South African Institute of Tax Professionals

23 August 2019

The National Treasury
240 Madiba Street
PRETORIA
0001

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

VIA EMAIL: National Treasury (2019AnnexCProp@treasury.gov.za)
Adele Collins (acollins@sars.gov.za)

RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2019 (draft TLAB)

We have attached the comments from the SAIT International Tax Work Group on the draft Taxation Laws Amendment Bill (draft TLAB) pertaining to key international tax issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Yours sincerely,

The SAIT International Tax Work Group

T (012) 941 0400
F (086) 626 0650
E info@thesait.org.za
W www.thesait.org.za

Riverwalk Office Park, Building A
C/O Garsfontein & Matroosberg
Roads, Pretoria, South Africa, 0081
Reg no 2007/014730/08

PO Box 712
Menlyn Retail Park
0063

All references are to the Income Tax Act, No. 58 of 1962 (the ITA), unless otherwise indicated.

1. Reviewing the comparable tax exemption

[Applicable provisions: Section 9D(2A), further proviso (i)(aa) and (ii); section 23I]

Proposed amendment

National Treasury is of the view that due to the global trend towards lower corporate tax rates, the current 75% threshold is no longer comparable. The proposed solution is to reduce the comparable tax exemption threshold to 67.5%, effective from years of assessment ending on 1 January 2020.

Problem identified and suggested solution

The effective date appears to be retrospective, and will apply to existing arrangements. Although, considering the fact that the UK is lowering their tax rate to 17% on 1 January 2020, it seems that the amendment may be out of date before it has been made effective. We refer here to the UK Budget 2016, wherein the UK Government announced a further reduction to the corporation tax main rate (for all profits except ring-fence profits) for the year starting 1 April 2020, setting the rate at 17%. It is recommended that a 15% base rate be implemented in line with international practice.

While slightly outside the scope of the draft TLAB, we wish to reiterate that this form of controlled foreign company (CFC) relief remains administratively burdensome. A hypothetical tax calculation for each foreign subsidiary becomes especially difficult for South African multinationals with multiple foreign subsidiaries. Accounting and the information systems in the foreign local country are geared solely for the country's own local tax systems and not for hypothetical South African tax calculations.

Most foreign subsidiaries (especially in Africa) lack staff dedicated solely to tax issues, thereby requiring head office involvement for the hypothetical calculation. Head office staff dedicated to foreign operations is often stretched without regard to the CFC rules (usually being only one or two head office support per group). Our view is that there is a need to simplify the calculation without undermining the policy intent of ensuring that the foreign location is reasonably taxed. A number of companies in the industry are repeatedly asking for administrative relief in this regard.

2. Addressing circumvention of controlled foreign company anti-diversionary rules

[Applicable provision: Section 9D(9A)]

Proposed amendment

In order to address the multinational enterprises that are circumventing CFC anti-diversionary rules by diverting profits to members of the group that are subject to tax at a lower rate and are not subject to the specific anti-diversionary rules. It is proposed that changes be made to section 9D to extend the anti-diversionary rules to include both direct and indirect transactions, to become effective in respect of years of assessment commencing on or after 1 January 2020.

Problem identified and suggested solution

The work group questions the return of the diversionary rules in the first instance. These rules were removed many years ago as quite accurately hitting legitimate structures. Moreover, the rules were introduced to supplement transfer pricing rules, and to counter the fact that SARS at that time did not have a strong transfer pricing unit. SARS' current unit is sophisticated and operates well within the industry.

The aim is for transfer pricing rules and enforcement to be sufficient to manage the risk. Especially since CFC legislation itself (without even adding anti-diversionary rules) already affects South Africa's competitiveness in the global arena. However, if there is still a concern that certain scenarios pose risk and cannot be policed under the current legislation, the remedy elected to address the risk should be clear and targeted. The rationale and the offending transactions and/or scenarios should be started explicitly.

In our view, the proposed amendment may not only fail to curtail the avoidance being targeted, but may also unintentionally draw in scenarios that are legitimate. The target of the legislation is unclear. In particular, the broad application of the word "indirectly" makes it unsuitable under the circumstances (e.g., it remains unclear whether the concept of "indirectly" can effectively be applied to transactional sales and services).

Considering that the concept/word ("indirectly") is also used for indirect ownership under section 9D and as such has an existing interpretation and ambit, there is a strong possibility that its use may lead to greater confusion. Since rules such as these are factors in determining a country's competitiveness, it is important to ensure that their ambit and application are unequivocal.

We request that further engagement with industry follow in order to ensure that the remedy decided upon is clear and unambiguous for both taxpayers and SARS.

3. Clarification of the qualifying criteria for domestic treasury management company

[Applicable provision: Section 1 of the Act - definition of "Domestic Treasury Management"]

Proposed amendment

The proposed amendment aims to reconcile the perceived misalignment between the definition of a domestic treasury management company (DTMC) in the ITA and in SARB Circular 5/2013. The amendment proposes the reinstating in the ITA for a DTMC to be incorporated or deemed to be incorporated in South Africa in respect of new companies that are registered with SARB for the first time on or after 1 January 2019. However, the requirement is not intended to apply to those companies that were already incorporated or deemed to be incorporated offshore if registered with SARB before 1 January 2019.

Problem identified and suggested solution

The DTMC relief

We understand that the DTMC relief was originated to protect South Africa's global competitiveness, i.e., to allow South Africa to compete effectively by allowing for groups to locate their treasury management companies with South African incorporation, rather than as, for example in Mauritius, with South African effective management.

At a later stage, it was successfully argued that should foreign incorporated treasury companies decide to move to South Africa to take advantage of the relief, they may trigger unfortunate tax and other consequences in their country of incorporation. The barrier of having to be incorporated in South Africa was thereafter removed from the requirements of the DTMC relief.

If the amendment goes through, the possibility for groups to bring their foreign treasury operations onshore falls away, unless the group is prepared to transfer its foreign treasury operations / business from a foreign company into a South African company. The main (or only) tax benefit that a DTMC offers then is that it can have a functional currency other than ZAR.

The reasoning behind the retraction of the previous relaxation is not clear; the amendment does not apply only if SARB has jurisdiction. According to the proposed amendment, the company must be incorporated or deemed to be incorporated under South African law, i.e., not registered under the Companies Act, because a foreign incorporated company registered here as an external company would still qualify.

Furthermore, comparing South Africa's "headquarter company" package, with the (proposed) limited DTMC relief is telling: The headquarter company has the same benefit as a DTMC (and some extras) and it is possible to be a headquarter company simply by making an election. However, with the headquarter company, the option to have a functional currency other than ZAR is not available.

In order to keep the DTMC relief competitive, it is recommended that if a foreign company falls outside of the exchange control net, then the legislation can provide that the foreign company may elect to be a DTMC (with no exchange control requirement) if it is a tax resident in South Africa. Lastly, it may be valuable to note that foreign banks are far more amenable to making loans at all, or making loans on better terms, to non-South African companies than to South African companies.

The retrospectivity of the amendment

There are a number of groups that have established offshore DTMCs under the current regime. Given that the matter was not addresses in the Budget Speech, there may be unintended consequences for these groups that are caught in the middle.

4. Reviewing of the "affected transaction" definition in the arm's length transfer pricing rules

[Applicable provision: Section 31, definition of "affected transaction"]

Proposed amendment

Changes are to be made in section 31 so that the scope of the transfer pricing rules be extended to also include transactions between persons that are not connected persons, but that are "associated enterprises" as described in Article 9(1) of the OECD Model Tax Convention on Income and on Capital (MTC). The proposal will be effective in respect of years of assessment commencing on or after 1 January 2020.

Problem identified and suggested solution

The commentary on Article 9 of the MTC has a stronger relationship in mind than that described in the proposal. Furthermore, although the South African definition of "connected person" has too low of a percentage in many cases, the analysis is largely free of the facts-and-circumstances analysis of associated persons (joint management and control).

It is unclear why a change that is a one-way street against the taxpayer is justifiable. In essence, one could just replace the South African definition with the OECD definition, especially if treaty principles should dominate cross-border analysis. Furthermore, the facts- and circumstances-analysis is based on OECD precedent – not South African law. As a result of this mismatch, the stated facts-and-circumstances approach creates uncertainties. The work group is not aware of other countries that follow this approach. Indeed, it appears that most countries use their domestic connected / related party test as opposed to the treaty test. It is also unclear whether the commentary is included.

In order to shift profits on the basis of a relationship, a taxpayer should have access and control over the give and take of the process. Through bringing the concept of "associated enterprises" in, the net in respect of transfer pricing will be thrown too widely and will include a true arm's length transaction. It is recommended that the legislation remain as is.

As a side note, it is the view of the work group that the 20% threshold is too low and often picks up parties that are legally connected but not economically connected.

5. Clarification of the interaction of capital gains tax and foreign exchange transaction rules

[Applicable provisions: Section 24I and paragraph 43 of the Eighth Schedule]

Proposed amendment

The rules for companies and trading trusts in paragraph 43 of the Eighth Schedule will be amended by inserting a new proviso to provide an appropriate mechanism for eliminating double taxation. The amendment is to apply in respect of years of assessment commencing on or after 1 January 2020.

Problem identified and suggested solution

It appears that the policy intent is clear, and that the matter may be resolved through providing interpretative clarity. As such, the work group questions whether it is necessary to have this clarification in legislation given the operation of paragraph 35(3)(a). Lastly, the example used in the EM may be misleading since paragraph 43(6A) specifically excludes debt.

End.