Standing Committee on Finance
Parliament of the Republic of South Africa

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RE: 2017 DRAFT TAXATION LAWS AMENDMENT BILL (TLAB) AND DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL: COMMENTS PERTAINING TO KEY TAX ISSUES

We have attached the comments from the SAIT Business Tax Work Group on the 2017 draft Taxation Laws Amendment Bill pertaining to select key tax issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Yours sincerely

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PERSONAL TAX ISSUES

A. Repeal of foreign employment income exemption

Proposed amendment

It is proposed that the current section 10(1)(o)(ii) exemption be repealed. As a result, all South African tax residents will be subject to tax on foreign employment income earned in respect of services rendered outside South Africa with relief from foreign taxes paid on the income under section 6quat of the Act.

Problem identified and suggested solution

1. Problem identified: The effect of the repeal of the exemption on business in South Africa has not been analysed. The direct cost of the increased tax burden that will have to be carried by employers as a result of the repeal is likely to have a significant impact on their bottom line. Particular concerns are possible retrenchments, the continued competitiveness of South African business in the continent, and of South Africa as the ‘Gateway to Africa’.

Suggested solution: It is proposed that the repeal of the exemption be postponed until an economic analysis can be done on the potential effect on business, the labour market, and the economy of the country.

Note that these points have been discussed in more detail in the 15 May 2017 collaborative submission by Deloitte, EY, KPMG, PwC, SAICA and SAIT to National Treasury on Foreign Remuneration Exemption.
We further note that our experience indicates a widespread hostility to the proposed repeal of the exemption as suggested. Employers and employees are very upset about the potential added costs, risks and compliance burden involved. As you are aware, many expatriates have been signing a petition and voicing their opposition in various media platforms. We also expect a number of foreign-located individuals to emigrate if the exit charge is not too significant. There is also an indication that the proposed repeal is negatively impacting the question of business making use of South Africa as a ‘Gateway to Africa’ in structuring their group activities.

2. **Problem identified:** The tax credit system is complex and difficult to negotiate. We say this based on difficulties and time delays experienced by individuals who do not qualify for the exemption (such as contractors and short-term assignees) and who has to make use of the credit system. It is particularly difficult to provide sufficient proof of foreign taxes having been paid, especially in cases where certain self-assessment taxes do not require any assessment from the revenue authorities and the only proof that the individual would have of taxes having been paid would be their foreign tax return. The loss due to the cash flow and the administrative cost will have a profound effect on business should the tax credit system not run smoothly.

**Suggested solution:** It is proposed that the repeal of the exemption be postponed until the regulations required to regulate the tax credit system have been negotiated, promulgated, and implemented by SARS.

3. **Problem identified:** There is no mechanism in our employees’ tax (PAYE) legislation to take foreign payroll withholding taxes into account to reduce the amount of PAYE to be withheld and paid over to SARS on a monthly basis. The effect could, therefore, be that the South African employer is obliged to withhold PAYE in both South Africa and the foreign jurisdiction on the same remuneration throughout most of the year until assessment. The cash flow hardship for employees who work in foreign jurisdictions where the tax rates are not low could accordingly be severe. For example, if the income tax rate in the foreign jurisdiction is say 30%, the combined
PAYE could be as high as 75% during the year. Taxpayers would then be required to seek refunds at year-end to reduce this double tax burden.

**Suggested solution:** It is proposed that the repeal of the exemption should not go ahead without a monthly tax credit mechanism against the South African PAYE. Special arrangements will also be required for the payroll system operates in a foreign location.
BUSINESS TAX ISSUES

A. SHARE BUY-BACKS AND DIVIDEND STRIPPING ANTI-AVOIDANCE RULES (Proposed substitution of section 22B / Paragraph 43A)

1. Treasury proposal

The proposed amendment rightly seeks to end the current mischief associated with a growing number of subsidiary shares sales by parent companies. It is well-known that many parent companies no longer simply sell shares in a controlled subsidiary but instead become entangled in share buy-backs and similar schemes. All of these schemes seek to artificially convert capital gains upon the sale of shares into tax-free dividends wherein the sale is disguised in a different form.

The proposed substitution of section 22B and paragraph 43A seeks to broaden the application of the current anti-avoidance rules via a much more blunt approach. Under the revised rules, any dividend preceding the sale of subsidiary shares triggers an increase in capital gain upon the disposal of the shares. The dividend need not be directly or indirectly funded by the purchaser.

2. Problem #1: Over-Taxation of Ordinary Dividends

a. Background

We note that the real abuse of dividends preceding the sale of shares arises only where the dividend is directly or indirectly funded by the purchaser. However, we understand that the tracing of funds to dividends may be impractical for SARS.
That said, we still suggest that the new anti-avoidance rules be narrowed to exclude wholly innocent transactions.

- Firstly, many sales of subsidiary shares are preceded by normal dividends wholly unrelated to the sale. In this vein, we suggest that the new anti-avoidance rules be limited to extraordinary dividends (see paragraph 19 of the 8th Schedule).

- Secondly, dividends may come in the form of reorganisations (e.g. unbundling and liquidations). For instance, assume Parent Company holds all of the shares of Sub 1 and Sub 1 owns all the shares of Sub 2. Sub 1 may unbundle Sub 2 (as an unwanted asset by the purchaser). Parent could then fall foul of the new anti-avoidance rule if Parent Company sells the shares of Sub 1.

- Thirdly, the proposed rules fail to account for certain indirect group sales that are wholly innocent. For instance, assume Parent Company owns all of the shares of Sub 1, which in turn owns all of the shares of Sub 2. Sub 1 sells all of the shares of Sub 2. After the sale of Sub 2, Sub 1 distributes the proceeds of Sub 2 to Parent Company by way of dividend. Under this scenario, the new anti-avoidance rule applies the language that links the sale of Sub 2 shares to the dividend by Sub 1 (whereas the intention is only to target dividends by Sub 2 if shares of Sub 2 are sold).

Examples of normal dividends preceding a share sale:

i. Listed companies often pay regular dividends to the listed shareholders, which are often funded from dividends via lower-tier subsidiaries. These lower-tier subsidiaries could easily distribute dividends in the normal course before the listed group decided to sell the lower-tier subsidiary.

ii. Many unlisted companies are often forced to distribute regular dividends as part of their BEE shareholder commitments, which are often funded by lower-tier subsidiaries.
iii. Preference shares regularly generate dividends without regard to the timing of sale. These normal preference dividends may typically occur annually, six-monthly or quarterly. Preference dividends could also be accumulated and paid upon redemption (a disposal).

b. Suggested solution

The proposed anti-avoidance rules should not apply to dividends occurring within the ordinary course. A carve-out of this nature could possibly be based on paragraph 19, which only applies to extra-ordinary dividends (i.e. dividends falling 15 per cent above total sale proceeds). The schemes of concern are only effective if the dividend amounts are extra-ordinary in any event. As a practical matter, these dividends usually result in a negative reserve (or would dip into capital under old company law).

We also note that note that certain forms of dividends should be wholly excluded. The rule was primarily aimed at cash dividends. Yet, the word “dividend” could include a section 46 unbundling distribution or other tax-free reorganisation distribution, such as a distribution falling under the intra-group rules of section 45 (the latter of which has a whole series of claw-back rules to prevent disguised exits from the group).

Funding preference shares that are redeemed or disposed of at face value plus accumulated dividends should also be excluded as it would be inappropriate to recharacterize the coupon on the preference shares as additional proceeds on their disposal.

3. Problem #2 – Concerns About the Ownership Test

a. Background

The proposed legislation is triggered when the selling company and the target company to be sold have either a 50 per cent ownership connection, or the selling company has a mere 20 per cent share interest in the target when no other person holds the majority. We are
concerned that this level of ownership is becoming far too low as an objective avoidance standard.

It must be stated at the outset that the vast majority of abusive transactions involve the sale of shares of a wholly owned subsidiary. Perhaps, a significant minority of shares sales may involve target subsidiaries involved a 70-per cent level of ownership (with black economic empowerment partners owning only 30 per cent). While SARS may be aware of handful of transactions falling below this level, we question whether Treasury should adopt objective legislation that targets this handful when this lower-threshold will most likely pick up a larger set of wholly innocent transactions where the dividend and sale are tied by mere happenstance.

b. **Suggested solution**

The ownership trigger should be retained at the current level of more than 50 per cent. If Government would like to take the matter slightly further, one could perhaps rely on the connected person test of section 1, which would additionally cover minority shareholders of 20 per cent where no majority shareholder exists.

We also point out that this reduction in percentages is becoming problematic in terms of other anti-avoidance provisions, such as section 23M (which also uses a 50 per cent threshold). Section 23M was designed to limit the interest deduction of debt owed by a South African subsidiary to a foreign parent. The concern is that the foreign parent chooses debt in lieu of equity because interest payments to the parent are deductible whereas dividend payments are not (i.e. a classic base erosion profit shifting concern). Nonetheless, this indifference exists only when the foreign parent has 100 per cent control of the subsidiary or the minority shareholders are inconsequential. Debt has a real economic consequence to real minority shareholders.
The net effect of section 23M has been to adversely impact genuine 50 / 50 joint ventures. The most notable being a sizeable real estate joint venture in Cape Town that is 50 per cent owned by the Public Investment Corporation. We accordingly again ask for relief in this area (with the test being moved to a “more than 50 per cent” test (and preferably a group test).

4. Simple Share Buybacks, Redemptions and Liquidations

a. Background

The proposed anti-avoidance legislation is triggered via two sets of timing rules. The dividend must either be 18 months “prior to” the share disposal. Alternatively, the dividend must be “in respect of, by reason of or in consequence of” that disposal without regard to time.

b. Share buybacks, redemptions and liquidations 18 months prior to disposal

We note that every buy-back and redemption technically involves both a distribution and a disposal of the shares. The distribution portion typically occurs at the same time as the share disposal. One would accordingly assume that a straight buy-back or redemption of this kind would not implicate the anti-avoidance rules because the dividend does not occur “prior to” the disposal. That said, we believe this fact must be confirmed as a matter of company law and the tax law should be clarified accordingly (at least by way of explanatory memorandum).

We further note that liquidations will most likely give rise to unintended difficulties. In most liquidations, one or multiple distributions will most likely occur “prior to” the actual final withdrawal of the shares. We believe this answer is in error, however, because there is no outside party seeking to acquire the shares. Therefore, we suggest that liquidations be wholly excluded from the anti-avoidance rule.
c. Share buybacks, redemptions and liquidations in respect of, by reason or in consequence of the disposal

The second timing test presents a much bigger problem in terms of share buybacks, redemptions and liquidations. All of these distributions occur in respect of, by reason of or in consequence of the share disposal. We therefore suggest that this second timing rule be dropped or possibly that the dividend must be in respect of a different set of shares than the shares disposed of.

B. CLOSING CONTRIBUTED TAX CAPITAL SCHEMES INVOLVING FOREIGN-OWNED SOUTH AFRICAN SUBSIDIARIES (Section 8G)

1. Treasury proposal

Section 8G disallow the artificial creation of contributed tax capital of a South African subsidiary where: (i) the shares of that South African subsidiary are initially owned by a foreign company, and (ii) a Newco Holdco (another South African company) is interposed between the foreign company and the South African subsidiary. The key point is that the foreign company transfers the shares of the South African company to the Newco Holdco by way of a taxable asset-for-share transfer. The net result is that the foreign company obtains a fair market value amount of contributed tax capital in the Newco Holdco without tax (because foreign persons are not generally subject to capital gains tax on shares).

Once the foreign company has a market value contributed tax capital in Newco Holdco, this newly created contributed tax capital is used as a basis for withdrawing South African subsidiary funds in a tax-free manner. More specifically, the South African subsidiary distributes dividends to Newco Holdco because both are South African companies. Newco Holdco then makes a capital distribution to the foreign company. This capital distribution is then tax-free to the extent of the market value of the contributed tax capital because capital distributions either reduce the base cost in the Newco Holdco on a tax-free basis or give rise to non-taxable capital gain (because foreign persons are generally free from capital gains tax).
The proposed rules essentially reduce the contributed tax capital in the Newco Holdco to eliminate the avoidance of concern. It is intended that the contributed tax capital instead mirror the contributed tax capital of the pre-existing South African subsidiary.

2. Problem #1 – Section 42 Transfers

a. Background

The above anti-avoidance rule presumes that the foreign company obtains an uplifted market value amount of contributed tax capital in Newco Holdco based on the general rules for contributed tax capital. However, this fair market value amount will not exist if the transfer occurs via section 42 because section 42 would only result in a carry-over contributed tax capital based on the tax attributes of the foreign company’s holdings in the pre-existing South African subsidiary shares.

b. Suggested solution

The proposed anti-avoidance rule should not apply if the Newco Holdco has obtained contributed tax capital by way of section 42 or other reorganisation transaction as long as the contributed tax capital is based on a carry-over determination. The abuse concern exists only where the contributed tax capital stems from the market value of group company shares contributed to the Newco Holdco.
3. Problem #2 – Unintended Wording

The proposed wording may have the unintended impact of applying when a new foreign company simply purchases South African holding company shares of a South African group subsidiary from another independent company. In cases of this kind, the purchase has no effect on the pre-existing contributed tax capital of the South African holding company. Yet, if one reads the proposed words carefully, the new anti-avoidance seemingly applies.

In particular, the foreign purchaser is using “consideration” to acquire the shares of the South African Newco Holdco and this “consideration” “is used directly or indirectly to acquire any shares of the South African group subsidiary” (as pronounced under proposed section 8G(2)). We do not believe that National Treasury intended to strike at simple cash purchases of this kind. The term “indirect” was more likely aimed at share-for-share transactions involving the contribution of a holding company higher up the chain.

C. GENERAL NARROWING OF CURRENT DEBT RELIEF MECHANISMS

1. Background (current law)

Under current law, the cancellation of debt of a debtor is viewed as either capital gain or ordinary revenue for the debtor because the debtor is enriched by the debt relief (as if the debtor received cash proceeds). While this taxable result is correct as a matter of pure tax policy theory, paragraph 12A of the 8th Schedule and section 19 were enacted to provide partial relief from this immediate tax charge in order to facilitate various forms of business rescue and debt workouts. Government was concerned that the taxation of debt cancellations would simply mean that commercial debt would effectively return the debtor into insolvency if automatically subject to a new tax debt charge. Both provisions provide this relief by allowing the debtor to offset potential capital gain / ordinary income via a one-for-one substitution of capital gain / ordinary revenue tax attributes.

We further note that two other mechanisms currently exist that provide an even greater set of relief. The first relief mechanism is the wholesale exemption of capital gain when debt cancellations involved group
members. The second (more informal) relief mechanism applies when an indebted company issues its own shares to a creditor in cancellation of debt. Both these mechanisms (and the attribute reduction rules described under paragraph 12A of the 8th Schedule and section 19) are consistent features of the tax debt cancellation landscape found in other jurisdictions. All these mechanisms mitigate adverse tax charges otherwise resulting for a debtor when debt is cancelled.

2. Policy Objections

Despite the explanatory memorandum discussion to the contrary, the proposed amendments essentially eviscerate the current system of group relief as well as the existing relief for share-for-debt transactions. The new dormant company rule is then suggested in the explanatory memorandum as a generous replacement when, in fact, debt of a dormant company is in-consequential by comparison to the mechanisms lost. We also note that the new dormant company debt relief mechanism is so laden with burdensome requirements as to have essentially no practical application at all.

a. Point #1 – Economics over Tax Purity

As an economic policy matter, one would think that National Treasury would be assisting distressed debtors during this period of economic distress. Many distressed companies need to be assisted when creditors provide debt relief in order to retain the debtor’s long-term viability. Indeed, we understood that National Treasury was previously examining the possibility of extending the mechanisms for debtor relief further based on this practical understanding of the current economic landscape. The proposed amendments essentially go in the opposite direction. Purist tax theory should not be placed as a higher priority than weathering the current period of economic turbulence. More importantly for SARS, relief for distressed business means greater tax revenue for the longer-term future.
b. **Point #2 – Intra-Group Debt Relief is Sound Tax Policy**

The lack of taxation when cancelling debt amongst group companies represents sound and tested tax policy. Pure cancellation of debt between group companies essentially represents cash capital contributions within the group. Intra-group cash contributions have no adverse tax consequences whether transferred for shares or for no consideration at all. A group of companies represents a single economic unit, meaning that intra-group transfers receive deferral and intra-group dividends are exempt (even under the old Secondary Tax on Company regime ended many years ago).

We also note that intra-group debt cancellation of underlying debt capital are essentially neutral for the fiscus. The initial creation of the debt has no consequence for the creditor or debtor (see the well-known Genn decision). While cancellation of debt outside the group context does indeed trigger capital gain / revenue, the same cancellation generally triggers a similar loss for the creditor. Group relief means that the cancellation of gain for the debtor is matched by denial of the loss for the creditor, thereby retaining tax neutrality.

c. **Point #3 – Relief for Shares Issued in Exchange for Debt is also Sound Tax Policy**

Debt cancellation should only potentially give rise to adverse tax consequences for a debtor when the consideration for the debt cancelled falls below the amount cancelled. Even though SARS may view the issue of new shares as having no value, this perception is in error from a commercial vantage point. Banks and other creditors often surrender their creditor rights in debt owing to a company for that company’s shares as a key mechanism for mitigating their potential loss on the underlying debt. This conversion is the essential ingredient of many debt rescue packages, where the creditor takes control over the debtor, restructures the indebted company and then sells the shares of the revitalised company as an offset against the losses stemming from the debt previously cancelled. Many of these debt-for-share swaps are value-for-value exchanges.
Example – Facts: Company X is in a distress situation. Company X has gross assets (including goodwill) of R5 million. Company X also owes R4 million of debt, including R3 million owed to Bank. Even though Company X has a net value of R1 million, Company X is currently facing cash-flow insolvency due in part to the high level of monthly interest on debt owing. Bank and Company X accordingly enters into a rescue package to save Company X. Bank agrees to cancel R2 million of the debt in exchange for 2/3rds of the shares. Immediately after the debt-for-share swap. Company X has a value of R3 million (R5 million gross less R1 million of third party creditor debt and R1 million of bank debt). Bank holds R2 million shares worth of equity in Company X (i.e. 2/3rd of R3 million).

Outcome: All parties are neutral because R2 million of debt is cancelled for the issue of shares worth R2 million immediately after the swap. In tax terms, no debt cancellation gain / income should arise because an equal value of shares are issued in exchange. Bank should similarly incur no tax loss because an equal value of shares were received in exchange for the debt cancelled.

3. Share-for-Debt Avoidance of Concern (Section 19B)

a. Background

According to the explanatory memorandum, the main concern for SARS are value mismatches disguised through artificial subscription prices. More specifically, the explanatory memorandum states that:

“These structured arrangements involve a creditor that is an unrelated creditor subscribing for shares in the debtor company. The subscription price would be equal to the total amount of the borrower’s indebtedness to the creditor in spite of the market value of the shares of the borrower. This subscription price gets paid to the debtor in cash and the debtor then uses the cash to settle the capital of and the interest on the loan or debt. Soon after the payment is effected, the original shareholder of the debtor will buy the shares [of] the creditor. The
creditor will (if at all) only be subject to CGT on a very small gain in respect of the shares in the debt sold to the shareholder.”

We believe that this example is very helpful in understanding the concern. Given the above, it appears that the issue could be restated via the following example:

Example – Facts: Parent Company owns all of the shares of Subsidiary. Subsidiary has R8 million of assets and has liabilities of R15 million, of which R12 million is owed to Independent Bank. In order to eliminate much of this debt, Subsidiary issues a new set of shares to Independent Bank at a stated subscription price of R12 million. Subsidiary then uses the R12 million to fully pay of the bank. Bank subsequently sells the shares back to Parent Company.

Outcome: The value of the shares issues are worth far less than the subscription price. The value of Subsidiary is only worth R5 million (R8 million gross as assets less R3 million remaining debt) even after the Bank repayment. The concern for SARS is that the Bank effectively cancelled R12 million debt for share consideration of only R5 million.

In essence, the anti-avoidance rules of section 19B are seeking to ensure that the tax on the straight cancellation of debt are not circumvented via a share-for-debt swap, followed by an artificial full repayment of debt to the creditor.

b. Suggested solution

We believe that the share-for-debt mismatch can be eliminated without eviscerating the current system of group company relief. The real problem is that the share-for-debt swap of concern is not an equal value-for-value exchange and that the stated subscription price is not a proper reflection of value. Under example of the explanatory memorandum, the existence of group shareholder is irrelevant.

Given this mismatch, we would suggest the better remedy is to revise section 24BA and scrap the proposed section 19B in its entirety. Section 24BA is specifically designed to trigger tax when shares are issued for assets when the shares and assets are not of the same value. Tax
is triggered if the assets contributed exceed the value of the shares and if the share value exceeds the value of the assets.

We would accordingly suggest that section 24BA be extended to cover share mismatches involving debt (and even cash). Under this approach, share value that falls below the debt cancelled should trigger tax under section 24BA. The stated subscription price would be wholly disregarded. This excess should be treated as a gain for the company receiving the excess value (see section 24BA(3)(a)). Under debt rescue scenario’s, however, we would recommend that the shortfall of the share value under the debt cancelled should be used as a “reduction amount” and that the normal debt relief provisions in section 19 and paragraph 12A should apply.

4. Recoupment of interest associated with intra-group debt if paid with shares (section 19A)

a. **Background**

It is proposed that the conversion of debt to equity in a group scenario will not trigger the debt reduction rules, but will, effectively be accepted as a method of repayment of the debt (subject to point 3 above). The proposal is aimed at achieving the outcome that would have been achieved had the creditor originally funded the company by means of equity rather than a loan. It is, therefore, proposed that the interest claimed by the borrower should be recouped if the lender was not subject to income tax on the interest income. This could mean that even if the lender was subject to interest withholding tax, the interest would be recouped by the borrower.

b. **Suggested solution**

The provision should not apply if the interest is subject to cross-border withholding (after taking tax treaties into account) even though the foreign creditor is not subject to normal tax
on the interest. The withholding tax in many cases can exceed the taxable net income associated with the receipt / accrual of interest.

Where the interest deduction has contributed to assessed losses, which have subsequently been forfeited because the debtor has ceased trading, we are of the view that such losses should be available to shield the interest recoupment.

We also note that the timing of the group relationship in respect of the debt is unclear.

c. **Conclusion**

Cross-border debt recoupment oppressive and harsher than most jurisdictions:

   a. SA law is already too harsh vis-à-vis cross-border debt - both thin capitalisation (TP); section 23M and now this new amendment
   b. Unfairness of new regime - assumption is that all share issues are evil across the board when cross-border group

5. **New Dormant Company Rule (Section 19(8)(e) / Paragraph 12A(d)(6))**

   a. **Background**

   The proposed legislation seeks to provide specific relief for intra-group debt cancellations in the case of dormant debtor companies. For a company to be viewed as dormant, the company must not carry on a trade, have no receipts / accruals, have no assets and have no liability incurred or assumed. These activity limitations must remain in place for at least three years preceding the debt cancellation. This relief is the one new rule in favour of distressed companies seeking debt relief proposed by the Bill.
b. **Suggested solution**

The level of activity required to determine dormancy is excessive in practical terms. While we agree that the dormant company at issue should not be allowed to engage in a trade, dormant companies often have residual assets, liabilities, income and expense during the dormancy period after years of activity. These companies may hold a final set of difficult assets to sell, receive cash from unanticipated sources stemming from prior active years and frequently incur liabilities due to final legal, accounting and other administrative expenses associated with the final termination of the dormant company. For instance, the “dormant” company may continue to prepare Annual Financial Statements and Tax Returns and would maintain its company registration. Debtors may settle amounts owing to the company or the company may receive a tax refund.

Hence, the test for dormancy should only focus on the existence of a trade. Alternatively, final wind-down activities should simply be ignored.

6. **Debt Cancellations in the Case of Mining Companies (Section 36(7E))**

Please refer to our comments under Mining Tax below.

7. **Debt cancellation effective dates**

a. **Background**

Sections 19 and 19B as well as paragraph 12A of the 8th Schedule come into operation on 1 January 2018. No effective date is given for section 19A. These effective dates, however need further precision as to the actual trigger.
b. **Suggested solution**

We recommend that the provisions explicitly state that the amendments come into operation on 1 January 2018 and apply to the issue of shares, debt cancellation and other similar disposals on or after that date.

D. **FINANCIAL SECTOR CHANGES**

1. **Lack of Alignment to IFRS for Key Banking Transactions (Sections 11(jA) and 24J)**

a. **Background**

The proposed legislation makes significant changes to instruments held by banks. The proposed legislation removes the alternative method for calculating interest deductions under section 24J under the stated reason that South Africa no longer applies GAAP. The proposed legislation also provides objective rules for claiming deductible impairments on bank loans.

We believe these changes need to be reconsidered as a matter of tax policy and administration. As recognised by the explanatory memorandum, banks are highly regulated with IFRS accounting having a real impact on the calculations leading to those regulations (such as the bank solvency requirements). Therefore, IFRS accounting represents a true reflect of net economic income that lies at the core of the income tax system. It also anomalous for regulator reserves to be based on one set of calculations while tax is based on another. This form of incongruity was specifically eliminated for short-term insurers in terms of their reserves and lies at the heart of many of the tax changes regarding the derivatives held by banks.
b. **Suggest solution**

Our position is that the bank tax rules should generally follow IFRS for impairments and for the section 24J interest calculations. Reliance on IFRS is not something that be easily manipulated. Banks are listed companies wherein IFRS is utilised as the key measure for accounting to shareholders. More importantly, banks are highly regulated by the Reserve Bank and internationally in terms of their lending requirements, especially in terms of their solvency ratios. Again, IFRS is a key point of analysis for this regulation.

We understand that SARS may be reluctant to apply IFRS for impairments due to the potential loss of revenue. That said, these rules are about fairness and economic efficiency – not solely about raising revenue targets. We are also concerned that over-taxation of impaired loans may lead to a further aversion against risk-taking in terms of riskier loans because the banks won’t obtain an appropriate level of deductions for doubtful debts, thereby added to the cost of troubled loans.

c. **Non-Banking Financial Institutions**

We lastly note that many of the rules for formal banking institutions do not currently apply to other lenders, many of whom are also fairly regulated. These lenders would include licenced Financial Service Providers (FSP’s) who engage in the business of providing retail and commercial funding to customers (e.g. automotive finance companies). Query whether some of the financial instrument rules for banks could be extended to these non-bank lenders.
1. Section 9D: Extending the application of the CFC rules to foreign subsidiaries held by foreign trusts and foundations within an IFRS 10 Group

1.1 Proposed amendment

The proposed amendment seeks to overcome the use of foreign trusts and foundations as a means for artificially breaking the CFC status in relation to a foreign entity. In effect, the rules treat foreign subsidiaries as CFCs if those foreign subsidiaries would be part of a consolidated set of financial statements under IFRS 10. The tainted income of these foreign subsidiaries is allocable to “the holding company, as defined in the Companies Act, that is a resident”.

1.2 Problem identified

We fully understand the desire for National Treasury to pull foreign subsidiaries held through foreign trusts / foundations into the CFC net. We presume the situation of concern is where a South African parent company with multiple South African subsidiaries holds multiple foreign subsidiaries through a discretionary foreign trust / foundation. The discretionary nature of the foreign trust / foreign foundation allows for vesting to any one of the South African group members while leaving the economic group in effective control of all foreign subsidiary income. This discretion can technically be used to undermine the CFC regime for all South African multinational groups.

The problem with IFRS 10 is that consolidation is also very open-ended depending on the facts and circumstances. IFRS 10 technically requires an investor to consolidate in its financial statements in respect of any investee when the following attributes apply to the investor, namely:

- Power over the investee,
- Exposure or rights to variable returns to its involvement in the investee,
- The ability to use its power over the investee to effect the amount of the investors returns.
It also provides guidance on different situations, for example having power without having the majority voting rights i.e. de facto power or potential voting rights or agency relationships or relationships within entities designed so that voting rights are not a dominant factor to show control.

Given the above, the main difficulty with the IFRS 10 allocation lies in the precision needed for the section 9D(2) income allocation. The consolidation of the foreign company’s financial results as determined under IFRS 10 can easily become a clumsy method of determining the pro rata percentage participation rights held by a resident company as there are many variables involved in determining control under the IFRS 10 statement.

Furthermore, it is noted that IFRS 10 has a particular focus on the investment management industry, which does not translate neatly to the CFC legislation. It is also noted that IFRS 10 provides guidelines on how applicable consolidated financial statements should be prepared, but this does not always result in a set percentage of the financial results – the key variable required for a section 9D(2) proportional income allocation.

1.3 Suggested solution

While we understand the desire to rely on IFRS 10 given that the main structure of concern should fall into IFRS 10, we wonder whether the impact will be as successful for SARS as intended. In essence, what SARS really needs is a test for practical control via commercial law concepts. The determination should be limited to a factual test of a right or entitlement to receive income from the underlying foreign company.

If the link to IFRS 10 is indeed maintained, we recommend that greater clarity be introduced around what percentage participation rights are to be assumed for the application of the proposed proviso.
2. Section 25BC: Taxing distributions received by SA resident beneficiaries from foreign trusts and foundations

2.1 Proposed amendment

A new section 25BC is proposed to be introduced which will tax as ordinary income any distribution received by a South African resident beneficiary (other than a company) from a non-resident trust or foreign foundation. The proposed section 25BC will apply where a non-resident trust or foreign foundation holds a participation right in a foreign company and that foreign company would have constituted a CFC if the trust or foundation had been a resident (i.e. where the foreign company is more than 50 per cent held by the foreign trust / foundation).

2.2 Policy concerns

The proposed amendment runs contrary to longstanding South African tax policy. The proposal effectively punishes South African taxpayers when they repatriate funds back to South African. This tax upon repatriation will simply mean that funds will not return unless the taxpayers at issue are in dire need of funds without other options.

The participation exemption of section 10B specifically recognises the need to exempt funds upon repatriation (along with the Exchange Control credit). This exemption stems from Europe and remains in place even after the OECD pronouncements of Base Erosion and Profit Shifting. We note that the United States is one of the few countries that seeks to tax CFCs when repatriating funds back home via dividends, and this tax on repatriation is often slated as one of the main reasons that United States companies have left so much excess funds offshore (as opposed to return and reinvestment in the United States).
We also question why section 25BC is required if the proposed changes to section 9D create the required level of section 9D(2) income. If the foreign subsidiaries of a foreign trust / company structure fall under section 9D, why should there by a reason to tax the repatriation again? The goal has always been to tax the offending income offshore as that CFC income arises as opposed to repatriation charge that hinders the return of funds back to South Africa.

2.3 Process concerns

Proposed section 25BC goes far beyond group structures in which foreign subsidiaries are held through foreign trusts and foundations. The proposed change also seems to be directly aimed at family wealth held through foreign trusts. This is a big change that was not explicitly raised in the 2017 Budget Review. It appeared to the common eye that changes to “interposed trusts” were mainly aimed at the group structures outline above (not family trusts).

Despite the Davis tax committee statements that further taxes should fall on the wealthy, we question the wisdom of hitting wealthy South African families hard when their “foot” is already halfway out the door. A large tax increase in their offshore repatriations could easily lead to further emigration in the current economic climate. While National Treasury and SARS may take comfort in the existence of the section 9H exit charge, we note that this charge would not apply to holdings currently held through a foreign trust / foundation. A new charge of 45 per cent on offshore repatriations may easily become the tipping point, especially for retired South Africans who are heavily relying on these structures as a major source of their retirement funding.
2.4 Technical problems identified

Proposed section 25BC could easily be viewed as onerous. In effect, if a foreign trust / foundation holds a foreign subsidiary, all dividends from that subsidiary will be subject to normal tax rates of 45 per cent. The participation exemption of section 10B no longer applies (nor does the capital gain exemption of paragraph 64B if those funds are received or accrued to a foreign trust / foundation beneficiary).

Moreover, the mere existence of a more than 50 per cent subsidiary taints everything else held by the trust. All other income or capital gains will be pulled into the 45 per cent net.

Lastly, we wonder how section 25BC will interact with the vesting rules of section 25B. It would appear that section 25B could apply to trigger tax first, followed by section 25BC. Both charges must take cognizance of one another to eliminate the problem of double taxation.

2.5 Suggested solution

We think that section 25BC is overly complicated and excessive. If Government does indeed want to tax dividends from foreign companies held through foreign trusts, we believe a far simpler mechanism is possible.

We would instead suggest that foreign companies held through foreign trusts lose the benefit of the foreign dividend and capital gain participation exemptions (of section 10B and paragraph 64B of the 8th Schedule). Indeed, some would argue that these provisions already do not apply when shares are held through discretionary trusts. Under this approach, foreign dividends purchased through foreign trusts would be subject to a 20 per cent charge (and capital gains on the shares would be subject to an effective 22.4 per cent charge). Other amounts within the foreign trust / foundation would be wholly unaffected. This approach would at least be viewed as far more reasonable the new 45 per cent charge outlined above.
MINING TAX ISSUES

1. Debt Cancellations in the Case of Mining Companies (Section 36(7E))

a. Treasury proposal

Current law does not adequately cater for debt cancellations of funding that was used for mining capital expenditure. It is now proposed that the cancellation of debt initially used for mining capital expenditure be applied to reduce mining capital expenditure not yet taken into account as a deduction. Excess debt beyond this expenditure gives rise to ordinary revenue.

b. Comment

We question the basis for the inclusion of the excess amount, once the mining capital expenditure has been eliminated, in gross income. This is inconsistent with the general rules where the borrower suffers debt relief tax consequences, in terms of section 19 and paragraph 12A. Under the general rules the borrower may suffer recoupments, suffer a reduction in the cost of assets and forfeit capital losses. The borrower would not, however, have an inclusion in gross income of any remaining amount.

Paragraph 56 of the 8th Schedule sets out the circumstances under which capital losses arising from the cancellation of a debt by a connected person must be disregarded. It then carves-out circumstances where the borrower has suffered the debt relief tax consequences to prevent a double hit. To be consistent, the paragraph 56 carve-outs should be extended to cover the situation where section 36(7EA) read with paragraph (j) of the gross income definition applies. Group relief as envisaged for paragraph 12A (prior to the proposed amendment to 12A which we do not support) should also apply in this case. This could potentially be achieved by inserting the reference to section 36(7EA) in paragraph 56(2)(a)(ii).
The proposed amendment does not adequately address the treatment of debt foregone which was used to finance multiple mining assets located in separately ring-fenced mines. The amendments should address the treatment of debt used to fund mining capital expenditure across separately ring-fenced mines.

Once Gold Mines have effectively recouped against its capital balances, the impact of paragraph (j) results in the excess amount being taxed at the average rate of tax since inception. Historically this is something that the taxpayer has to obtain from the SARS e-filing system. Currently the e-filing system is unable to obtain such a rate and would again coincide with our recommendation to limit the recoupment to unredeemed capital expenditure and capital losses.

2. Strengthening Anti-Avoidance Measures Related to Mining Rehabilitation Funds (Section 37A)

a. Treasury proposal

It is proposed that the current provisions aimed at curbing abuse of the benefit of tax-deductible contributions (by using such funds for purposes other than rehabilitation) be strengthened. It is proposed that the premise for the penalty regime be changed to one where there is a deemed normal tax calculated based on 40% of the market value of certain investments/withdrawals.
The following penalty provisions are proposed to replace the existing penalty regime:

<table>
<thead>
<tr>
<th>Measure</th>
<th>Basis</th>
<th>Link back to</th>
<th>Nature</th>
<th>Taxed in</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impermissible investments by the fund</td>
<td>40% of highest MV of impermissible investment</td>
<td>Cash originally paid by company into fund</td>
<td>Deemed normal tax</td>
<td>Mineral right holder or mining company</td>
</tr>
<tr>
<td>Impermissible distributions from the fund</td>
<td>40% of highest MV of distribution</td>
<td>Property distributed</td>
<td>Deemed normal tax</td>
<td>Rehabilitation fund</td>
</tr>
<tr>
<td>Contravention of any s37A provision</td>
<td>2 x 40% of highest MV of fund property</td>
<td>Property derived from cash paid by company into fund</td>
<td>Deemed normal tax</td>
<td>Mineral right holder or mining company</td>
</tr>
</tbody>
</table>

b. **Comment**

We question whether the proposed penalty regime will address the abuse that it is designed to attack. Historically the section was introduced to encourage mining companies to contribute throughout the Life of Mine to the fund as opposed to closure dates. With all the amendments relating to the National Environmental Management Act as well as SARS VAT audits, this has become an incentive that is no longer effectively utilised by the mining companies.

Clearly the main concern should be material misappropriation of the funds by unscrupulous operators. We are of the view that effective measures, outside of the tax legislation, are required to prevent this from happening. Retrospective reporting and the imposition of tax penalties are unlikely to be effective. For example, if a fund has distributed all its funds in an impermissible manner, how will SARS collect the tax penalty from it? Will this really be an effective deterrent? Furthermore, if a fund incurs a significant tax penalty, will it be able to pay the tax penalty from its funds bearing in mind that the limited objects of the fund would not include paying tax penalties?
Ironically, the even more onerous proposed penalty regime is more likely to serve as a deterrent for rehabilitation funds to be applied to perform legitimate rehabilitation. Fund trustees are already very concerned that any minor unintended mistake in the application or management of the funds could trigger the penalties for contravention of any provision of section 37A. Whereas SARS has a discretion whether or not to impose the penalty under the current regime, under the proposed new regime, they will have no discretion. We do not know if this was drafted intentionally, with the result that even minor contraventions could lead to massive penalties.

Please note that mining companies and their fund trustees carry significant risk in relation to the use of the funds in the rehabilitation trusts for rehabilitation. There are no proper mechanisms in place to enable the mining group to mitigate these risks by receiving confirmation that their modus operandi is compliant, be that from the Department of Mineral Resources (DMR) or Department of Environmental Affairs (DEA). This results in the funds being passive and not utilised. We suggest that a way should be found for an efficient and effective certification process.

According to Annexure C of the 2017 Budget Review:

“In November 2015, the Department of Environmental Affairs published regulations in terms of the National Environmental Management Act (1998) for financial provisioning for the rehabilitation, management and effects of mine closures for mining companies. To take into account some of the financial provisioning requirements, amendments will be made to the Income Tax Act.”

There are no proposed amendments to section 37A to take into account the process of amendment of the regulations. We suggest that section 37A should be amended in such a way that the any amendments to the regulations are concurrently aligned for tax purposes. In order to achieve this, we recommend that the DMR, DEA and National Treasury meet in order to align its expectations and concerns.

The deeming of a penalty amount to be normal tax does not fit into the scheme of the Income Tax Act which defines “normal tax” with reference to section 5(1). In terms of section 5(1) normal tax is an income tax based on taxable income. This is per definition calculated after the set-off of assessed losses. We are also of the view that it is not good tax policy to give a tax penalty a different label and to then not give the taxpayer access to the remedies that it would have had in respect of penalties. Be that in the form of objection, appeal so applicable under the Tax Administration Act. For example, the
taxpayer cannot mitigate its risks by obtaining a filing position opinion under section 223 of the Tax Administration Act. We suggest, given the very severe nature of the penalties, that taxpayers should be given access to full administrative justice provisions and that the current regime more than serves as a deterred when it comes to the Rehabilitation Funds.

We generally think that this penalty regime should be subject to further consultation.
BUSINESS TAX INCENTIVE ISSUES

1. INDUSTRIAL POLICY PROJECTS – WINDOW PERIOD EXTENSION

Treasury Proposal

It is proposed that the window period for section 12I applications be extended from 31 December 2017 to 31 March 2020. The purpose of the extension is to allow sufficient time for the review of the tax incentive, including its overall effectiveness.

According to the Explanatory Memorandum:

“While the window period for the tax incentive will be extended, the current approval threshold of R20 billion in potential investment and training allowances will not be increased at this stage. Tax revenues are under severe pressure in a fiscally constrained environment at present. As a result, no increase in the approval threshold for the 12I programme is currently being considered.”

Problem Identified

The extension is supported. However, potential investors do not have the much-needed certainty that they require in order to make investment decisions because the funding required for the programme is in short supply. If the availability of an incentive is not certain at the time when the investment decision has to be made, its effectiveness as an incentive is doubtful.

In this regard, it is important to note that the Industrial Policy Projects tax incentive was introduced to support new Greenfield industrial projects as well as the expansion and upgrading of existing (Brownfield) industrial projects. Therefore, the tax incentive encourages new investment and expansion projects that stimulate economic growth and job creation. This should in turn lead to additional taxes such as PAYE, VAT and Corporate Income Tax being
collected by SARS from the supported projects. The projects supported under section 12I will therefore over time have a positive impact on the fiscal revenue collection.

**Suggested Solution**

Additional budget is needed to create certainty regarding the availability of the incentive. The timelines for approval are also vital as a backlog in the processing of applications creates further uncertainty especially as approval is needed before assets are ordered. The need for certainty is greatest in terms of large projects that have the most opportunity of stimulating the economy.

Please note that the Budget allocation for these projects comes more in the form of future revenue foregone as opposed to an immediate cash outlay. This future notional cash outlay will stimulate upfront investment that should generate added receipts in terms of payroll and VAT in the short run. Stated differently, current economic difficulties should not be viewed as a barrier to allocating future budget.

2. **INDUSTRY CONCERNS NOT ADDRESSED**

While we appreciate that some of the concerns that we have raised in the past have been addressed, a number of issues remain unresolved. For example, we made the following Annexure C submissions for the 2017 Budget:

- **Section 12L Energy Efficiency Savings** - legislative clarity is required to make it clear that no pre-approval is required and to ensure that the implementation period lines up with the periods used by the South African National Energy Development Institute (SANEDI). We are concerned that there may be unnecessary disputes between SARS and taxpayers, resulting in the disallowance of relief that taxpayers should have been entitled to. This uncertainty is deterring future investment in this important area. [Point 7]

- **Section 12R Special Economic Zones (SEZ)** – the connected person rule acts as a detractor and/or trap for the unwary and we continue to recommend the use of an arms-length test
instead. Investors do not come to these SEZ areas in isolation; the SEZ is only effective if seen as part of a supply chain. In the meantime, we do not expect that the SEZ regime will have a reasonable chance of success. [Point 3]

We would welcome further engagement regarding these unresolved concerns to prevent problems arising in future.
TALAB 2017 SUBMISSIONS -TAX ADMINISTRATION ACT

1. General

On behalf of our members, we set out our submissions below, as these pertain to specific sections of the Tax Administration Act, 2011 (TAA). We repeat in the attached Annexure some of our significant Annexure C submissions for Budget 2017 which have not been responded to by Treasury/SARS.

2. Proposed Amendment to Section 9 of the TAA

2.1 The Draft Memorandum on the Objects of TALAB 2017 states, in relation to the proposed amendment to section 9 of the TAA:

“Decisions by SARS are generally subject to the internal remedy in section 9 of the Tax Administration Act, in terms of which specified SARS officials may reconsider the decisions. Decisions that are given effect to in an assessment or notice of assessment are however excluded, since assessments generally have the separate remedy of objection and appeal. As a result of the public comment process on the 2016 legislation, a situation has been identified where a decision given effect to in a notice of assessment is not subject to objection and appeal. It is therefore proposed that such a decision be subject to the remedy under section 9. This will afford the taxpayer an internal remedy before exercising the external remedy of a review application to the High Court under PAJA.” (emphasis added)

2.2 We are unaware of this internal remedy in section 9 of the TAA, and how to practically take advantage of it. We were unable to find descriptions and processes in relation to this internal remedy, on the SARS website, for example on the page “Dispute Resolution Process”.

2.3 In the circumstances, it is submitted that, in order to properly achieve the purpose of the relevant amendment, as well as the apparent purpose of section 9 of the TAA more generally, details of this internal remedy should either be legislated or fully set out in some other formal publication, to enable taxpayers to make use of the relevant remedy.
1. Denial of Request for Suspension of Payment in Terms of Section 164 of the TAA: Alternative Legal Recourse Requested

*Background*

1.1 Given the current negative South African economic climate, the high cost of living pursuant to a weak Rand, drought and inflation, coupled with steadily rising interest rates and continuing high unemployment, it has created a situation where most taxpayers (both corporate and individual) are financially strained, and would not have available cash resources to settle a tax debt which the taxpayer fully believes is not legally owing (and which the taxpayer accordingly disputes).

1.2 The trend that has arisen in respect of section 164 of the TAA, is that duly completed and fully motivated submissions for the suspension of payment, are denied by the relevant senior SARS official. This has the result of placing the taxpayer in an unfair position without any further recourse to any effective internal remedies to provide relief while finding an alternative mechanism to resolve his current position with SARS.

In terms of current practice, SARS’ view in considering a taxpayer’s request for a suspension of payment turns on whether the taxpayer has in fact met all the requirements under section 164 of the TAA. Where the taxpayer is unable to comply or meet all of the requirements or, alternatively SARS takes the view that the taxpayer is not in a position to make payment, the request for suspension is denied in the majority of cases. The denial of the request to suspend payment, effectively results in the taxpayer being without any recourse to any other internal remedy. The TAA does not provide an alternative internal remedy for the aforementioned position, which places the taxpayer in a potentially prejudicial position.

1.3 The taxpayer’s only other option is to take the matter up on review before the High Court, which is not protected by secrecy, but is in open and in public court. A further problem with High Court review is that this can be expensive for taxpayers, and in particular taxpayers whose dispute falls within the
R1 million threshold for appeal to the tax board. This group of taxpayers, as regards the actual tax dispute, has access to a semi-informal tribunal where it is possible to self-represent, the purpose of which is to make access to an independent review financially accessible to smaller taxpayers. In contrast, the dispute concerning SARS’ decision to invoke the “pay now, argue later” rule is not heard by an affordable tribunal.

1.4 It should also be noted that, before the actual High Court review of the SARS decision, an interim urgent interdict is necessary, to prevent SARS from taking any collection proceedings pending the outcome of the review, which typically takes 6 to 12 months to be heard.

1.5 A denial of a request to suspend payment under section 164 of the TAA only leaves the taxpayer with an administrative review remedy and temporary relief by way of the 10-business day grace period under section 164(6) of the TAA.

Recommendation

1.6 We propose an amendment to section 104(2) so as to allow an objection to a decision under section 164(6) of the TAA. Practically this would result in two dispute processes running parallel (i.e. the merits of the case and the denial to suspend payment). While this dual process sounds unusual, this is already the case where the taxpayer takes SARS’ decision on High Court review. The key advantages of the objection and appeal process being followed are that:
   a) this would maintain taxpayer secrecy; and
   b) this would facilitate appeal to the tax board, with less formalities and lower cost, for smaller tax disputes, making justice more financially accessible.

1.7 As an alternative to the taxpayer bringing an urgent application before the High Court, for an interim interdict, we proposed that this is either replaced with:
   (a) Granting the taxpayer with the right to approach the Tax Ombud for an urgent interim interdict to suspend SARS’ ability to collect the debt pending the review or objection and appeal process in relation to SARS’ decision in section 164 of the TAA. Factors to be taken into account in order not to burden the Tax Ombud is that the request for suspension has been
denied and that the taxpayer has or intends to dispute the decision. The Tax Ombud’s decision
would not be a final decision and it would not take away the right of either SARS of the
taxpayer to approach the court under the objection and appeal process; and/or
(b) SARS’ rights to collect would be automatically suspended by the objection and appeal process
(or review process, if our submissions in relation to replacing the High Court review process
with an objection and appeal process are not accepted), provided that the taxpayer either
paid a minimum deposit (say 10% of the disputed amount), or tendered appropriate security
for the disputed tax.

2. Pay Now, Argue Later Rule in Section 164 of the TAA – Application Beyond Chapter 9 of the TAA

Background

2.1 The suspension of the obligation to pay tax, in terms of section 164 of the TAA, is only possible if the
taxpayer intends to dispute the liability to pay that tax under Chapter 9. Chapter 9 includes the
objection and appeal process.

2.2 However, in various instances, the remedy in relation to a disputed tax debt is not an objection and
appeal under Chapter 9. For example, section 93 of the TAA allows for SARS to issue a reduced
assessment in certain circumstances, and section 98 of the TAA allows for SARS to withdraw an
assessment in certain circumstances. If SARS makes a decision in relation to one of these sections, the
taxpayer’s legal remedy is not to object and appeal in terms of Chapter 9, but rather to take SARS’
decision on review to the High Court in terms of the Promotion of Administrative Justice Act.

2.3 In these circumstances, the relevant taxes involved, are also factually disputed.

Recommendation

2.4 We proposed that section 164 of the TAA should also be available to the taxpayer, to suspend the
obligation to make payment of the relevant tax, if the taxpayer is disputing or intends to dispute the
relevant tax through any relevant legal remedy, not only under Chapter 9. In other words, the ability
for SARS to suspend a tax debt should also apply where the tax debt is disputed in terms of a review by the High Court.

3. The Voluntary Disclosure Programme Provisions

**Problem: no objection and appeal process for rejections of application for VDP**

3.1 The SARS VDP Unit may reject an application for Voluntary Disclosure Programme (VDP) relief if it is of the view that the requirements in sections 226 and 227 of the TAA are not met.

3.2 Such decisions by the VDP Unit are not currently subject to objection or appeal under Chapter 9. A taxpayer who disagrees with such a decision must take the matter on judicial review. Because of the cost and delay involved in such a process, few taxpayers are willing or able to do so.

3.3 The VDP serves an important policy objective, which is to bring more taxpayers, assets and income into the South African tax net. The recent Special VDP expands that aim further. Many practitioners believe that certain decisions by the VDP Unit to incorrectly narrow the qualification criteria run contrary to this policy.

**Problem: Denial of objection and appeal process for erroneous assessments in relation to VDP**

3.4 In terms of section 231 of the TAA, if subsequent to the conclusion of a voluntary disclosure agreement, it is established that a VDP applicant failed to disclose a matter that was material for the purposes of making a valid voluntary disclosure, a senior SARS official may:

(a) withdraw any relief granted under s 229 of the TAA;

(b) regard an amount paid in terms of the voluntary disclosure agreement as constituting part-payment of any further outstanding tax debt in respect of the relevant default; and

(c) pursue criminal prosecution for a tax offence.

3.5 Section 231(2) of the TAA states that any such decision taken in terms of section 231 of the TAA is subject to objection and appeal.
3.6 Further, if a voluntary disclosure agreement has been concluded, SARS may, despite anything to the contrary contained in a tax Act, issue an assessment or make a determination for purposes of giving effect to the agreement (see section 232(1) of the TAA).

3.7 However, as regards such an assessment issued or determination made to give effect to a voluntary disclosure agreement, this is not subject to objection and appeal in terms of section 232(2) of the TAA.

3.8 In practice, clause 7 of SARS standard VDP agreement, reads as follows:

(a) "7 ASSESSMENT BY THE COMMISSIONER

7.1 To give effect to this Agreement the Commissioner may issue an assessment or make a determination. Although great care is taken to ensure accuracy, it must be noted that any amount payable given to the Applicant by SARS for purposes of indicating the amount of tax payable is merely an indicative amount and is not an assessment of the Applicant’s final liability.

7.2 Despite anything to the contrary which may have been issued by SARS during or after the assessment or determination, the assessment issued or determination made to give effect to this Agreement is not subject to objection or appeal (as per section 232 of the TA Act).

7.3 This Agreement and the corresponding assessment or determination giving effect thereto do not prevent the Commissioner from selecting the Applicant for inspection, verification or audit in the normal course of SARS operations or from applying the provisions of any Act under its administration in the normal course of SARS operations."
3.9 Reference is made to section 232 of the TAA.

3.10 Whilst one may understand that section 232(2) of the TAA prohibition on lodging and objection and appeal intends to prevent taxpayers from instituting (probably frivolous) objection procedures based purely on the erroneous submissions made by it under the VDP, the issue is that the wording used in Clause 7 restricts itself to this intent.

3.11 Section 232 of the TAA deals with the Assessment issued to give effect to the VDP Agreement. SARS' own VDP Guide supports this by stating:

Implementing the VDP Agreement:

(a) The VDP agreement is a contract between SARS and the applicant.
(b) Both SARS and the applicant are obliged to give effect to the terms of the contract. As such, SARS will ensure that assessments are adjusted or raised where required and that full effect is given to the relief granted by the Act.
(c) The applicant on the other hand must ensure that payment is effected on the date(s) agreed in terms of the VDP agreement and that any other duty or obligation is given effect to on the agreed terms.

3.12 The problematic wording in Clause 7 is the following: "Although great care is taken to ensure accuracy, it must be noted that any amount payable given to the Applicant by SARS for purposes of indicating the amount of tax payable is merely an indicative amount and is not an assessment of the Applicant's final liability."

Despite anything to the contrary which may have been issued by SARS during or after the assessment or determination, the assessment issued or determination made to give effect to this Agreement is not subject to objection or appeal."
3.13 The wording implies that SARS may issue an assessment with a different amount, or contrary to the principles submitted, and the taxpayer may not object/appeal. Surely that cannot be the case because then SARS won't, in spirit, be issuing the assessment to give effect to the agreement. However, with these terms included in the VDP Agreement, the argument may be made that the assessment does follow the agreement.

3.14 The upshot of the prohibition in section 232(2) of the TAA on lodging and objection or appeal is that a taxpayer may be placed in a position where SARS issues an assessment different to what was agreed or submitted, and then be left with no remedies.

3.15 It follows that there may be a situation that SARS differs from the submitted VDP information, and the agreement is signed, but because SARS has stated it is merely indicative, a taxpayer is deprived of its rights to object and appeal.

3.16 The prohibition on the lodgement of an objection or appeal is thus clearly a major cause for concern with taxpayers, as they are not able to dispute any assessment issued or determination made should this differ from the agreement. Of course, there is scope to take the decision on review, but this represents scant comfort and is clearly a barrier to the uptake of the VDP.

Recommendation

3.17 Decisions concerning qualification for VDP relief in terms of Part B of Chapter 16 of the TAA should be subject to objection and appeal. This amendment should apply retrospectively to 1 January 2017, so that applications incorrectly rejected in recent times can be reconsidered.

3.18 The proposal would be that section 232(2) of the TAA be either deleted, or at the very least allow for a taxpayer to be able to object or appeal where the assessments issued or determination made differs from the terms of the agreement signed.
4. Reduced Assessments Under Section 93 of the TAA

Background

4.1 Section 93 of the TAA was amended by the Tax Administration Laws Amendment Act, 2015, to provide that SARS may only issue a reduced assessment if SARS is satisfied that there is a (currently undefined) ‘readily apparent’ undisputed error in the assessment.

4.2 In practice, it appears that taxpayers are severely negatively impacted by this amendment. What is ‘readily apparent’ to one person may not be so to another. The number of cases in which SARS is likely to grant reduced assessments is likely to drop dramatically and a lack of consistency in interpretation between SARS’ assessors may be taken as a given. To date, several negative decisions have been received from SARS, where SARS appears to interpret the words “readily apparent” to mean “effortlessly obvious”, which it is submitted is not the legal test.

4.3 The previous wording of the TAA stated that SARS may issue a reduced assessment if satisfied that an assessment contains an undisputed error by SARS or the taxpayer. The reduced assessment could be made within five years of the date of the original assessment in the case of VAT, which is a self-assessment tax, and within three years of the date of the original assessment in the case of income tax.

4.4 Since then, SARS and National Treasury accepted that the three-year period will be retained and that SARS will attempt to mitigate the risks presented by older requests for correction through its risk management systems. The insertion of the phrase ‘readily apparent’ in addition to the requirement that the error be ‘undisputed’ is to ensure that ‘substantive issues are properly challenged through the objection and appeal system’.

4.5 In terms of the objection and appeal system, the taxpayer has only 30 business days in which to object to an assessment. A senior SARS official may under section 104(5) of the TAA extend the 30- business day period by up to 30 business days if reasonable grounds exist for the delay in lodging the objection.
resulting in a maximum of 60 business days in total. The period in which an objection may be lodged may be extended by up to three years if ‘exceptional circumstances’ exist which gave rise to the delay.

4.6 An indication of how SARS is likely to interpret the term ‘exceptional circumstances’ is found in Interpretation Note 15, dealing with the exercise of SARS’ discretion in the case of late objections or appeals. The Interpretation Note indicates that the term ‘exceptional circumstances’ may be understood to be referring to, among others:

(a) A natural or human-made disaster.
(b) A civil disturbance or disruption in services.
(c) A serious illness or accident.
(d) Serious emotional or mental distress.

4.7 It is important to be aware of the fact that errors in a previous tax filing would typically be identified during the course of a subsequent audit or tax filing. Typically, then, for income tax, any problematic prior submission would be identified at the earliest approximately one year later, during completion of the subsequent income tax return. The objection process and timelines are therefore insufficient to address the real practical issues that taxpayers experience. It appears unfair and unreasonable that SARS is still able to audit and assess a taxpayer as long as three or more years after the tax return submission, to correct underpayments of taxes, but that a taxpayer is not able to correct overpayments of taxes identified during the very next tax return filing process.

Recommendation

4.8 National Treasury needs to consider withdrawing this amendment to section 93 of the TAA on the basis that it was not properly consulted on and it has been far too narrowly interpreted by SARS. The requirement that the error is “undisputed” already ensures that only items that SARS agrees were incorrect are corrected in terms of section 93.
5. **Issuing of Letter of Audit Findings – Should Apply in Relation to All Additional Assessments**

5.1 Section 42 of the TAA requires that, upon conclusion of the audit, SARS provide the taxpayer with a letter of audit findings and 21 business days in which to respond to the letter of audit findings, before issuing the relevant assessment.

5.2 The problem that has arisen in practice is that SARS is in various instances alleging that this section only applies to a formal audit, and not to a “verification”, an adjustment that SARS wishes to make as a result of a request for relevant material, and so on.

5.3 This approach by SARS undermines the intent of section 42 of the TAA, since SARS would then be able to avoid its obligations to keep a taxpayer informed, which were inserted into the TAA in order to comply with administrative justice provisions, merely by changing the “label” of the relevant interaction with the taxpayer.

*Recommendation*

5.4 In order to preserve within the TAA the rights that are afforded in terms of administrative justice provisions, it is recommended that section 42 of the TAA should be amended such that it is compulsory for this section to be complied with, in relation not only to any “audits”, but also any: verifications, or any other process the result of which is a potential assessment being raised.

5.5 In other words, the taxpayer should be entitled to receive a letter of findings setting out the potential adjustments of a material nature, and 21 business days within which to respond, before any additional assessment is issued by SARS, regardless of the form of the interactions between SARS and the taxpayer prior to this intended assessment.
6. **Notification of Audit for VDP Purposes**

*Background*

6.1 A proposal that should be considered again relates to the ‘notice’ for purposes of section 226(2) of the TAA. It appears that SARS intends on retaining an element of subjectivity as it pertains to what constitutes a ‘notice’.

*Recommendation*

6.2 A potential solution would be for SARS to specifically indicate that the ‘notice’ (in whichever form it may be), is in fact a ‘notice’ for purposes of section 226(2) of the TAA, which is then an objective determination as to whether any disclosure, after the date of that ‘notice’, is in fact voluntary.

6.3 Practically, it should be a written statement made on the relevant SARS letter. The aforementioned would not affect the discretionary power available to a senior SARS official (under section 226(2)), to still allow the submission of an application under the VDP, if that official is satisfied that the ‘default’ would not otherwise have been detected during the normal course of an audit.