25 MAY 2018

TAX & EXCHANGE CONTROL ALERT

IN THIS ISSUE

EFFICIENT OR INEPT? SOUTH AFRICA'S CORPORATE INCOME TAX RATE AND RESTRUCTURING RULES

As indicated in our Tax and Exchange Control Alert published on 13 April 2018, the Davis Tax Committee (DTC) released a media statement on 12 April 2018 in which it announced the publication of four additional final reports and conclusion of its work based on its Terms of Reference.

CUSTOMS HIGHLIGHTS

This week's selected highlights in the Customs and Excise environment since our last instalment.

CLIFFE DEKKER HOFMEYR

EFFICIENT OR INEPT? SOUTH AFRICA'S CORPORATE INCOME TAX RATE AND RESTRUCTURING RULES

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As indicated in our Tax and Exchange Control Alert published on 13 April 2018, the Davis Tax Committee (DTC) released a media statement on 12 April 2018 in which it announced the publication of four additional final reports and conclusion of its work based on its Terms of Reference.

For purposes of this alert, certain aspects from the report on the efficiency of South Africa's corporate income tax (CIT) system (CIT Report) will be expanded upon, with particular reference to the reviews undertaken in respect of:

- the efficiency of the CIT rate; and
- the efficiency of the corporate restructuring rules (CRRs).

Background

The DTC formed a CIT sub-committee on 31 October 2016 to prepare the CIT Report setting out the DTC's position. To ensure that the recommendations made in the CIT Report are practical, the DTC has taken South Africa's current economic position, as well as its future outlook into consideration. The DTC is cognisant that in the context of low economic growth, it is critically important to ensure that taxes are raised in a manner that is as least disruptive to economic growth and employment as possible.

The efficiency of the CIT rate

In 1997, the Katz Commission specified that a residence based system of taxation in South Africa would carry the danger of promoting the export of South African human capital and contributing to an undeveloped South African multi-national sector. However, despite the recommendations made by the Katz Commission, a residence based system was introduced into South Africa's income tax system for the years of assessment commencing on or after 1 January 2001.

The relevance of the residence based system of taxation stems from the definition of "resident", as defined in the Income Tax Act, No 58 of 1962 (ITA), particularly when it comes to the identification of the residence of a corporate, which is dependent on whether the corporate is incorporated, established or formed within South Africa, or where the corporate has its place of effective management (POEM). With the increase in globalisation and the mobility of capital, the concept of POEM is capable of being manipulated, enabling a corporate's residence to be a matter of deliberate choice rather than one of circumstance, especially in the digital economy. Therefore, should the CIT rate be seen as being too high in comparison with other jurisdictions, corporates are motivated to move their POEM to jurisdictions with lower tax rates.

South Africa has seen a decline in the CIT rate from 40% in 1994, to the current CIT rate of 28% which has been consistent since 2010. As noted from the CIT rate movement during the last 24 years, the CIT rate responds quickly and negatively to the economic conditions faced by South Africa. Therefore, the CIT sub-committee noted the importance of having regard to the current economic conditions when deciding whether to adjust the CIT rate. Despite the CIT rate remaining at 28% following the 2018 Budget Speech, the Minister of Finance acknowledged that 28% is still high by international standards. This could have an impact

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on the competitiveness of South African corporates in a market which is already highly competitive in nature.

Arguments in favour of and against decreasing the CIT rate have been put forward in the CIT Report. In this regard, the CIT sub-committee indicated that international tax competition has played a significant role in applying pressure within competitive jurisdictions, which as a result has caused the decrease in CIT rates in other jurisdictions to attract multinational corporates. Another argument put forward in favour of decreasing the CIT rate is that corporates have less incentive to shift their profits outside of South African borders with the aim of eroding their tax bases. Furthermore, evidence has shown that in jurisdictions with lower tax rates, there is a higher level of compliance. Earlier this year, SARS announced that approximately 21 million CIT returns are outstanding. The DTC's argument that a higher level of compliance has been noted in jurisdictions with lower CIT rates, may be of interest to National Treasury for the 2019 budget.

Despite arguments in favour of the decrease of the CIT rate, arguments against it must also be considered in order to make the most appropriate recommendations going forward. Due to the significant contribution of revenue from corporates within South Africa to the fiscus, without some level of certainty that a reduced CIT rate will be effective in stimulating growth and thus increasing the overall tax base and overall collection of taxes, a resultant reduction in revenue would need to be compensated for elsewhere. From an international perspective, it appears that the best approach may be to leave the CIT rate the same whilst using other efforts to widen the tax base, such as introducing restrictions in respect of deductions and allowances, as well as bringing new forms of income into the tax net. National Treasury appears to have adopted this approach.

The DTC's recommendations regarding the CIT rate within South Africa's current economic circumstances

- Any change to the CIT rate must be made with appropriate circumspection as it may not only involve taking cognisance of the applicable rate used by trade partners, but also of South Africa's neighbouring states. This process must be undertaken in a holistic manner considering different allowance and exemptions regimes;
- Regarding the competitiveness of corporates within different jurisdictions, the European Commission indicated in a press release in 2011 (Competitive Tax Pricing), that when a government lowers its tax rates to increase competitiveness within the market, this may not necessarily lead to an increase in its productivity. Furthermore, jurisdictions that attract foreign direct investment by offering lower tax rates are not necessarily more competitive than jurisdictions with higher tax rates and therefore the competitiveness of a tax system cannot simply be judged by rates. To enable South Africa to compete in competitive markets, the focus should be on the quality of the tax system by ensuring that tax evasion is reduced;

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The CIT sub-committee has raised concerns, especially with regards to the specific anti-avoidance provisions that apply to transactions between connected persons.

- It is also important to keep in mind that other policy changes would need to be reviewed, such as changes in respect of labour, immigration and power supply, for example, for tax to be a factor that might assist in promoting economic growth; and
- Taking the current economic position into account, the DTC did not recommend a decrease in the CIT rate at the time of publication of the CIT Report, however CIT rates should be reviewed regularly in light of other factors and policy decisions made.

The efficiency of the CRRs

One reason for the introduction of the CRRs in 2001, taking into account the policy objectives of competitiveness, was to promote domestic restructuring of South African groups of companies (as defined in s41 of the ITA) in order to promote growth. The second reason was to alleviate unintended hardships caused by the enactment of capital gains tax (CGT), which was also introduced into South Africa's tax system in 2001. The CRRs do not only provide relief from the tax consequences of CGT, but also defer the incidence of income tax, donations tax, dividends tax, transfer duty, securities transfer tax and value-added tax.

In terms of the CRRs, the CIT sub-committee has raised concerns, especially with regards to the specific anti-avoidance provisions that apply to transactions between connected persons. The main issue raised is the volume of anti-avoidance provisions which create unintended difficulties to ordinary commercial transactions.

We will deal with the anti-avoidance provisions in more detail below. The concerns identified and addressed in the CIT Report in respect of the CRRs comprise, amongst others:

1. The "rules based" nature of the CRRs makes them mechanical:
    - Should a taxpayer not meet the detailed and specific requirements of the provisions, relief is not available. This goes against the reason for the introduction of the CRRs which aim to promote domestic restructuring by granting relief from the tax consequences that would otherwise result from a restructure;
    - The CRRs are mechanical as opposed to conceptual in nature which results in difficulties when the CRRs interact with other sections of the ITA which do not fall within the restructuring provisions. The mechanical nature makes the provisions quite complex and restrictive as the CRRs attempt to cater for each and every scenario that may arise when dealing with a corporate restructure; and
    - The CRRs do not cater for liabilities in the context of corporate restructures with the focus being on assets and the relief granted in respect of those assets. This results in other provisions of the ITA still finding application to liabilities, such as the debt reduction rules provided for in s19.

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The CIT sub-committee suggested that it would be more appropriate to reformulate the rules so that they are "principle based" as opposed to "rule based".

2. The complexity and volume of anti-avoidance provisions contained within the CRRs:
   - The CRRs have over the years been amended and refined to prevent their abuse for tax avoidance purposes, however, the continuous amendment of the CRRs makes it difficult to comply with the requirements. The question which the DTC faces is whether the efficiency of the CRRs have not been hindered following the fear of their abuse;
   - Section 45 was highlighted as the "most burdensome" CRR in the context of anti-avoidance as it has been used in several avoidance schemes, one of which relates to debt push down schemes involving the claiming of substantial amounts of interest deductions leading to large tax losses. Currently there are two main types of anti-avoidance measures that apply to s45 transactions:
     1. 18-month deemed sale rule which prevents the disposal of an asset within 18 months after acquiring the asset in terms of s45. Therefore, should the asset be disposed of within the 18-month period, this will result in a "deemed sale" on the date that the s45 transaction took place and the profits from the disposal cannot be set off against any accrued loss. The CIT Report notes that taxpayers view the 18-month anti-avoidance rule as unnecessarily strict, unfair, harsh and does not contribute to fiscal neutrality. In addition, the 18-month period has been criticised for being too long and unrealistic in a modern world where business opportunities emerge at an accelerated pace;
     2. de-grouping charges which trigger a deemed disposal should one of the companies engaged in the s45 transaction leave the group or is no longer part of the same group of companies (referred to as the 6-year de-grouping charge). Further, where consideration received by the group as part of a series of transactions, with the purpose of transferring the assets 100% tax free, the CIT sub-committee indicated that the aforesaid de-grouping charges have been criticised for inhibiting commercial activity and creating undue burdens on taxpayers.

The DTC's recommendations regarding the CRRs and the anti-avoidance provisions

- Since the fundamental principle underlying the CRRs is for the transferee to "step into the shoes" of the transferor, the CIT sub-committee suggested that it would be more appropriate to reformulate the rules so that they are "principle based" as opposed to "rules based". Therefore, instead of the provisions trying to cater for every scenario, the provisions should set the framework within

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As the DTC is only advisory in nature, the recommendations made in the CIT Report will be presented to the Minister of Finance and therefore it remains to be seen whether the recommendations made in respect of the CIT rate and CRRs will be considered and implemented going forward.

which the underlying principles must be allowed to operate and develop through interpretation and practice. This approach would need to be examined with the view of streamlining the CRRs to ensure more flexibility and adaptability;

- From a policy perspective, the DTC is of the view that the de-grouping charge is in line with underlying policy and therefore the DTC is unable to support the proposal that the 6-year de-grouping charge be reduced to 18-months. However, it was recommended in the CIT Report that a period shorter than 6 years be considered following a review;
- The DTC further acknowledged that the calculation relating to de-grouping charges are complex in nature and may need to be simplified; and
- CRRs are purposive in nature as opposed to "rules based". This recommendation stems from the literal interpretation of the de-grouping charge in s45, which creates situations where a de-grouping charge may be triggered in scenarios that were never intended. For example, a change in shareholding further up the corporate structure could trigger a de-grouping lower down the corporate structure where the companies that were originally required for the s45 transaction are still intact. The DTC therefore recommended that s45 be revisited with the view of allowing and encouraging group restructures. The DTC is of the view that any abuse in respect of the CRRs could be countered by making use of the general anti-avoidance provisions.

As the DTC is only advisory in nature, the recommendations made in the CIT Report will be presented to the Minister of Finance and therefore it remains to be seen whether the recommendations made in respect of the CIT rate and CRRs will be considered and implemented going forward.

Candice Gibson

CLIFFE DEKKER HOFMEYR

CUSTOMS AND 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.

This week's selected highlights in the Customs and Excise environment since our last instalment:

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

   1.1 Draft amendment to Rules to s38 of the Act:

   The unique consignment reference (UCR) is assigned to a consignment of goods for tracking purposes throughout the supply chain from origin to destination. The current UCR is being replaced with a Southern African Customs Union (SACU) UCR, which will initially create a platform for exchange of customs information between SARS Customs and the customs administration of Swaziland, followed later by the customs administrations of the other SACU members. The purpose of the proposed SACU UCR is to link export and import declarations using a common reference, enabling data exchange and facilitating trade within the SACU region. The draft amendments provide for the generation, use and constitution of the UCR.

2. Amendments to Schedules to the Act:

   2.1 Schedule 1 Part 1:

   2.1.1 A reduction in the rate of duty for "Wheat and meslin" and "Wheat or meslin flour" of TH's:

   2.1.1.1 1001.91;

   2.1.1.2 1001.99;

   2.1.1.3 1101.00.10; and

   2.1.1.4 1101.00.90.

   2.2 Schedule 2:

   2.2.1 The substitution of safeguard item 260.03/7225.99/01.06 to exclude rebate item 460.15/7225.99/01.06 in order to exclude certain hot-rolled steel plates from being subject to safeguard duty from 18 May 2018 up to and including 10 August 2018;

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.

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CUSTOMS AND EXCISE HIGHLIGHTS

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2.2.2 The substitution of safeguard item 260.03/7225.99/01.06 to exclude rebate item 460.15/7225.99/01.06 in order to exclude certain hot-rolled steel plates from being subject to safeguard duty from 11 August 2018 up to and including 10 August 2019; and

2.2.3 The substitution of safeguard item 260.03/7225.99/01.06 to exclude rebate item 460.15/7225.99/01.06 in order to exclude certain hot-rolled steel plates from being subject to safeguard duty from 11 August 2019 up to and including 10 August 2020.

2.3 Schedule 4:

2.3.1 The insertion of rebate item 460.15/7225.99/01.06 in order to create a rebate facility on certain hot-rolled steel plates.

3. The International Trade Administration Commission has (certain sections quoted from the notice):

3.1 Received the following application concerning the Customs Tariff:

3.1.1 An increase in the Dollar-Based Reference Price (DBRP) for sugar, classifiable under heading 17.01 from US$566/ton to US$856.32/ton.

Enquiries: ITAC Ref: 01/2018, Mr Oatlhotse Madito, Ms Dolly Ngobeni, Mr Jacob Mtimkulu, or Ms Manini Masithela at e-mails: omadito@itac.org.za / dngobeni@itac.org.za / jmtimkulu@itac.org.za / mmasithela@itac.org.za. Alternatively, contact (012) 3940-3692 / 3667 / 3691 / 3682.

Representations should be submitted within three weeks from 11 May 2018.

Petr Erasmus

OUR TEAM

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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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