INTEGRITAX

MAY 2017 – ISSUE 212

COMPANIES

2600. Hybrid debt instruments

The hybrid debt rules were introduced into the Income Tax Act, 1962 (the Act) and came into effect in 2014 by way of specific anti-avoidance provisions contained in section 8F and 8FA of the Act.

The provisions relating to "hybrid debt instruments" as contained in section 8F seek to identify and provide for specific tax treatment of certain debt instruments that contain equity-like features. In instances where section 8F applies to a "hybrid debt instrument", the legislation disallows the deduction of the amounts of interest incurred by the issuer and furthermore deems such amounts to be dividends *in specie* declared and paid by the issuer.

Section 8F was introduced in 2014 and has been subject to a number of changes since then. The latest set of changes to section 8F as promulgated in the Taxation Laws Amendment Act, 2016 are important from a substantive perspective as well as a timing perspective, and are summarised below.

Cross-border hybrid debt has been excluded from the rules retrospectively

The South African Revenue Service and National Treasury identified that non-resident issuers were able to create tax arbitrage opportunities by issuing cross-border hybrid debt instruments.

Section 8F has now been amended with effect from 24 February 2016 (i.e. the date that the initial announcement regarding cross-border hybrid debt was made during the 2016 Budget Speech) and are applicable in respect of amounts incurred in respect of an instrument on or after that date.

Even if an issuer has issued an instrument with equity-like features which falls within the scope of the definition of a "hybrid debt instrument", section 8F will not apply to that instrument unless it has been issued by a company that will take its interest deductions into account for South African tax purposes, i.e. the instrument must be issued by:

- a South African resident company;
- a non-resident company if the interest in respect of that instrument is attributable to a South African permanent establishment of that company; or
- a company that is a "controlled foreign company" if the interest incurred in respect of that instrument must be taken into account in determining the net income of that controlled foreign company as contemplated in section 9D of the Act.

Subordinated debts - timing aspects clarified

The hybrid debt rules may be triggered by subordinated debts, i.e. where the terms of an instrument in issue are such that the obligation of the issuer to make payment of any amount owing in respect of that instrument is conditional on the solvency of such issuer.

However, the rules were not clear in respect of certain aspects pertaining to such subordinated debts. In particular, it was not clear as to whether the rules would apply to a subordinated instrument from the date of issue thereof or from the date that payment of amounts owing were actually deferred (i.e. whether the rules apply for the entire term of the instrument, or only for the termthat the subordination is active and the payment obligations of the payor are actually deferred).

In this regard, it has now been clarified (with effect from 1 January 2016 and applicable in respect of years of assessment commencing on or after that date) that a hybrid debt instrument will exist in a particular year of assessment where the obligation to pay an amount owing in respect of an instrument on a date or dates falling within that year of assessment has been deferred by reason of that obligation being conditional upon the market value of the assets of that company not being less than the amount of the liabilities of that company.

In other words, the hybrid debt rules will only apply to an instrument that is subject to subordination terms where, in a particular year of assessment, the obligation to make a payment in terms thereof has actually been deferred due to the solvency and liquidity circumstances of the payor. It is therefore necessary to analyse each subordinated debt on a continuous basis with reference to whether or not any payment obligations have actually been deferred.

Subordination relief for entities in financial distress

The hybrid debt rules pertaining to subordinated instruments were found to give rise to adverse tax implications (such as the non-deduction of interest and potential liability for dividends tax) for companies already in financial distress.

Relief has been provided in that, with effect from 1 January 2016 and applicable in respect of years of assessment commencing on or after that date, a subordinated hybrid debt instrument will fall out of the hybrid debt rules if:

- that debt instrument constitutes a hybrid debt instrument solely by virtue of paragraph (*b*) of the definition of a "hybrid equity instrument" (i.e. the instrument falls within the scope of a "hybrid debt instrument" only by virtue of having payments deferred as discussed in more detail above); and
- a registered auditor has certified that the payment, by the issuing company, of an amount owed in respect of that instrument has been or is to be deferred by reason of the market value of the assets of that company being less than the amount of the liabilities of that company.

Consequently, a company in financial distress that has been required by its auditors to defer payments under a subordinated loan will not have its financial position compromised further due to the non-deduction of interest payments and suffering a potential dividends tax burden.

Third-party backed instruments

Section 8F, which applies to debt with equity-like characteristics, in certain circumstances effectively mirrors the provisions of section 8E, which applies to equity with debt-like characteristics.

In order to align section 8F with section 8E, the concept of a "third-party backed instrument" has been introduced with effect from 1 January 2017 and applicable in respect of years of assessment commencing on or after that date.

In this regard, the provisions of section 8F will not apply to an instrument that qualifies as a "hybrid debt instrument", if that instrument falls within the definition of a "third-party backed instrument".

A "third-party backed instrument" is defined as any instrument in respect of which an "enforcement right" is exercisable as a result of any amount relating to that instrument not being received by or accruing to any person entitled thereto.

An "enforcement right" is in turn, defined as, in relation to an instrument, any right, whether fixed or contingent, to require any person other than the issuer of that instrument to:

(a) acquire that instrument from the holder thereof;

(b) make any payment in respect of that instrument in terms of a guarantee, indemnity or similar arrangement; or

(c) procure, facilitate or assist with any acquisition contemplated in (*a*) above or the making of any payment contemplated in (*b*) above.

Therefore, broadly speaking, the hybrid debt provisions contained in section 8F will not apply to a hybrid debt instrument in issue where the holder is able to require a person other than the issuer to either acquire that instrument, make a payment in respect thereof, or assist with such acquisition or payment in instances where the issuer has failed to make a payment in respect of such instrument.

ENSafrica
ITA: Sections 8E, 8F, 8FA and 9D
Taxation Law Amendment Act, 2016

2601. Date of issue - section 8E

In terms of section 8E of the Income Tax Act, 1962 (the Act), dividends received by or accrued to a person in respect of certain shares and "equity instruments", as defined, must be deemed in relation to that person to be an amount of income if that share or equity instrument constitutes a "hybrid equity instrument" at any time during that year of assessment.

The term "hybrid equity instrument" is defined in section 8E, *inter alia*, as:
(*a*) "any share, other than an equity share, if –
(i) the issuer of that share is obliged to redeem that share in whole or in part; or
(ii) that share may at the option of the holder be redeemed in whole or in part,
within a period of three years from the date of issue of that share."

Paragraph (*b*) of the definition deals with shares other than those contemplated in paragraph (*a*) (and thus, broadly speaking, equity shares), contains similar provisions, but with an additional requirement should paragraph (i) or (ii) above be met.

"Date of issue" is defined in section 8E of the Act, in relation to a share in a company, as the date on which:
(a) "the share is issued by the company;

(b) the company at any time after the share has been issued undertakes the obligation to redeem that share in whole or in part; or

(c) the holder of the share at any time after the share has been issued obtains the right to require that share to be redeemed in whole or in part, otherwise than as a result of the acquisition of that share by that holder."

It is submitted that the object of paragraphs *(b)* and *(c)* is to ensure that shares, the terms of which when issued did not result in that share qualifying as a hybrid equity instrument, will qualify as such if there is a subsequent undertaking by the issuer to redeem, or acquisition of a right by the holder to require the redemption of that share within a period of three years from the date of issue.

In practice, to ensure that a share does not qualify as a "hybrid equity share", the redemption date is typically more than three years from the date on which the share is issued by the company.

Where a share is issued with a scheduled redemption date more than three years after the date of issue, and the term of that share is subsequently varied to extend such redemption date, the question arises whether such variation of the terms of the share (other than a variation that introduces an obligation or right to redeem the share as contemplated in paragraph *(b)* or *(c)* of the definition of "date of issue") after the date on which the share was issued will constitute a new "date of issue" for purposes of section 8E.

By way of example, if shares are issued on 31 January 2017 and the terms provide for a scheduled redemption date of 1 February 2020, such shares should not constitute a hybrid equity instrument as there is no obligation or right to redeem the shares within a period of three years from the date of issue (assuming any "redemption events" which may trigger an earlier redemption are objectively defined and outside of the control of the issuer).

However, should the terms of the shares be varied before the redemption date, say on 20 January 2020, to extend the redemption date of the shares by one year, i.e. the shares are only redeemable on 1 February 2021, and thus within three years from the date of change of the rights and obligations attaching to the share, the question is whether that variation constitutes a new "date of issue".

If the date of the variation constitutes a new date of issue, such share should constitute a hybrid equity instrument from 20 January 2020, as the issuer would be obliged and the holder would have a right to require the redemption of such shares within three years from the new "date of issue".

To constitute a new "date of issue", the company must, after the share has been issued, undertake the obligation to redeem that share or the holder of the share must, after the share has been issued, obtain the right to require that share to be redeemed.

The question is therefore when the obligation or right to redeem the shares comes into existence. Does such obligation or right arise when the shares are first issued and carry forward to the extended period of the shares, or does a new right or obligation come into existence when the period is extended?

In terms of the original agreement between the parties, there was a right or obligation to redeem the shares more than three years from the date of issue (at the scheduled redemption date, the company would be obliged and the holder would have the right to require the shares to be redeemed). These terms are then varied to provide that the right or obligation to redeem is extended for a further period. In our view, this is distinguishable from the issues that paragraph *(b)* and (*c*) of the definition of "date of issue" attempt to address, a situation where there is no obligation or right to redeem, and such obligation or right is subsequently introduced.

The South African Revenue Service has previously stated that the "date of issue" is defined not with reference to a fixed date, but with reference to the date on which an obligation or right to redeem come into existence. Further, the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004 provides that: "Importance is placed on the redemption features added after the initial date of issue of the share. For instance, a company originally issued a non-redeemable preference share and subsequent to the original date of issue the terms of the share are altered to make the share redeemable within three years."

While an Explanatory Memorandum does not have the force of law, it provides an indication of the legislature's intention with regard to the legislation in question.

Therefore, in our view, where a share has been issued and the issuer has an obligation or the holder a right to redeem after more than three years, and the parties subsequently agree to extend such redemption date (and such extended redemption date is within three years from the date of the variation), the obligation or right to redeem arises on the date that the shares were originally issued and no new "date of issue" should arise upon this variation of the terms.

ENSafrica

ITA: Section 8E

Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004

DONATIONS TAX

2602. Waiver of a loan and reduced interest

On 10 October 2016, the South African Revenue Service (SARS) issued binding private ruling 252 (Ruling) which determines the donations tax and capital gains tax (CGT) consequences of the waiver of a portion of a loan and the reduction of interest on the remaining balance of the loan to 0%.

By way of background, debt relief in South Africa has become somewhat of a norm due to the current stressed economic climate. One of the most common means of debt relief by creditors has been the waiver of the whole or part of a debt. For the years of assessment commencing before 1 January 2013, the reduction of debt was subject to income tax, donations tax and/or CGT, which had the result of effectively undermining the economic benefit of the debt relief.

As a result, SARS introduced a uniform system that provides relief to persons under financial distress in certain circumstances in the form of section 19 (which deals with the income tax implications of debt reduction) and paragraph 12A of the Eighth Schedule (which addresses the CGT consequences) to the Income Tax Act, 1962 (the Act).

In the Ruling, SARS had to determine the donations tax and CGT consequences of the part waiver of a loan and the reduction of the interest rate on the remaining balance of the loan to 0% (Proposed Transaction). The parties to the Proposed Transaction are a South African resident company (Applicant) and a South African resident trust (Trust), the beneficiaries of which are employees of the Applicant who are historically disadvantaged persons as contemplated in the broad-based socio-economic empowerment Charter for the South African Mining and Minerals Industry.

The Applicant is in the business of processing mining residues and waste material in order to extract precious metals which are sold to third parties. In order to conduct the processing activities, the Applicant had a precious metals refining licence (Licence) as required in terms of the Precious Metals Act, 2005 (Precious Metals Act).

Against this backdrop, the Applicant established the Trust in order to meet its Black Economic Empowerment (BEE) objectives. Upon the creation of the Trust, the Applicant issued some of its ordinary shares to the Trust at market value. The subscription price for such shares was financed by the Applicant on loan account and the interest thereon was to be levied at the "official rate of interest" as prescribed by the Seventh Schedule to the Act. More specifically, paragraph 2(*f*) of the Seventh Schedule states that where a debt has been incurred by an employee directly or indirectly to his employer and (i) no interest is payable, or (ii) interest is payable at a rate lower than the official rate of interest, the difference between the official rate of interest and the interest paid by the employee is a fringe benefit.

The loan balance had not significantly reduced due to the capitalisation of interest and the Applicant was of the view that the outstanding balance of the loan exceeded the market value of the shares held by the Trust. Furthermore, based on current forecasts, it would take the Trust approximately 41 years to repay the full loan amount.

The regulations published under the Precious Metal Act require the Applicant to provide "meaningful economic participation" to the beneficiaries of the Trust, in order to maintain the Licence. In light of the anticipated repayment period, two empowerment agencies confirmed that the Trust might not be able to provide the required meaningful economic participation and accordingly, the Applicant was at risk of losing the License.

As a result, the Applicant proposed to waive approximately one third of the loan (which includes capitalised interest) and reduce the interest rate on the balance remaining to 0%.

SARS ruled that:

- donations tax will not be levied under section 54 of the Act in respect of the part waiver of the loan and the amendment of the loan agreement to reduce the interest rate to 0%;
- the part waiver of the loan and the amendment of the loan agreement to reduce the interest rate to 0%, will not be deemed to be a donation in terms of section 58 of the Act; and
- the Trust will be required, under paragraph 12A read with paragraph 20 of the Eighth Schedule, to reduce its base cost for the shares to the extent that the original loan capital is to be waived.

The Proposed Transaction would be entered into for purposes of meeting both the Applicant's BEE objectives and statutory requirements for maintaining the Licence. Accordingly, it could arguably not have constituted a donation for purposes of section 54 of the Act. However, it is particularly interesting to note that the reduction of the debt would not be seen as the disposal of property for inadequate consideration in terms of section 58 of the Act. Presumably the argument was that adequate consideration would be received in the form of the benefit of maintaining the Licence.

It was not indicated whether the Trust claimed any deductions in respect of the interest on the loan (to the extent that it may have qualified).

Cliffe Dekker Hofmeyr

ITA: Sections 19, 54 and 58, paragraph 2(*f*) of Seventh Schedule and paragraphs 12A and 20 of the Eighth Schedule

Precious Metals Act, 2005

BPR 252

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.

EMPLOYEES TAX

2603. Non-executive directors – PAYE and VAT (Refer to Article 2607)

The question whether non-executive directors (NEDs) of companies are employees or independent contractors has bedevilled taxpayers, and especially the payroll departments of companies, for years. The question is important because it goes to whether their fees are remuneration, and subject to PAYE, or fees for independent services, and potentially falling within the VAT net. Following an announcement in the 2016 Budget documents, SARS investigated these issues and the results appear in the form of Binding General Rulings 40 and 41 (BGR 40 and 41) issued on 10 February 2017.

An NED is not defined in the Income Tax Act, 1962 (the Act). According to the King III report, an NED must provide objective judgment independent of management, must not be involved in the management of a company, and must be independent of management on issues such as strategy, performance, resources and diversity. Put differently, the NED must not countenance undue influence and must show no bias.

BGR 40 takes these concepts and places them into the context of the Fourth Schedule to the Act, which provides the definitions of "remuneration", "employee" and "employer". The definitions are interrelated: an employee is a person who receives remuneration; remuneration is something paid to an employee; and an employer is a person who pays remuneration to another person.

The Fourth Schedule recognises two tests for determining whether a person is an employee.

1. The first is the so-called common law test, which broadly determines that a person who earns a salary, wage, stipend, commission, fee, bonus or some similar reward for services is an employee.

2. The second consists of two statutory tests which, even though the recipient is carrying on an independent trade, determine whether the reward for services is remuneration for purposes of the Fourth Schedule. These are the "premises" test, where the services must be performed mainly at the premises of the client; and the "control or supervision" test, where the client exercises control or supervision over the manner in which the duties are to be performed or the hours of work. Both statutory tests must be satisfied in order to render the recipient an employee in receipt of remuneration.

A moment's reflection should lead one to conclude that a genuine NED, one who meets the criteria set out in King III, for example, cannot be an employee but must be an independent contractor. The prohibitions placed upon employees as to the deductions they may claim against remuneration will consequently not apply to NEDs, who may claim various expenses denied to employees.

Of course, if a person professes to be an NED but the facts indicate otherwise, not only is the company in breach of its governance obligations but it will also be in breach of its obligation to withhold PAYE from amounts paid to the "non-independent" NED.

Now to BGR 41. If the NED is not an employee, the question arises as to the nature of the amounts paid to the NED. BGR 41 deals with this. The NED, being an independent person, is carrying on an enterprise as defined in the Value-Added Tax Act, 1991 (VAT Act). Employment can never qualify as an enterprise for VAT purposes but the NED is not an employee. The next question is whether the NED is required or chooses to register as a vendor under the Vat Act. The crisp test here is whether the NED is continuously or regularly carrying on the enterprise of an NED. It is submitted that infrequent or occasional services as an NED would not qualify as an enterprise. However, an NED who is conducting that office correctly is likely to be conducting an enterprise because regularity and continuity are surely requirements of a genuine NED.

If the NED's enterprise generates fees in excess of the compulsory registration threshold, currently R1 million, the NED must register. An NED whose fees are less than the threshold but who nonetheless wishes to register as a vendor may do so provided the fee income has exceeded R50 000 in the preceding period of 12 months.

In summary, an NED whose conduct meets the criteria expected of an independent director is not an employee of the company. The NED must submit invoices for services and, if necessary based on the monetary thresholds, register as a vendor and levy output tax on fees.

Professor Peter Surtees
ITA: Definition of 'employee' - Paragraph 1 of the Fourth Schedule
VAT Act: Section 1(1) – definition of 'enterprise'
Binding General Rulings 40 and 41

TAX ADMINISTRATION

2604. Complaints to Tax Ombud

The Tax Ombud released its report for the 2015/16 year on 6 October 2016. Of the 2,133 complaints received, 938 (44%) were rejected. When one is already struggling with some aspect of a matter with the South African Revenue Service (SARS), the last thing one needs is to face further obstacles when complaining to the Tax Ombud. To address these obstacles, we have put together some tips and pointers on how to get your matter dealt with.

Some 354 (37.7%) of the complaints sent to the Tax Ombud were rejected on the basis that the SARS internal resolution process had not been exhausted. It therefore appears that there is significant uncertainty regarding the correct SARS internal dispute resolution process. This is the process that should ordinarily be followed before one can complain to the Tax Ombud. This process, as well as the "compelling circumstances" that can allow you to skip this process, are described below.

In addition, 581 (61.9%) of the complaints were rejected because of the limitation of authority of the Tax Ombud. These limitations are briefly highlighted below, together with some alternatives that you can use, instead of complaining to the Tax Ombud.

SARS complaints process to be followed before going to the Tax Ombud

SARS complaints process

Step one: Phone the call centre or go into your local branch to discuss your complaint, and get a case number. You will need this case number in order to continue with the complaints process. Give the call centre/local branch a reasonable time to attempt to resolve your complaint (typically a minimum of seven business days, or else your complaint in the next step would be rejected).

Step two: Submit your complaint to the SARS Complaints Management Office. This can be done by phone (0860 12 12 16), in person at your nearest SARS branch, or via e-filing. (There is a step-by-step SARS Guide to the Complaints Functionality on E-Filing, available on the SARS website, to guide you through this process.) SARS has publicised that your complaint should be dealt with within 21 business days.

If the matter is not successfully resolved after these processes, you are entitled to lodge a complaint with the Tax Ombud.

Compelling circumstances for not following SARS complaints process

If there are compelling circumstances for not following the complaints resolution mechanisms in SARS, the Tax Ombud may accept the complaint even though the SARS complaints process was not followed. The Tax Ombud must determine whether there are compelling circumstances, considering factors such as whether:

- the request raises systemic issues;
- exhausting the SARS complaints process would cause undue hardship to the taxpayer; or
- exhausting the SARS complaints process is unlikely to produce a result within a reasonable period of time.

In the complaints form for the Tax Ombud, there is a section which states: "*If you have not exhausted the SARS internal complaints process, please motivate why the OTO should handle your complaint i.e. explain your compelling circumstance.*"

This is where you would need to explain the reasons for not following the SARS complaints process, for example saying that to the best of your knowledge and belief, your issue is a systemic issue, and explaining what hardship is caused to you by further delaying the matter by going through the SARS complaints process. If there have already been substantial delays on the matter, you would explain these, so that the Tax Ombud could conclude that following the SARS complaints process would in all likelihood not result in an appropriate result within a reasonable period of time.

If you properly explain your reasons in the relevant section of the Tax Ombud complaints form, the Tax Ombud may decide that they can accept your complaint, without you first having to go through the SARS complaints process.

Limitation of authority of the Tax Ombud

Certain types of problems with SARS cannot be dealt with by the Tax Ombud, because of limitation of authority. In this respect, the Tax Ombud may not review:

- legislation or tax policy – to address these issues, you can send your tips to the Finance Minister ahead of the National Budget Speech each year, make submissions to National Treasury and SARS in relation to draft legislation each year, and even attend parliamentary hearings on draft legislation and publicly speak up about any proposed changes;
- SARS policy or practice generally prevailing (unless it is administrative or service related) – submissions can be made to SARS legal, including requesting interpretation notes on tricky aspects of tax. If more appropriate, submissions could be made to National Treasury for changes to the law (as opposed to only the interpretation thereof by SARS);
- a matter subject to objection and appeal, or a Tax Court matter – matters subject to objection and appeal must be dealt with by the Tax Board or Tax Court, so you will get to be heard by an independent tribunal that is capable of making a binding decision. That is better than a mere "recommendation" by the Tax Ombud.

For these matters, you could make use of these alternative suggestions, and avoid wasting time on a Tax Ombud complaint for matters where the Tax Ombud cannot help.

Bowmans
SARS Guide to the complaints functionality on Efiling

TRADING STOCK

2605. Mining and manufacturing expenditure

In the decision of the Supreme Court of Appeal ('SCA') in the matter of *Commissioner for the South African Revenue Service v Marula Platinum Mines Ltd* [2015] ZASCA 121 (22 September 2016), a large part of the judgment was devoted to the questions whether mined ore was trading stock and whether the processes to extract a saleable product were processes of manufacture. Viewed from the sidelines, these appeared to be unnecessary inquiries.

The issue

Marula Platinum Mines Ltd ('Marula') mined ore from which it produced a concentrate in powder form containing various minerals (platinum group metals), which it sold to an associated company. The associated company, in turn, further processed the concentrate to separate and extract the individual minerals contained within the concentrate.

The price paid by the associated company could not be established at the time that the concentrate was delivered, presumably because the price was contingent on the value of the respective minerals of which the concentrate consisted. There was therefore a delay of approximately four months before the income derived by Marula from the sale of the concentrate could be finally determined.

In terms of section 24M of the Income Tax Act (the Act), any amount which is not quantifiable as at the end of the year of assessment is deemed not to have accrued in that year of assessment. Marula had accordingly excluded from its taxable income any amount relating to concentrate sold during the relevant years of assessment where the consideration due to it had not yet been finally determined.

Section 23F of the Act contains provisions that are designed to match the expenditure to the income in circumstances such as those referred to above. It provides in subsection (2):

Where a taxpayer has during any year of assessment disposed of any trading stock in the ordinary course of his or her trade for any consideration the full amount of which will not accrue to him or her during that year of assessment and any expenditure incurred in respect of the acquisition of that trading stock was allowed as a deduction under the provisions of section 11(a) during that year or any previous year of assessment, any amount which would otherwise be deducted must, to the extent that it exceeds any amount received or accrued from the disposal of that trading stock, be disregarded during that year of assessment.

The Court was required to determine the amount of expenditure to be disregarded in the relevant years of expenditure under section 23F(2).

Much of the judgment was devoted to finding that the concentrate was derived by a process of manufacture and that the mineral-bearing ore from which it was derived was also trading stock.

The definition of 'trading stock' in section 1 of the Act states that trading stock includes:
anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by the taxpayer or on behalf of the taxpayer …

On the face of it, a determination that the concentrate was trading stock appears to be a 'no brainer'. If that was the product sold by Marula in the ordinary course of its business, it is inconceivable that it could have been anything other than trading stock.

However, in the Tax Court, counsel for Marula had raised an issue that a portion of the cost of the acquisition did not relate to trading stock. The processes by which the concentrate was acquired or produced involved two phases. The first was the extraction of the ore-bearing rock and the second was the crushing and processing of the rock to produce the concentrate. It was argued that the rock was not trading stock; therefore, the costs of excavating it and bringing it to the surface could not be disregarded, and only the costs of processing could be disregarded.

The Tax Court had been persuaded by this argument and had ruled that only the processing costs incurred in the second phase fell to be disregarded. The appeal to the SCA was against this finding.

The assertion that the cost of bringing the ore to the surface was not a cost incurred in respect of the production or acquisition of the concentrate was a smokescreen.

The activities of Marula were devoted entirely to producing the concentrate. It would seem but a short logical step to identify that Marula produced the concentrate for the purposes of sale and that the concentrate that had been sold, but for which the consideration had not yet been quantified, was the trading stock referred to in section 23F(2).

That said, 17 paragraphs of the judgment were devoted to establishing, first, that the stockpiles of mineral-bearing ore were trading stock and, secondly, that the process by which the concentrate was produced was a process of manufacture. Neither of these findings actually had a bearing on the outcome.

That the SCA found itself compelled to consider aspects that had no bearing on the application of section 23F(2) in these circumstances is perplexing. The concentrate was 'produced … or otherwise acquired' for purposes of sale. That is, it was the trading stock referred to in section 23F(2). Whether the mineral-bearing ore in an intermediate state was or was not trading stock and whether the processes through which the mineral-bearing ore passed in order to derive the concentrate were or were not processes of manufacture was irrelevant.

The amount to be disregarded

Importantly, the judgment of the SCA clearly explained the application of section 23F(2). The judgment of the Tax Court had not been helpful in this regard. The particular issue related to the meaning of the term 'any amount which would otherwise be deducted'. The SCA judgment explains the law in paragraph 30:

"When this phrase is read within the context of section 23F(2), it is clear that 'any amount which would otherwise be deducted' refers to section 11(*a*) expenses that would be deductible had the full income of the disposal of the trading stock accrued to the taxpayer during that year of assessment. That section 23F(2) refers to deductions claimed under section 11(*a*) and not to any other deductions, is also made clear by Silke on South African Income Tax …

The amount must therefore be determined with respect only to amounts allowable as a deduction under section 11(*a*) (which would exclude allowances for capital expenditure, for example) to the extent that the expenditure was incurred in the acquisition of the trading stock in relation to which an amount has not been included in income."

Conclusion

There can be no doubt that the SCA came to the correct decision and that the order issued gave proper effect to the law.

Of concern is the ease with which the attention of the Court was diverted from consideration of the true subject matter of the appeal, namely the goods that were sold, and was instead directed towards consideration of intermediate products from which the trading stock was produced and the processes by which it was produced.

As a result, much of the judgment may be considered obiter dicta–statements made in passing and not directly relevant to the issue in dispute.

PwC
ITA: Section 1(1) – definition of 'trading stock' and sections 11(*a*), 23F(2) and 24M

TRUSTS

2606. Interest free loans – section 7C

In the 2016 National Budget, the Minister of Finance indicated that legislation would be introduced to deal with interest-free loans made available by natural persons to trusts. Legislation was subsequently drafted and was promulgated on 19 January 2017 as section 7C of the Income Tax Act, 1962, as amended (the Act) by way of section 12 of the Taxation Laws Amendment Act, 2016.

It must be noted that the new section will apply in respect of any loan or advance made by a natural person or at the behest of such person by a company in relation to which a natural person is a connected person under the definition of connected person contained in section 1(1) of the Act to a trust.

It must be noted that the new section applies in respect of all loans made on, after, or before 1 March 2017 and therefore applies in respect of pre-existing loans on which no interest is charged.

The legislation provides that where a natural person makes an interest-free loan to a trust, the non-charging of interest will be regarded as a donation subject to donations tax at the rate of 20%.

The benchmark to be used for purposes of ascertaining whether the section applies is the so-called official rate of interest as defined in paragraph 1 of the

Seventh Schedule to the Act which currently amounts to 8% per annum. Thus, where a natural person makes an advance or loan available to a trust and no interest is charged, that person will be liable to donations tax on an amount of 8 % of the loan advanced to the trust for each year during which the loan is in existence.

Should interest be charged at a rate lower than the official rate, the difference will attract donations tax in the hands of the natural person.

Thus, where a natural person advanced funds to a trust in an amount of R10 000 000 and chooses not to charge interest thereon from 1 March 2017, that will constitute a donation of R 800 000 for the 2018 tax year which will result in a liability of donations tax amounting to R 160 000 per annum, ignoring for the moment the fact that the first R100 000 of donations are exempt from donations tax. Where a loan advanced to a trust does not exceed an amount of R1 250 000, 8% thereof amounts to R 100 000 and the taxpayer would be entitled to rely on the exemption of donations tax, which exempts the first R100 000 from donations tax.

The donation will be regarded as having been made to the trust by the natural person on the last day of the year of assessment of the trust and donations tax will be payable by the end of the month following the month during which the donation takes effect. Thus the donations tax will be payable by 31 March 2018. The new rules also apply where, for example, a natural person makes a loan to a company to which the natural person is connected and that company in turn, directly or indirectly provides those funds to a trust.

Section 7C(5) provides that no donations tax will arise in respect of loans or advances where:

- the trust is a public benefit organisation approved by the Commissioner under section 30(3) of the Act or a small business funding entity approved by the Commissioner under section 30C;

- the trust is a special trust as defined in paragraph (*a*) of the definition of 'special trust';

- the trust used the loan wholly or partly for purposes of funding the acquisition of an asset and the natural person or their spouse used that asset as a primary residence as envisaged in the definition of primary residence in the Eighth Schedule to the Act and the amount owed relates to the part of that loan that funded the acquisition of that residence;

- that loan or advance was provided to that trust in terms of an arrangement that would have been regarded as a sharia compliant financing arrangement as referred to in section 24JA of the Act;

- that loan or advance is subject to the provisions of section 64E(4) relating to deemed dividends under the dividends tax rules;

- that loan or advance comprises an affected transaction as referred to in section 31(1) of the Act which is subject to the provisions of that section; or

- that loan or advance was provided to that trust by a person as a result of the vested interest held by that person in the receipts and accruals of the assets of that trust and the conditions specified in section 7C(5)(*b*) are complied with.

Where the natural person makes a loan to a foreign trust and does not charge interest thereon, that loan is subject to the provisions of section 31 and on that basis section 7C should not apply. It is important that where a loan is made available by a South African tax resident to a foreign trust that interest is charged at a rate that would have been charged by person's dealing at arms' length thereby complying with the provisions of section 31.

Unfortunately, the legislature decided not to provide any relief to taxpayers wishing to unwind their trust structures in order to do away with loans advanced by natural persons to a trust as was the case when a concession was introduced allowing natural persons to remove primary residences from trust structures when capital gains tax was introduced. Taxpayers were allowed to transfer their primary residences from a trust for a limited period without paying capital gains tax and transfer duty.

Thus, where a natural person has advanced funds to a trust, it is necessary to review the annual financial statements of the trust to decide what to do and where the trust owns an asset producing income, it may make financial sense to charge interest on the loan which would then ensure that the trust receives a deduction for interest payable to the natural person but remembering that the interest paid will be taxable in the hands of the natural person. It is not possible to generalise and state what course of action a person should follow where they have made an advance available to a trust as it does depend on the totality of the circumstances and it will be necessary to review the taxpayer's personal situation as well as that of the trust to determine what should be done to alleviate the donations tax that would otherwise become payable if no interest is charged on the loan due by the trust to the natural person.

The question that often arises is whether an amount payable to a beneficiary as a result of an award or distribution made by a trust but not actually paid in cash to the beneficiary will also be subjected to the rules contained in section 7C.

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016 published by National Treasury on 15 December 2016 indicates that an amount which is vested irrevocably by a trustee in a trust beneficiary, which is used or administered for their benefit will not qualify as a loan or credit provided by that beneficiary to the trust where the vested amount may, in accordance with the trust deed, not be distributed to that beneficiary: for example before the beneficiary reaches a specific age, or that the trustee has the sole discretion in terms of the trust deed regarding the timing of and extent of any distributions to that beneficiary of such vested amount.

The Explanatory Memorandum points out that where an amount vested by a trust in a trust beneficiary, which is actually distributed to the beneficiary, will qualify as a loan under section 7C where the non-distribution results from an election made by that beneficiary or request by the beneficiary that the amount not be distributed or paid over. It will therefore be necessary to review the trust deed to establish whether awards made, other than cash, to a beneficiary fall within the rules of section 7C or not.

It must be noted that section 7C will apply so long as the loan remains in place between the trust and the natural person which can become expensive when one considers that donations tax at the rate of, currently, 20% will be paid on the interest foregone on the loan made by the natural person to the trust for so long as the loan is in existence. Persons who have interest-free loans in place with a trust should review their position as a result of section 7C.

ENSAfrica

ITA: Section 1(1) – definition of ‘connected person’ and ‘special trust’ and sections 7C, 24JA, 30(3), 30C, 31(1), 64E(4),paragraph 1 of the Seventh Schedule – definition of ‘official rate of interest’ and paragraph 44 of the Eighth Schedule - definition of ‘primary residence’

Taxation Laws Amendment Act, 2016: Section 12
Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016
2016 Budget Review

VALUE-ADDED TAX

2607. Non-executive directors – VAT and PAYE (Refer to Article 2603)

The South African National Treasury indicated in the 2016 Budget Review that there are differing views as to whether the remuneration paid to a non-executive director (NEDs) is subject to employees' tax, that is, pay-as-you-earn (PAYE) and whether a NED should register for value-added tax (VAT). It was suggested that these issues be investigated to provide clarity. In its final response document on the Taxation Laws Amendment Bill, 2016, National Treasury and the South African Revenue Service (SARS) proposed that SARS addresses the uncertainties relating to VAT and PAYE in relation to NED remuneration in an interpretation note.

On 10 February 2017, SARS issued Binding General Ruling (Income Tax) 40 (BGR 40) and Binding General Ruling (VAT) 41 (BGR 41) in which it sets out its interpretation of the Income Tax Act (the Act) and the Value-Added Tax Act (the VAT Act) in relation to NED remuneration. Unlike what has become common practice by SARS to publish binding general rulings in draft format for public comment first, BGR 40 and BGR 41 were issued as final documents without inviting public comment.

Binding General Ruling 40

This BGR sets out SARS's interpretation of the employees' tax consequences of fees derived by NEDs as well as the impact of section 23(*m*) of the Act on NEDs claiming deductions against fees derived by them.

SARS points out that since the introduction of the so-called statutory test contained in paragraph (ii) of the exclusions to the definition of remuneration contained in the Fourth Schedule to the Act, there has been uncertainty over the nature of amounts paid to NEDs and whether they should be subject to employees' tax.

The Act does not define the term "non-executive director". The King III Report on Governance for South Africa, 2009, commissioned by the Institute of Directors of Southern Africa, stated that the crucial elements of an NED's role in a company are that an NED:

- must provide objective judgement independent of management of a company;
- must not be involved in the management of the company; and
- is independent of management on issues such as, among others, strategy, performance, resources, diversity, etc.

SARS points out that for the purposes of the BGR 40, it is considered that an NED is to be a director who is not involved in the daily management or operations of a company but attends and provides objective judgment on the company's affairs and votes at board meetings.

The BGR 40 makes it clear that SARS accepts that the nature of the duties performed by an NED mean that they are not regarded as common-law employees. Thus, the only basis on which an NED could be subject to employees' tax, is if the so-called statutory tests apply. Those tests provide that, notwithstanding an amount is paid for services rendered to a person carrying on an independent trade, the recipient is regarded as an employee if two requirements are satisfied, namely, the "premises" test and the "control or supervision" test.

These tests comprise the following:

- The premises test requires that the services must be performed mainly at the premises of the client. “Mainly” is regarded as meaning a quantitative measure in excess of 50% based on the judgment of *Sekretaris van Binnelandse Inkomste vs Lourens Erasmus (Eiendoms) Bpk* [1966] 28 SATC 233.
- the control or supervision test envisages either control or supervision, which must be exercised over one of the following:
    - the manner in which the duties are required to be performed, or
    - the hours of work.

It is required that both of the above tests must be met, that is, both the premises test and the control or supervision test must be fulfilled before the recipient will be regarded as not carrying on an independent trade and therefore receiving remuneration subject to employees’ tax. However, if only one of the abovementioned tests is fulfilled, or neither, the deeming rules cannot apply.

Where the NED is not deemed to be an employee and is also not a common law employee, the amounts payable to the NEDs will not constitute remuneration.

The BGR 40 makes reference to the fact that it has been suggested that payment made by a company to an NED for time spent preparing for board meetings, for example, which result in payment of an hourly rate for a specified number of hours before each meeting, creates some form of control or supervision of the hours of work performed by the NED. SARS indicates that this is not the correct manner in which to apply the control or supervision test. The fact that there may be a contractual relationship regulating the number of hours for which preparation time may be billed does not result in control or supervision being exercised over the hours during which an NED’s duties are performed. Thus, such payments will not satisfy the test in question. It must be noted though that this rule does not apply to non-resident independent contractors.

Section 23(*m*) prohibits employees and office holders from claiming the deduction of certain expenses. The section requires that expenditure must relate to an office held by the taxpayer and, furthermore, that the taxpayer must derive remuneration from that office.

SARS accepts that directors are holders of an office and thus if they do receive remuneration, section 23(*m*) will result in the prohibition from claiming deductions applying to that director. Where, however, the NED does not receive remuneration, SARS accepts that section 23(*m*) cannot apply and the ordinary rules for deductibility of expenditure set out in the Act will apply.

For purposes of the ruling published by SARS, SARS accepts that the NED does not constitute a common law employee. SARS further accepts that no control or supervision is exercised over the manner in which an NED performs his or her duties or their hours of work.

As a result, the director's fees received by an NED for services rendered in that capacity on a company's board do not constitute remuneration and are not subject to the deduction of employees' tax. The NED must reflect the income received for services rendered as an NED for tax purposes and pay tax thereon via the provisional tax system.

In addition, SARS accepts that because the amounts received by an NED do not constitute remuneration, the prohibition of claiming expenses under section 23(*m*) will not apply in relation to the fees received by such persons. The ruling does not apply in respect of fees received by non-resident NEDs, in which case the company paying the fees will be required to withhold and deduct employees' tax. The ruling is published as a BGR in accordance with section 89 of the Tax Administration Act, 2011, which means that taxpayers are entitled to rely thereon. It must be noted that the ruling has been published such that it will apply from 1 June 2017 until it is withdrawn, amended or the relevant legislation is amended.

The terms of the ruling further provide that any ruling and decision issued by the Commissioner, which is contrary to BGR 40 is withdrawn with effect from 1 June 2017.

When reference is made to the BGR40 referred to, the question arises as to what companies should do from the date of publication of the ruling until the date of application thereof, that is, 1 June 2017.

Where, based on an analysis of the law, the company is satisfied that it does not exercise supervision or control over the NED and the director is resident, there is a basis in law for the company not to deduct employees' tax from the fees paid to that director from 10 February 2017 until 31 May 2017. Clearly, this does not mean that the amount is not taxable. The ruling and the law merely regulates the manner in which the tax is to be paid by the NED. Where employees' tax is not withheld by the company, the director has an obligation to include that income for provisional tax purposes and comply with the provisions of the Fourth Schedule to the Act, failing which penalties will be imposed for either the late payment or under payment of provisional tax. Where employees' tax has been deducted historically in the past, NEDs should ensure, if not yet registered for provisional tax purposes, that are so registered with effect from 1 June 2017 so that they can adhere to the BGR 40 published by SARS.

Binding General Ruling 41

In BGR 41, SARS refers to its conclusion in BGR 40 that an NED is not considered to be a common law employee and that the remuneration paid to an NED is therefore not subject to PAYE. SARS ruled that for VAT purposes, an NED is treated as an independent contractor as contemplated in proviso (iii)(*bb*) to the definition of "enterprise" in section 1(1) of the VAT Act, in respect of the NED's activities.

BGR 41 further stipulates that an NED who carries on an enterprise in South

Africa is required to register and charge VAT where the value of the remuneration exceeds ZAR1-million in any consecutive 12-month period, and that this applies to ordinary residents of South Africa and to non-resident NEDs.

BGR 41 is made effective from 1 June 2017. SARS indicated in a media statement issued on 14 February 2017 that where the remuneration paid by the NED was subject to PAYE, the NED would not be required to register for VAT prior to 1 June 2017. This would allow NEDs who are affected by BGR 41 approximately three months to register for VAT with effect from 1 June 2017.

In terms of section 66(8) of the Companies Act, 2008, a company may pay remuneration to its directors for their services as directors. However, such remuneration may be paid only in accordance with a special resolution approved by the shareholders within the previous two years. In terms of section 64 of the VAT Act, any price charged by any vendor for the taxable supply of goods or services is deemed to include VAT. Therefore, where the NED's remuneration is not increased by the VAT rate by a special resolution of the shareholders before 1 June 2017, the NED's remuneration will be deemed to be inclusive of VAT.

The question arises as to whether SARS is correct in its interpretation of the VAT Act as set out in BGR 41. SARS considers an NED to be an independent contractor "as contemplated in proviso (iii)(*bb*) to the definition of "enterprise" in section 1(1) of the VAT Act". However, proviso (iii)(*bb*) only applies to services rendered by employees or office holders as contemplated by proviso (iii)(*aa*) where the remuneration payable constitutes "remuneration" as defined in the Fourth Schedule to the Act. SARS has ruled in BGR 40 that the remuneration paid to an NED does not comprise "remuneration" as defined in the Fourth Schedule, and therefore proviso (iii)(*bb*) is not applicable as contended by SARS.

The question that remains is whether an NED is carrying on an "enterprise" as contemplated by that definition. BGR 40 stipulates that SARS considers an NED to be a director who is not involved in the daily management or operations of the company, but simply attends, provides objective judgment and votes at board meetings. The question is whether such activities of attending and voting at board meetings comprise the supply of “services” as contemplated by the definition of that term as defined in the VAT Act, or whether they are merely the fulfilment of the statutory duties of the NED. In addition, an NED is elected to that position in his or her personal capacity as contemplated by section 68 of the Companies Act, 2008 to serve for a specified term, unlike an independent contractor who is appointed under a contract to provide specific services, and who is entitled to delegate the performance of the services.

The independence of a NED from the management of a company should further not be confused with independence from the company itself. The company, being a legal entity, cannot, on its own, make any decision or take any actions. A company’s mind and soul has been considered by our courts to be that of its board of directors, which include the NEDs. It therefore seems that it could be argued that the activities of a NED do not fall within the ambit of the definition of “enterprise” as defined in the VAT Act as contended by SARS in BGR 41. However, in the absence of a court ruling to the contrary, a NED may be held liable for the VAT, penalties and interest if he or she does not comply with BGR 41.

ENSAfrica
ITA: Section 23(*m*) and paragraph 1 of the Fourth Schedule – definition of ‘remuneration’
TAA: Section 89
VAT Act: Section 1(1) – definition of ‘enterprise’ and section 64
Binding General Rulings 40 and 41
Taxation Laws Amendment Bill, 2016
Companies Act, 2008: Sections 66(8) and 68

2016 Budget Review

King III Report on Governance for South Africa, 2009

2608. Advertising of prices

An efficient advertising campaign can often be the difference between a successful and an unsuccessful business venture. When advertising the price of a product, however, businesses must be mindful of the provisions of the Value-Added Tax Act, 1991 (the VAT Act). This issue recently came up in the matter of Security Outfitters Safety Gear/L Munian/2016-4420F, a ruling handed down by the Directorate of the Advertising Standards Authority of South Africa (ASA Directorate) on 18 November 2016 (Ruling).

<u>Facts</u>

The complainant, Munian, lodged a consumer complaint against a print advertisement for safety gear clothing sold by the respondent, Over-All Gear CC. The respondent's advertisement featured different ranges of security uniforms, reflective jackets, safety boots and conti suits. At the bottom of the advertisement it stated, among other things, "PRICES VALID UNTIL STOCKS LAST. PRICES EXCLUDING VAT". The complainant objected to the fact that the advertised prices excluded VAT. The respondent submitted, among other things, that it was a registered VAT vendor, is charged VAT in all processes of manufacture or purchasing of stock and is therefore entitled to charge VAT on its prices.

For these reasons, the respondent's advertising clearly indicated that its prices exclude VAT, meaning that there could be no confusion. In support of this argument, the respondent made reference to other safety wear companies that excluded VAT and provided a copy of its VAT registration documentation from the South African Revenue Service (SARS).

Ruling of the ASA Directorate

In terms of clause 19.4 of section II of the ASA's Advertising Code of Practice (Code), section 64 and section 65 of the VAT Act have to be considered. Section 64(1) of the VAT Act states that any price charged by a vendor for a taxable supply shall for purposes of the VAT Act be deemed to include any VAT that is to be levied on such supply in terms of section 7(1)(*a*). Section 65 of the VAT Act states that any price advertised or quoted by a VAT vendor must include VAT and the vendor must state in the advertisement or quote that the price includes VAT, unless the total amount of VAT in terms of section 7(1)(*a*), the price excluding tax and the price inclusive of tax are advertised or quoted.

Importantly, section 65 goes on to state that if the VAT vendor decides to advertise or quote the VAT, the price exclusive of VAT and the price inclusive of VAT separately, both prices must be advertised or quoted with equal prominence and impact.

In its ruling, the ASA Directorate referred to its decision in Republic Bus & Truck/W Heckroodt/18961 (2 February 2012), where SARS had clarified, among other things, that the practice of only reflecting a price excluding VAT on an advertisement does not comply with the requirements of section 65 and that it is not permissible to quote the price excluding VAT and have a statement that VAT has been excluded. In light of the above authority, the ASA Directorate found that the mere inclusion of a statement to the effect that "prices exclude VAT" is not compliant with the provisions of the VAT Act, which in turn means that such advertising contravenes clause 19.4 of section II of the Code.

The fact that the respondent is registered for VAT and is entitled to charge VAT is not relevant to this enquiry.

The ASA Directorate therefore upheld the complaint and made the following order:

- the advertising must be withdrawn;
- the process to withdraw the advertising must be done with immediate effect on receipt of the Ruling;
- the withdrawal of the advertising must be completed within the deadlines stipulated by Clause 15.3 of the ASA's Procedural Guide, which states that the time within which an advertisement must be withdrawn depends on where the advertisement appeared e.g. newspapers, radio etc; and
- the advertising may not be used in its current format.

Comment

In its Ruling, the ASA Directorate noted that the practice of the respondent in this case appears to be relatively widespread in the respondent's industry, but that it cannot impose the Ruling on other advertisers as it can only act on complaints against one advertiser at a time. Taxpayers who are making use of this practice should therefore take heed of this Ruling and amend their advertising accordingly, so as to prevent themselves from being hauled before the ASA at a later stage.

Although section 58 of the VAT Act does not list the abovementioned practice as an offence for which a taxpayer could pay a fine or face imprisonment, a taxpayer could suffer reputational damage if it is found to have contravened this provision of the VAT Act and the issue becomes public.

Cliffe Dekker Hofmeyr

VAT Act: Sections 7(1)(*a*), 58, 64 and 65

ASA's Advertising Code of Practice: Section II clause 19.4

ASA's Procedural Guide: Clause 15.3

VOLUNTARY DISCLOSURE PROGRAMME

2609. Exchange control regulations

On 13 July 2016, the South African Reserve Bank's (SARB) Financial Surveillance Department (FinSurv) issued Exchange Control Circular No. 6/2016 (First Circular).

The First Circular sets out the exchange control (Excon) relief that will be available for all South African persons who are residents from an Excon perspective (Excon residents) and who wish to regularise their offshore assets from an Excon perspective. It contains the rules applicable to applications for Excon relief under the Special Voluntary Disclosure Programme (Excon SVDP).

Section (C) of the First Circular (Section C), which has received less attention than the Excon SVDP, provides for administrative relief outside the SVDP under certain circumstances (Section C Relief). This means that no levy will be payable if use is made of Section (C). In this article we discuss the circumstances under which Section (C) relief is available.

Persons to whom Section (C) Relief is available, requirements and period of application

Section (C)(*a*) of the First Circular makes provision for certain natural persons to qualify for Section (C) relief, namely immigrants, certain persons who inherited offshore assets from resident or non-resident estates and persons who received foreign income prior to 1 July 1997. A person who wishes to make use of Section (C) relief, must bring such an application via an Authorised Dealer (AD) in foreign exchange, such as a bank, to FinSurv.

Disclosures made in terms of Section (C) will in most instances not attract a levy in terms of Regulation 24 of the Exchange Control Regulations (Excon Regulations), but merely require “a full disclosure declaration” to an AD. The disclosure must include, but is not limited to, confirmation of the source of all unauthorised foreign assets, details of the manner in which assets were transferred and retained abroad as well as proof of the market value of the unauthorised foreign assets as at 29 February 2016. Section (C)(*b*) of the First Circular sets out the circumstances under which Section (C) relief will be available to corporate entities and approved foreign investments.

In the First Circular, it is stated that Section (C) relief will only be available until 31 March 2017. Although two subsequent circulars were issued by FinSurv, namely Exchange Control Circular No. 8/2016 (Second Circular) and Exchange Control Circular No. 4/2017 (Third Circular), in terms of which the Excon SVDP window period was extended to 30 June and 31 August 2017 respectively, the Second and Third Circulars made no reference to Section (C).

During our engagement with the SARB-SVDP Unit, it has come to our attention that the extended period which applies to the Excon SVDP, also applies to Section C. This means that applications for Section (C) relief can now be brought until 31 August 2017, but not thereafter. A successful application for Section (C) relief will regularise the Excon resident’s possession and retention of the offshore assets, without any levy payable.

Immigrants

The First Circular states that in terms of section B.2(F) of the Excon Rulings (the Excon Rulings were subsequently replaced by the Currency and Exchanges Manual for Authorised Dealers on 1 August 2016), immigrants were required to declare to an AD whether they were in possession of any foreign assets and if so, were required to give an undertaking to the effect that they will not place such foreign assets at the disposal of any third party normally resident in South Africa.

Such a declaration would regularise the qualifying resident’s possession and retention abroad of such foreign assets, but must be made before 31 August 2017.

Persons who received foreign inheritances and legacies from non-resident estates

Excon residents, who became entitled to a foreign inheritance from a *bona fide* non-resident estate (excluding South African estates with foreign assets), prior to 17 March 1998, were required to declare such foreign assets via an AD to FinSurv to be exempt from the provisions of Regulation 6 and/or 7 of the Exchange Control Regulations, 1961 (the Excon Regulations). Regulations 6 and 7 of the Excon Regulations state that as a general rule, a person who becomes entitled to an amount of foreign currency or a foreign asset, must declare that foreign currency or foreign asset to an AD within 30 days of becoming entitled thereto. Excon residents who have not yet made such declarations via an AD may do so before 31 August 2017 and such declaration would regularise the qualifying resident’s possession and retention abroad of such foreign assets.

Persons who received foreign inheritances and legacies from resident estates with foreign assets

According to the First Circular, Excon residents who became entitled to a foreign inheritance from the estate of another Excon resident, previously held in compliance with the Excon Regulations, may declare such foreign assets and apply for exemption from Regulations 6 and/or 7. The FinSurv will grant approval to retain such foreign assets abroad subject to the condition that the foreign assets may not be placed at the disposal of other residents or used to create “loop structures”. No levy will be payable by the Excon resident beneficiary.

Where it is disclosed that the foreign assets inherited were held by the deceased in a manner contrary to the provisions of the Excon Regulations, including “loop structures”, such assets must be reported to FinSurv via an AD and no levy would be payable if the assets are repatriated. If such assets are, however, to be retained abroad a levy of 10% will be payable to FinSurv and any existing “loop structures" must be terminated. Furthermore, the retention abroad of such assets is subject to the condition that the assets may not be placed at the disposal of other Excon residents or used to create any "loop structure".

If the Excon resident beneficiary held the assets abroad in contravention of the Regulations, for example where he/she created the "loop structure" after inheritance, the person will not be exempt from paying a levy and must apply for relief under the Excon SVDP. A declaration made before 31 August 2017 will regularise the Excon resident's possession and retention abroad of such foreign assets.

Persons who earned foreign income

Section (C) of the First Circular states that Excon residents who earned income abroad prior to 1 July 1997 were required to repatriate such foreign earned income to South Africa, in terms of Regulation 6 of the Excon Regulations. Those residents who have not repatriated foreign income earned prior to 1 July 1997, may declare such income via an AD to FinSurv before 31 August 2017, which would regularise the qualifying resident's possession and retention abroad of such foreign assets.

Corporate entities and approved foreign investments

Excon residents with approved foreign investments which have been approved by FinSurv and/or an AD, but who have not done one of the following prior to 29 February 2016 may also apply for Section (C) Relief before 31 August 2017:

- Submitted to FinSurv on an annual basis, financial statements and progress reports with regard to such approved foreign investments;
- Lodged share certificates in respect of such approved foreign investments with AD's (unless exempted from so doing);
- Placed on record, with FinSurv, the expansion of their approved foreign investments;

- Declared dividends and repatriated such dividends to South Africa prior to 26 October 2004; and
- Placed on record, with FinSurv, the disposal of all and/or part of an approved foreign investment (which includes the dilution of the Excon resident's interest in such foreign investment by the issue of new shares to a non-resident or other Excon resident) and/or where the proceeds of such disposal have not been repatriated to South Africa.

Section (C)(*b*)(bb) of the First Circular details the requirements that must be met to regularise each one of these contraventions. Where certain contraventions have taken place with respect to foreign investments, the Excon resident will have to apply for relief under the Excon SVDP.

Comment

Where an asset was derived from funds or assets which can be regularised in terms of Section (C) and funds which have to be regularised in terms of the Excon SVDP, the applicant would have to submit two separate applications – one to the SARB-SVDP Unit via eFiling and one to FinSurv via an AD. Any levy that is imposed in terms of the Excon SVDP, will only apply to the portion of the asset that is regularised through the SVDP and not to all the assets. Excon residents who decide not to apply for Section (C) relief or for relief under the Excon SVDP and who make a disclosure directly to FinSurv after 31 August 2017, could face a levy of between 10% and 40% at the discretion of FinSurv on the current market value of the unauthorised foreign assets.

The most important thing to take note of is that the window period within which applications for Section (C) relief may be made, has been extended until 31 August 2017.

Cliffe Dekker Hofmeyr

Exchange Control Circular No. 6/2016

Exchange Control Circular No. 8/2016
Exchange Control Circular No. 4/2017
Exchange Control Regulations: Regulations 6, 7 and 24

SARS NEWS

2610. 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.