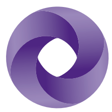

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E-TAXLINE MAY 2015

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Tax management – more complex by the day

Concerns about aggressive "tax management" by global and South African firms are not new and the issue is receiving increasing attention from policy makers, lobby groups and the media. Rightly so, if you consider that according to Global Financial Integrity, a non-profit, research and advocacy organisation, an estimated $530-billion has been lost to sub-Saharan African country's tax coffers between 2003-2012 due to tax avoidance and illegal activity.

At the Africa Tax Administration Forum (Ataf) conference on base erosion and profit shifting (BEPS) held in Sandton at the end of April, Finance Minister Nene reiterated the need to protect South Africa's already small tax base. He specifically highlighted practices such as incorrect trade invoicing that must be addressed to prevent tax losses to African countries like ours that rely on tax from multinational corporations.

Minister Nene is certainly not alone in his view and the non-profit lobby group the Alternative Information & Development Centre (AIDC) recently argued in a submission to Davis tax committee that, "Shifting profits to low-tax jurisdictions not only erodes South Africa's tax base, it erodes the base for paying living wages to employees - as well as the base for creating value for black economic empowerment partners."

They argue further that companies shifting profits out of South Africa to avoid tax are causing political and social instability and called on Judge Davis to recommend tougher reporting standards on companies operating in South Africa and to improve the capacity of the Companies and Intellectual Property Commission when the committee's recommendations are handed to Minister Nene.

We urge all companies to develop a clear understanding about the potential implications of these suggested reforms, and those contained in the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan. It's not too late to engage in shaping the final form of these proposals, which will evolve and be refined over the coming months and into next year."

With these issues of profit shifting and tax avoidance in mind, we share an important ruling issued by the China State Administration of Taxation regarding the payment of service fees and royalties from China to overseas related parties.

In a related topic, Bruce Russell, Tax Consultant at Grant Thornton Cape, considers the potential for double taxation on fees for advisory or other technical services rendered by South African companies to clients abroad.

Hylton Cameron, Associate Director at Grant Thornton Johannesburg questions whether SARS' powers extend to infinity when he reviews the case of Ackermans Ltd v CSARS that re-visited the issue of prescribed tax returns.

David Honeyball, Partner Grant Thornton Cape, paints a silver lining around the looming cloud of more stringent tax compliance requirements by suggesting that there may be untapped opportunities for anyone investing in startups, SMMEs and junior mining companies.

Finally, in case you're not in the loop, Douglas Gaul, Tax Manager at Grant Thornton Johannesburg summarises everything you need to know about the recently introduced tax-free savings vehicles.

Transfer Pricing alert – China's transfer pricing administration on outbound payments

This Alert provides an in-depth analysis of a new announcement by the China State Administration of Taxation regarding the payment of service fees and royalties from China to overseas related parties. The new rules set out in Announcement 16 will have a direct and substantial effect on all companies doing business in China because paying service fees and royalties are among the most common means for Chinese entities to repatriate profits to its overseas affiliates.

In summary, the new regulations will see China applying an even more stringent standard (to certain extent even more so than the OECD and BEPS definition) when reviewing outbound payment of service fees or royalties. Failure to prove the business substance of the overseas party, the benefit nature of the rendered services, or the economic ownership of the overseas party on royalty will result in the non-deductibility of such expenses at China corporate income tax level. This ruling also empowers China tax authorities to conduct retroactive adjustment on such transactions for a maximum of 10 years.

Cross-border technical services income – Double Tax Agreements should be considered to reduce double tax burdens

By Bruce Russell, Tax Consultant, Grant Thornton Cape

South African resident taxpayers performing advisory or other technical services within South Africa to clients abroad, may be subject to foreign withholding taxes. To reduce the risk of this income being subjected to double taxation, it is necessary to consider the source of this income.

The source of services income

South African courts have interpreted the concept of source in applying the Income Tax Act. Source in this context is not a legal concept, but rather something a reasonable man would regard as the real source of income. In establishing the source of income, our courts have not looked to the origin of the income, but rather have focused on the originating cause of the income. The originating cause is the quid pro quo given by the taxpayer to earn the income. In the case of service income, the source is usually the location from where the services are rendered.

The impact of double tax agreements on the source of technical services income
A double tax agreement ("DTA") may contain a technical services clause. For example, DTAs concluded by South Africa with Swaziland, Botswana, Uganda and India contain such a clause. In terms of this clause, fees for technical services that are paid by a resident of a foreign country to a South African resident, are usually deemed to arise in the foreign country. Furthermore, this DTA clause usually permits the foreign country to impose a withholding tax of 10%.

However, the provisions contained in these DTAs, usually conflicts with the South African common law view of source. The SARS interpretation - Interpretation Note No. 18 (issue 2) and its Draft Interpretation Note No. 18 (issue 3) - is that the DTA deemed source provisions overrides the South African common law view of source. Applying SARS' interpretation, the source of technical services income is located in the payer's resident country.

The importance of determining the source of technical services income in light of double tax relief measures

Where a South African tax resident is liable for foreign taxes, relief in terms of a tax rebate or a tax deduction may be available. The extent or type of relief available depends on the source of the income.

Where the source of the income is South Africa, the taxpayer may be entitled to a section 6quin rebate. To qualify for this rebate, an FTW01 form must be submitted to SARS within 60 days of the tax being withheld. Failing to comply with this requirement means that the taxpayer may only be entitled to claim the foreign taxes paid as a deduction in terms of section 6quat. A deduction for foreign taxes is less desirable, as for instance a corporate taxpayer in this position would only be entitled to reduce their South African income tax liability by up to 28% of the foreign tax paid.

If the source of the income is foreign, the taxpayer may be entitled to a section 6quat rebate. No form needs to be submitted to SARS in order to claim this rebate.

Therefore, South African taxpayers deriving technical services income from which foreign taxes are withheld must evaluate and conclude on the source of this income within a short space of time to ensure that double taxation is minimised. In determining the source of technical service income, a relevant DTA may need to be evaluated.

Interpreting the provisions and implications of DTAs may not be straightforward and to avoid penalties and frustration, please contact us for assistance.

Has your tax return prescribed? SARS' powers reach to infinity and beyond

By Hylton Cameron, Associate Director, Grant Thornton Johannesburg

In the recent case of Ackermans Ltd v CSARS the issue of prescribed tax returns was re-visited in Pretoria in the High Court.

In terms of the Income Tax Act, SARS is entitled to raise additional assessments for three years from the date of final assessment. However if there is a misrepresentation of a material fact in the original return, the three prescription period does not apply.

In this case however, SARS only raised additional assessments some seven to thirteen years after the original assessments, sparking concern about SARS' almost infinite reach to reassess tax returns.

SARS argued that Ackermans misrepresented and failed to disclose material facts regarding the true nature and substance of a series of agreements, which were simulated loans in SARS's view. Ackermans on the other hand, argued that the additional assessments should be set aside in terms of the Promotion of Administrative Justice Act (PAJA), or declared unconstitutional unlawful and invalid.

Between October 2003 and February 2005 SARS and Ackermans exchanged a slew of correspondence about these 'simulated loans'. Ackermans maintained that all documents were provided, while SARS alleged that some documents were actually not handed over.

On 5 February 2005, SARS notified Ackermans that it would raise additional assessments for 1998 to 2003. However, SARS did not take any action and 6 July 2006 another notice of the same intent was issued and then communication ceased between the parties until more than five years later. SARS finally issued the additional assessments in 2012.

SARS contended that Ackermans misrepresented facts when answering "no" on their tax return to the questions of whether they had been party to interest rate swap transactions and whether the company was party to a structured finance transaction. Because these were misrepresentations in SARS' view, it entitled them to raise the additional assessments.

Ackermans argued that there was an unreasonable delay in issuing the additional assessments, especially taking into consideration the period of utter silence on the topic between July 2006 and November 2011.

As defence, SARS argued that it was waiting for another case (CSARS v NWK) to be concluded. Additionally, in terms of prescription it has 30 years in which they are entitled to raise such additional assessments.

As explained above, SARS is indeed entitled to raise additional assessments after three years provided there was a misrepresentation of a material fact.

While the legislation is reasonable, one would expect that if SARS became aware of an issue, and enter into correspondence with the taxpayer regarding it, SARS should act within reasonable time.

Due to the dispute of facts, i.e. whether all information was provided or not and whether there was a misrepresentation the court held that further evidence was required. As result, the matter was referred to the tax court.

In essence, even if we assume the tax return misrepresented the facts, SARS became of aware of it and corresponded with Ackermans until July 2006. SARS should then arguably be under a legal duty to issue the additional assessments either in terms of the Constitution or PAJA. What constitutes a reasonable timeframe is debatable, but five years does seem excessive, which should mean such additional assessments should be rejected.

How does this case affect you and other taxpayers?

The main issue is that all questions in your tax return must always be answered honestly and correctly. If you fail to do this, there is a risk that SARS will raise additional assessments even if it becomes aware of the misrepresentation years from now. Well, at least within 30 years according to SARS.

As we're approaching Tax Season, contact us to assist you in compiling a tax return that will withstand SARS' scrutiny now, and in the future.

Venture Capital Investments – are you missing an excellent opportunity?

By David Honeyball, Partner, Grant Thornton Cape

Small business development continues to be a focus area for economic development for South Africans desperate for faster economic growth. Therefore, the introduction of Section 12J of the Income Tax Act, which was introduced on 1 July 2009, created a welcome pooling mechanism allowing investors to channel funds into small businesses and junior mining companies.

The intention of the legislation is that by pooling funds, a Venture Capital Company (VCC) can provide equity and management services to the investee. As incentive, the VCC shareholders enjoy a 100% upfront tax deduction of the value of their investment (shares) and with no recoupment if the shares are sold within 5 years.

The deduction is based on the actual cost the taxpayer paid for the shares. The VCC does not carry on any trade, except for managing investments in qualifying companies. There are some restrictions or "impermissible trades" which the underlying investee companies are prevented from performing.

To qualify, some restrictions and limitations apply to both the VCC and the qualifying entity or investee.

Venture Capital Company's limitations

- The VCC must be approved by the Commissioner and must issue the taxpayer with a certificate setting out the amount of the investment
- The VCC must be resident in South Africa, have its tax affairs in order, its sole object must be to manage investments in qualifying companies and it must be used in terms of section 7 of the FAIS Act
- At least 80% of the expenditure incurred by the VCC must be to acquire qualifying shares in companies. These qualifying companies' assets and book value may not exceed R500m in the case of junior mining companies, and R50m for other companies.
- From 1 January 2015 a new provision restricts the VCC to invest more than 20% of its total share capital in any one qualifying company.

Qualifying entity's limitations

- Qualifying companies must be resident and have their tax affairs in order.
- A qualifying company's investment income may not exceed 20% of its gross income.
- Qualifying companies may not carry on "impermissible trades"

This section provides a deduction to taxpayers who invest in qualifying start up and high growth companies. Yet to date very few VCC companies have been formed and potential investment opportunities and tax benefits are being forfeited. Consult us if you want to explore the possibilities of investing in VCC shares, or if you own a company that may be a qualifying company and you are looking for external investors.

Take advantage of tax-free savings now

By Douglas Gaul, Tax Manager, Grant Thornton Johannesburg

Following much anticipation, tax-free savings accounts (TFSA) were introduced on 1 March 2015 as a way to encourage South Africans to save. Natural persons, as well as the deceased or insolvent estates of a natural person, can invest in certain approved tax-free investment vehicles.

What you need to know about tax-free savings

- There is an annual contribution limit of R 30 000, and a lifetime limit of R 500 000 to tax-free investments.This means that by investing R 30 000 per annum, an individual can build up a tax-free investment of R 500 000 over a period of approximately 17 years.
- The final Regulations provide that existing investor products may not be converted into TFSAs, implying that all TFSAs must be originated with new contributions from the investor. The aim of this requirement is to encourage new savings
- Two kinds of platform providers currently offer tax-free savings accounts – LISPs (linked investment service providers) and stockbrokers. While no direct share trading is allowed within TFSA, certain ETFs are eligible for inclusion. These TFSA administrators may not levy performance fees but there is no restriction on the asset manager's flat fee and your capital is not guaranteed.
- All savings and investment products that have a term of maturity must be accessible within 32 business days from the time that the money is requested, meaning you will have access to your investment at any time. However, be aware that if you withdraw any funds, you will not be able to return the money later and you will lose the value of that withdrawal from your lifetime limit. In other words, these investments should ideally only be used for long-term investments i.e. 20 years and longer.
- All amounts received or accrued from the investment will be exempt from normal tax - income tax, dividend withholdings tax or even capital gains tax when disposing of the investment.
- None of the income generated by the investment, for example capitalised interest, will be taken into account when calculating the annual contribution limit of R 30 000, or lifetime contribution limit of R 500 000, and investors can transfer amounts between tax-free investments without affecting these limits , but such transfers may only be made after 1 March 2016. A transfer of TSFA between investors, however, will not be allowed.

- Interest received from tax-free investments will also not be taken into account when determining a taxpayer's existing interest exemption of R 23 800 (for taxpayers younger than 65 in terms of section 10(1)(i) of the Act). Thus, an individual younger than 65 who invests R 30 000 in a tax-free savings vehicle at a rate of 6% could earn tax-free interest of R1 800 in the 2016 year of assessment. However, the taxpayer will also still be exempt from tax on interest earned on other investments up to an amount of R 23 800. Effectively, the taxpayer will enjoy a total interest exemption of R 25,600 in that year of assessment.
- Finally a word of caution, in terms of the legislation, if you exceed the annual contribution limit of R 30 000 or the lifetime limit of R 500 000, 40% of the excess will taxed at your marginal rate. However, National Treasury recently announced in a media statement, that institutions are also not allowed to accept deposits in excess of these limits. They cautioned that, "Service providers are not allowed to accept amounts in excess of the contribution limits. It remains the responsibility of the investor to ensure that he or she adheres to the annual and lifetime limits or else face the penalties for breaching these limits."

Contact us for more advice for tax advice to best structure your estate and investments.

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