Binding Private Ruling – Exemption from donations tax and the net value of an estate

On 1 July 2015, the South African Revenue Service (SARS) released Binding Private Ruling 197 (BPR 197) dealing with the donations tax consequences arising from the onward or subsequent donation of funds received by way of a donation from a foreign source. BPR 197 further deals with the estate duty consequences that will apply in the event of the foreign sourced funds being retained or used to acquire property that is located and remains outside South Africa.

By way of background, the applicant, a resident of South Africa as defined in s1(1) of the Income Tax Act, No 58 of 1962 (Act), is one of a number of beneficiaries of a foreign trust (Foreign Trust). The funds held by the Foreign Trust consist solely of funds which have been sourced outside of South Africa. In terms of an agreement reached between the trustees of the Foreign Trust, a certain amount of the trust funds would be awarded to the applicant, whereafter the applicant would be removed as a beneficiary of the Foreign Trust.

Subsequent to the funds being transferred to the applicant’s offshore bank account, the applicant intends to donate an amount thereof to certain elected individuals, hereinafter referred to as the donees. The applicant further intends to invest and retain the balance of the awarded funds offshore in order to acquire property, as defined in s3(2) of the Estate Duty Act, No 45 of 1955 (Estate Duty Act), located outside South Africa.

Section 56(1) of the Act deals with certain transactions in respect of which donations tax shall not be payable on the value of property which is disposed of. In particular, s56(1)(g) of the Act provides that donations tax shall not be payable in respect of the value of any property which is disposed of under a donation:

"(g) if such property consists of any right in property situated outside the Republic and was acquired by the donor –

(i) before the donor became a resident of the Republic for the first time; or

(ii)by inheritance from a person who at the date of his death was not ordinarily resident in the Republic or by a donation if at the date of the donation the donor was a person (other than a company) not ordinarily resident in the Republic; or

(iii)out of funds derived by him from the disposal of any property referred to in sub-paragraph (i) or (ii) or, if the donor disposed of such last-mentioned property and replaced it successively with other properties (all situated outside the Republic and acquired by the donor out of funds derived by him from the disposal of any of the said properties), out of funds derived by him from the disposal of, or from revenue from any of those properties."

Having regard to the background set out above, SARS ruled as follows:

- the awarding of funds by the Foreign Trust to the applicant will not trigger any income tax liability in the hands of the applicant;
- the donations made by the applicant to the donees will

be exempt from donations tax under s56(1)(g)(ii) of the Act; and

- the remaining portion of the award received and/or the property acquired using the proceeds of the award from the Foreign Trust will be excluded from the net value of the applicant’s estate for estate duty purposes under s4(e)(ii)(aa) or (iii) of the Estate Duty Act.

It is interesting to note that SARS specifically stated that whether or not the proposed transaction is connected with any arrangement implemented or to be implemented for the avoidance of tax falls outside the scope of BPR 197 and shall not be decided on.

BPR 197 is valid until 28 February 2025.

Tax Alert – 3 July 2015 (125KB)

The ABC of Donations deductions

“Social responsibility is an ethical theory that an entity, be it an organisation or individual, has an obligation to act to benefit society at large.”

When your moral compass and sense of social responsibility lead you to acts of benevolence, you could, in addition to the sense of wellbeing that comes from helping others, also qualify for a reduction in your tax bill. In recognition of the valuable role these donations from individuals and businesses play in these tougher economic times, government has legislated further concessions to allow greater tax relief in respect of such donations.

Generally, donations made to certain organisations established to carry out public benefit activities will qualify as a tax deduction. However, donations made or transferred on or after 1 March 2014 will also benefit from certain concessions.

To whom can you donate? Qualifying organisations

- You will only qualify for a tax deduction if your donation was made to approved public benefit organisations and certain qualifying institutions (‘approved organisations’).
- There are numerous regulations that determine whether an organisation qualifies as an approved organisation. If you wish to qualify for a tax deduction, you need to establish if the beneficiary of your donation can issue a receipt as intended under section 18A of the Income Tax Act No. 58 of 1962 (the Act).

How much can you claim as a tax deduction?

- Taxpayers – natural persons, trusts, companies, or close corporations – can deduct from their taxable income, the amounts they donated to approved organisations, up to the value of 10 percent of their taxable income.
- For natural persons, the term taxable income refers to the taxpayer’s taxable income, whether derived from trade or from a non-trading source, and after allowing all permitted deductions, but before the donation deduction. Taxable income excludes any retirement lump sum benefit, retirement lump sum withdrawal benefit and severance benefit. However, it includes taxable capital gains.
- The donation must actually be paid or transferred during the year of assessment in order to qualify for a tax deduction in such tax year.

An additional concession – roll over treatment of excess

- As from 1 March 2014, any donations in excess of the 10 percent limit will be rolled over and carried forward to the succeeding year of assessment. It will thus be deemed a donation actually paid or transferred during the succeeding year.
- This rollover treatment will continue to apply in respect of any future excesses.

How it affects PAYE

- Your donation can also reduce your monthly employees' tax (PAYE), if your employer agrees to process your donation through its payroll.
- Essentially, any qualifying donation made, limited to five percent of your salary (subject to certain allowable deductions), can be deducted from your salary before PAYE is calculated. However, these further requirements must also be met:
  - The beneficiary must be an approved organisation;
  - The donation amount is deducted from your salary and paid to the approved organisation on your behalf;
  - The approved organisation must issue the section 18A certificate to your employer;
  - Your employer must reflect the full amount of the donation, not only the five percent, on your IRP5 certificate; and
  - The IRP5 certificate will suffice as the supporting documentation required to claim the tax deduction on your annual tax return.

What else can you give and how will it work? Donations other than cash

- Your donation can be in the form of cash or property in kind.
- If you donate property in kind and it qualifies for the section 18A deduction, the deemed donation amount will

be dependent on whether the donation is in the form of trading stock, trading assets or other assets.
- If the donation is in the form of immovable property, which is of a capital nature, and the cost does not exceed the lower of the market value or municipal value, the deemed donation will be calculated according to a prescribed formula.

What else should you know?

- If you donate to any organisation that does not qualify as an approved organisation, you (the donor) are liable to pay donations tax at a rate of 20 percent on the value of such donation in excess of the exemption limits.
- The relevant exemptions are:
  - Donations by natural persons: up to R100 000 in total per year
  - Donations by all other persons: up to R10 000 in total per year
- Furthermore, if you donate an asset to a tax exempt entity, you can disregard any capital gain or capital loss determined in respect of such donation.
- Donations to foreign organisations will not qualify as a tax deduction in determining your normal tax in South Africa.

Donations made between spouses

Sections 54 to 64 of the Income Tax Act, No 58 of 1962 (Act) provide for the imposition of donations tax on the value of any property disposed of by way of a donation.

Donations tax is levied at a rate of 20% of the value of the asset or the amount of money donated, and the donor is generally liable for payment.

A donation is defined as 'any gratuitous disposal of property including any gratuitous waiver or renunciation of a right'. Also, in terms of s58 of the Act, the disposal of any property for an inadequate consideration can be deemed to be a donation.

Section 56 of the Act lists various exemptions in respect of donations tax. One such exemption is for donations between spouses. That is, persons who are married to each other may freely donate assets or money to each other (or for the benefit of each other), irrespective of the marital property regime that applies to them, without triggering donations tax. This exemption does however not apply to spouses who are legally separated.

A further exemption applies to donations made between spouses under a duly registered ante-nuptial or post-nuptial contract or under a notarial contract in terms of s21 of the Matrimonial Property Act No 88 of 1984.

Despite the general exemptions from donations tax that apply to spouses, it is important to appreciate the income tax consequences that the anti-avoidance rules contained in s7 of the Act (which are mainly aimed at income splitting) may have in respect of donations.

In terms of s7(2) of the Act, any income received by or accrued to a person married in or out of community of property will be deemed to be income accrued to that person's spouse, if the income was derived by the person in consequence of a donation made by the person's spouse, and the sole or main purpose of the donation was the reduction, postponement or avoidance of the donor's liability for any tax which would otherwise have become payable by the donor.

If a person has made a donation to any other person (including a spouse or a trust of which the spouse is a beneficiary), which donation is subject to a stipulation that the other person will not receive the income under such donation until the happening of a future event, the income that would otherwise have accrued to the beneficiaries as a result of the donation, will be deemed to have accrued to the person (s7(5) of the Act).

If a deed of donation contains a stipulation that the right to receive any income under such donation may be revoked or conferred on someone else, the income received by or accrued to the donee under such donation will be deemed to be the income of the donor (s7(6) of the Act).

If a person donates (by way of cession or otherwise) his or her right to receive rent, dividends, interest, royalties or other income in respect of any property to another person (such as a spouse, or a third party for the benefit of the spouse), and the donor retains an interest in the property, including a reversionary interest, the rent, dividends, interest, royalties or other income will be deemed to be that of the donor (s7(7) of the Act). The same applies to the donation of a beneficial interest in a trust (s7(7)(b) of the Act).

For the purposes of these anti-avoidance provisions, the disposal of an asset for consideration that is less than its market value, will be deemed to be a donation (s7(10) of the Act).

Even though donations between spouses are generally exempt from donations tax, married persons should be careful when making donations to each other, especially where the result of the donation is that income is diverted from the donor to the donee.

Taxpayers are obliged in terms of s7(10) of the Act to disclose such donations to the South African Revenue Service when submitting their tax returns.

Aurthors:

- DLA Cliffe Dekker Hofmeyr
- Heinrich Louw and Gigi Nyanin

Deductible Donations

By Doné Howell, Tax Partner Grant Thornton Johannesburg

“Social responsibility is an ethical theory that an entity, be it an organisation or individual, has an obligation to act to benefit society at large.”

When your moral compass and sense of social responsibility lead you to acts of benevolence, you could, in addition to the sense of wellbeing that comes from helping others, also qualify for a reduction in your tax bill. In recognition of the valuable role these donations from individuals and businesses play in these tougher economic times, government has legislated further concessions to allow greater tax relief in respect such donations.

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- The donation must actually be paid or transferred during the year of assessment in order to qualify for a tax deduction in such tax year.

An incentive to give more now. Roll over treatment of excess

- As from 1 March 2014, any donations in excess of the 10 percent limit will be rolled over and carried forward to the succeeding year of assessment. It will thus be deemed a donation actually paid or transferred during

- the succeeding year.
- This rollover treatment will continue to apply in respect of any future excesses.

More ways to give. Payroll giving

- Your donation can also reduce your monthly employees' tax ('PAYE'), if your employer agrees to process such through its payroll.
- Essentially, any donation made, limited to five percent of your salary (subject to certain allowable deductions) can be deducted from your salary before PAYE is calculated. However, these requirements must also be met:
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What else should you know?

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- However, there are various exemptions to this, including inter alia:
    - Donations by natural persons: up to R100 000 per year
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- Furthermore, if you donate an asset to a tax exempt entity, you must disregard any capital gain or capital loss determined in respect of such donation.
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These new concessions provide more opportunities for taxpayers to have control over the good their money can do in the broader society. With some planning and goodwill, it can truly result in a win-win outcome for all.

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On South African tax compliance, tax morality and taxpayers’ freedom to do tax planning – Canada, Ireland and South Africa are not worlds apart

Tax Planning – PNM

Financial Services

The upcoming Budget Speech comes against the backdrop of a depressing South African growth rate, stubbornly high unemployment, a depreciating Rand (with more US tapering still to come), continued strikes in the mining sector, deadly service delivery protests and declining tax revenues.

On a more positive note: In November 2013 Minister Gordhan pointed to the continued growth in tax compliance by South Africans and said: "… the ability to collect tax revenue …to finance the provision of public services and socioeconomic infrastructure has been a cornerstone of our democracy these 20 years."

Commentators question, however, whether such compliance gains are sustainable in light of wide-spread wasteful and fruitless State expenditure. There have been headlines warning that "Taxpayers' pockets are not bottomless" (BusinessDay, 15 Nov 2013), that "Profligacy threatens legitimacy of the tax system" (BusinessDay, 25 October 2013) and that "It is indeed an emergency when government throws away the tax revenue that could be fixing real problems" (Financial Mail, November 22 – 27, 2013).

The SARS Strategic Plan 2013/14 – 2017/18 recognises the risk: "Research and empirical evidence show that taxpayer's attitude towards compliance, and their willingness to comply, is influenced by how they perceive public funds to be utilised.

Concerns about corruption in the public sector remain an issue.

Recent surveys show that corruption has replaced crime as the number one issue concerning South African citizens."

Despite the above, SA taxpayers should expect to hear, during Budget time, continued references to the notion of "tax morality", urging each one to pay his or her "fair share".

As explained by the previous SARS Commissioner: "In SARS, we have for many years promoted the notion that there is a moral component to tax compliance and this has seen us at odds with some tax advisors and professionals who insist tax is simply a cost to be reduced wherever possible."

What should SA taxpayers' take on this be?

A recent Canadian tax case complemented the litigants for sticking to tax fundamentals and for keeping tax morality arguments out of the proceedings.

The judgment in ***Mckesson Canada Corporation (Appellant) and Her Majesty The Queen (Respondent) (heard in the Tax Court of Canada in December 2013 (2013 TCC 404; 2013 Can.Tax Ct. LEXIS 323))*** is both lengthy and complex. It deals with transfer pricing. But it makes the following observations regarding tax morality versus a taxpayer's freedom to do tax planning:

- "The Crown did not directly or indirectly raise any fair share or fiscal morality arguments that are currently trendy in international tax circles. It wisely stuck strictly to the tax fundamentals: the relevant provisions of the legislation and the evidence relevant thereto. Issues of fiscal morality and fair share are surely the realm of Parliament." [par 167].
- "There is certainly nothing wrong with taxpayers doing tax-oriented transactions, tax planning, and making decisions based entirely upon tax consequences (subject only to GAAR which is not relevant to this appeal). The Supreme Court of Canada reminds us regularly that the Duke of Westminster is alive and well and living in Canada." [par 275].

The last quotation might as well have come from SA case law.

In ***CSARS v NWK Ltd [2011] 2 All SA 347 (SCA)*** Lewis JA held: "It is trite that a taxpayer may organise his financial affairs in such a way as to pay the least tax permissible.

There is, in principle, nothing wrong with arrangements that are tax effective." [par 42]

The footnote to the abovementioned passage mentions that the SA taxpayers' freedom to do tax planning was based on, and had been affirmed, in the *Duke of Westminster, Ladysmith* and *Conhage* cases.

A reminder: In ***Inland Revenue Commissioners v. the Duke of Westminster (1936) AC 1***, Lord Tomlin proclaimed:

"Every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

It seems that the *Duke of Westminster* is alive and well and (also) living in South Africa.

At a major Global Tax Policy Conference (held in Dublin, Ireland during October 2013) Josephine Feehily who is the chair of the Irish Revenue Commissioners and chair of the OECD Forum on Tax Administration opined on the topic of tax morality. She stated that that tax morality was not the issue, but rather the enforcement of the correct tax payable. Such enforcement should be based on the laws made by government, and through reasonable and purposive interpretation of those laws rather than through tax morality that is difficult to enforce. She further said that, should the tax laws be abused, alternatively their intent and purpose not be clear, they should either be amended to clarify them or referred to the courts for interpretation. [Refer Conference feedback as reported in TaxTalk Journal, January / February, 2014 edition, at p. 14].

Clearly Canada, Ireland and South Africa are not worlds apart in saying that ‘fair share’ and ‘tax morality’ concepts belong in the realm of Parliament and that a taxpayer’s tax liability should be determined with reference to the applicable statutory provisions.

Author: Johan van der Walt – Tax Director at DLA Cliffe Dekker Hofmeyr

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Taxpayer's rights on SARS audits

The Tax Administration Act, Act 28 of 2011 (the TAA) came into effect on 1 October 2012. Its promulgation brought with it many changes to not only taxpayers’ rights and obligations but the reciprocal rights and obligations on the part of the South African Revenue Service (SARS) in its continuous business of revenue collection. Some of the amendments and repeals of sections previously contained in the Income Tax Act No. 58 of 1962 (the Act) have seen a welcome improvement in taxpayers’ rights. One of these improvements is contained in section 42 of the TAA.

Previously, the Act contained no obligation on SARS to keep the taxpayer informed during an audit, nor did it provide for a timeline on the time period SARS could take to complete an audit. The taxpayer could thus be left in limbo and be uncertain as to when an audit may be completed. This position was clearly not conducive to good commercial nor equitable practice and if the taxpayer were to enquire with SARS for the purpose of obtaining a status update on the audit or request that such an audit be completed within a reasonable time, SARS could merely state that it was under no statutory obligation to complete the audit within a certain timeframe and that complexities in conducting the audit required extensive use of resources.

Section 42 of the TAA, however, now provides that a SARS official involved in or responsible for an audit must, in the form and in the manner as may be prescribed by the Commissioner by public notice, provide the taxpayer with a report indicating the stage of the completion of the audit. SARS issued Public Notice No. 788 on 1 October 2012 in Government Gazette No. 35733 (the Public Notice) for this purpose.

In terms of the Public Notice, a taxpayer is entitled to a status update of the audit within 90 days after commencement of the audit and within 90 day intervals thereafter. The definition of ‘day’ is currently an anomaly in our law, but for the sake of this note it suffices to say that ‘days’ indicate calendar days. The Public Notice goes on to provide the manner and form which the report should take:

“The report must include the following details as at the date of the report:

- A description of the current scope of the audit;
- The stage of completion of the audit;
- Relevant material still outstanding from the taxpayer”

This must be seen as a welcome development in South Africa’s tax law as it attempts to provide the taxpayer with greater certainty and provides suggested timeframes of completion of an audit and hence allows a better opportunity to put into place contingency plans for any eventualities. It is furthermore, in line with many overseas jurisdictions. However, despite this welcome development there are questions regarding its effect and usefulness in enforcing taxpayers’ rights.

Despite this new obligation on SARS to keep the taxpayer informed throughout the course of an audit, it is unfortunate that where SARS fails to abide by its legal obligations there is no sanction against SARS nor remedy for the taxpayer. In effect SARS could continue to issue such reports indefinitely, alternatively, could merely fail to issue the report as it will have no adverse effect on its ability to collect revenue in the long term.

Rule 26(5) of the Rules prescribing the procedures to be observed in lodging objections and noting appeals against assessments (the Rules) provides that where a party fails to comply with any requirement contained in the Rules, the Court may, upon application on notice by the other party, order the defaulting party to comply with that requirement within such time as the court deems appropriate. Rule 26(6) goes on to state that where the defaulting party fails to comply with such a court order in terms of Rule 26(5), then the court may upon application on notice by either party make an order which in effect either confirms the assessment or allows the objection. This remedy therefore ensures finality and certainty and is open to utilisation by both SARS and the taxpayer. It is unfortunate that it only applies to objections and appeals and not to the situation before SARS issues an assessment.

The question therefore remains – what are the remedies available to a taxpayer where SARS does not issue the report nor finalises the audit and the timeframe involved is extensive having regard to reasonability?

One possible solution may be to approach the civil courts for the purpose of granting a *mandamus* (mandatory interdict) against the relevant SARS official to carry out his obligations in terms of section 42 of the Act. The courts, may, however, be hesitant to grant such an order as it may be difficult to prove the requirements for an interdict, which include, *inter alia*, that there is a well-grounded apprehension of irreparable harm or that an injury has actually been committed or is reasonably apprehended.

The initiation of an audit does not necessarily mean that SARS will issue additional assessments against the taxpayer, and thus it is most certainly difficult to prove irreparable harm. An exception to this is perhaps the situation where a taxpayer requires a Tax Clearance Certificate (TCC) from SARS for business and commercial purposes, but where SARS refuses to issue such a certificate as a result of the pending audit or an audit which has not been finalised. Notwithstanding the fact that in the aforementioned situation, the taxpayer may be able to prove irreparable harm, litigation in the High Court is time and cost intensive and it seems unnecessarily burdensome taking into account the purpose of such an application.

An alternative could be to approach the High Court to take SARS on review for its failure to comply with section 33 of The Constitution of the Republic of South Africa, 1996 (the Constitution), as well as the Promotion of Administrative Justice Act, Act 3 of 2000 (PAJA). Again, the high costs of litigation involved in this process far outweigh the possible remedy the court may order. Furthermore, such applications are not financially viable for the majority of taxpayers and it could be too often a case of the taxpayer having to succumb to SARS' authority.

Unfortunately, at this stage there does not appear to be any further alternative remedies for the taxpayer or sanctions against SARS for not abiding by its legal obligations in terms of the TAA. It is always valuable to compare our position with overseas jurisdictions. However, in this instance it seems that although many foreign jurisdictions recognise the need and importance of keeping the taxpayer informed, there are neither sanctions on the revenue authorities nor reciprocal remedies for the taxpayer.

In the Irish Tax and Customs Code of Practice for Revenue

Audit it states that it is in the best interests of everybody that the audit is concluded as quickly as possible and also provides that where the taxpayer has complied with all requests for information timeously, then Irish Revenue must advise of the status of the audit after the expiry of three months, and in so far as possible the estimated timeframe of completion thereof. The Code does not, however, provide for a sanction where the Irish authorities fail to adhere to these obligations.

In the Australian Tax Office (ATO)'s guidelines on the conduct of complex audits, it sets out the auditor's obligations during the course of the audit, which includes, *inter alia*, to keep the taxpayer informed. Unfortunately there is no mention of a suitable remedy where the auditor abrogates from his obligations. The ATO, did however, recently introduce a system where it develops an 'Aged Case Report' showing all audits which have not been finalised within two years and the reasons behind the delays. This report is then forwarded to the ATO's Deputy Commissioner: Large Business and International on a regular basis, for the purpose of determining any action required to speed up resolution of the audits.

It thus appears that, although the TAA went a long way to improving taxpayers' rights and enhancing SARS administrative obligations, there are several issues which have arisen since its implementation. While it is accepted that the need for an efficiently functioning revenue authority is key for the success of the country's economy and this goes hand in hand with the powers given to SARS in the new legislation, one must not lose sight of the fact that the sanctions imposed against the taxpayer for failing to comply with certain provisions are often harsh, whereas the reciprocal sanctions imposed on SARS are often not even catered for. Nevertheless, it is vitally important for all taxpayers to know their rights in these circumstances and to seek professional assistance where issues surrounding the interaction with SARS pertaining to requests for information, audits, objections and appeals arise.

Edward Nathan Sonnenbergs
TAA: Section 42
SARS Public Notice No. 788
SARS Rules for Objection and Appeal: Rules 26(5) and 26(6)
The Constitution of the Republic of South Africa: Section 33
PAJA

Receipt of foreign assets and the subsequent donation thereof to a non-resident trust

Binding Private Ruling 157 dealt with the income tax consequences arising from, and the attribution rules applicable to a distribution of foreign assets made by non-resident discretionary trusts to a beneficiary who is a resident of South Africa, and the subsequent donation by the beneficiary of such assets to another non-resident trust.

The parties to the transaction were as follows:

- ‘The Applicant’: a natural person who is a resident of South Africa.
- ‘Trust A’: a non-resident testamentary discretionary trust.
- ‘Trust B’: a non-resident discretionary trust.
- ‘Trust C’: a non-resident trust to be founded by the Applicant.
- ‘Company A’: a non-resident company.

- 'Company B': a non-resident company.

The Applicant is a beneficiary of Trusts A and B. Trusts A and B held all the shares in Companies A and B. It was proposed that Trusts A and B will, in due course, distribute certain foreign assets in the form of loan accounts, cash reserves and shares to the Applicant. Upon receiving the distributed assets the Applicant intended to donate them to Trust C. Company B is not dealt with further in the ruling.

Ruling made in connection with the transaction:

Trusts A & B's distributions to the Applicant

- The distribution of Trust A's shares held in Company A and Trusts A and B's loan account in Company A to the Applicant fell outside the ambit of section 25B(1), (2) and (2A) of the Income Tax Act.
- The provisions of paragraph 80 of the Eighth Schedule to the Income Tax Act did not apply to the distributions of the loan account and shares to the Applicant. The base cost of the loan account and shares in the Applicant's hands will be equal to the face value (or market value) of the loan and shares respectively as at the date of distribution in terms of paragraph 20(1)(h)(vi) of the Eighth Schedule.
- Similarly the distribution of Trust B's cash reserves to the Applicant fell outside the ambit of section 25B(1), (2) and (2A).

Section 25B of the Act is the principal taxing section that relates to trusts. This section provides that (subject to certain other provisions) the income of a trust is taxed either in the trust or in the hands of the beneficiaries. South African taxpayers should be mindful of implications of section 25B when determining the liability for tax in respect of trust income.

Applicant's subsequent donations to Trust C

- The Applicant’s donation of the foreign assets to Trust C was exempt from donations tax under the provisions of section 56(1)(g)(ii) of the Income Tax Act.
- Section 7(8), read with section 10B(2)(a), would apply to the donation of the Company A shares to Trust C.
- Section 7(8) would apply to the donation of Trusts A and B’s loan accounts to Trust C as well, to the extent that any interest was charged or any obligation exists to pay interest on these loans.
- Section 7(8) would also apply to the donation of Trust B’s cash reserves to Trust C to the extent that any interest is earned on such reserves, or from any amounts arising in Trust C as a result of the utilisation of such funds for the purchase of an income–generating asset.
- The application of section 7(8) to the loan accounts and cash reserves above will be limited to the amounts generated in Trust C, as a result of the donation of the foreign assets by the Applicant, and it will not apply to any amounts generated in or by Company A.

Section 7(8) deems any amount to be the income of a resident if such amount is received by or accrues to a non-resident in consequence of a donation, settlement or other (gratuitous) disposition made by the resident, and such amount would have been included in the non-resident’s income had he been a resident.

This section however does not apply to a donation, settlement or disposition made to a non-resident which is an entity which is similar to a PBO or income (e.g. from a donation) received by a CFC in relation to the resident donor.

Unfortunately this Binding Private Ruling does not specify the reasons why neither section 25B nor paragraph 80 do not apply to the distributions of the shares and loan account by the trust.

Receipt of Foreign Assets and the Subsequent Donation Thereof to a Non-resident Trust

Author: BDO

Binding Private Ruling 157 dealt with the income tax consequences arising from, and the attribution rules applicable to a distribution of foreign assets made by non-resident discretionary trusts to a beneficiary who is a resident of South Africa, and the subsequent donation by the beneficiary of such assets to another non-resident trust.

The parties to the transaction were as follows:

• 'The Applicant': a natural person who is a resident of South Africa.

• 'Trust A': a non-resident testamentary discretionary trust.

• 'Trust B': a non-resident discretionary trust.

• 'Trust C': a non-resident trust to be founded by the Applicant.

• 'Company A': a non-resident company.

• 'Company B': a non-resident company.

The Applicant is a beneficiary of Trusts A and B. Trusts A and B held all the shares in Companies A and B. It was proposed that Trusts A and B will, in due course, distribute certain foreign assets in the form of loan accounts, cash reserves and shares to the Applicant. Upon receiving the distributed assets the Applicant intended to donate them to Trust C. Company B is not dealt with further in the ruling.

Ruling made in connection with the transaction:

Trusts A & B's distributions to the Applicant

• The distribution of Trust A's shares held in Company A and Trusts A and B's loan account in Company A to the Applicant fell outside the ambit of section 25B(1), (2) and (2A) of the Income Tax Act.

• The provisions of paragraph 80 of the Eighth Schedule to the Income Tax Act did not apply to the distributions of the loan account and shares to the Applicant. The base cost of the loan account and shares in the Applicant's hands will be equal to the face value (or market value) of the loan and shares respectively as at the date of distribution in terms of paragraph 20(1)(h)(vi) of the Eighth Schedule.

• Similarly the distribution of Trust B's cash reserves to the Applicant fell outside the ambit of section 25B(1), (2) and (2A).

Section 25B of the Act is the principal taxing section that relates to trusts. This section provides that (subject to certain other provisions) the income of a trust is taxed either in the trust or in the hands of the beneficiaries. South African taxpayers should be mindful of implications of section 25B when determining the liability for tax in respect of trust income.

Applicant's subsequent donations to Trust C

• The Applicant's donation of the foreign assets to Trust C was exempt from donations tax under the provisions of section 56(1)(g)(ii) of the Income Tax Act.

• Section 7(8), read with section 10B(2)(a), would apply to the donation of the Company A shares to Trust C.

• Section 7(8) would apply to the donation of Trusts A and B's loan accounts to Trust C as well, to the extent that any interest was charged or any obligation exists to pay interest on these loans.

• Section 7(8) would also apply to the donation of Trust B's cash reserves to Trust C to the extent that any interest is earned on such reserves, or from any amounts arising in Trust C as a result of the utilisation of such funds for the purchase of an income–generating asset.

• The application of section 7(8) to the loan accounts and cash reserves above will be limited to the amounts generated in Trust C, as a result of the donation of the foreign assets by the Applicant, and it will not apply to any amounts generated in or by Company A.

Section 7(8) deems any amount to be the income of a resident if such amount is received by or accrues to a non-resident in consequence of a donation, settlement or other (gratuitous) disposition made by the resident, and such amount would have been included in the non-resident's income had he been a resident.

This section however does not apply to a donation, settlement or disposition made to a non-resident which is an entity which is similar to a PBO or income (e.g. from a donation) received by a CFC in relation to the resident donor.

Unfortunately this Binding Private Ruling does not specify the reasons why neither section 25B nor paragraph 80 do not apply to the distributions of the shares and loan account by the trust.

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SARS to fight for its fair share of the tax pie

Earlier this year Minister Pravin Gordhan (“**the Minister**”) announced the members of the Tax Review Committee (“**the committee**”) as well as the committee’s terms of reference.

The terms of reference for the committee include inquiring into the role of the South African tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability. The committee is required to take into account recent domestic and global developments and, in particular, the long-term objectives of the National Development Plan (NDP) and thereafter make recommendations to the Minister. Any tax proposals arising from these recommendations will be announced as part of the normal budget and legislative processes.

In addition, the committee’s mandate includes the evaluation of the South African tax system against international tax trends, principles and practices, as well as recent international initiatives to improve tax compliance and deal with tax base erosion. Aspects that will receive specific attention have also been set out and include reviewing the corporate tax system with reference to, inter alia, tax avoidance (e.g. base erosion, income splitting and profit shifting, including the tax bias in favour of debt financing) and further consider issues such as whether the current South African mining tax regime is appropriate, taking account of the agreement between Government, Labour and Business to ensure that the mining sector contributes to growth and job creation, remains a competitive investment proposition, and all role players contribute to better working and living conditions. The challenges facing the mining sector, including low commodity prices, rising costs, falling outputs and declining margins as well as the mining sector’s current contribution to tax revenues should also be taken into account.

In carrying out the review the committee should take into account the objectives of the South African tax system, bearing in mind that the South African tax system has changed since the recommendations of the last tax commission and these changes have contributed to the development of a relatively robust and competitive tax system. However, given the pace of globalisation, relative modest economic growth after the 2008/09 economic recession and the significant social challenges such as persistent unemployment, poverty and inequality, there is a need to review what role the tax system can play as part of a coherent and effective fiscal policy framework in addressing these challenges. There is also a need to address concerns about base erosion and profit shifting (“**BEPS**”), especially in the context of corporate income tax, as identified by the Organisation for Economic Co-operation and Development (“**OECD**”) and the G20-countries.

In order to address BEPS, the OECD has published an Action Plan on BEPS (“**the Action Plan**”). The Action Plan sets out 15 actions, which can briefly be summarized as follows:

1. **Address the tax challenges of the digital economy** – Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services.
2. **Neutralise the effects of hybrid mismatch arrangements** – Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (“**CFC**”) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention.
3. **Strengthen CFC rules** – Develop recommendations regarding the design of CFC rules.
4. **Limit base erosion via interest deductions and other financial payments** – Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments.
5. **Counter harmful tax practices more effectively, taking into account transparency and substance** – Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context.
6. **Prevent treaty abuse** – Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.
7. **Prevent artificial avoidance of permanent establishment (“PE”) status** – Develop changes to the definition of a PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.
8. **Assure that transfer pricing outcomes are in line with value creation: intangibles** – Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.
9. **Assure that transfer pricing outcomes are in line with value creation: risks and capital** – Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation.
10. **Assure that transfer pricing outcomes are in line with value creation: other high – risk transactions** – Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.
11. **Establish methodologies to collect and analyse data on BEPS and the actions to address it** – Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an on-going basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spill over effects across countries) and actions to address it.
12. **Require taxpayers to disclose their aggressive tax planning arrangements** – Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of “tax benefit” in order to capture such transactions.
13. **Re-examine transfer pricing documentation** – Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that multinationals provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.
14. **Make dispute resolution mechanisms more effective** – Develop solutions to address obstacles that prevent countries from solving treaty related disputes under Mutual Agreement Procedures (“**MAP**”), including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.
15. **Develop a multilateral instrument** – Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.

Tax authorities and governments worldwide (especially G20-countries) will be hoping that the actions suggested by the OECD will lead to a tax system in which profits are taxed “where economic activities deriving the profits are performed and where value is created”, as opposed to being taxed in the lowest tax jurisdiction.

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