SA Budget 2020/21 – Proposal to prevent tax avoidance through the use of loop structures

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According to the Budget, the current exchange control provisions restrict the use of loop structures, in part to protect the tax base. The current policy is that a South African resident may not collectively hold more than a 40% interest in an offshore entity, which in turn, holds interests in a South African entity or made loans to a South African company. Where an interest is held in this manner, it is known as a loop structure.

The Budget explains that tax legislation is a more appropriate tool to combat tax avoidance, as opposed to the policy restricting the use of loop structures. For example, if a resident individual or trust holds at least 10% of the total equity shares and voting rights in a foreign company, they qualify for a participation exemption, as dealt with in paragraph 64B of
the Eighth Schedule to the Act. Furthermore, section 10B of the Act states that all foreign dividends received are exempt from tax, if a South African resident individual or trust holds a 10% interest.
If the resident shareholding is more than 50%, the foreign company is a controlled foreign company (CFC). Furthermore, all of the CFCs dividend income is exempt from tax. The CFC

provisions are dealt with in section 9D of the Act. If loop structures are no longer restricted, it would be possible to set up a structure where the CFC owns a South African company, and any dividends flowing from the resident company to the resident individual or trust through the CFC are tax-exempt for the individual or trust. This would enable the resident individual or trust to reduce their dividend tax liability in respect of dividends declared by a resident company from 20% to, in some instances, 0%.

A further loop structure risk exists if a resident disposes of shares in a CFC that owns South African assets. The unrealised gains attributable to the South African assets may not be taxed if the resident qualifies for the participation exemption in paragraph 64B of the Eighth Schedule to the Act.

Government proposes that the CFC legislation be amended to limit the dividend exemption available to a resident individual or trust relating to the accrual or receipt of dividends from a resident company to a CFC. As a result, such dividends would be taxed at an effective rate of 20%, in line with cases where resident individuals receive dividends from resident companies.

In addition, the Budget proposes that the participation exemption for capital gains on the disposal of shares in CFCs by residents, should not apply to the extent that the value of those shares is derived from South African assets.