South African Institute of Tax Professionals

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The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS, 299 Bronkorst Street
PRETORIA
0181

BY EMAIL: Nombasa Nkumanda (nombasa.nkumanda@treasury.gov.za)
Adele Collins (acollins@sars.gov.za)

RE: SPECIAL VOLUNTARY DISCLOSURE PROGRAMME IN RESPECT OF OFFSHORE ASSETS AND INCOME: COMMENTS FROM MEMBERS (INTERNATIONAL WORKING GROUP)

We are responding to the request for submissions from the public as announced in the 12 April 2016 National Treasury media statement. At issue is the efficacy of the special voluntary disclosure programme (Special VDP) as announced on 24 February 2016 by the Minister of Finance. Our comments mostly relate to the tax aspects of the Special VDP, but additionally touch on non-tax issues where relevant.

Initial Thoughts

Before going into detail, we note that a number of our members have dealt with clients over the years who have expressed interest in an additional amnesty for foreign assets in terms of tax and Exchange Control. The main causes that these clients missed the 2003 amnesty and are now seeking relief are varied, including:

- Initial distrust that the 2003 amnesty would be fully executed as promised by Government (with Government having since fully lived up to its promises);
- Some applicants were uncertain about the amnesty and chose only to declare riskier offshore assets – they are now seeking disclosure of the remainder;

- Increasing international pressure on illegal funds due to the OECD BEPs project, HSBC and the Panama Papers;
- Omissions within the initial 2003 amnesty that removed certain persons from applying (e.g. the exclusion of foreign residents);
- Lack of control over all of the stakeholders involved in the offshore scheme (e.g. lack of supporting signatures from beneficiaries and / or trusts in terms of illegal offshore trusts) that prevented the applicant from successfully applying for the 2003 amnesty.
- Innocent errors since the 2003 period:
    - For instance, certain South Africans located offshore found themselves as unintended residents (e.g. when Australia changed its rules excluding persons with temporary work permits despite satisfaction of the 183 day test);
    - Other temporary expatriates erred by relying on the section 10(1)(o)(ii) offshore remuneration exemption when they, in fact, received money-for-services as an independent consultant;
- Much of the foreign assets offshore are illiquid (being shares in closely held companies with non-liquid assets); and
- Ongoing lack of full control over secretive foreign assets vis-à-vis investment choice and administrative costs.

Fundamentally at issue is the strength of the need for these clients to come forward as opposed to the cost of cleansing foreign assets. In terms of SAIT members, it is in their strong interest to have as many clients come forward as possible because credible advisors deal with legally sanctioned actions (not with attempted endorsement of illegal activities). Government, of course, needs accelerated funds to cover temporary budget shortfalls as well as an enhanced long-term tax base.

The overall pull of a taxpayer depends on the fear, anxiety and the inconvenience of holding illegal assets. We unfortunately cannot formally poll the clients of our members, and therefore, have no way of scientifically determining what is the appropriate cost relief versus demand ratio. That said, initial indications based on informal discussions with our membership are at best mixed. While it is true that illegal offshore assets are facing increasing theoretical risk, many of these clients have been down this road before. We also note that

South African enforcement after 2003 has been relatively small but for the one or two cases of excessive cash seizures at the airport.

At a member-advisor level, our members are further hampered by the uncertainties in the legislation proposed. These uncertainties are making it hard for advisors to provide clear advice for clients on the risk/reward ratio of the Special VDP with most advisors suggesting that matters not be taken forward until these uncertainties are resolved.

General Issues

Provided below are general issues raised by most of our members as initial "no-go" problems:

1. *Protection for local advisors:* Advisors need protection before assisting their clients in order not to be tainted themselves. Of concern is the Financial Intelligence Centre Act. In the last amnesty, this relief was freely given to advisors assisting in the amnesty application process. Also missed is the role of tainted facilitators, which was covered in the last amnesty.

2. *Need for broader tax coverage:* The proposed relief needs to cover all tax violations – not just the normal tax. Therefore, others taxes such as the Donations Tax, Estate Duty and Value-added Tax need to be specifically included. Illegal life-time and death-time family transfers are part and parcel of offshore violations. Many holders of illegal foreign assets (e.g. children) passively received these assets and now seek to bring the situation to order. Value-added Tax relief is also important because the illegal offshoring of assets often involves domestic businesses as well as personal activities.

3. *Amnesty window period:* The relief window period is simply too short. Time has already been lost due to the uncertainties caused by the draft proposal. Clients do not magically appear when government announcements are made. The press of life slows them down and the conversion of foreign assets to cash payable to SARS is often harder said than done. The proposed relief also requires a fair amount of tracing (see further points below), meaning that documentation collection will be elongated. We therefore suggest that the amnesty be extended for a period of one-year.

In making this suggestion, we surmise that government is seeking to collect money quickly to cover temporary budget shortfalls. This proposal was announced before SARS exceeded its R1 trillion collection so we question the continued urgency. If urgency is indeed an issue, we suggest that National Treasury create two tiers – one cost for paying by 31 March 2017 and another slightly higher cost for paying thereafter.

4. *Unknown disclosure:* The amnesty does not apply to amounts that have "been disclosed to SARS under an international agreement." While we suspect that not too many of these circumstances actually exist, this prohibition creates an unknown risk for all applicants that will dissuade disclosure. We suggest that the prohibition apply only when SARS has provided direct notification to the applicant of SARS's awareness of offshore illegal funds.

5. *Relationship between the standard VDP and the special VDP:* The relationship between the standard VDP and the Special VDP is unclear. We assume that applicants should have a choice. If so, what is the latest point that this choice can be made?

6. *Prohibition against trusts:* The tax administration portion of the amnesty legislation seems to preclude all applications in respect of trusts; whereas, the money bill portion merely requires a "deemed to have been held" election. Presumably, *be wind* and vesting trusts should be covered by the proposed relief. On the other hand, we believe that it is intended that discretionary trusts require an election before being eligible. Clarification is required on this point.

7. *Partial errors:* Given some of the factual complexities of taxpayer situations, it is not entirely clear what will happen if taxpayers are found to have made errors in their applications. Concerns exist that SARS can review and challenge relief applications at a later date, thereby undermining all of the protection sought.

8. *Offshore foundations:* Like the 2003 amnesty, the Special VDP fails to provide relief for offshore foundations. Significant sums exist in this space and the Special VDP should create rules so these amounts can be disclosed.

Primary Concerns

A. *Nature of the amnesty: Initial (50 per cent inclusion)*

As a general matter, the current nature of the amnesty requires far too much tracing of historic records. The persons at issue must trace initial amounts moved offshore with sufficient proof. This proof may be hard to obtain if the initial movement occurred many years ago. It should also be noted that financial institutions charge substantial amounts for gathering this information (representing an additional cost that does not benefit the applicant or Government). In addition:

- Not all applicants know where their funds are derived from. Many applicants received these amounts as gifts or inheritances at a later date;
- Records may be lost (even for years not so long ago) because the initial collection of this information may have seemed irrelevant or of lesser significance; and
- Legal and illegal amounts may have been commingled, especially where the shift offshore involved transfer pricing abuses (which were common).

In view of these concerns, the Committee members strongly suggest that the amnesty be based on the value of the offshore assets seeking tax clearance at a set point in time. The date would preferably be as of 24 February 2010 or later. Applicant relief would simply match the disclosure of assets like the old amnesty utilising an "insurance" model. The more assets disclosed – the more relief given (and the greater price paid for the relief). The benefit of this approach is to simplify the information process, thereby simplifying and accelerating Special VDP collections.

Technical point: We also note that the wording of section 13(2)(a) of the proposed legislation probably does not read as intended. We presume that the goal is to impose the 50 per cent charge only in respect of funds initially moving offshore. However, the words appear to impose a charge in respect of the acquisition of all "assets situated outside the Republic" before the 1 March 2015 date even if funded from pre-existing offshore amounts. Also, what is the meaning of the term "asset"? We presume that the term was not meant to exclude

South African and foreign currency (see the capital gains tax definition of asset as defined in paragraph 1 of the Eighth Schedule).

One concern raised by a number of advisors is the potential for double taxation in the proposed approach. The seed money is subject to the 50 per cent rule regardless of whether the amounts were fully taxed or illegal while earned onshore. Many contend that this rule effectively amounts to a double tax.

B. *Nature of the amnesty: 5 Five Years of Returns*

In theory, we understand the desire to have five years of tax returns dating back to 2010. Based on the standard VDP, we assume that interest will apply for underreported amounts but not penalties. Again, the assembly of five years of records greatly enhances the information collection required. The net result is a slower process and higher compliance costs. Better to have a simple asset charge on assets as of a certain date (i.e. 24 February 2016) with a higher price than to force reviews of old returns.

Technical point: We are not sure whether the amnesty process will smoothly co-ordinate with the year-end closings of 31 March 2016 and 2017. In particular, we are concerned that Special VDP applications starting from October 2016 will create administrative co-ordination issues in respect of final and provisional tax returns for the 2016 and 2017 years.

In short, these 5-year review of returns should be dropped and illegal assets tested solely as of 24 February 2016. If this test is to remain, an error in a particular year, should not undermine amnesty protection for the other four years or the initial offshore shift of capital.

C. *Overall cost of the amnesty*

The overall cost of the Special VDP is fairly high. So high in fact that many clients may be dissuaded from the Special VDP altogether. The charge on capital (50 per cent times 40 per cent), the 5-years of charges on taxable income and the 10 per cent Exchange Control will, in aggregate, be much higher than the aggregate charge of the 2003 amnesty.

The Committee is of the view that the total cost of the amnesty should not exceed 25 per cent of total assets disclosed if funds remain offshore and 15 per cent if the assets are brought back to South Africa. Stated differently, taxpayers should be required to include 25 per cent of total offshore illegal assets as income as at 24 February 2016 (with the charge applying at the top marginal rate of 41 per cent) plus a 10 per cent Exchange Control charge for leaving illegal assets offshore. We also note that this charge is not insignificant given the recent devaluation of the Rand vis-à-vis assets held offshore.

With an aggregate-asset approach as suggested above, the benefit / burden calculation will be easier. Again, the price of the Special VDP directly correlates to the amount of relief desired. Alternatively, the Special VDP could contain an aggregate ceiling so that applicants can at least make an early determination to go forward.

SAIT thanks you for requesting comment on this very important matter. We appreciate the fact that comment was requested before sending the proposed legislation to the Standing Committee on Finance.

Yours sincerely

Keith Engel

Chief Executive