20 JULY 2018

TAX & EXCHANGE CONTROL ALERT

SPECIAL EDITION:

2018 Draft Tax Amendment Bills Published for Public Comment

On 21 February 2018, the Minister of Finance announced in the 2018 Budget Review, a raft of proposed additional tax amendments for the upcoming legislative cycle pursuant to the annual tax policy process. The Special Budget Alert published on the same day discussed some of the various tax policy proposals. On 17 July 2018, National Treasury published for public comment, the draft Taxation Laws Amendment Bill, 2018 (TLAB) and draft Tax Administration Laws Amendment Bill, 2018 (TALAB). The TLAB and TALAB include the legislative amendments for the more complex tax proposals that were announced in the 2018 Budget Review. In this Tax Alert we discuss some of the more significant proposed legislative amendments including the rules dealing with the conversion of debt into equity as well as the anti-dividend stripping provisions. Comments on the draft bills are due by 16 August 2018.

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CLIFFE DEKKER HOFMEYR

TAXPAYERS SEEKING DEBT RELIEF SHOULD FEEL RELIEVED

In years of assessment that commenced before 1 January 2013, the reduction of debt was generally subject to either income tax, capital gains tax or donations tax.

Debt restructuring and debt relief within the business environment has been undertaken since time immemorial. Given the current economic climate, such debt restructuring and relief has been increasingly implemented and with that it has received concomitant increased attention from the relevant tax and finance authorities in South Africa.

Of particular significance was the replacement of the trigger of the application of the relevant provisions pursuant to a "reduction of debt" with two new concepts namely a "debt benefit" and "concession or compromise".

Background

In years of assessment that commenced before 1 January 2013, the reduction of debt was generally subject to either income tax, capital gains tax or donations tax. The purpose of the relevant provisions at the time were, amongst others, to ensure that a debtor who was relieved of the obligation to pay any portion of the amount owing, would result in such debtor being subject to tax in its hands. Additionally, the provisions were aimed at achieving tax symmetry so that while creditors would be able to claim losses, debtors would also be taxed on the corresponding gains.

For years of assessment commencing on or after 1 January 2013, the relevant rules governing this area of tax law were subjected to a significant overhaul. The new rules, contained in s19 of the Income Tax Act, No 58 of 1962 (Act) and paragraph 12A of the Eighth Schedule to the Act, were designed to introduce a new uniform system that provided relief to persons under financial distress who were unable to pay their debts. The amendments were necessary on the basis that the pre-existing provisions may have effectively undermined the economic benefit of the debt relief for debtors given the potential tax imposed on them.

In 2017, further significant changes were made to the debt relief rules including the introduction of definitive rules dealing with the tax treatment of conversion of debt into equity and to ensure that the relevant rules applied in all instances where a debt is settled by a debtor and the creditor receives inadequate consideration for the debt claim (ie in order to address certain abuses pursuant to the artificial repayment of debt). Of particular significance was the replacement of the trigger of the application of the relevant provisions pursuant to a "reduction of debt" with two new concepts namely a "debt benefit" and "concession or compromise". Additionally, the amendments made provision for the exclusion of interest from the application of the debt relief rules and that debt to equity conversions would be limited to arrangements between companies forming part of the same group.

TAXPAYERS SEEKING DEBT RELIEF SHOULD FEEL RELIEVED

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The first proposal is that a more comprehensive definition of "concession or compromise" should be included.

Reasons for the further proposed changes

As is often the case when introducing new tax legislation designed to deal with specific tax avoidance arrangements, various concerns were raised about unintended consequences that could arise from the application of the recent tax amendments. The latest round of proposed tax amendments thus attempt to address the following concerns discussed in the Explanatory Memorandum on the TLAB:

- The inclusion of any changes in the terms or conditions of a debt as a "concession or compromise" could have the unintended consequence of affecting legitimate transactions. For example, it is often required by a lender bank that related party debt should be subordinated which would trigger the debt relief unintendedly. It has been argued that the inclusion of a change in the terms and conditions of a debt as a "concession or compromise" is a blunt instrument aimed at targeting a narrow group of taxpayers and as a result, should be removed.
- The inclusion of a substitution of an obligation in respect of a debt adversely affects arrangements that do not result in any loss to the fiscus (eg the use of bridging loans) and as a result, should be removed.
- Determining the amount of a "debt benefit" by comparing the face value of a debt prior to a "concession or compromise" with the market value thereafter is cumbersome for each and every event and as a result, should be removed.

First proposal: definition of "concession or compromise"

The first proposal is that a more comprehensive definition of "concession or compromise" should be included. The intention is for the new definition to limit the application of the rules to realisation events (eg cancellation, waiver, redemption, acquisition or conversion of debt to equity) and importantly, any change in the terms and conditions of a debt will not trigger the rules unless such changes result in an actual realisation event.

TAXPAYERS SEEKING DEBT RELIEF SHOULD FEEL RELIEVED

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The recent amendments to the debt relief rules resulted in various concerns raised by taxpayers given the unintended consequences that could arise.

Second proposal: definition of "interest-bearing debt"

The intention has always been to exclude equity loans that are non-interest bearing from the ambit of the debt relief rules and therefore only interest-bearing debt that is converted to equity will fall within the ambit of the debt relief rules. The proposal therefore envisages including a definition of "interest-bearing debt", in respect of which, interest will take on its meaning as already defined in s24J of the Act. Any debt substituted for any interest-bearing debt will also fall within the ambit of the provisions.

Third proposal: definition of "debt benefit"

It is proposed that the definition of "debt benefit" is amended in order to clarify when the new debt reduction provisions will be triggered. In summary, "debt benefit" will include the following scenarios:

- In the case of cancellation, waiver, or remittance - the amount cancelled, waived or remitted;
- In the case of a redemption of a debt or merger by reason of the debtor acquiring the claim in respect of the debt - the amount by which the face value of the claim exceeds the market value of the debt after such redemption or merger;
- In respect of conversions of debt into equity where the subscriber does not hold shares in the debtor prior to the arrangement - the amount by which the face value of the claim prior to the conversion exceeds the market value of the shares held or acquired by reason of or as a result of that conversion;
- In respect of conversions of debt into equity where the subscriber does hold a direct or indirect interest in the debtor prior to the arrangement - the amount by which the face value of the claim prior to the conversion exceeds the amount by which the market value of the shares held by the creditor or that other company after the conversion exceeds the market value of the shares held by that person in that company prior to that conversion.

Fourth proposal: multiple layers of shareholdings

It is proposed that definitions of "direct interest" and "indirect interest" should be inserted in order to eliminate double counting which currently allows taxpayers to reduce their "debt benefit" by multiple increases of multiple layers of shareholdings in the debtor company.

TAXPAYERS SEEKING DEBT RELIEF SHOULD FEEL RELIEVED

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National Treasury have identified two further loopholes in the legislation which require attention.

Fifth proposal: introduction of definition of "market value"

Lastly, it is proposed that a definition of "market value" will also be introduced under the debt relief rules. The key issue is that the proposal does not in itself clarify the meaning of the words "market value" but rather the purpose of the introduction of this definition is to provide clarity regarding the timing of the determination of the market value of shares acquired in respect of a debt to share conversion.

Further proposal: closing a loophole in the debt relief rules

In addition to the specific proposed amendments above, National Treasury have identified two further loopholes in the legislation which require attention. The debt relief rules currently provide for ordering rules that give preference to the application of other provisions of the Act, before the application of the debt relief rules. In particular, these ordering rules broadly apply, inter alia, in the case of estate duty, donations tax and employees' tax. The rationale is thus to avoid double taxation in respect of the same economic event.

It has, however, come to National Treasury's attention that in certain instances there may be double non-taxation which was not the original intention of the legislature. The proposals in this regard are thus twofold:

- The donations tax exclusion under the debt relief rules should be amended to provide that the exclusion will only be available where donations tax is actually payable on a donation arising from a debt relief arrangement.
- Amendments should be made in the debt relief rules to provide that where a "concession or compromise" arises after a capital or allowance asset has been disposed of, this will give rise to tax consequences.

Conclusion

The tax laws pursuant to debt restructuring and debt relief form a complex web of technical rules and while the additional proposed amendments will hopefully clear up some of the concerns recently raised, taxpayers would be well advised to keep their fingers on the pulse by studying the final proposed amendments and seeking professional advice when considering any debt restructuring arrangements so as to avoid any unintended consequences.

Jerome Brink

A RE-PRIORITISING OF SORTS? PROPOSALS REGARDING THE INTERACTION BETWEEN THE ANTI-AVOIDANCE RULES ON DIVIDEND-STRIPPING AND CORPORATE RE-ORGANISATIONS

Amendments were also made so that the corporate re-organisation rules in the Act were made subject to these anti-avoidance rules dealing with dividend stripping.

In 2017, the Income Tax Act, No 58 of 1962 (Act) was amended to strengthen the anti-avoidance rules dealing with dividend stripping. The Explanatory Memorandum on the TLAB (Memorandum) states that these anti-avoidance rules were initially introduced in 2009 to curb the use of dividend stripping structures, whereby a resident shareholder company would avoid income tax (including capital gains tax) on the sale of shares, by ensuring that the target company declares a large pre-sale dividend to it. This dividend would be exempt from dividends tax and would result in the shares being sold at a lower amount.

It is proposed that the term "deferral transaction" is introduced under the anti-avoidance rules dealing with dividend stripping.

The effect of the 2017 amendments, was that exempt dividends that arise in the manner above could now constitute extraordinary dividends, if the resident shareholder company sells the shares in respect of which it received the dividends, within 18 months of receiving the dividends. To the extent that the exempt dividends constitute extraordinary dividends, as defined in s22B of the Act and in paragraph 43A of the Eighth Schedule to the Act, such dividends are treated as income or proceeds received from the disposal of those shares. Furthermore, amendments were also made so that the corporate re-organisation rules in the Act were made subject to these anti-avoidance rules dealing with dividend stripping.

Reasons for change

The Memorandum notes that it has come to Government's attention that the 2017 amendments providing that the anti-avoidance rules on dividend stripping override the corporate re-organisation rules, may affect some legitimate transactions. Considering this, a number of amendments have been proposed.

Corporate re-organisation rules no longer overridden

To ensure that the anti-avoidance rules dealing with dividend stripping do not affect legitimate transactions, National Treasury proposes that these rules should no longer override the corporate re-organisation rules. Instead, it proposes that these anti-avoidance rules should only be triggered when the corporate re-organisation rules are abused by taxpayers who use the corporate re-organisation rules to subsequently dispose of their shares to unrelated purchasers, outside the realm of the re-organisation rules.

Introduction of the "deferral transaction" and application of the anti-avoidance rules on dividend stripping

To address instances where taxpayers use the corporate re-organisation rules to subsequently dispose of their shares to unrelated purchasers outside of the realm of the re-organisation rules, amendments are proposed to clarify the timing of the trigger of the anti-avoidance rules dealing with dividend stripping. To achieve this, it is proposed that the term "deferral transaction" is introduced under the anti-avoidance rules dealing with dividend stripping, which will be defined to mean transactions in respect of which the corporate re-organisation provisions in the Act will apply.

Where a disposal does not take place in terms of a deferral transaction and a resident company received an extraordinary dividend within 18 months of that disposal or as a consequence of that disposal, the

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A RE-PRIORITISING OF SORTS? PROPOSALS REGARDING THE INTERACTION BETWEEN THE ANTI-AVOIDANCE RULES ON DIVIDEND-STRIPPING AND CORPORATE RE-ORGANISATIONS

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The Memorandum states that there are proposals to prevent connected persons that form part of the same group of companies to use deferral transactions to split exempt dividends among themselves.

extraordinary dividend amount must be added to the income or proceeds from the disposal in the year of assessment of the disposal. However, if the dividend that qualifies as an extraordinary dividend is received by or accrues to the resident company in a subsequent year of assessment, it must be taken into account to determine the resident company's tax liability in that subsequent year of assessment.

As stated above, where a resident company disposes of shares it holds in another company in terms of a deferral transaction, the anti-avoidance rules dealing with dividend stripping will not be immediately triggered. However, the Memorandum states that specific claw-back rules should apply to exempt dividends received or accrued in respect of those shares or other shares acquired in exchange for those shares in respect of which such exempt dividends were received or accrued within 18 months of their acquisition. The purpose is for these claw-back rules to apply at the time when such shares are subsequently disposed of in terms of a transaction that is not a deferral transaction, within 18 months of their acquisition. Without going into detail, the Memorandum sets out two scenarios here:

- Scenario 1: Where exempt dividends were received by or accrued to a resident company in respect of certain shares, 18 months prior to a deferral transaction and those shares are disposed of to another resident company in terms of the deferral transaction: If these companies were connected persons immediately after the deferral transaction and the other resident company disposes of the shares within 18 months thereafter, outside of a deferral transaction, the other resident company is deemed to have received or accrued the exempt dividends that were received by or accrued to the resident company from these shares.
- Scenario 2: Where exempt dividends are received by or accrued to a resident company in respect of certain shares, 18 months prior to the deferral transaction and a company acquires other shares in exchange for shares disposed of in terms of the deferral transaction: If a company disposes of the other shares within 18 months of the deferral transaction, the exempt dividends that were previously received by or accrued to the resident company for shares disposed of under the deferral transaction, are deemed to be received by or accrued to that company.

The proposed claw-back rules only apply for the purposes of determining whether the anti-avoidance rules on dividend stripping apply to the subsequent deferral transaction.

Other proposals regarding the anti-avoidance rules that apply to dividend stripping

In addition to the above, the Memorandum states that there are proposals to prevent connected persons that form part of the same group of companies to use deferral transactions to split exempt dividends among themselves. The purpose of splitting the exempt dividend is to ensure that no one connected person or a group company receives an extraordinary dividend. Finally, there is also a proposal to prevent taxpayers from stripping the value of a company after entering into a deferral transaction and avoid the application of the extraordinary dividend by using a company with high value shares to on distribute an exempt dividend.

Louis Botha

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CUSTOMS & EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

Herewith below selected highlights in the Customs & Excise environment since our last instalment:

1. Amendments to Schedules to the Customs & Excise Act, No 91 of 1964 (Act) (certain sections quoted from the SARS website):

   1.1 Schedule 1 Part 1:

      1.1.1 Substitution of tariff subheadings 1001.91 and 1001.99 as well as 1101.00.10 and 1101.00.90 to reduce the rate of customs duty on wheat and wheaten flour from 43,72c/kg and 65,59c/kg to 28,17c/kg and 42,26c/kg respectively;

2. SARS issued a circular dated 17 July 2018 wherein external stakeholders were advised as follows (certain sections quoted from the circular):

   2.1 SARS implemented the first phase of its RCG project on 20 April 2018 in respect of the receipt and processing of the various supply chain cargo reports prescribed in the rules to s8 of the Act;

   2.2 For those who would not be ready on the date of implementation, SARS allowed an additional 60-day period for development, testing and implementation until 1 August 2018, with the intention to enforce reporting compliance from that date;

   2.3 SARS has decided to extend the grace period for reporting enforcement to 1 November 2018; and

   2.4 All categories of cargo reporters, as well as their service providers, are urged to use this time to ensure that they become reporting compliant as SARS does not intend granting further extensions beyond this date.

3. The Department of Agriculture, Forestry and Fisheries published notice number 368 of 2018 in the Government Gazette. It notifies of an application for the amendment of the wine export generic promotion statutory levy received from the wine industry, in terms of the Marketing of Agricultural Products Act, No 47 of 1996.

   The requested amendment is applicable to the export levy and it is proposed that the amendment be implemented from 1 January 2019 and lapse on 31 December 2021.

   Previously, the export levy was on bulk drinking and packaged drinking wine. The wine industry requested that these two categories be re-named into two new categories, namely certified and uncertified wine.

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CUSTOMS & EXCISE HIGHLIGHTS

CONTINUED

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

4. National Treasury released the draft Taxation Laws Amendment Bill, 2018 (TLAB) and draft Tax Administration Laws Amendment Bill, 2018 (TALAB) on 16 July 2018. From a customs and excise point of view, the TLAB and TALAB include the following draft legislative amendments (which were announced in the 2018 Budget Review on 21 February 2018) (certain sections taken from the publications and/or memorandums):

4.1 The insertion of s58A into the Act was announced in the Budget Review 2018 to prevent "forestalling" in respect of excisable goods which was explained as "a practice through which abnormal volumes of products are moved from warehouses into the market to avoid increases in excise duty rates".

The proposed amendment inserts a new provision into the Act, aimed at combatting forestalling before an anticipated increase in the rate of excise duty and allowing the Commissioner to limit the quantities of excisable goods that may be entered for home consumption during a controlled period leading up to the anticipated increase.

Provision is made for the Commissioner to determine by rule the excisable goods to which the anti-forestalling measures apply, the controlled period before the increase during which the measures will apply, the quantities of goods that may be entered for home consumption during such period and the formula for calculating such quantities and penalties.

4.2 The insertion of s114A into the Act, which provides for the writing off or compromise of debt in terms of the Act, by making Chapter 14 of the Tax Administration Act, No 28 of 2011, applicable to such debt. The current s114A will become s114AA.

4.3 Proposed amendments making provision for the continuation of certain amendments of Schedules to the Act.

Written comments to be sent to Nombasa Langeni at: Nombasa.Langeni@treasury.gov.za and Adele Collins at: acollins@sars.gov.za by the close of business on 16 August 2018.

5. Please advise if additional information is required.

Petr Erasmus

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 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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