

1 February 2016

National Treasury

Chief Director: Legal Tax Design

&

Group Executive: Interpretation & Rulings

SARS Legal & Policy Division

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Dear National Treasury and SARS officials:

RE #1: TECHNICAL CORRECTION IN REPECT OF SECTION 58(1) OF THE INCOME TAX ACT

RE #2: RESPONSE TO THE PROPOSED DRAFT “ADDITIONAL CONSIDERATIONS IN RESPECT OF WHICH THE COMMISSIONER MAY REJECT AN APPLICATION FOR A BINDING PRIVATE RULING OR A BINDING CLASS RULING”

1. BACKGROUND

We wish to comment on the Commissioner discretion contained within section 58(1) of the Income Tax Act. In particular, section 58(1) creates a deemed donation for purposes of the Donations Tax if the property is not transferred for consideration that is not adequate “in the opinion of the Commissioner.”

This discretion adds further uncertainty to an already complex factual determination of adequate versus inadequate consideration. To make matters even more difficult, SARS has now released a draft notice regarding matters on which rulings cannot be sought (item 2.1.8), which will now include:

“Any exercise of the Commissioner's discretion under section 58(1) to determine whether the consideration given for the disposal of property is adequate.”

The concept of adequate consideration is multi-dimensional. For instance, one could view the concept as equivalent to market value regardless of the taxpayer's independent non-tax circumstances, or one could take these individual non-tax circumstances into account. A taxpayer may sell an asset at a reduced price due to urgent cash flow concerns or other causes forcing a rushed sale. A common set of issues relate to hidden discounts contained in black empowerment transfers, all of which involve wholly independent parties acting in good faith free from tax considerations. The key point is whether the Commissioner can freely consider or disregard these circumstances as opposed to reliance on standard judicial principles.

2. SUGGESTED RECOMMENDATION

We believe that the Commissioner discretion contained within section 58 should simply be removed. It is noteworthy that the Taxation Laws Amendment Act, 2015 (Act No. 25 of 2015) contains the removal of a whole series of Commissioner discretions.

We further note that the inclusion of a discretion in relation to adequate consideration (i.e. value) deviates from other notable value rules. The Commissioner discretion for determining value under the arm's length standard of section 31 was removed several years ago. The deemed capital gains rules associated with "arm's length price" of paragraph 38 of the Eighth Schedule have never contained a Commissioner discretion. Therefore, we see no reason to retain the Commissioner discretion within section 58; retention of the discretion merely adds to uncertainty vis-à-vis other value determinations.

3. ALTERNATIVE SUGGESTION

The ongoing exclusion of section 58(1) from the advanced ruling list remains a continued concern as long as the Commissioner discretion of section 58(1) is retained. Taxpayers need some level of certainty in regards to the meaning of adequate consideration – not so much in terms of a statistical valuation – but more in relation to the facts and circumstances that can be taken into account.

We note the importance of Binding Ruling 95 (24 February 2011), which specifically addressed the concept of black economic empowerment in the context of section 58. The ruling effectively gave sanction to a black economic empowerment disposal in terms of finding adequate consideration despite the possible value distortions caused by empowerment requirements.

At a more theoretical level, if the Act provides the Commissioner with a discretion and the taxpayer calls upon the Commissioner to exercise the discretion, the Commissioner is bound to do so. If high-value transactions are to proceed with only a modicum level of tax risk, taxpayers should be allowed to invoke the discretion before proceeding with the transaction as opposed to waiting for completion (only to find an adverse finding after the transaction cannot be unwound). This raised level of risk will simply deter otherwise commercial activity as an abundance of caution.

The purpose of an advance ruling is merely to obtain certainty about the tax consequences of a proposed transaction so taxpayers can proceed with viable commercial transactions unhindered by unnecessary risk. That's why the system exists. So why should the system apply any differently to the question of a sale for adequate consideration under section 58 of the Act? Stated differently, why must a taxpayer lock him/herself into a transaction with possibly adverse tax consequences in these circumstances as opposed to others, especially if no impermissible element of gratuity or liberality exists.

4. SUMMATION

We believe that the Commissioner discretion contained within section 58(1) should be completely removed in alignment with the removal of the other discretions enacted in 2015. This omission in respect of section 58(1) should be seen as a technical oversight that only creates unnecessary uncertainty. In the alternative, SARS should not treat section 58(1) as an impermissible "no-rule" area so taxpayers can seek rulings such as those contained in Private Binding Ruling 95.

Yours sincerely,

Keith Engel

Chief Executive