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BUDGET SPEECH

26 February 2020

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THE CLOSING OF A POTENTIAL LOOPHOLE – ACQUISITION OF ASSETS IN EXCHANGE FOR DEBT

Paragraph 38 of the Eighth Schedule to the Income Tax Act, 1962 (Act) indicates that transactions between connected persons are deemed to take place at arm's length. In other words, assets are disposed of at market value by the seller and deemed to have been acquired at market value by the purchaser.

However, this deeming provision does not apply to any asset in respect of which section 40CA applies. Section 40CA indicates that, if a company acquires an asset from a person in exchange for debt issued by the company, the company is deemed to have actually incurred an amount of expenditure in respect of the acquisition of that asset which is equal to the amount of the debt. The so-called market value rule therefore does not apply. It is important to appreciate that the deeming provision only deals with the acquisition of the asset by the acquiror and does not deal with the accrual in the hands of the seller.

A number of taxpayers have made use of this deeming provision so as to avoid the potential negative consequences of having been deemed to have disposed of an asset at market value. In other words, to the extent that shares are not issued in return for the acquisition of an asset, but the purchaser is a company which becomes indebted to the seller, the consequence of section 40CA of the Act would have been that the asset is deemed to have been acquired for an amount equal to the debt.

To the extent that an asset for share transaction is implemented in terms of section 42 of the Act, the consequences are that:

- the seller is deemed to have disposed of the asset at original base cost;
- the purchaser company is deemed to have acquired the asset at original base cost; and
- the seller is deemed to have acquired the relevant shares issued by the purchaser company at base cost.

The deemed acquisition at base cost and the issue of shares at base cost does not necessarily apply to the extent that a debt is created pursuant to the transfer of an asset.

In terms of section 45 of the Act, an intra-group transaction can be entered into pursuant to which an asset is transferred to another group company in return for the issue of debt. Such debt would then not be subject to tax in the hands of the seller. The argument is thus that, if one reads section 45 of the Act together with section 40CA, one can transfer an asset without paying tax whereas the purchaser company is deemed to have acquired the asset for an amount equal to the debt.

Transactions could thus have been entered into on the basis that:

- the seller of the asset transfers the asset to a new company (Newco) in return for the issue of debt by the purchaser company. In other words, the asset is then transferred to Newco at a cost equal to the debt that is created. The shares in Newco can thereafter be disposed of at market value without triggering the deemed market value provisions as one is disposing of the share in Newco as opposed to the asset that has been acquired by Newco.

The Minister has thus proposed that relevant amendments to the legislation be introduced to address these concerns.

Emil Brincker

POTENTIAL DIVIDEND DEDUCTIONS BY BANKS OR OTHER COVERED PERSONS

Currently banks or other covered persons must, subject to certain exclusions, include in or deduct from their Statement of Comprehensive Income all amounts from qualifying financial assets and financial liabilities that are recognised as profits or losses.

However, currently this deeming provision does not apply to a financial asset that is a share or a dividend received by or accrued to a bank or a covered person.

Investors have been offered the opportunity to subscribe for shares in a special purpose vehicle that is introduced between the investor and a covered person. In other words, this entity will issue shares to an investor and pay dividends to the investor. These dividends will be exempt. However, it will receive interest or other income in respect of the financial assets which would be deductible. Higher returns can therefore be paid to the investor.

It has now been proposed that the exclusion pertaining to dividends will no longer apply. In other words, the question is whether these dividends will in future become taxable. This could have a substantial effect on the ultimate return to the investor.

Emil Brincker

PROPOSED MEASURES TO CURB EXCESSIVE INTEREST DEDUCTIONS

National Treasury proposes the introduction of a new interest limitation rule which is aimed at addressing profit shifting and base erosion by multinational corporations. The rule is aimed at practices involving the artificial inflation of company debt and/or interest rates to a related party in a jurisdiction with a lower corporate tax rate. The interest is claimed in South Africa as an income tax deduction, subject to transfer pricing provisions and existing interest limitation rules and taxed in a jurisdiction with a lower corporate income tax rate. This practice results in the exportation of the South African tax base to be taxed at a lower rate offshore. The proposal applies to years of assessments commencing on or after 1 January 2021 and limit the net interest expense (NIE) deductions to 30% of "*earnings*".

National Treasury also released a discussion document on the National Treasury website which provides useful insights.

What should the new interest limitation apply to?

It is proposed that the rule will apply to the total (external and connected) net interest expense and equivalent payments. The section 24J definition in the Act is not wide enough to include payments economically equivalent to interest and therefore the rules will apply to a wider concept of interest. It would be very interesting to see what instruments will be regarded as yielding "*payments economically equivalent*".

Who will be impacted?

The rule will apply to entities operating in South Africa and forming part of a foreign or South African multinational group. The total net interest expense paid by the entities will be impacted by the rules. Definitions will be introduced for a "*Group*" and "*MNE Group*".

A "*Group*" will be defined as meaning a collection of enterprises connected through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange. The term "*MNE Group*" will be defined as meaning any Group that includes two or more enterprises the tax residence for which is in different jurisdictions, or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.

Calculating earnings and setting the limitation

It is proposed that "*earnings*" or a tax "*EBITDA*" will be calculated as the sum of (i) taxable income (ii) net interest expense and (iii) deductions in respect of capital assets (such as depreciation and amortisation).

PROPOSED MEASURES TO CURB EXCESSIVE INTEREST DEDUCTIONS...continued

Various factors were considered in arriving at the interest limitation. The most important considerations were the relatively high interest environment in South Africa and the analysis of taxpayers NIE/EBITDA ratios from 2013 to 2016. If the ratio is set at 30%, roughly 75% of all taxpayers with a positive tax EBITDA will be able to deduct their entire interest expense in the year in which it is incurred.

Smoothing the volatility in earnings

National Treasury realises that earnings fluctuate and will therefore impact on a company's ability to claim interest deductions. It is therefore proposed that if a taxpayer is not able to fully deduct an interest expense in a year of assessment, the excess amount can be carried forward. The interest charges cannot be carried forward indefinitely and therefore it is proposed that the carry forward is limited to five years on an annual FIFO basis.

De minimis rule

National Treasury realises that it will be overly burdensome and unfair for smaller stand-alone companies to comply with these rules. It is therefore proposed that a de minimis rule is introduced for smaller companies not forming part of multinational groups.

Existing interest limitation rules and transitional measures

The new interest limitation rule will replace section 23M of the Act and transitional measures will be considered for existing third-party loans. It is however proposed that existing targeted rules such as section 23N will remain.

Interaction with other provisions in the Income Tax Act

Transfer pricing rules contained in section 31 of the Act can potentially also limit interest deductions based on an arm's length test. The interest limitation rule reflects government's right to protect its tax base from what it deems excessive interest deductions. Therefore, although a financial transaction might have been structured on an arm's length basis, the transaction can still fall within the ambit of the interest limitation rule on the basis that the NIE/EBITDA ratio is breached. National Treasury proposes that companies firstly apply the arm's length test to financial transactions followed by the interest limitation rules.

It is certainly a very interesting development and affected taxpayers should participate in the consultation process. The Budget states that the closing date for comments on the discussion document is 17 April 2020.

Dries Hoek

THE SUN BEGINS TO SET ON TAX INCENTIVES

Tax incentives are aimed at encouraging certain behaviours and activities by providing businesses and individuals with favourable tax treatment. The introduction of a tax incentive is generally based on a social, economic or environmental need that has been identified, which need can be alleviated by the actions or behaviours of taxpayers in exchange for a tax benefit.

Although tax incentives are introduced in order to remedy or improve a particular circumstance or behaviour, there are potential negative effects to these incentives that make them economically less desirable, including:

- reduction of the tax base;
- increasingly complicated governing legislation;
- greater benefits to larger entities that can obtain specialised tax advice; and
- additional SARS resources required to monitor and audit the incentives.

In order to mitigate these negative effects and in accordance with Government's aim to broaden the corporate tax base, it has been proposed that several of the tax incentives contained in the Act be reviewed and, specifically, that sunset clauses either be inserted (to the extent that no such clause currently exists) or be reviewed in order to determine whether they should be extended.

Among the tax incentives to be reviewed are those dealing with airport and port assets, rolling stock, and loans for residential units. It has also been proposed that the urban development zone (UDZ) incentive be extended by one year in order for the review thereof to be completed and that the section 12I tax incentive pertaining to industrial policy projects not be renewed beyond 31 March 2020.

One of the most topical tax incentives is section 12J of the Act, which provides for the venture capital company (VCC) tax incentive regime. In simple terms, section 12J allows taxpayers to claim an income tax deduction in respect of expenditure incurred to subscribe for VCC shares provided various requirements are met. The section 12J VCC incentive currently provides for a sunset clause of 30 June 2021. It has been proposed that this tax incentive be reviewed in order to assess the effectiveness, impact and role thereof and to determine whether or not the VCC tax incentive regime will be discontinued.

The VCC tax regime was initially introduced for purposes of assisting small and medium-sized businesses and junior mining exploration companies in terms of equity financing. At the time of its inception, National Treasury intended it to be a marketing vehicle that would attract retail investors. In particular, it was envisaged that it would have the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector.

However, since its conception, the VCC tax incentive regime has not at times been implemented in the manner in which National Treasury initially envisaged and in particular, it has been subject to various avoidance and investment structures outside the initial policy intent. While various ongoing amendments have been made to the legislation in order to address these abuses, certain aspects of the VCC tax incentive regime remain a concern for National Treasury. With reference to the purpose for which this tax incentive was initially introduced, being the combatting of growth challenges faced by small and medium sized businesses due to the inaccessibility of equity finance, and the various abusive schemes identified by National Treasury it will be interesting to see whether Government decides to extend the incentive or rather discontinue it.

Louise Kotze

CLIFFE DEKKER HOFMEYR

RESTRICTION ON THE USE OF ASSESSED LOSSES – BROADENING THE CORPORATE TAX BASE

Given the current economic climate, often the only light at the end of the financially crippling tunnel is the knowledge that the losses incurred in this year of assessment (YOA) can (hopefully) be set off against taxable income in the following YOA. However, the light appears to be dimming as the Minister proposes restricting the extent to which an assessed loss may be used to offset future taxable income.

When the tax-deductible expenses of a company exceed the income derived by it in a YOA, an assessed loss is realised. Such an assessed loss may be carried forward to the next YOA and may be used to decrease the taxable income of the company in that next YOA.

To the extent provided for in section 20 of the Act, the full amount of that assessed loss may be used to reduce the taxable income generated by a company in a subsequent YOA. Furthermore, if the assessed loss is greater than the taxable income in that subsequent year, the balance of the assessed loss not utilised may be carried forward to the next year of assessment.

It has been proposed in the Budget that the offset of assessed losses that have been carried forward, be restricted to 80% of taxable income from the YOA, commencing on or after 1 January 2021. As such, if a company is in a taxable position before taking into account an assessed loss that is carried forward, that company will be liable to pay tax on at least 20% of its taxable income, regardless of whether the assessed loss carried forward exceeds the taxable income.

The proposed limitation is said to be in line with global trends and has been introduced in order to broaden the corporate income tax base.

It is possible that this proposed amendment will receive opposition from corporate entities as they will incur some measure of tax liability as soon as taxable income is derived, regardless of the extent of the assessed losses that may have been carried forward. This may be particularly problematic for entities with substantial start-up costs as the tax benefits in respect of losses incurred in the first years of operation will likely be limited during later YOAs.

Louise Kotze

CLARIFYING ROLLOVER RELIEF FOR UNBUNDLING TRANSACTIONS INVOLVING NON-RESIDENT SHAREHOLDERS

Generally, as a matter of tax parity within South Africa's corporate tax system, the distribution of an asset (including shares) by a company to its shareholders should have the same tax impact as a company sale of the asset followed by a distribution of after-tax cash proceeds. However, section 46 of the Act makes provision for rollover relief where shares of a resident company (referred to as an unbundled company) that are held by another resident company (referred to as an unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders.

However, these unbundling transactions are subject to an anti-avoidance rule in section 46(7) of the Act aimed at limiting the extent to which taxpayers can distribute shares in resident companies to non-residents on a tax neutral basis. In simple terms, section 46(7) of the Act excludes the shareholders and the unbundling company from benefitting from the rollover relief if 20% or more of the shares in the unbundled company are, after the transaction, held by "*disqualified persons*" (including, amongst others, non-residents), either alone or together with persons connected to those non-residents.

National Treasury has identified that the current rule creates a loophole in that the 20% exclusionary rule may not apply where non-resident shareholders are not connected persons in relation to each other. In other words, non-residents may collectively hold 20% or more of the shares in the unbundled company, but to the extent that they are all independent, the anti-avoidance rule in section 46(7) of the Act would not be applicable as one would not breach the 20% threshold. To close this loophole, it has been proposed that the relevant legislation be amended to ensure that the rule applies irrespective of whether the non-resident shareholders are connected persons in relation to each other.

Jerome Brink

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CONTRACT MINING AND CAPITAL EXPENDITURE: PROPOSED AMENDMENTS FOLLOWING THE BENHAUS MINING JUDGMENT

Mining by its nature requires large initial capital outlays and in recognition of this the Act provides for an accelerated deduction of such capital expenditure by miners. In *Benhaus Mining (Pty) Ltd v Commissioner for the South African Revenue Service* (165/2018) [2019] ZASCA 1, it was held that this special regime extended to contract miners who engage in mining operations, under a contract with the holder of a mining right, and who earn a determinable fee under such agreement. For a discussion of this case see our Alert of 12 April 2019.

Section 15(a) of the Act, read with section 36(7C), provides the mechanism and requirements for the deduction of capital expenditure incurred in respect of a mining operation (Redemption Allowance). One of the requirements is that the taxpayer must be conducting "*mining operations*" or "*mining*", as defined. "*Mining operations*" and "*mining*" are defined in section 1 of the Act to "*include every method or process by which any mineral is won from the soil or from any substance or constituent thereof*". Section 15 of the Act provides that a deduction shall be allowed as per section 36, *in lieu* of an ordinary deduction under section 11. Section 36 in turn provides for a deduction of any capital expenditure to be allowed from income derived from the working of any producing mine.

The effect of these provisions is that a taxpayer engaged in mining operations on a producing mine will be entitled to fully deduct capital expenditure in the year of assessment in which it was incurred. This is a departure from the standard deductions in the Act relating to allowances that may be claimed on capital assets acquired.

The Budget states that the Redemption Allowance would now be available to both a contract miner and the holder of the mining right. The Budget therefore proposes a review of the definition of the rules relating to the Redemption Allowance in the Act to address this concern.

Tsanga Mukumba and Louis Botha

REFINING THE TAXATION OF REAL ESTATE INVESTMENT TRUSTS (REITS)

Prior to the commencement of specific legislation regarding real estate investment trusts (REITs) on 1 April 2013, two forms of listed property investment entities existed in South Africa, namely, property loan stock companies (PLS) and property unit trusts (PUT), i.e. collective investment schemes in property. These entities were subject to different regulatory controls and tax treatment.

A unified tax regime was adopted with effect from 1 April 2013 and REITs were introduced. In terms of the Act, a REIT is defined as a resident company, the shares of which are listed on an exchange as defined in section 1 of the Financial Markets Act 19 of 2012 (Financial Markets Act) and are listed as shares in a REIT as defined in the listing requirements of an exchange approved in consultation with the Minister.

In the Budget, the Minister has made various proposals aimed at refining the taxation of REITs. These proposals include clarifying the definition of REITs; clarifying the meaning of a share in the definition of REITs and amending the anti-avoidance provisions regarding taxation of foreign dividends received by REITs.

The Budget proposes that the definition of REIT in the Act, which currently refers to the approval of listing requirements by the appropriate authority under the Financial Markets Act in consultation with the Minister, be updated to be in line with the Financial Sector Regulation Act 9 of 2017 (i.e. twin peaks). It further proposes that the consultation requirements regarding the listing criteria in an approved exchange be reviewed.

In regards to the definition of a share, National Treasury has identified that some REITs wish to issue and list preference shares. However, it was never envisaged that holders of preference shares should benefit from the REIT tax dispensation given that preference shares are mainly used for financing and not to provide full equity exposure to investors. In order to prevent the issue and listing of preference shares by REITs, it has been proposed that the legislation should be amended to exclude preference shares and non-equity shares from the shares that must be listed on the exchange to qualify as a REIT.

Lastly, according to government there is a mismatch that occurs in respect of foreign dividends received by REITs. This mismatch occurs where a REIT holds shares in a non-resident property company thereby qualifying for the section 10B participation exemption in respect of the foreign dividend received from that non-resident company. In addition to the dividends tax participation exemption, the REIT also obtains a full deduction when it distributes profits from those foreign dividends thereby escaping taxation altogether. In order to address this mismatch, it has been proposed that the legislation be amended so that the full dividend is subject to tax if the recipient is a REIT.

Aubrey Mazibuko and Jerome Brink

EXPORT OF DUAL LISTED SECURITIES - PROPOSED INCOME TAX AMENDMENTS

Under South Africa's current exchange control (Excon) rules, South African residents are required to seek approval from the South African Reserve Bank (SARB) should they wish to export a South African listed security outside of the Common Monetary Area. As a result of the proposed modernisation of South Africa's Excon regime, discussed in the Exchange Control section of our Budget Alert, under which the SARB's permission will no longer be required, it is proposed that such an export results in income tax consequences. Specifically, the Budget proposes that such a transfer now constitute a deemed disposal of that security for income tax purposes, with further consequences once the share is traded on the relevant foreign exchange.

In the context of a dual-listed company, where a South African resident shareholder holds shares listed on a South African exchange, it can give instructions to have the share removed from the South African securities registry and placed onto the foreign securities registry. This constitutes an export for exchange control purposes and would require the prior approval of the SARB.

Considering the proposal in the Budget that this be treated as a deemed disposal, the proceeds from such deemed disposal will be capital or revenue in nature, depending on whether it was held as trading stock or a capital asset in the South African resident's hands.

Essentially, it appears that to prevent the transfer of securities abroad in the dual-listed context, adverse tax consequences will arise, as opposed to adverse Excon consequences, as is the case under the current Excon regime.

Tsanga Mukumba and Louis Botha

PROPOSAL TO PREVENT TAX AVOIDANCE THROUGH THE USE OF LOOP STRUCTURES

According to the Budget, the current exchange control provisions restrict the use of loop structures, in part to protect the tax base. The current policy is that a South African resident may not collectively hold more than a 40% interest in an offshore entity, which in turn, holds interests in a South African entity or made loans to a South African company. Where an interest is held in this manner, it is known as a loop structure.

The Budget explains that tax legislation is a more appropriate tool to combat tax avoidance, as opposed to the policy restricting the use of loop structures. For example, if a resident individual or trust holds at least 10% of the total equity shares and voting rights in a foreign company, they qualify for a participation exemption, as dealt with in paragraph 64B of the Eighth Schedule to the Act. Furthermore, section 10B of the Act states that all foreign dividends received are exempt from tax, if a South African resident individual or trust holds a 10% interest.

If the resident shareholding is more than 50%, the foreign company is a controlled foreign company (CFC). Furthermore, all of the CFC's dividend income is exempt from tax. The CFC provisions are dealt with in section 9D of the Act. If loop structures are no longer restricted, it would be possible to set up a structure where the CFC owns a South African company, and any dividends flowing from the resident company to the resident individual or trust through the CFC are tax-exempt for the individual or trust. This would enable the resident individual or trust to reduce their dividend tax liability in respect of dividends declared by a resident company from 20% to, in some instances, 0%.

A further loop structure risk exists if a resident disposes of shares in a CFC that owns South African assets. The unrealised gains attributable to the South African assets may not be taxed if the resident qualifies for the participation exemption in paragraph 64B of the Eighth Schedule to the Act.

Government proposes that the CFC legislation be amended to limit the dividend exemption available to a resident individual or trust relating to the accrual or receipt of dividends from a resident company to a CFC. As a result, such dividends would be taxed at an effective rate of 20%, in line with cases where resident individuals receive dividends from resident companies.

In addition, the Budget proposes that the participation exemption for capital gains on the disposal of shares in CFCs by residents, should not apply to the extent that the value of those shares is derived from South African assets.

Louis Botha

UTILISATION OF TRUSTS AS A PLANNING TOOL REMAINS UNDER THE MICROSCOPE

Historically many individuals made use of estate planning schemes through trusts, whereby taxpayers would transfer assets to a trust and the purchase price owed by the trust to the taxpayer in respect of the assets would be left outstanding as a loan, advance or credit in favour of that taxpayer on which no interest or very low interest would be charged. Alternatively, taxpayers would advance a low interest or interest-free cash loan, advance or credit to a trust in order for the trust to use the money to acquire assets.

The use of these schemes often resulted in donations tax not being leviable on the basis that such transfers would be treated as sale transactions and not donations. Furthermore, on occasion, the amount that was owed to the taxpayer (i.e. the loan claim) would remain outstanding indefinitely and the trust would likely have no real intention to pay it off. In some instances taxpayers would reduce or waive the loan which would then not form part of his/her estate for purposes of estate duty, notwithstanding that taxpayers could make their dependents, beneficiaries of the trust.

The use of these estate planning schemes have been under the microscope in recent times which culminated in the introduction of anti-avoidance measures in the Act. In order to limit taxpayers' ability to transfer wealth to a trust without being subject to tax, section 7C of the Act was introduced with effect from 1 March 2017. In simple terms, interest foregone in respect of low interest loans or interest free loans that are made to a trust are now treated as an ongoing and annual donation made by the natural person to the trust on the last day of the year of assessment of that trust. Effectively, one then has to make a decision as to whether to charge interest on the loan at market related rates which would be taxable in the hands of the holder of the loan and which may or may not be deductible in the hands of the trust. Alternatively, in the event one does not charge interest, the donor would be liable for donations tax on the interest foregone.

National Treasury identified further schemes aimed at avoiding the application of section 7C of the Act whereby taxpayers advanced interest free or low interest loans to companies whose shares are held by trusts. The anti-avoidance rules in section 7C were thus strengthened in 2017 by extending the application of section 7C to the scenario where natural persons or a company (at the instance of a natural person) advance interest free or low interest loans to a company that is held by a trust that is a connected person in relation to a natural person or a beneficiary of such trust.

Notwithstanding the strengthening of the rules, National Treasury has identified a further scheme aimed at circumventing the application of the section 7C rules. In this regard, instead of advancing a "*loan, advance or credit*", taxpayers subscribe for preference shares in a company owned by a trust that is a connected person in relation to the natural person. In this manner, the preference shares would not constitute a "*loan, advance or credit*" as envisaged in section 7C of the Act thereby circumventing the relevant provisions. As a result, the Minister announced in the Budget that in order to curb this new form of abuse, further rules preventing tax avoidance through the use of trusts would be introduced.

Given the proposal it is clear that the utilisation of trusts for estate planning and other purposes will remain under the microscope with particular reference to implementing various schemes aimed at utilising such trusts for purposes of shielding growth assets.

Jerome Brink

VALUE-ADDED TAX

Despite much speculation regarding another increase in the VAT rate, it was announced that the VAT rate would remain unchanged. This is on the basis that a further increase in the VAT rate would not be possible without significant relief measures, either in the form of further zero-rated supplies or increased social grants to poor households at the same time as any increase. No further significant VAT amendments were announced.

VAT on electronic services: Telecommunication services

Revised regulations to prescribe and clarify the electronic services (e-services) supplied by foreign suppliers to South African consumers which are subject to VAT were proposed in 2018 which significantly broadened the scope of "*e-services*". The Minister, in the 2019 Budget Review, then announced that further amendments would be made to the e-services regulations to address certain oversights. The revised regulations came into effect on 1 April 2019.

The revised regulations define "*telecommunication services*" with reference to the Electronic Communications and Transactions Act 25 of 2002 (ECTA). The term "*telecommunication services*" is, however, not explicitly defined in the ECTA.

It is proposed that further changes will be made to the e-services regulations to address this issue.

Reviewing of VAT accounting basis for intermediaries of e-service providers

Foreign e-service providers are entitled to account for VAT on the payments basis. In certain instances, certain supplies made by e-service providers are deemed to be made by an intermediary, who is then required to levy and account for VAT on these supplies.

It is proposed that amendments be made to the Value-Added Tax Act 89 of 1991 (VAT Act) allowing an intermediary to also account for VAT on the payments basis in these instances.

Changing the VAT treatment of transactions under the corporate reorganisation rules

In line with the corporate rollover relief afforded to group companies in the Income Tax Act, the VAT Act provides relief for group companies by deeming the supplier and the recipient for purposes of that supply or subsequent supplies, to be one and the same person. No VAT needs to be accounted for by the supplier or recipient on these supplies.

The corporate rollover relief may, however, not apply to certain of the business assets being transferred. In this instance, the VAT relief under section 8(25) will then also not apply. Reliance on the corporate rollover provisions automatically requires section 8(25) of the VAT Act to apply. VAT relief will therefore not be available notwithstanding that the transfer of the business may have qualified for VAT relief under the going concern provisions in section 11(1)(e) of the VAT Act.

VALUE-ADDED TAX...continued

It follows that in certain instances, where the transfer of a business does not qualify for rollover relief, a vendor will not be able to rely on section 8(25) or section 11(1)(e) of the VAT Act for relief, notwithstanding the vendor's intention that the entire business will be transferred. It is proposed that amendments be made to section 8(25) of the VAT Act to address this issue.

Section 72 arrangements and decisions

Section 72 of the VAT Act allows the Commissioner in certain circumstances where "*difficulties, anomalies or incongruities*" have arisen, the discretion to disregard the provisions of the VAT Act, and to make arrangements or decisions as to the application of the provisions of the VAT Act, provided that the ultimate VAT liability was not affected.

In 2019, significant amendments were made to section 72 of the VAT Act dealing with the Commissioner's discretion to make such arrangements or decisions. The amendments to section 72 have had an impact on the validity of arrangements or decisions made prior to 21 July 2019 when the amendments took effect. It has been proposed that government will review decisions and arrangements made prior to 21 July 2019 to ascertain whether they should be discontinued or extended in line with the amendments made to section 72 of the VAT Act.

VAT treatment of irrecoverable debts

In terms of section 22(3) of the VAT Act, where a recipient vendor who accounts for VAT on an invoice basis, has claimed an input tax deduction in respect of an expense incurred, but then fails to pay the full consideration within twelve months of the due date for such payment, such vendor is required to account for output tax equal to the tax fraction of the outstanding debt in the next tax period after the expiry of the twelfth month.

Notwithstanding that section 22(3) currently provides for the time of supply in respect of irrecoverable debts, it has been expressed that there exists uncertainty regarding the value of supply of irrecoverable debts. It is therefore proposed that clarity be provided in the legislation to undress this certainty.

Measures to address undue VAT refunds on gold

Fraudulent VAT refunds relating to gold exports has been on the increase. These malpractices generally involve the import of coins, purchase of Krugerrands and illicit gold. It has been proposed that appropriate regulations be introduced to address these schemes.

Varusha Moodaley and Gerhard Badenhorst

CUSTOMS & EXCISE

Certain sections quoted from the Budget 2020 documents.

Excisable Products

As is the case each year, Government proposes an increase in duties and levies for excisable products in Schedule 1 Part 2A to the Customs and Excise Act 91 of 1964 (Customs Act).
Of relevance this year is the following:

- Tobacco and alcohol – an immediate increase in excise duties on alcohol and tobacco products by between 4,4% and 7,5%. Per example, the following:
  - **Malt beer:** Increase of 4,4% to R106,56 per litre absolute alcohol;
  - **Unfortified wine:** Increase of 4,4% to R4,39 per litre;
  - **Sparkling wine:** Increase of 6% to R14,36 per litre;
  - **Spirits:** Increase of 4,4% to R213,13 per litre absolute alcohol;
  - **Cigarettes:** Increase of 4,4% to R17,40 per 20 cigarettes;
  - **Cigars:** Increase of 7,5% to R96,45/23g; and
  - **Pipe tobacco:** Increase of 7,5% to R5,79/25g.
  - There will be no change to the excise duty on traditional African beer.

Environmental Taxes

- Motor vehicle emissions will increase as follows from 1 April 2020:
  - **Passenger cars:** To R120 gCO_2/km;
  - **Double cabs:** To R160 gCO_2/km; and
  - The threshold will be adjusted from 120 gCO_2/km to 95 gCO_2/km for passenger cars.
- Incandescent light bulbs: Increase from R8 to R10 from 1 April 2020.
- Plastic bag levy: Increase from 12c to 25c per bag from 1 April 2020.

Fuel Taxes

- Fuel taxes will increase as follows from 1 April 2020:
  - **General fuel levy:** Increase of 16c/litre; and
  - **Road Accident Fund levy:** Increase of 9c/litre.
- Schedule 1 Part 2A duties on fuel will remain as is.

Carbon Tax

- Increase by 5,6% to R127 per tonne of carbon dioxide equivalent.

General

- Government intends to start taxing heated tobacco products and electronic cigarettes as follows:
  - **Heated tobacco products:** A new category of tariff subheading will be introduced for these products in Schedule 1 Part 2A to the Customs Act, to be taxed at the rate of 75% of the cigarettes excise rate with immediate effect; and
  - **Electronic cigarettes:** Government intends to tax these products in 2021.
- Government intends to extend the current levy on plastic bags to all single-use plastics used for retail consumption, including plastic straws, utensils and packaging. Changes will be implemented in 2021.
- Concerns regarding duty-free shops operating within the country were noted by Government in the 2019 Budget. Government intends to review potential abuse in relation to duty-free purchases by diplomats. It may be proposed that SARS may disclose information in this regard to the Department of International Relations and Cooperation.

CUSTOMS & EXCISE...continued

- Government will consult with affected industries on the introduction of export taxes on scrap metal. The proposed export taxes are as follows:
    - **Ferrous metals:** R1,000 per tonne;
    - **Aluminium:** R3,000 per tonne;
    - **Red metals:** R8,426 per tonne; and
    - **Other waste and scrap metals:** R1,000 per tonne.

Consultation in this regard is expected to be concluded by end May 2020.

- Government proposes an amendment to the Customs Act to provide for publication of tariff determinations and rules regarding:
    - circumstances under which these publications will be permitted;
    - the kinds of information that may be published; and
    - the manner of publication.
- Stakeholders complained in relation to the difficulty in cessation of liability of import duties of the master, pilot or carrier of imported goods due to various factors. It is proposed that the Customs Act be amended to allow licensed removers of goods in bond to move containerised cargo from container terminals before they are released by customs. It is also proposed that the licensed removers be held liable from receipt of the cargo until delivery.

Petr Erasmus

THE TIME HAS ARRIVED – PROPOSED MODERNISATION OF SOUTH AFRICA'S EXCHANGE CONTROL REGIME

For a long time, South Africa's exchange control (Excon) regime has been viewed as cumbersome, onerous and greatly complicating the transfer of funds abroad. This sentiment is captured in the following statement in the Budget:

"Since 1933, South Africa has operated a "negative list" system. By default, foreign-currency transactions are prohibited, except for those listed in the Currency and Exchanges Manual. As a result, even small individual transactions – such as for travel – require onerous approval processes. This regime constrains trade and cross-border flows, particularly in relation to fast-growing African economies."

National Treasury proposes modernising the foreign exchange system, that is, the Excon regime. Over the next 12 months, a new capital flow management system will be put in place. All foreign-currency transactions will be allowed, except for a risk-based list of capital flow measures. This change will increase transparency, reduce burdensome and unnecessary administrative approvals, and promote certainty. The risk-based list of capital flow measures, includes the following:

- South African corporates will not be allowed to shift their primary domicile, except under exceptional circumstances approved by the Minister.
- Approval conditions granted by the Minister for corporates with a primary listing offshore, including dual-listed structures, will be aligned to the current foreign direct investment criteria and/or conditions to level the playing field.
- Cross-border foreign-exchange activities will continue to be conducted through dealers authorised and regulated by the SARB.
- Prudential limits on South African banks and institutional investors will remain, but the limits will be reviewed regularly.
- Banks' unhedged foreign-currency exposures will remain limited to 10% of liabilities (known as the net open foreign exchange position) and will remain regulated by the Prudential Authority of the SARB.
- The domestic treasury management company policy, which allows South African companies to establish one subsidiary as a holding company for African and offshore operations without being subject to exchange control restrictions, will remain in place, as will the international headquarter company regime.
- The export of intellectual property for fair value to non-related parties will not be subject to approval.
- The current policy of certain loop structures, which relates to the acquisition by private individuals of equity and/or voting rights in a foreign company, will remain until tax amendments are implemented to address the risks. The proposed tax amendments in this regard are discussed in an earlier article in our Budget Alert.

There are also proposed changes regarding the Excon rules applicable to individuals. Following reforms to the income tax treatment of South African tax residents who receive remuneration abroad (see amendments to section 10(1)(o) of the Income Tax Act), government proposes to remove the rules regarding the Excon treatment for individuals. Rather, it aims to strengthen the rules regarding tax treatment. The intention is to allow individuals who work abroad more flexibility, provided funds are legitimately sourced and the individual is in good standing with SARS. Individuals who transfer more than R10 million offshore, which is what is currently allowed under the foreign investment allowance, will be subjected to a more

THE TIME HAS ARRIVED – PROPOSED MODERNISATION OF SOUTH AFRICA'S EXCHANGE CONTROL REGIME...continued

stringent verification process. Such transfers will also trigger a risk management test that will include certification of tax status and the source of funds, and assurance that the individual complies with anti-money laundering and countering terror financing requirements prescribed in the Financial Intelligence Centre Act (2001). This will be phased in by 1 March 2021.

Furthermore, under the new system natural person emigrants and natural person residents will be treated identically. Additional restrictions on emigrants, such as the restrictions on emigrants being allowed to invest, and the requirement to only operate blocked accounts are being repealed. The concept of emigration as recognised by the SARB will be phased out and replaced by a verification process. Tax residency for individuals will continue to be determined by the ordinarily resident and physically present tests as set out in the Act.

The proposed modernisation will likely be welcomed by South Africans living both locally and abroad as well as by the South African business community. It is likely that in the coming days, weeks and months, the SARB will issue further circulars and provide further information dealing with the various changes.

Louis Botha

OUR TEAM

For more information about our Tax & 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

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

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

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

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

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

Louise Kotze
Associate
T +27 (0)11 562 1077
E louise.Kotze@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 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.

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

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

CLIFFE DEKKER HOFMEYR