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RE: REQUEST FOR AN EFFECTIVE DATE TECHNICAL CORRECTION ARISING FROM 2015 TAX LEGISLATION

This is a request for a technical correction stemming associated with the 2015 Taxation Laws Amendment Act. At issue is the effective date of a change to section 42(5), which was inadvertently retrospective for a taxpayer's activities.

1. Transaction

The taxpayer entered into a transaction over the course of 2015 with the process beginning before the 2015 taxation amendment bill was ever released. More specifically,

- Documentation was signed on 2 June 2015 (subject to certain conditions precedent, such as competition commission approval and deeds office approval).
- Implementation took place at the end of October 2015 once the conditions precedent were satisfied.
- The transaction was reported to SARS during December 2015 (as a reportable arrangement).

2. Current April 2015 Effective Date

Section 42(5) was amended by section 62(1)(e) of the Taxation Laws Amendment Act (No. 25 of 2015) promulgated 8 January 2016. In terms of section 62(2) of that Act, the amendment has a retrospective effective date of 1 April 2015.

We believe that this outcome is unfair, especially because the amendment was not driven by urgent anti-avoidance concerns. Annexure C of the 2015 Budget Review merely stated that “the current anti-avoidance measure in section 42(5) of the Income Tax Act [was] creating anomalies and need[ed] to be clarified.” We further understand that the amendment was undertaken at the behest of certain taxpayers to remove overly harsh results for taxpayers.

When the taxpayer entered into the transaction on 2 June 2015, we note that the details of the legislation were wholly unavailable. Moreover, when the draft Tax Laws Amendment Bill 2015 was published for public comment on 22 July 2015, the draft bill lacked any specific effective date for the proposed change to section 42(5) (see clause 58). The explanatory memorandum, however, specify the effective date as the date of promulgation (see section 2.3 (IV) of the explanatory memorandum (page 14 of version accessed at the National Treasury website on 23 May 2016).

However, for reasons unknown, the final legislation moved the effective date to 1 April 2015 - even before the taxpayer’s agreement was signed (see section 62(1)(e), effective date of 1 April 2015 by reason of section 62(2)). Meanwhile, the explanatory memorandum continues to reflect the date of promulgation as the effective date (section 2.2 (IV) of the explanatory memorandum (page 15 of version accessed at the SARS website on 23 May 2016)).

3. Unintended Impact on Share buybacks

The purpose of section 42(5) was initially to prevent the conversion of trading stock and / or allowances assets into capital gains by undertaking a section 42 involving those assets, followed by a sale of shares newly received in exchange. The explanatory amendment states that anomalies would be removed by having a gross income inclusion, but the actual legislation creates an automatic “income” inclusion.

The net effect of the use of the word “income” (as opposed to gross income) is to trigger ordinary revenue for buy-backs, redemptions and other company reacquisitions of their own shares. While this result may seem to make sense given that a share reacquisition is a disposal from a shareholder perspective, one should not forget that a share reacquisition is a transaction involving the shareholders and the underlying company. The only potential abuse in these circumstance would be the surrender of the shares in exchange for the initially transferred trading stock and /or allowance assets. This exchange, however, triggers a charge at the corporate level, which includes ordinary revenue (see sections 8(4), 22(8) and paragraph 75 of the Eighth Schedule). Therefore, there is no need to have a second ordinary charge for the shares.

4. Ultimate Recommendation

We recommend that the 2015 changes to section 42(5) be revisited or at least that the effective date be postponed to promulgation date. It is clear that the legislation is having an adverse impact on certain taxpayers (which is contrary to the understanding that adverse legislation will not have retrospective application to a date earlier than announcement).

For additional information on the points outlined above, see the attached link to a Werksmans article (by Ryan Killoran) - <http://www.werksmans.com/legal-briefs-view/asset-share-transactions-beware-selling-shares-within-18-months-especially-context-share-buy-back/>

We hope that the proposed change to the effective date as outlined above can be included within the 2016 taxation laws amendment bill.

Yours sincerely,

Keith Engel

Chief Executive