

24 May 2018

The South African Revenue Service
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BY EMAIL: policycomments@sars.gov.za

RE: DRAFT INTERPRETATION NOTE: SECTION 23I PROHIBITION OF DEDUCTIONS FOR CERTAIN INTELLECTUAL PROPERTY

We write to comment on the draft interpretation note on section 23I. The section prohibits deductions of expenditure incurred for the right or permission to use intellectual property under certain circumstances.

A. Legislation

Section 23I was amended in 2017 by the addition of subsection (4). This amendment applies the comparable tax exemption test to a controlled foreign company for purposes of section 23I. It became effective for years of assessment commencing on or after 1 January 2018. This subsection has not been included in the law quoted in the draft interpretation note and has also not been discussed. It appears to have been an oversight and we suggest that subsection (4) should also be discussed.

B. Comments for consideration – the meaning of “corresponding invention”

It is stated on page 5 of the draft interpretation note that:

Applying the above definition, “corresponding invention” refers to another invention which has similar features to the one used by the end user.

The statement is not correct. In intellectual property law, “corresponding invention” refers to the invention claimed in a patent. A person cannot really use a patent, instead the person uses the invention claimed in the patent. As a general matter, the definitions used in the draft interpretation note should be based on our body of intellectual property law, rather than dictionary definitions.

C. Comments for consideration – bare dominium property schemes

It is stated on page 7 that:

Section 23I also applies to bare dominium intellectual property schemes. These schemes involve the ownership of intellectual property by a taxable person (the bare dominium holder), while the right of use is vested in a taxable end user.

A further requirement which should be mentioned is that a third party enjoys the royalty benefits.

D. Comments for consideration – material part

It is stated on page 8 that:

Thus, in order to be classified as tainted intellectual property, a taxable portion must have made use of a significant portion of the intellectual property while carrying on a business. Deciding what a “significant portion” amounts to is subjective. It is, however, considered that 20% or more would be material.

It is not clear by what criteria the 20% will be measured e.g. volume, value, etc. Or would it be different on a case-by-case basis?

We welcome the opportunity to comment on the draft guide and look forward to future engagements.

Yours sincerely

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