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TAX & EXCHANGE CONTROL **ALERT**

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- restrict the ability to offset an assessed loss carried forward against taxable income arising in a year.

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Reducing the headline corporate tax rate and broadening the corporate tax base: Where do we stand now?

The overriding purpose of these proposed changes was always framed as a means to allow South Africa some leeway to reduce its headline corporate tax rate, which has been out of sync for some time now with the global trend that has seen significant reductions in the rates of tax imposed on corporates by almost all of South Africa's major trading partners.

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In this article we revisit these proposals with an emphasis on recent developments in the final Taxation Laws Amendment Bill issued on 10 November 2021 (Final 2021 Bill).

Strengthen the rules that limit a tax deduction of interest paid to tax exempt persons

The rules that limit the tax deductibility of interest paid to tax exempt persons are encapsulated in section 23M of the Income Tax Act 58 of 1962 (ITA) and first became effective for interest incurred on or after 1 January 2015. In order to strengthen the application of these rules (i.e. to increase the amount of "*interest*" that does not qualify for a tax deduction) the Draft 2021 Bill included proposed amendments to section 23M to:

- broaden the definition of interest for purposes of these rules to include payments made under interest rate swap agreements, the finance cost element of finance leases, and foreign exchange differences;
- introduce a fixed ratio limitation of 30% of adjusted taxable income, which is essentially a form of earnings before interest, taxes, depreciation, and amortization for purposes of the rules in section 23M of the ITA;

Reducing the headline corporate tax rate and broadening the corporate tax base: Where do we stand now?

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The overall aim of this proposal, being to provide some leeway for a reduction in the headline corporate tax, is generally appreciated by the tax paying public but concerns were raised that the timing of this restriction may be unfortunate.

- curb the circumvention of the rules by using back-to-back loans; and
- ensure that the rules apply to some extent even if the interest is subject to interest withholding tax in South Africa.

Under the current regime section 23M will not apply where the interest is subject to any amount of withholding tax in South Africa.

These proposals elicited many comments from corporates, tax professionals, and associations/bodies countrywide, particularly in relation to the first and last proposals listed above. The comments made have for the most part seemingly been rejected by the National Treasury as the only meaningful relaxation of the proposed amendments is the carve-out of interest that is already subject to the hybrid debt rules.

Corporate taxpayers are thus advised to revisit the application of section 23M to interest paid when the revised rules become effective, which is linked to the date from which a reduced headline corporate tax rate will apply to the relevant company.

Strangely, the fact that the application of these revised rules will only come into effect when the headline corporate tax rate is reduced is positioned as a concession of sorts, but this was always the intention. What is perhaps implicit in this message is that the headline corporate tax rate will not be reduced next year as announced in the 2021 Budget Speech.

Restricting the ability to offset an assessed loss carried forward against taxable income arising in a year

The ITA currently allows corporate taxpayers to carry forward an assessed loss indefinitely with the only requirement being that it should continue to trade. However, the Draft 2021 Bill proposed that this be restricted for tax years commencing on or after 1 April 2022 to the effect that only 80% of taxable income arising in a year can be offset by an assessed loss.

To illustrate, if Company A has an assessed loss of R2,000,000 carried forward and makes taxable income of R1,100,000 in the year then, in terms of the proposed restriction, only R880,000 (80% of R1,100,000) of that income can be offset by the assessed loss. Company A will then pay tax on R220,000 and will carry forward an assessed loss of R1,120,000 to the following tax year.

The overall aim of this proposal, being to provide some leeway for a reduction in the headline corporate tax, is generally appreciated by the tax paying public but concerns were raised that the timing of this restriction may be unfortunate as it will likely burden many businesses still trying to recover from the effects of the COVID-19 pandemic. These concerns were acknowledged, and a concession has thus been made to introduce a de minimis threshold before the restriction applies. In terms of the Final 2021 Bill then a company can offset the higher of R1,000,000 or 80% of taxable income by an assessed loss.

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The fact that effective date of the revised rules will ultimately be linked to the same date that a reduced headline corporate tax rate applies was again positioned as a concession here, but this was always the intention.

Applying this *de minimis* threshold to the example above, Company A can offset the higher of R1,000,000 or R880,000 (80% of R1,100,000) by the assessed loss of R2,000,000. Company A will then pay tax on R100,000 and will carry forward an assessed loss of R1,000,000 to the following tax year.

Finally, the fact that effective date of the revised rules will ultimately be linked to the same date that a reduced headline corporate tax rate applies was again positioned as a concession here, but this was always the intention. This again implies that a reduction of South Africa's headline corporate tax rate will not occur next year. as promised by the Minister of Finance in this year's Budget Speech and, while this may help to settle some accounting scores regarding whether a rate change should have been applied for deferred tax purposes, South Africa's high corporate tax rate arguably remains a deterrent for investors and out of sync with global trends.

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The end of taxpayer confidentiality? Gauteng Division hands down potentially groundbreaking judgment

The judgment will undoubtedly be the subject of debate for many months to come, but in this article, we will briefly discuss the court's analysis of the relevant TAA provisions regarding taxpayer confidentiality and some of the practical implications of the judgment for taxpayers.

On 16 November 2021, the Gauteng Division of the High Court, Pretoria handed down a potentially groundbreaking judgment in the matter of *Arena Holdings (Pty) Ltd t/a Financial Mail and Others v South African Revenue Service and Others* (Case No 88359/2019) (unofficial citation and as yet unreported), pertaining to taxpayer information confidentiality.

The court held, amongst other things, that sections 67 and 69 of the Tax Administration Act, 28 of 2011 (TAA) are unconstitutional and invalid to the extent that:

- they preclude access to information being granted to a requester in respect of a tax record in circumstances where the requirements set out in subsections 46(a) and (b) of the Promotion of Access to Information Act, 2 of 2000 (PAIA) are met; and
- they preclude a requester from further disseminating information obtained as a result of a PAIA request.

The judgment will undoubtedly be the subject of debate for many months to come, but in this article, we will briefly discuss the court's analysis of the relevant TAA provisions regarding taxpayer confidentiality and some of the practical implications of the judgment for taxpayers.

Facts

- The applicants' case was generated by the requests for access to the IT12 documents (tax returns) relating to Mr Jacob Zuma, for the years that he was President of South Africa.
- The applicants relied on the averments extracted from a book published in October 2017, titled The President's Keepers and written by Jacques Pauw.
- The averments relied on by the applicants in their papers regarding Mr Zuma's tax affairs during his presidency are the following:
  - that Mr Zuma did not submit tax returns at all for the first seven years of his presidency;
  - that he owed millions of rand in tax for the fringe benefits he received because of the so-called security upgrades to his Nkandla residence;
  - that he received various donations from illicit sources - alleged to be tobacco smugglers, Russian oligarchs and the Gupta family:
  - that he had drawn a six-figure 'salary' as an 'employee' of a Durban security company for the first few months of his Presidency (it appears that he had subsequently paid the money back in response to queries);
  - that Mr Zuma had appointed Mr Tom Moyane as the SARS Commissioner to undermine the institution's enforcement capability and to prevent it from prosecuting Mr Zuma for non-payment of taxes and other financial malfeasance, and from investigating people linked to him; and
  - that it was not clear whether Mr Zuma was tax-compliant at the time of publication and that it was probable that SARS was not taking steps to extract the tax he owed.

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The court held that SARS' argument that without taxpayer secrecy, tax administration cannot properly function, is not a universal truth.

- Based on these allegations, some of which are confirmed or corroborated by the findings of the Nugent Commission, the applicants aver that "*credible evidence*" exists that Mr Zuma was not tax-compliant while he was president.
- In SARS' opposing affidavits and in arguments presented on its behalf, it pleaded "*agnostic*" to the tax affairs of former President Zuma, based on its obligations not to disclose the tax affairs of any taxpayer in terms of section 69 of the TAA and in circumstances as the present.
- The applicants argue that the tax compliance of South African head of state, where accusations of non-compliance are in the public domain entitle them to invoke their rights of access to information and if those rights are statutorily limited, to challenge the constitutionality of those limitations.

Judgment

- The court held that SARS' argument that without taxpayer secrecy, tax administration cannot properly function, is not a universal truth.
- The court noted that the expert research relied on by the parties reflected that in those tax regimes where there is less taxpayer secrecy, tax administration is neither hampered nor prevented thereby.
- The court referred to various academic writings which in its view, cast some doubt on SARS' assertion that voluntary compliance, at least as far as disclosure goes, is dependent on the secrecy "*compact*" written in law.
- In the court's view, there is no direct or factual evidence that taxpayers in South Africa rather make disclosure of their affairs because of the secrecy provisions as opposed to the coercion of the penalties and sanctions which follow upon disclosure.
- In light of the applicants' arguments that the "*public override*" requirements in section 46 of PAIA should apply to taxpayer confidentiality, where there is reason to believe that the disclosure of the taxpayer information would reveal evidence or failure to comply with the law, the court considered the constitutionality of sections 67 and 69 of the TAA.
- In considering the constitutionality of sections 67 and 69 of the TAA, the court considered whether these sections infringed on the rights of access to information and freedom of expression, in sections 32 and 16 of the Constitution of the Republic of South Africa, 1996 (Constitution). In doing so, it also considered whether the limitation of these rights was justifiable in light of section 36 of the Constitution.
- After undertaking this analysis, the court held that the limit imposed by the absolute taxpayer secrecy on the rights to freedom of speech and access to information, was not justifiable in the circumstances.
- In other words, it held that the TAA needed to include a public interest override provision.

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If the order of constitutionality is ultimately confirmed by the Constitutional Court in its current form, it is important that taxpayers understand what the potential impact will be on them.

Comment

Firstly, the court appears to have interpreted the confidentiality provisions in the TAA as prescribing an absolute bar to the disclosure of taxpayer information. In providing the backdrop and context against which the judgment is given, the court referred to numerous provisions in the TAA, but only made mention of parts of section 69. If one considers sections 69(1) and (2) of the TAA, there is a general bar to disclosure of confidential taxpayer information, subject to certain exceptions. One of these exceptions is that disclosure of taxpayer information is not prohibited where the disclosure is ordered by the High Court. Furthermore, section 69(5) then states that the court may only grant the order if it is satisfied that specific circumstances apply. Section 69(4) of the TAA also mentions that SARS may oppose an application for disclosure on the basis that it may seriously prejudice the taxpayer concerned or impair a civil or criminal tax investigation by SARS. It is slightly strange that in its limitations analysis, the court did not consider these subsections in the TAA that provide for disclosure if certain requirements are met, in greater detail. Had it considered these provisions, the extent of the finding on constitutionality might have potentially been different.

Secondly, one must appreciate the potential effect of altering the taxpayer information confidentiality provisions as they currently stand. While the court did not agree with SARS' arguments as to why there should not be a public interest exception to confidentiality, one can appreciate that if taxpayer information was generally available and more easily accessible by persons other than the taxpayer, taxpayers would justifiably be concerned that their personal tax information could appear in the public domain. Therefore, if the order of constitutionality is ultimately confirmed by the Constitutional Court in its current form, it is important that taxpayers understand what the potential impact will be on them.

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