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DONATIONS TAX

2586. Introducing a BEE shareholder

On 19 October 2016, the South African Revenue Service (SARS) issued a binding private ruling (BPR 253) which deals with the donations tax consequences in respect of a transaction which has the effect of introducing a Black Economic Empowerment (BEE) shareholder into a group of companies in order to benefit all the entities within the group in respect of their BEE scorecard ratings and increase the profitability of the Applicant (X), a South African resident company.

The other parties to the proposed transaction are the Seller (Y), a South African resident trust that holds all of X’s shares, Company A (A), a South African resident non-profit company, and the Acquirer (Acquirer), a South African resident company whose shares are wholly-owned by A. SARS had to decide whether the disposal of Y’s shares in X at a discounted price and the subsequent acquisition of the shares by Y in the Acquirer at a nominal subscription price, in order to introduce the acquiring company into Y’s existing group structure for BEE purposes, constitutes a donation in terms of the Income Tax Act, 1962 (the Act).

The proposed transaction can be described as follows:
Prior to the transaction the Acquirer possesses no assets or liabilities. Y and the Acquirer propose to enter into the following transactions as an indivisible transaction:

- While the Acquirer is still a wholly-owned subsidiary of A, Y will dispose of 26% of the issued equity shares in X to the Acquirer for a purchase price which is the lower of:

- the market value of the shares at the date of disposal less a 10% discount; or

- a capital sum of 40% of X’s future dividends that will either be received by or accrue to the Acquirer over the eight year period following the disposal.

Furthermore, Y’s outstanding claim for the capital amount of the purchase price shall be payable in interest free instalments over the eight year period. In addition, immediately after Y’s disposal of 26% of the issued equity shares held in X to the Acquirer as part of the same indivisible transaction, Y will subscribe for 49% of the issued equity shares in the Acquirer at a nominal subscription price.

Having considered the facts of the proposed transaction and the wording of the relevant sections of the Act, SARS ruled that:

- Firstly, neither the disposal by Y of 26% of X's issued equity shares to the Acquirer at a discounted price (as contemplated above) nor the subsequent acquisition by Y of 49% of the equity shares in the Acquirer at a nominal subscription price will constitute a "donation" as defined in section 55(1) of the Act.

- Furthermore, neither of these transactions will be deemed to be a donation as envisaged in section 58(1), and section 57 of the Act will not be applicable to the proposed transaction.

SARS ruled that the ruling is subject to the additional condition and assumption that Y and the Acquirer are independent parties dealing at arm's length.

Section 55 of the Act defines a donation as any gratuitous disposal of property including any gratuitous waiver or renunciation of a right. As a brief comment to BPR 253, it should be noted that in *Welch's Estate v CSARS* [2005] 66 SATC 303, the Supreme Court of Appeal held that the legislature did not eliminate from the statutory definition of "donation" the common law requirement that the disposition be motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a quid pro quo of some kind from whatever source it may come.

As the disposal of X's equity shares to the Acquirer will take place to improve the BEE scorecard ratings of the group, amongst other things, the donation is not motivated by pure liberality or disinterested benevolence and it is done for self-interest and with the expectation of a quid pro quo. It is most likely for this reason that SARS ruled that the transactions did not constitute a "donation" as defined in the Act.

Cliffe Dekker Hofmeyr

ITA: Sections 55, 57 and 58
BPR 253

Editorial Comment: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear.

GROSS INCOME

2587. Date of accrual (refer to article 2582 February 2017)

A pivotal aspect of the judgment in the Income Tax Court for the Eastern Cape delivered on 20 August 2016 (*ABC (Pty) Ltd v CSARS* Case No. 13539/13673), was a finding that the Productive Asset Allowance (PAA) certificates accrued when the importation of qualifying goods occurred.

The PAA certificate was an instrument used by the Department of Trade and Industry to pay incentives under the Motor Industry Development Programme (MIDP). An approved participant which, based on the value of the investment made in qualifying productive assets, qualified for an incentive known as the PAA, submitted annual applications for the payment of the incentive, which was spread over a five-year term.

Payment was effected by the issue of PAA certificates which the participant could redeem by claiming, for duty purposes, a reduction in the value of specified imported goods cleared for entry into South Africa. In the event that the participant did not redeem the certificates within 12 months, the certificates ceased to be valid.

The law

Gross income, as defined in the Income Tax Act, 1962 is the total amount, in cash or otherwise, received by or accrued to or in favour of a person who is a resident in a year of assessment, other than an amount of a capital nature.

The term "accrued to" has been judicially interpreted to mean that the person must have become entitled to the amount in question –this principle was established in *WH Lategan v CIR* [1926] 2 SATC 16 at paragraph 20.

It was required that an "amount" should have accrued, and Watermeyer J in *WH Lategan v CIR* (*supra*) at page 19 stated that the term "amount":

"… must include not only money but the value of every form of property earned by the taxpayer whether corporeal or incorporeal which had a money value".

As to whether a benefit that was not tradable constituted an amount, the Supreme Court of Appeal has determined that this is not a requirement, and that the only requirement for an amount to have accrued is that it should have an objective monetary value. This was expressed by Cloete JA in *CSARS v Brummeria Renaissance (Pty) Ltd and Others* [2007] 69 SATC 205 at 214:

"It is clear … that the question whether a receipt or accrual in a form other than money has a money value is the primary question and the question whether such receipt or accrual can be turned into money is but one of the ways in which it can be determined whether or not this is the case; in other words, it does not follow that if a receipt or accrual cannot be turned into money, it has no money value. The test is objective, not subjective".

Cloete JA went on to consider the decision in *Stander v Commissioner for Inland Revenue* [1997] 59 SATC 212, in which it had been held that a benefit that was not tradable had no value, and found that the matter was wrongly decided. This is found in the words that immediately follow the passage cited above:

"It is for that reason that the passages quoted from the *Stander* case incorrectly reflect the law and the reasoning of Conradie J in *ITC701* was correct. The question cannot be whether an individual taxpayer is in a position to turn a receipt or accrual into money".

For an amount to accrue to a taxpayer, there are two further requirements that must be met. The first is that the amount must accrue to the taxpayer for his own benefit (*Geldenhuys v CIR* [1947] 14 SATC 419 at paragraph 431). The second is that the amount must be unconditionally received (*Mooi v* [1972] *CIR* [1972] 34 [1972] SATC 1 (A) at paragraph 10-11) and that no accrual takes place while the operation of the benefit is suspended by an unfulfilled condition, during which time any right to the enjoyment of the benefit is contingent.

Application of the law

Applying the law to the accrual of a PAA certificate, the expected outcome should be determined as follows:

The PAA certificate is an instrument, and therefore a form of incorporeal property;

Objectively the PAA certificate has a monetary value as it may be redeemed in return for a discount on the duty payable on importation of goods, the value of which is objectively determinable.

The recipient has the power to exercise the redemption immediately upon the accrual of the PAA certificate, and there is therefore no condition attached to the issue of the PAA certificate that postpones the rights of the holder.

The conclusion that should be reached is that the PAA certificate constitutes an amount that accrues to the recipient upon issue.

The Court's approach

Schoeman J took a completely different approach. Her approach is found in paragraph 22 of her judgment:

"However, if the PAA certificate was not utilised, within a stipulated period, as payment for customs duties on imported motor vehicles, the PAA certificate would lapse. The certificate was not tradable. <u>The certificate was conditional and did not accrue until there were imports</u>. If there were no imports within the necessary time frame, the condition had not been fulfilled and the certificate could not be used. The certificates only had value upon import of motor vehicles and not when the capital expenditure was incurred". (*Emphasis added*)

There appear to be fatal flaws in this logic.

The first appears to be a perception that the PAA certificate was subject to suspensive conditions. The limitation of the time within which the certificate may be redeemed in no way suspended its operative effect. This was a resolutive condition. The fact that the PAA certificate had a limited application and could only be used to claim a rebate of import duty did not deprive it of its legal effect or defer that legal effect.

The second is an apparent reliance on the idea that the PAA certificate could not have value because it was not tradable. Reliance on this factor has been held by the Supreme Court of Appeal to be wrong and, until such finding is overturned, that is the law and Schoeman J should have recognised that she was bound by it.

The third flaw is that the time of accrual occurred when the PAA certificate was redeemed. This finding rides roughshod over the undisputed principle that an amount that has monetary value accrues when a person becomes entitled to it, and not when the value is realised (and even if the value is never ultimately realised).

Commentary

It is submitted that the finding of Schoeman J that accrual was deferred until importation of the goods was wrong in law.

The finding that the PAA certificates did not accrue until there were imports was the *deus ex machina* which enabled Schoeman J to justify a conclusion that the subsidy related to the importation of motor vehicles and not to the qualifying investment. She recognised that the cause of the subsidy was the capital expenditure ("*… the grant was made due to capital expenditure*"), and, to get to her desired destination, she crafted a finding that accrual only occurred at the time of the importation of motor vehicles. Thus, she reasoned, the accrual could not have arisen as a result of the capital expenditure but only as a result of the importation. By this means, it could be concluded that, because the accrual occurred at the same time as the liability to import duty arose, the cause of the accrual was the incurral of the liability to duty.

It is considered likely that another court might view the matter in a different light.

PwC

ITA: Section 1(1) – definition of 'gross income'

TAX ADMINISTRATION

2588. Penalties: the application of "bona fide inadvertent error"

30 min CPD VERIFIABLE ARTICLE

What is the "*bona fide* inadvertent error" relief?

The Tax Administration Act, 2011 (the TAA) introduced the understatement penalty regime with effect from 1 October 2012, typically resulting in much more severe penalties for taxpayers. In response to much public outcry, the Minister of Finance, Mr Pravin Gordhan, announced in the budget speech on 27 February 2013 that the understatement penalty provisions would be refined and there would be relief for *bona fide* errors.

The Tax Administration Laws Amendment Act, 2013, then introduced an exclusion from understatement penalties for an understatement resulting from a "*bona fide* inadvertent error". This relief was backdated to the commencement of the TAA namely, 1 October 2012.

What did the explanatory memorandum say about this?

The Draft Memorandum on the Objects of the Draft Tax Administration Laws Amendment Bill 2013 set out in clause 2.62 how *bona fide* inadvertent errors would be assessed, as follows:

"*In determining if the 'understatement' results from a bona fide inadvertent error, a SARS official will generally have regard to the circumstances in which the error was made as well as other factors, for example:*

- *In the context of factual errors—*
- *if the standard of care taken by the taxpayer in completing the return is commensurate with the taxpayer's knowledge, education, experience and skill and the care a reasonable person in the same circumstances would have exercised;*
- *the size or quantum, nature and frequency of the error;*
- *whether a similar error was made in a return submitted during the preceding years; or*
- *in the case of an arithmetical error, whether the taxpayer had procedures in place to detect arithmetical errors.*
- *In the case of a legal interpretive error, whether—*

- *the relevant provision of a tax Act is generally regarded as complex;*
- *the taxpayer took steps to understand it including following available explanatory material or making reasonable enquiries; or*
- *the taxpayer relied on information that, although incorrect or misleading, came from reputable sources and a reasonable person in the same circumstances would be likely to find the relevant information complex."*

However, the final Memorandum on the Objects of the Tax Administration Laws Amendment Bill 2013 replaced this wording with the following (now at clause 2.75):

"The proposed amendment will apply with effect from 1 October 2012, but will also apply to understatements made in a return before 1 October 2012. Due to the broad range of possible errors, the proposal to define the term ''bona fide inadvertent error'' has the potential to inadvertently exclude deserving cases and include undeserving cases. SARS will, however, develop guidance in this regard for the use of taxpayers and SARS officials."

What does the "guidance" say?

Even though the Memorandum on the Objects of the Tax Administration Laws Amendment Bill 2013 said that SARS would develop guidance for the use of taxpayers and SARS officials, almost 3 years on, it appears that no such guidance has been developed.

What is SARS doing in practice?

Absent formal, publically disclosed guidelines, SARS officials appear to be at a loss as to how to apply the *bona fide* inadvertent error exclusion, with the result that it seems that they tend to simply ignore it. In the circumstances, taxpayers are routinely assessed for understatement penalties, as if the *bona fide* inadvertent error exclusion had not been introduced in the first place.

What is the legal position?

The terms *"bona fide"* and "inadvertent error" are not defined in the TAA or the Income Tax Act and therefore the ordinary meaning of each word must be determined.

"Bona fide" means "in good faith" and according to the Oxford Dictionary means "real" or "genuine". It refers to a sincere, honest intention or belief and represents the mental and moral state regarding the truth. The opposite of good faith is bad faith (*mala fide*) and this may involve intentional deceit.

"Inadvertent", according to the Oxford Dictionary, refers to that which is "not deliberate" and "unintentional". It refers to a state in which a consequence might have arisen from an act or omission which was never intended to arise.

"Error" in this context refers to an outcome which is objectively incorrect. In this respect, if one attempted to apply a subjective interpretation to error, the use of the term "error" in addition to "inadvertent" would be a tautology.

As a result of the above, it would appear that should an understatement be as a result of an unintentional mistake that was honestly made and did not involve intentional deceit, the Commissioner will not be empowered to impose the understatement penalty, as the relevant understatement would be a result of a "*bona fide* inadvertent error".

Section 102 of the TAA states that the burden of proving the facts on which SARS based the imposition of an understatement penalty, is upon SARS. SARS is therefore obliged to prove the bad faith or intent to claim an undue tax benefit in court, through cross-examination of the relevant witnesses. In this respect, SARS would need to persuade the court, on a balance of probabilities, that the witness is not reliable, and that the witness's version of the facts is not believable.

Conclusion

The absence of guidance by SARS legal on the meaning of "*bona fide* inadvertent error" appears to have resulted in SARS officials routinely disregarding this exclusion from understatement penalties. However, this exclusion from understatement penalties was specifically enacted to provide relief from unfair and excessive penalties, and taxpayers have a legal entitlement to proper application of this law.

The burden of proof is on SARS, in relation to understatement penalties. SARS would need to discredit the taxpayer's version of events that it acted with good faith and without intent to obtain any undue tax benefits, for any understatement penalties to be upheld by a relevant court.

Bowmans
TAA: Section 102
Tax Administration Laws Amendment Act, 2013
Draft Memorandum on the Objects of the Draft Tax Administration Laws Amendment Bill, 2013
Final Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2013

VALUE-ADDED TAX

2589. Payments on loan account

30 min CPD VERIFIABLE ARTICLE

In the case of *Claremont Library Development Company (Pty) Ltd v The Commissioner for the South African Revenue Service*, (not yet reported) the Tax Court recently considered the question of whether crediting a loan account constitutes “payment” of full consideration for purposes of the Value-Added Tax Act, 1991 (the VAT Act).

The appellant, Claremont Library Development Company (CLDC), appealed against an assessment issued by the South African Revenue Service (SARS) in terms of section 22(3) of the VAT Act. Section 22(3) of the VAT Act provides that where a vendor (who is required to account for tax on an invoice basis) has claimed an input tax deduction in respect of the acquisition of a taxable supply, but has not, within a period of 12 months from the date of such supply, made payment of the full consideration in respect of such supply, that vendor shall be liable to account for deemed output tax equal to the tax fraction of the outstanding amount not paid.

Section 22(3) is aimed at preventing the situation where the debt, being outstanding for more than 12 months, is written off by the supplier as irrecoverable and the supplier claims the bad debt relief for the output tax accounted for, and the recipient deducts the VAT charged as input tax even though no payment is ever made for the supply, which would be to the detriment of the fiscus.

On 2 April 2009, Corevest (Pty) Ltd (Corevest), the sole shareholder and holding company of CLDC, issued a tax invoice to CLDC in respect of a taxable supply amounting to ZAR 82 095 000. CLDC accordingly claimed an input tax deduction in respect of the amount incurred. On receipt of the input tax refund from SARS, CLDC paid the input tax amount over to Corevest, which Corevest then paid over to SARS as output tax. The remaining liability due to Corevest of ZAR 73 023 258 was then credited to Corevest’s loan account in CLDC's books in accordance with a funding arrangement between the parties.

Both CLDC and Corevest considered that the liability under the tax invoice had been paid after Corevest's loan account was credited. The amount in question was accordingly reflected in CLDC's financial records as a long-term debt, whereas it was reflected as a non-current asset in Corevest's books.

SARS subsequently conducted an audit in 2013, four years after the tax invoice in question had been raised by Corevest. SARS held that the consideration in respect of the supply by Corevest to CLDC was not paid in a period of 12 months following the expiry of the tax period in which the input tax was claimed, as is required by section 22(3) of the VAT Act. SARS argued that despite the fact that there was no loss to the fiscus, the provisions of section 22(3) of the VAT Act are not discretionary and that no "payment" had been made by CLDC merely by reason of CLDC having credited Corevest's loan account in this regard.

SARS held that the recording of the amount in the loan account of Corevest did not constitute "payment" of the consideration in that it remained a debt on the books. The court had to consider, having regard to the provisions of section 22(3) of the VAT Act, whether the crediting of a loan account constitutes payment of full consideration. The court found that the commercial transaction on the matter arose within the context of an agreed funding arrangement between CLDC and Corevest, as group companies, and that it was this context that should be considered in determining whether "payment" had been made.

The court recognised that what was contemplated by the funding arrangement was that the invoice would be settled by crediting the loan account of Corevest in the books of CLDC. Crediting Corevest's loan account had the effect of changing the current liability to a long-term one in CLDC's books. The court therefore considered whether in adjusting the liability to a long-term one, CLDC complied with section 22(3)(*b*) of the VAT Act insofar as it "paid the full consideration in respect of such supply", which was the subject of the invoice received.

The CLDC relied on the decision of *Commissioner SARS v Scribante Construction (Pty) Ltd* [2000] 62 SATC 443, in which a dividend declared at interest, which was credited to shareholders' loan accounts with the company, was found to constitute a payment by the company to the shareholders and as an actual deposit. CLDC also relied on the case of *Commissioner for Inland Revenue v Guiseppe Brollo Properties (Pty) Ltd* [1994] 56 SATC 47 in terms of which the enquiry turned on the overriding purpose of the loan account liability incurred. The court found that the undisputed evidence for CLDC in the matter was that the purpose of the loan liability incurred was to discharge the invoice debt.

In considering the definition of "consideration", the court held that to the extent that payment amounts to the discharge of an obligation to another, there is no reason as to why an obligation under an invoice may not be discharged through the creation of another liability such as one under a loan. The court further considered the purpose of section 22(3), being the prevention of deliberate manipulation so as to create tax benefits, and held that section 22(3) was accordingly not aimed at barring an invoice from being considered "paid" through the creation of a loan account liability where a funding arrangement exists between group companies.

Lastly, in support of its interpretation of section 22(3) of the VAT Act as one aimed at deliberate manipulation and not one aimed at *bona fide* transactions between companies within a group in circumstances in which there is no loss to the fiscus, the court acknowledged the introduction of section 22(3A) of the VAT Act, which was introduced with effect from 10 January 2012, to expressly provide that section 22(3) was not applicable in respect of taxable supplies made between group companies. However, since section 22(3A) was only effective from 10 January 2012, it was not applicable to the invoice issued by Corevest to CLDC in the April 2009 tax period.

In view of the above, the court accordingly held that the crediting of Corevest's loan account by CLDC in the context of the funding arrangement between the two companies amounted to payment of "consideration" in relation to the supply of goods and services invoiced. CLDC was accordingly not required to account for deemed output tax in terms of section 22(3) of the VAT Act. The appeal was upheld with costs (which is unusual for a tax court that does not normally award costs).

Notwithstanding the fact that this judgment deals with a transaction between group companies that is now specifically provided for by section 22(3A) of the VAT Act, it remains that the principles may be applied to transactions between non-group entities that enter into transactions, or make payment of consideration, on loan account.

ENSafrica and Cliffe Dekker Hofmeyr
VAT Act: Sections 22(3) and 22(3A)

Editorial comment: The court in effect endorsed, without mentioning the case, the decision in* CSARS v Capstone 556 (Pty) Ltd *[2016] 78SATC 231 ZASCA which entrenched the principle that tax legislation should be interpreted from a commercial perspective.

VOLUNTARY DISCLOSURE PROGRAMME

2590. Undeclared foreign assets in offshore trusts

Introduction

In the context of trusts situated in foreign participating jurisdictions, the Common Reporting Standards (CRS) require the trustees to identify the settlor, beneficiaries and other natural persons exercising ultimate effective control (including through a chain of ownership) and report the necessary financial information in respect of those persons to the relevant foreign revenue authority. In the event that the said persons are identified as residents of South Africa, the reported information will, in turn, be automatically exchanged with the South African Revenue Service (SARS).

The South African authorities have, with regard to the imminent reporting under CRS and the investigations surrounding the Panama Papers, provided an opportunity for non-compliant South African residents to regularise their tax and/or exchange control affairs in respect of offshore assets under the Special Voluntary Disclosure Programme (SVDP), which commenced on the 1 October 2016 and will close on 31 August 2017. The tax relief under the permanent Voluntary Disclosure Programme in terms of the Tax Administration Act, 2011 (permanent VDP) also remains available. It has, however, been questioned whether any alternatives to voluntary disclosure are available for South African residents with undeclared foreign assets in offshore trusts.

Timing of the automatic exchange of information

Early adopters of CRS, such as Guernsey and Jersey, are committed to commence the exchange of information from 2017 in respect of the 2016 calendar year. The so-called “fast followers” of CRS, such as Mauritius and Switzerland, are committed to commence the exchange of information from 2018 in respect of the 2017 calendar year. Although some countries have not yet undertaken to exchange information under CRS, these jurisdictions could still exchange information either on request in respect of a specific tax investigation or spontaneously in respect of information that is foreseeably relevant to a competent authority of another jurisdiction, such as SARS.

SVDP – relief granted for tax non-compliance

An application for relief under the tax SVDP may not be made by or on behalf of a trust. However, a person who is a donor (or the deceased estate of a donor) or a beneficiary in relation to a discretionary trust, which is not a resident, may elect that any asset situated outside South Africa, which was held by the discretionary trust during the period 1 March 2010 to 28 February 2015, be deemed to have been held by that person for the purposes of all tax legislation (including for estate duty purposes).

The election contemplated above may only be made if the relevant asset:

- had been acquired by the trust by way of a donation or is derived from such a donation
- has been wholly or partly derived from any amount not declared to the Commissioner as required by the Estate Duty Act, 1955 or the Income Tax Act, 1962
- has not vested in any beneficiary of that trust at the time that election is made

As a result of this election, the trust will effectively be "transparent" for tax purposes, to the extent of the election made by the relevant person.

Accordingly, the so-called attribution and distribution rules will not apply in respect of any income, expenditure or capital gain relating to that elected asset, during the time such asset is deemed to be held by that person.

The relevant person would then apply for relief under the tax SVDP in respect of the elected asset. The relief provided would include the following:

- the undeclared receipts and accruals will be exempt from income tax (other than employees' tax) and estate duty in respect of any tax year ending on or before 28 February 2015

- no penalties for understatement will be levied
- no criminal prosecution will be pursued.

However, an amount will be included in the taxable income of the relevant person in the 2015 tax year equal to 40% of the highest market value of the elected asset determined at the end of each of the 2011 to 2015 tax years (inclusive). The market value must be determined in the applicable foreign currency and translated to South African Rand at the spot rate on the last business day in South Africa on or before the end of each tax year.

In terms of the guidance published by SARS, the permanent VDP remains open for disclosures where it is argued that all or part of the funding of the elected asset is not taxable in South Africa or has already been taxed in South Africa.

SVDP – relief granted for exchange control contraventions

In terms of the special rules provided for donors to discretionary trusts under the exchange control SVDP, a South African resident who is a donor (or the deceased estate of a donor) may elect that any foreign asset that was held by the discretionary trust on 29 February 2016, be deemed to be held by such resident.

The election contemplated above will only apply in respect of a foreign asset of a discretionary trust which:

- was acquired by that discretionary trust by way of a donation made by a South African resident of funds transferred from South Africa or funds that have been accumulated abroad
- has been wholly or partly derived from any unauthorised asset or from any amount not declared by the donor to the Commissioner for SARS as required by the Estate Duty Act, 1955 or the Income Tax Act, 1962
- has not, at the time of that election, vested in any beneficiary of that discretionary trust;

As a result of this election, the South African resident will be deemed to have held the elected asset, for purposes of the administrative relief, from the date that the trust acquired that foreign asset until that foreign asset is disposed of by that trust to another person. At that point, the South African resident will be deemed to have disposed of the elected asset for market value on the date of disposal.

The South African resident may apply for relief under the exchange control SVDP in respect of the elected asset. Although no criminal prosecution will be pursued in that instance, a levy equal to 5% or 10% (depending on whether the asset is repatriated to South Africa) of the value of the elected asset disclosed, will be payable. The market value, in the foreign currency of the foreign asset, will be that on 29 February 2016.

The South African Reserve Bank has confirmed in a non-binding email that residents may apportion the value of the elected asset to the extent that it was derived from both authorised and unauthorised funds. In that instance, the necessary proof should be provided in respect of the authorised portion which is excluded from the levy calculation.

What are the alternatives?

The question has been raised whether, if the trustees of a foreign discretionary trust in an early adopter country distribute the whole of its assets to a new trust in a fast-follower country in settlement thereof for the benefit of the existing beneficiaries and the first mentioned trust is wound up before 2017, for CRS purposes, the identity of the settlor of the original trust would not be reported in either jurisdiction.

It may also be considered whether, if the trustees in an early adopter country retire and appoint new trustees in a fast-follower jurisdiction, this could have the effect of migrating the tax residence of the foreign trust, for CRS purposes, into another jurisdiction. The argument is that the outgoing trustees would not have any CRS reporting obligations in respect of the trust since its place of effective management will be located in the adopted jurisdiction. However, certain trustees hold a different view in this regard.

Subsequent to the migration, the foreign trust should, in principle, be subjected to the information exchange procedures of its adopted jurisdiction.

Closing remarks

It is advisable for South African residents with undeclared assets in offshore trusts to have regard to the fact that the relief under the tax and exchange control SVDP will not be available in respect of offshore assets that have been disclosed to SARS under an international exchange of information procedure, such as CRS.

Although offshore trustees may have differing views regarding their obligations in respect of the implementation of CRS in the relevant offshore jurisdictions, CRS will ultimately result in the offshore assets of South African residents being reported to SARS.

ENSAfrica

TAA: Chapter 16, Part B

2591. Final changes

On 26 October 2016, the Minister of Finance tabled the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, Bill 19 of 2016 in Parliament when he introduced the so-called Mini Budget. The Bill was enacted as the Rates and Monetary Amounts and Amendment of Revenue Laws Act, No. 13 of 2016 on 19 January 2017.

This Act contains the legislation regulating the Special Voluntary Disclosure Programme (SVDP) which commenced on 1 October 2016 and which will come to an end on 31 August 2017. The Act confirms that the SVDP will run for eleven months as opposed to the originally announced period of six months.

Under the SVDP, qualifying applicants must include in their 2015 taxable income an amount equal to 40 per cent of the highest amount of the Rand value of the unauthorised foreign assets at the end of each year of assessment ending on or after 1 March 2010 but not ending on or after 1 March 2015. Thus, the Act gives effect to the Treasury's announcement in September that the inclusion rate has been reduced from 50 per cent to 40 per cent.

In addition, the Act contains a provision whereby the base cost of the unauthorised foreign assets for which an application is lodged under the SVDP will be deemed to have been acquired on 28 February 2015 at a cost equal to the highest market value, in foreign currency, of that asset as determined under section 16 of the Act. Section 16 refers to the manner in which the amount to be included in the applicant's taxable income in 2015 is to be determined.

This is based on the market value of the unauthorised foreign assets in the relevant foreign currency and translated into South African Rands at the spot rate on the last business day in South Africa at the end of each year of assessment in question, namely, 28 February 2011, 29 February 2012, 28 February 2013, 28 February 2014 and 28 February 2015. This is a concession to taxpayers in that the base cost of the foreign assets is effectively increased when determining the capital gain that will be liable to tax when the foreign assets are ultimately disposed of. Instead of relying on the historic cost of the foreign assets taxpayers will be entitled to rely on the market value used to determine the tax payable on those foreign assets under section 16 of the Act.

If the proceeds received on the sale of the foreign assets is less than the adjusted base cost, the cost will be limited to the proceeds received. Thus no capital loss will be allowed to be carried forward to a future year in such cases.

Furthermore, the SVDP legislation makes it clear that where any amounts exempt from tax under the SVDP legislation were received or accrued by way of an inheritance or donation, that inheritance or donation must be exempt from estate duty under the Estate Duty Act or donations tax under the Income Tax Act in the hands of the estate or the donor. Where, for example an applicant seeks relief under the SVDP in respect of unauthorised foreign assets held by a deceased relative on which estate duty was not paid, the estate duty that should have been paid by the deceased effectively falls away.

Similarly, where an applicant donated assets to a foreign trust on which donations tax should have been paid, that donations tax is effectively waived where the donor makes the election available under the SVDP legislation to treat the assets owned by the foreign trust as belonging to them for income tax and estate duty purposes.

The SVDP legislation also deals with controlled foreign companies subject to the provisions of section 9D of the Income Tax Act. Where, for example, an applicant transferred funds from South Africa and invested them in a controlled foreign company and that company is located in a low tax jurisdiction, the income derived by the controlled foreign company should have been declared as part of the income of the applicant. In such a case the income that should have been attributed in favour of the applicant will not be liable to tax but the applicant can apply for SVDP relief on the basis that 40 per cent of the highest market value of the controlled foreign company at the end of 2011 – 2015 tax years must be included in the applicant’s income in the 2015 year of assessment.

As indicated above, the legislation was enacted on 19 January 2017 and prospective applicants should collate the information required to apply for SVDP tax and exchange control relief and start submitting applications to the South African Revenue Service on the basis that it is possible to submit applications for SVDP relief via the SARS e-filing system.

ENSafrica
ITA: Section 9D
Rates and Monetary Amounts and Amendment of Revenue Laws Act, No. 13 of 2016

SARS NEWS

2592. Interpretation notes, media releases and other documents

Readers are reminded that the latest developments at SARS can be accessed on their website http://www.sars.gov.za.

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