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

RE: DRAFT IN 18 ISSUE 4 - REBATES AND DEDUCTIONS FOR FOREIGN TAXES AND INCOME

We write to comment on the draft interpretation note on rebates and deductions for foreign taxes and income. We request your indulgence for the delay in submitting our comments.

A. Legislation

The draft Interpretation Note (IN) changes relate to the repeal of the section 6quin credit in 2015/2016, along with the consequential deduction for foreign taxes paid or proved to be payable in section 6quat(1C) and (1D).

B. Comments for consideration - The consequential deduction for foreign taxes paid or proved to be payable in section 6quat(1C) and (1D)

From a policy point of view, a tax credit is supposed to be granted only for foreign sourced income, and only where the foreign jurisdiction has a valid claim (enforceable without dispute). However, the power imbalance of pitting taxpayers against foreign Revenue Authorities overstepping their bounds, is commonly acknowledged, and catered for in legislation.
The main purpose of section 6quin was to allow for tax credits when foreign countries impose taxes on South African source income from services. When section 6quin was repealed, National Treasury committed to allowing for the deduction under section 6quat as an alternative.

At the time, National Treasury indicated that section 6quin credits would no longer be allowed, but taxpayers could at least claim deductions for foreign taxes wrongfully required if the only alternative would be ‘competent authority’; i.e. section 185 of the Tax Administration Act, No. 28 of 2011, which makes provision for the recovery of tax on behalf of foreign governments.

Requests for assistance in recovery of tax can be made by the South African Competent Authority (SARS) to the Competent Authority of the relevant tax treaty partner with whom South Africa has a double taxation treaty or agreement in place; or by the Competent Authority of the relevant foreign tax treaty partner with whom South Africa has a double taxation treaty or agreement in place.

However, it is commonly accepted that ‘competent authority’ is largely impractical in these circumstances. This is an important issue because many countries (e.g. Tanzania), violate tax treaties with impunity, whilst not being open to dialogue via the ‘competent authority’ mechanism. It should also be noted that since the ‘competent authority’ is under SARS’ auspices, SARS is free to exercise that option at any point.

The changes in respect of section 6quat(1C) and (1D) are of concern because this interpretation effectively nullifies the impact of the deductibility of certain foreign taxes. This interpretation is concerning, because not only does it appear not to recognise that the ‘competent authority’ process is wholly within the mandate of SARS, but the main reasoning on initially allowing the 6quat application under those circumstances was that even if the expense was not a legitimate tax, it would still be a recognised business cost that should get some tax relief. The current interpretation completely reverses this understanding.
The draft ruling now seems to suggest that foreign taxes wrongfully imposed in these circumstances will no longer be deductible because the taxes themselves are not “proved to be payable”. Taxpayers must now bear the full brunt of double taxation without relief. The ruling even provides an example specifically working against taxpayers.

We request that the initial policy intent be following in respect of this legislation.

C. Comments for consideration - Ambit of section 6quat

We refer to Part 6 (p77), on section 6quat(1C). The first paragraph is objectionable because it says "The deduction under section 6quat(1C)(a) is therefore limited to foreign taxes levied on South African-source income derived from trade operations."

Subsections (1C) is not limited only to foreign taxes on South African-source income, but also applies to foreign taxes on foreign-source income if those foreign taxes fail (1A) due to not being "proved to be payable".

Our concern in respect with the opening paragraph (on p.77) starts when it is stated in the preceding sentence: "Its application is limited to foreign taxes on income other than taxes contemplated in section 6quat(1A). Section 6quat(1A) refers to section 6quat(1) which considers income and capital gains from a foreign source."

The second sentence is incomplete and misleading. Subsection (1A) does not refer only to subsection (1). Rather, there are two requirements, namely: (1) the taxes must be "proved to be payable"; and (2) they must be South African source ... i.e. the reference to subs(1).

This means that if a foreign tax is in fact a tax on foreign-source income, but is not proved to be payable, then such a tax would also be disqualified from subsection (1A) ... and thus fulfil the requirement of "other than taxes contemplated in section 6quat(1A)". The deduction for foreign taxes was always intended to be more expansive – indeed, imposition of a foreign source limitation effectively renders the provision meaningless.
Again, we recollect that the expansion of subsection (1C), to include foreign taxes that are simply "paid", coincided with the deletion of section 6quin, which (similarly) permitted foreign taxes that were either: (1) levied on SA-source income --irrespective of whether its proved to be payable; or (2) not proved to be payable --essentially incorrectly/unlawfully levied by the foreign tax authority--irrespective of source.

D. **Comments for consideration - Limiting the application of section 6quat**

The IN also seems to be narrowing the deduction for section 6quat even further by:

- Stating that section 6quat is no longer elective (i.e. credit must be chosen first); and
- Stating that the taxes must be imposed as part of a trade (as opposed to passive income) due to section 23(g).

Both these limitations were never intended when the legislation was introduced. We also question whether these limitations are a plausible interpretation.

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

Yours sincerely

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