to automatically exchange CbC Reports. In June 2017, SARS further released a draft briefing note as well as the External Business Requirements Specification document (BRS) which provided further clarity in respect of the submission and content regarding the CbC Report and Financial Data Reporting requirements.



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CONTINUED

Due to the fact that SARS signed the MCAA in January 2016, information which has been submitted in the CbC Report will be automatically exchanged between the other signatories to the MCAA.

The BRS further makes provision for the filing obligation contained in the draft notice to apply retrospectively for years commencing on or after 1 January 2016, and makes reference to a "three tiered standardised approach to transfer pricing documentation", which consist of the following:

- a Master File, which is generally completed by a parent or headquarter entity, but is available to all MNEs. A Master File should provide an overview of the MNE group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity;
- a Local File, which is compiled by all MNE entities, referring specifically to material transactions, as defined in the BRS. The Local File provides more detailed information relating to specific intercompany transactions in each country in which they operate; and
- a CbC Report which is compiled by the reporting entity of the MNE group containing certain information regarding global allocation on the MNE group's income, taxes paid, as well as certain indicators of the location of economic activity among tax jurisdictions in which the MNE operates.

The information provided in these submissions will be used to assist tax administrators to identify whether companies have engaged in transfer pricing activities, or any other type of activities which result in profits being shifted to low or no tax locations.

Who is required to submit and by when?

In the event that the taxpayer meets the threshold with a MNE Group consolidated revenue of more than R10 billion or €750 million in the event that the parent entity is a tax resident in a EU member's jurisdiction, and has a December reporting fiscal year-end, the taxpayer will be required to file a CbC Report with SARS on 31 December 2017. For taxpayers who do not have a December reporting fiscal year-end, the CbC Reports and returns must be filed within 12 months from the last day of the reporting fiscal year-end.

On 31 August 2017, in terms of the Tax Administration Act No 28 of 2011 (TAA), SARS published a draft list of jurisdictions which are intended to assist members of MNE Groups who are resident in South Africa in complying with their obligations under the CbC regulations. In terms of Article 2(2) of the CbC regulations, a member of a MNE Group who is resident in South Africa but is not the "Ultimate Parent Entity", as defined in the regulations, may be required to file a CbC Report with SARS. If members of MNE Groups are tax residents in South Africa and the "Ultimate Parent Entity" of the MNE Group is the tax resident of a country which has an international agreement (as defined in the regulations) with South Africa, the South African member of the MNE Group may be required to file a CbC Report with SARS. The filing of a CbC Report is not necessary where there is a Qualifying Competent Authority Agreement between South Africa and the country where the "Ultimate Parent Entity" is a tax resident or if an alternative arrangement has been made by the MNE Group. It has been anticipated that the draft list will be updated again in October 2017 as more jurisdictions enter into Qualifying Competent Authority Agreements.

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CONTINUED

As will be noted from the BRS, the information required to be submitted is extensive, and taxpayers who meet the filing threshold are urged to prepare timeously.

Countries such as the United Kingdom, Italy and South Korea, among others, have drafted financial penalty provisions for non-compliance with the reporting requirements, however at this time South Africa has not followed suit. Should taxpayers not file the relevant CbC Report or returns, they would be in contravention of the TAA and a penalty could be imposed, in addition to the transfer pricing adjustments made.

Information sharing between countries

Due to the fact that SARS signed the MCAA in January 2016, information which has been submitted in the CbC Report will be automatically exchanged between the other signatories to the MCAA. In addition, and in terms of s3(3) of the TAA, in the event that the Government of South Africa has entered into an international tax agreement with another country, and where SARS is obliged to exchange information or wishes to spontaneously exchange information to a competent authority of the other country concerned, SARS is permitted to do so.

The availability in respect of the sharing of information differs in respect of Master and Local Files. In respect of Master Files, the sharing of information will only be permitted on request, however in respect of Local Files, exceptional circumstances are required in order to share information contained therein.

Time is of the essence

Taxpayers who meet the threshold and who have their reporting fiscal year-end in December are required to file the relevant returns with SARS on 31 December 2017, a mere four months away. The BRS contains details in respect of the content and completion of the CbC Report, Master File and Local File and, as will be noted from the BRS, the information required to be submitted is extensive, and taxpayers who meet the filing threshold are urged to prepare timeously.

Candice Gibson

Tax Indaba 2017

SAIT, along with other recognised professional bodies in South Africa, have come together to host the largest annual gathering bringing together the entire tax community.

The 2017 Tax Indaba takes place at the Sandton Convention Centre from 11 – 15 September.
The event benefits professionals in the financial field who are seeking to refresh their knowledge and to learn about new tax-related developments. This includes tax practitioners and professionals, in-house tax staff members, government tax officials and tax academics.

CDH's Emil Brincker will be there to discuss the core elements of financing, including issues relating to the new hybrid share and hybrid debt anti-avoidance rules.

Mark Linington will discuss share buy-backs, while **Gerhard Badenhorst** will be providing input on the VAT implications of remuneration paid to executive and non-executive directors. **Johann Jacobs** will be tackling the trials and tribulations of dismantling trusts.

LIGHTS, CAMERA, ACTION! THE TAX EXEMPTION IN RESPECT OF FILMS

The South African income tax system contains an incentive to stimulate the production of films within the country.

"From the beginning of the production stage to the actual editing of the final film and exhibition, the industry contributes to the economy, revenue, job creation and economic activity." The results from the economic impact modelling report for 2017, prepared by Urban-Econ Development Economists for the National Film and Video Foundation (NFVF) (NFVF Report), reveal that the film industry has had a positive economic impact on the South African economy. During the 2016/17 financial year, the film industry in South Africa had a direct impact of R4,4 billion on economic production. The NFVF Report also revealed that the operations of the film industry in South Africa raised the level of production by approximately R12,2 billion in total.

Section 12O provides for an exemption from normal tax, specifically income derived from the exploitation rights of a film.

The South African income tax system contains an incentive to stimulate the production of films within the country. The current incentive comes in the form of s12O of the Income Tax Act, No 58 of 1962 (Act). Section 12O came into effect on 1 January 2012 and applies to all receipts and accruals of approved films if principal photography commenced on or after this date but before 1 January 2022. Section 12O provides for an exemption from normal tax, specifically income derived from the exploitation rights of a film. The South African Revenue Service (SARS) has also recently issued a guide, reflecting SARS's interpretation of this provision (SARS Guide).

Exemption requirements

In order to qualify for an exemption, taxpayers must satisfy the following criteria:

1. NFVF must approve the film as a local production or co-production. A film that is co-produced must be co-produced in terms of an international co-production agreement between South Africa and another country, which agreement must be subject to the Constitution.
2. Income is received by or accrued to two types of investors:
   - 2.1 Those who acquired exploitation rights prior to production of the film; or
   - 2.2 Those who acquired exploitation rights after the production commenced but before completion date provided that funds they receive will not be used to compensate pre-production investors.
3. Income must be received or accrued within a period of 10 years after the completion date of that film.

Basis for exemption

The point of departure for the exemption is that there must be a film. A "film" is defined in the Act:

- a feature film;
- a documentary or documentary series; or
- an animation,

conforming to the requirements stipulated by the Department of Trade and Industry in the Programme Guidelines for the South

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LIGHTS, CAMERA, ACTION!
THE TAX EXEMPTION IN RESPECT OF FILMS

CONTINUED

According to the SARS Guide, the purpose of this on-going reporting is to measure the success of the incentive and to guard against tax avoidance.

African Film and Television Production and Co-Production Incentive. These requirements contain, among other things, the duration of the film, the format and processing, and distribution methods used.

One requirement worth mentioning is that in order to qualify, the duration of a film must be 90 minutes or more (45 minutes or more for IMAX). This means that producers of short films, television series and even reality shows will not enjoy this exemption, which could have the unfortunate consequence of excluding producers of quality locally produced television content, who might not have the capital to make a full-length film.

As noted in the requirements for an exemption, income must be derived from the exploitation rights of the film. "Exploitation rights" are defined in the Act as rights to any receipts and accruals in respect of the use of, the right of use of, or the granting of permission to use any film to the extent that those receipts and accruals are wholly dependent on profits and losses in respect of the film.

It is important to note the words, "wholly dependent on profits and losses". The receipts and accruals must be dependent on the success of a film.

The exemption does not apply to a "Broadcaster" as defined in s1 of the Broadcasting Act, No 4 of 1999 (Broadcasting Act) or a connected person in relation to a Broadcaster.

The Broadcasting Act defines a "Broadcaster" as any legal or natural person who composes, packages, or distributes television or radio programme services for reception by the public or sections of the public or subscribers to such a service irrespective of technology used.

Reporting requirements

Section 12O also makes provision for "special purpose corporate vehicles", which are defined as companies responsible for the production of a film as required by the Department of Trade and Industry in terms of the Programme Guidelines for the South African Film and Television Production and Co-Production Incentive. Such special purpose corporate vehicles (SPCV) must provide a report to the NFVF containing such information, within such time and in such manner as is prescribed by the Minister, when income arising from exploitation rights of a film is distributed to a person within a period of 10 years commencing from the completion date of the film. The same duty applies to a collection account manager (CAM) that manages exploitation rights under a collection account management agreement and has been approved by the Minister of Trade and Industry for the purpose of s12O by notice in the Government Gazette.

According to the SARS Guide, the purpose of this on-going reporting is to measure the success of the incentive and to guard against tax avoidance.

Specific provision regarding deductions

Section 12O(5) states that notwithstanding s23(f) of the Act, a taxpayer may deduct from income an amount in respect of expenditure incurred to acquire exploitation rights in a film. The amount of the deduction is equal to the amount of any expenditure incurred to acquire exploitation

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CONTINUED

The deduction is a once-off deduction and is not available in any year of assessment after the year of assessment in which a deduction of a net loss was first claimed.

rights less any amount received or accrued during any year of assessment in respect of that film. Section 23(f) of the Act states that it is impermissible to deduct amounts incurred to receive exempt income. To the extent that the receipts and accruals derived from exploitation rights are exempt from tax in terms of s12O, one would still be allowed to claim the deductions incurred to acquire exploitation rights. It is therefore possible to deduct any net loss incurred in respect of exploitation rights, as stated in the SARS Guide. As the SARS Guide also points out, the net loss may only be claimed during any year of assessment commencing at least two years after the completion date of the film. It should also be noted, and as stated in the SARS Guide, that the deduction is a once-off deduction and is not available in any year of assessment after the year of assessment in which a deduction of a net loss was first claimed. Section 12O(5) further states that the net loss may not be claimed to the extent that the expenditure was funded from a loan, credit or similar financing.

The SARS Guide points out that contributions made by investors subsequent to acquiring the exploitation right are therefore excluded, the reason being that it cannot be said that the contributions are made to acquire the relevant exploitation right, which the investor already holds when making the contribution. According to the SARS Guide, to determine whether expenses are incurred to acquire the exploitation right, one must look at the facts of a particular case.

Additional exemption

There is an additional exemption of any amount received by or accrued to the SPCV by way of a government grant paid under the South African Film and Television Production and Co-production Incentive administered by the Department of Trade and Industry (DTI) but subject to the general provision regarding the recoupment of deductions and allowances in s8(4) of the Act.

Nandipha Mzizi and Louis Botha

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