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Dear Ms Nkumanda and Ms Collins

RE: ANNEXURE C PROPOSALS

Thank you for the opportunity to contribute proposals for the inclusion in Annexure C for the Budget Review, 2014.

Set out below, is the consolidated commentary on the **Corporate Tax issues only** developed from both an internal review of the provisions as well as from consultations with members, stakeholders and industry. The commentary reflects the collective view of members, stakeholders and industry role players consulted.

1. INCOME TAX ACT ISSUES

1.1 Section 1 – Introduction of the foreign partnership definition

Problem statement

Despite its name, some Limited Liability Partnerships (LLP's), for instance in the UK, are specifically legislated as corporate entities rather than as partnerships. These entities could, in some instances, thus fall within the ambit of section 9D of the Income Tax Act dealing with controlled foreign companies (CFC).

With the introduction of the 'foreign partnership' definition on 1 October 2011, certain of these LLP's (corporate entities) would now fall under the definition of a 'foreign partnership', which would have the following repercussions:

- The change in status (from CFC to foreign partnership), would cause the LLP to be excluded from the definition of a 'company', which would cause it not to be a CFC anymore which would lead to the application of section 9H (ceasing to be a CFC).
- If the South African shareholder previously held shares in a company (the LLP), after the introduction of the 'foreign partnership' definition, the South African shareholder would have an interest in a partnership. Did the South African shareholder "dispose" its shares in terms of the Eighth Schedule?
- If the LLP disposes of its assets (the LLP is now a foreign partnership), how does the South African partner (previously the shareholder in the LLP) calculate its gain/loss, i.e. what is base cost of the underlying assets?
- In terms of transfer pricing, if the LLP transacts with a connected person (say B), and on the assumption that the South African partner is a connected person to B, do transfer pricing provisions apply to the South African partner, e.g. LLP lends funds to B, is this now regarded as a loan from the South African partner to B?

Proposed solution / recommendation

In view of the above, clarification of the law is required as this insertion may lead to a multiplicity of applications being made to the ATR department at SARS.

1.2 Section 8FA of the Income Tax Act – Hybrid interest deemed to be dividends *in specie*

Problem statement

The amendments to s8F extend the scope of this provision quite extensively and, although exemption is given for small business corporations in terms of subsection (3)(a), it would seem that the amended provision could apply to quite ordinary and *bona fide* transactions entered into between small business owners and their companies that do not meet the definition of 'small business corporation'.

Take the situation where a shareholder/member has advanced a loan to a company/cc of which he is the sole or main shareholder/member. Interest is payable at the prime rate. It is quite common in this scenario for no repayment period to be specified.

When the new s8FA criteria are considered, Para (c) of the definition of 'hybrid debt instrument' includes a debt where 'that company owes the amount to a connected person in relation to that company and is not obliged to redeem the instrument, excluding any instrument payable on demand, within 30 years— (i) from the date of issue of the instrument; or (ii) from the end of that year of assessment.

This would seem to bring the above scenario within the scope of s 8FA, which would result in the company/cc being denied a deduction for the interest and instead facing dividends tax on the deemed dividend in specie.

Proposed solution / recommendation

All small businesses should be excluded from the application of section 8FA.

1.3 Section 64F(m) of the Income Tax Act – Uncertainty regarding dividends tax exemption

Problem statement

Certain loans by companies to shareholders or connected persons in relation to shareholders were subject to STC under section 64C(2)(g) when the loan or advance was granted or made available to such a person. The granting or making available of the loan or advance constituted a deemed dividend under that section.

Such loans could be outstanding at 1 April 2012 when dividends tax replaced STC. In order to prevent a loan that does not bear interest at the official rate to be subject to both STC (under section 64(2)(g)) and dividends tax (under section 64E(4)), an explicit exemption was included in section 64E(4)(e) to state that such a loan would not be subject to the deemed dividend provisions should it not bear interest at the official rate if the debt was subject to STC. It is submitted that this provision allows a company to leave such a loan outstanding without attracting further dividends tax.

Some companies however wish to extinguish the loan by writing it off, thereby turning the value transferred by way of loan (and deemed dividend for STC purposes) into a real dividend. In principle, the provisions of section 64E(4) and section 64F(m) would suggest that this write off should not be subject to dividends tax as the underlying amount has already been subject to STC. It is however difficult to read this in the wording of section 64F(m) which states that a divided is exempt from dividends tax "to the extent that the dividend was subject to the secondary tax on companies". In this case, the dividend that was subject to STC was arguably the granting or making available of the amount (deemed dividend under section 64C(2)(g)) while the dividend at the time of write off is the company giving up its right to be paid. Even though these events relate to the same loan, the dividend event that may be subject to dividends tax is not the same dividend event that was subject to STC. Uncertainty therefore exists whether the dividend arising from the write off of such a loan would be exempt from dividends tax.

Proposed solution / recommendation

A specific exemption can be included in section 64F to exempt any dividend which arises as a result of the writing off of a loan that was subject to STC. In addition, the exemption should make provision to exempt any dividend paid by way of reduction of the amount owing in terms of such a loan (i.e. if a dividend is declared, but the shareholder loan asset is reduced and utilised to pay the dividend rather than another asset or cash).

1.4 Paragraph 2 of the Eighth Schedule – Rollover relief for non-resident shareholders disposing of shares in a resident company

Problem statement

A non-resident will be subject to capital gains tax on the disposal of immovable property situated in South Africa, any interest or right held in immovable property situated in South Africa or any asset attributable to the non-resident's permanent establishment in South Africa. Consequently, when a non-resident company disposes of shares in a resident company (which meets the requirements of paragraph 2(2) of the Eighth Schedule) to another non-resident company forming part of the same group of companies as the seller according to the definition of section 41 of the Income Tax Act, the disposal will be subject to CGT.

Please note that the reference to group of companies is as per the definition in section 41, except for the fact that it includes non-resident companies.

This change in group structure does not result in a change to the ultimate capital gains tax that will arise on the disposal of the property or the shares.

Proposed solution / recommendation

Rollover relief should be provided to the above situation to defer the capital gain until the asset is disposed of by the group.

1.5 Paragraph 39 of the Eighth Schedule – Clogged losses between connected persons

Problem statement

In terms of paragraph 39 of the Eighth Schedule to the Income Tax Act, a person must disregard any capital loss when determining an aggregate capital gain or loss of that person, if the asset was disposed of to a connected person. The capital loss is therefore clogged and may only be offset against future capital gains resulting from subsequent disposals between the two connected parties, provided that they are still connected persons at the time of those subsequent disposals.

Should there only be one disposal between connected persons which took place at arm's length, with no subsequent disposals, then the person disposing of the asset would never be able to utilise his capital loss (if the disposal took place at a loss). This situation is seen as grossly unfair because there is no intention to evade tax and the transaction must have valid commercial reasons behind it.

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Proposed solution / recommendation

It is proposed that if a transaction between connected persons takes place at arm's length, then the capital loss shouldn't be clogged.

2. TAX ADMINISTRATION ACT ISSUES (No. 28 of 2011)

2.1 Section 6 - Definition of senior SARS official

Problem statement

Section 6 of the TAA does not specify who is considered to be a senior SARS official. No clarification on this matter has been provided by SARS despite letters being issued by senior SARS officials.

Proposed solution / recommendation

It is recommended that SARS publish and maintain a list of SARS officials who will be regarded as senior SARS officials for purposes of the administration of the Act.

2.2 Section 26 - Interest owed by SARS to taxpayers

Problem statement

Cases were encountered where an ADR was submitted and SARS pitched up stating that the taxpayer didn't declare all interest received or accrued. The said interest was interest on SARS' account owing to the taxpayer.

Proposed solution / recommendation

SARS should issue IT3's reflecting the interest paid on amounts owing by SARS.

2.3 Section 164 - Suspension payment of tax pending objection or appeal
Section 168 - Criteria for instalment payment agreement
Section 180 - Liability of financial manager for tax debts
Section 181 - Liability of shareholders for tax debts
Section 200 - Compromise of a tax debt

Problem statement

These sections are currently only subject to review – not to objection and appeal. A review is a costly procedure to follow to deal with a non-consideration by SARS. It is therefore suggested that these decisions

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should also be made subject to objection and appeal in instances where it can be proved that SARS hasn't adequately taken into account the surrounding circumstances.

Proposed solution / recommendation

These sections need to be subject to objection and appeal.

2.4 Section 197 - Permanent write-off of a tax debt

Problem statement

These sections only allow for a senior SARS official to authorise the permanent write off of a tax debt.

Proposed solution / recommendation

This section should allow the taxpayer to escalate the matter to the Commissioner, should the taxpayer not agree with a senior SARS official's decision.

Yours sincerely,

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