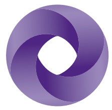

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E-TAXLINE NOVEMBER 2014

e-taxline

Early Christmas presents from SARS

Introduction

As the silly season approaches rapidly, many of us are starting to feel the effect of another busy year in South Africa's history. We've had elections, the Oscar Pistorius trial, COSATU's split, the (mild) threat of Ebola and the Springboks' defeat against the Irish. It's no wonder we're all feeling a little fatigued and in desperate need of good news to ring in the festive season and summer holiday.

But who would've thought that SARS could be the source of such good news? While they play an important part in our economy and are one of the most efficient government departments, the only good news we usually associate with SARS is notification of a tax refund. And not the bogus messages that promise a R4,230 refund if you provide your dog's date of birth and all your pin numbers.

It is therefore a delight to be the bearers of good news from our friends at the Revenue Service. Cliff Watson, Associate Tax Director and Indirect Tax specialist explains what the good VAT news is that SARS recently announced.

Douglas Gaul, Tax Manager at Grant Thornton Johannesburg shares the good news that SARS has reviewed the regulations around restraint of trade payments introduced by the definition of gross income in paragraph (cA), which has unfairly affected legitimate restraint of trade payments to some natural persons, labour brokers and personal service providers.

But wait, there's more! Bruce Russell, Tax Consultant at Grant Thornton Cape has more good news when he explains the relief measures Section 9D introduce to reduce the tax liability of some controlled foreign companies (CFCs).

And to wrap up the good news, South African Transfer Pricing leader AJ Jansen van Nieuwenhuizen brings positive tidings about how you can solve the Transfer Pricing conundrum.

On a final note, as SARS provides some relief on one hand, the Minister of Finance, in his inaugural Medium Term Budget Policy Statement in October 2014, has warned that from 2015, he will be taking away with the other. The Minister stated that he will be seeking increased tax revenues and it seems that our dear old Golden Goose will again be the target. His intentions will be known when he delivers his first Budget Speech in February next year, so watch this space. Now it would be fitting to add that your tax refund cheque is in the mail, but the ongoing Post Office strike renders that sentiment void so instead, we rather just wish you luck with the last few weeks until the holidays.

Good VAT-news from SARS

By Cliff Watson, Tax Director and Indirect Tax Specialist, Grant Thornton Johannesburg

Repeal of zero rating for farmers

In a previous e-taxline, we alerted our readers of the potential disadvantage farmers would face as result of SARS and National Treasury's proposal to repeal the zero-rating of certain goods such as animal feed, animal remedy, fertilisers and pesticides that are used or consumed for agricultural, pastoral or other farming purposes from 1 April 2015. The proposal would effectively add an additional 14% cost to acquire these products for farmers who are currently qualifying for the zero-rate, naturally affecting these farmers' cash flows negatively.

As was expected, the proposal was met with significant pushback by the affected stakeholders in the industry such as farmers, their unions, cooperatives and representatives contesting the repeal of the zero-rating provision.

The good news

SARS and the National Treasury recently issued a draft response document on the feedback hearings with the Standing Committee on Finance, relating to the Draft Taxation Laws Amendments Bill of 2014 and Tax Administration Laws Amendment Bill of 2014.

One of the responses was that the repeal of the provision for zero-rating of certain agricultural inputs will be postponed for at least another year. They indicated that this step will allow SARS and the National Treasury, in conjunction with the Department of Agriculture, to further examine and analyse the impact of these amendments. They also undertook to embark on additional consultations and will provide farmers sufficient time to prepare for the repeal. Hopefully farmers will not have to prepare for the repeal and that SARS and the National Treasury will come up with a more suitable alternative solution.

New import VAT timing rules

We also informed readers in a previous edition of e-taxline about the recent change in the VAT legislation which further extended the period which businesses importing goods into South Africa would have to claim the import VAT from SARS.

From 1 April 2014, importers may only claim back the import VAT in the tax period once the goods have been imported and the VAT is paid to Customs. This means VAT vendors who work with a clearing agent that only pays the import VAT to Customs in the next tax period via its deferment scheme, can only claim the import VAT after their clearing agent has paid the required VAT to Customs.

SARS and the National Treasury also received numerous comments and submissions from affected stakeholders in the industry such as importers, clearing agents, their unions and representatives on the adverse effect of the amendment. Effectively, importers had to finance the import VAT by a further one to two months, which had a severe negative effect on importers' cash flows. Another negative effect was the accounting and administrative burden that the new amendment placed on importer and clearing agents alike.

As the accounting entries are made in the importers records in the tax period in which the clearing agent issues its invoice to the importer, the VAT claim must be manually deferred to the tax period in which the VAT is paid to SARS. This necessitated significant human intervention, which often resulted in errors.

The good news

SARS and the National Treasury also indicated in the draft response document mentioned above that they will effectively reinstate the previous rules that importers may claim an input tax deduction in the tax period in which the goods are released by Customs, provided that the VAT is be paid to SARS either by the importer or its clearing agent, before the importer submits its VAT return. It didn't clarify if the proposed change will be effective retrospectively as if the amendment was never made, or if it will become effective from a future date.

Proposed tax changes to restraint of trade payments

By Douglas Gaul, Tax Manager, Grant Thornton Johannesburg

Paragraph (cA) of the definition of gross income was introduced into the Income Tax Act with the intention of preventing avoidance schemes whereby payment due to an employee was disguised as a capital payment for the so-called restraint of trade compensation. This inclusion has however had an impact on legitimate restraint of trade payments and is therefore being reconsidered again.

Prior to the introduction of this paragraph, it may have been possible for an employee to avoid paying normal tax on such payments (at the maximum marginal rate of 40%), despite possibly paying capital gains tax at the significantly lower rate of 13.3%.

Treasury however recently recognised that the wording of this paragraph adds restraint of trade payments to the gross income of natural persons, labour brokers and personal service providers, regardless of whether such payments arose by virtue of an employer/employee relationship.

Thus, for example, a sole proprietor who receives an amount in respect of a genuine restraint of trade by a person, so as to prevent him/her from competing with that person, would be required to include the amount in his/her gross income in terms of this paragraph. It disregards the fact that he/she was providing the services to that person as an independent contractor, and that result was not the intention of the legislator.

Treasury has since proposed an amendment to paragraph (cA) in the Taxation Laws Amendment Bill (2014) that was issued on 17 July 2014.

The intended changes will mean that any amounts received by, or accrued to, a natural person as a restraint of trade compensation, will only be included in his/her gross income in these instances:

- in respect or by virtue of employment or the holding of any office; or
- in respect of any past or future employment or the holding of any office.

The intended amendment will not affect the inclusion in gross income of restraint of trade payments to any person that is, or was a labour broker or a personal services provider, as they fall within the definition of an employee.

It is proposed that the amendment will be effective from the promulgation date of the Taxation Laws Amendment Act, applying to any restraint of trade imposed on years of assessment ending on, or after that date.

Proposed amendments to section 9D could offer a simpler means to avoid controlled foreign company imputations

By Bruce Russell, Tax Consultant, Grant Thornton Cape

The controlled foreign company (CFC) provisions seek to reduce the opportunity for income to be diverted and taxed offshore in the hands of foreign companies where:

1. South African tax residents may exercise, directly or indirectly, a majority of the voting rights in the foreign companies; or
2. where South African tax residents may participate, directly or indirectly, in the majority of the benefits attached to shares of the foreign companies.

In terms of section 9D of the Income Tax Act, a hypothetical taxable income, "net income", is calculated as if the CFC is South African tax resident. This net income may be included in the taxable income of the South African tax resident shareholders.

Section 9D offers the following relief measures that avoid subjecting the CFC's net income to South African income tax:

1. The net income of the CFC is deemed nil, where all foreign tax incurred by the CFC is at least equal to 75% of the South African income tax computed on that net income.
2. Amounts, other than tainted income, that are attributable to a "foreign business establishment" (FBE) are excluded from net income.

Where a CFC conducts a genuine business established at premises outside of South Africa, with sufficient on-site managerial and operational staff, it is usually evident that the CFC conducts business through a FBE. In contrast, determining whether foreign taxes incurred by the CFC will reach the 75% threshold can be a time consuming and complicated computation, especially if the South African taxpayer has numerous CFCs.

If a FBE exists and no tainted income is attributable to that FBE, no net income will need to be declared. This result is regardless of whether foreign taxes incurred by the CFC meet the 75% threshold.

However, as noted in the Explanatory Memorandum to the 2014 Taxation Laws Amendment Bill, the current structure of section 9D still requires the 75% threshold computation to be performed despite the fact that the net income of the CFC is attributable to a FBE. This computation would also need to be declared in an IT10B return that accompanies the annual tax return of the South African shareholder.

In recognising this unnecessary burden, the 2014 Taxation Laws Amendment Bill proposes that a CFC's net income will also be deemed nil where:

1. all of the receipts and accruals of the CFC are attributable to a FBE; and
2. none of those receipts or accruals relate to tainted income.

This logical amendment removes the compliance burden where CFCs conduct business through a FBE that does not derive tainted income.

A word of caution – the tainted income provisions of section 9D(9A) are complicated and therefore should be considered carefully before relying on this FBE relief. Tainted income includes the following passive and diversionary income earned by CFCs from South African tax resident connected persons:

- Interest;
- Royalties in respect of the use of intellectual property;
- Rental of certain movable property;
- Goods sold by the CFC;
- Services performed by the CFC, other than certain services performed outside of South Africa.

In conclusion, if the proposed amendments in the 2014 Taxation Laws Amendment Bill are enacted, the presence of an FBE can reduce the compliance burdens associated with a CFC. However, careful consideration must still be given to establish the existence and the impact of tainted income.

The Transfer Pricing compliance conundrum

By AJ Jansen van Nieuwenhuizen, Partner Tax Services and South African Transfer Pricing leader

By now, most South African taxpayers should be aware that when they enter into transactions with related parties who are not South African taxpayers, such transactions should be concluded on terms and prices that are at arm's length in nature. The term "arm's length" essentially indicates a position that two unrelated parties would adopt in an open market transaction, as a willing buyer and willing seller. Critical to managing tax risk for any taxpayer that has transactions of this nature is being able to defend the transfer pricing (TP) position that they have adopted and the only way to adequately to do so is through the preparation of TP policy documentation.

What is TP documentation?

As a starting point, it is important to highlight that, for now, it is not a statutory requirement to prepare TP documentation in South Africa – but there is a sting in the tail, and more on that later. Many years ago, SARS issued Practice Note 7 that provided guidance on their approach to TP and what TP documentation should cover. This Practice Note was largely based on the Organisation for Economic Cooperation and Development's (OECD) Guidelines. In this process, SARS also pointed out that TP documentation should be relevant to each taxpayer's circumstances and that it was not expected that a taxpayer should spend a disproportionate amount of money of preparing TP documentation. Unfortunately, many taxpayers have taken a very aggressive position and have compiled a one or two page document that simply states what price they charge their related parties – although this may deal with inter-group pricing, it is not what the OECD and SARS would consider to be a TP document.

TP documentation should provide the user (in most cases, SARS or the South African Reserve Bank) with insight into the following:

- The company and the group it forms part of, what products or services the group sells and some financial and statistical information like revenue, profit, number of employees, key locations, etc.
- The industry the company and group operate in, the regional and global factors that affect that industry, the competitive landscape, etc.
- The functions that the company undertakes, the various risks it assumes and the assets it uses to perform the said functions.
- The TP methodology that the taxpayer has elected to use in determining and setting its prices and why it has not used any of the other recognised TP methods.
- If appropriate (which in most cases it is), an economic analysis supported by benchmarking studies and analysis, of which the outcome is a pricing range commonly referred to as the inter-quartile arm's length range.

In the context of what SARS expects to see when a taxpayer says that they have prepared a TP document, when a taxpayer presents a one-pager document to SARS, they arguably compromise their position even further.

Critically, a taxpayer needs to discharge the onus of proof on why their pricing is considered to be at arm's length and merely stating that one thinks that the price is fair does not do so. SARS, and any other revenue authority, will want to see objective data or market information that provides appropriate support. Coming back to the sting in the tail – when submitting an ITR14 tax return, the taxpayer is required to do so on an arm's length basis. When answering questions relating to related party transactions with non-residents, the taxpayer is asked to confirm whether they have a TP policy document.

If the taxpayer answers "no", there is an immediate red flag, as SARS will question how the taxpayer knows that the tax return is submitted on an arm's length basis when he has not prepared TP documentation. By not having adequate documentation or any documentation at all, the taxpayer is immediately on the back foot - a precarious position from which to engage with SARS from! The alternative is to prepare appropriate TP documentation that could also serve to reduce any potential penalties that SARS may wish to impose on the finalisation of any TP audit by SARS.

We would be pleased to assist you in navigating the complexities of TP and cross-border trade with related parties.

Contact us

Cape Town

Anton Kriel
Tax Principal
T +27 (0)21 417-8731
E anton.kriel@za.gt.com

Mike Betts
Partner
T +27 (0)21 417-8822
E mike.betts@za.gt.com

George

Stef Lategan
Partner
T +27 (0)44 874-2320
E stef.lategan@za.gt.com

Durban

Ahmed Timol
Partner
T +27 (0)31 576-5500
E ahmed.timol@za.gt.com

Hawa Bibi Hoosen
Senior Tax Consultant
T +27 (0)31 576-5514
E hawabibi.hoosen@za.gt.com

Johannesburg

Eugene du Plessis
Partner & Head of Tax
T +27 (0)11 384-8116
E eugene.duplessis@za.gt.com

AJ Jansen van Nieuwenhuizen
Partner
T +27 (0)11 322-4559
E aj@za.gt.com

Doné Howell
Partner
T +27 (0)11 384-8038
E done.howell@za.gt.com

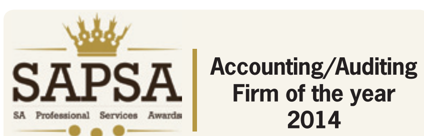
Louis van Manen
Partner
T +27 (0)11 384-8085
E louis.vanmanen@za.gt.com

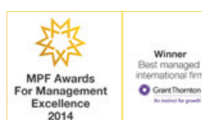
Port Elizabeth

David Honeyball
Partner
T +27 (0)41 374-3222
E david.honeyball@za.gt.com

Pretoria

Nick Kyriacou
Partner
T +27 (0)12 346-1430
E nick.kyriacou@za.gt.com





Bloemfontein
Terry Ramabulana
Director
Suite 6 The Park,
14 Reid Street,
Westdene,
Bloemfontein, 9300
T +27 (0)51 430-5368
E terry.ramabulana@za.gt.com

Cape Town
Ian Scott
Managing Partner
6th Floor, 119 Hertzog Boulevard,
Foreshore
Cape Town, 8001
P O Box 2275
Cape Town, 8000
T +27 (0)21 417-8800
E cape@za.gt.com

Durban
Deepak Nagar
National Chairman & Managing Partner
2nd Floor, 4 Pencarrow Crescent
Pencarrow Park
La Lucia Ridge Office Estate, 4019
P O Box 950
Umhlanga Rocks, 4320
T +27 (0)31 576-5500
E mail@gtdbn.co.za

George
Charles Minie
Managing Partner
124 Cradock Street
George, 6529
Private Bag X6544
George, 6530
T +27 (0)44 874-2320
E info.george@za.gt.com

Johannesburg
Andrew Hannington
CEO
137 Daisy Street,
Sandown, 2196
Private Bag X28
Benmore, 2010
T +27 (0)11 322-4500
E info@za.gt.com

42 Wierda Road West
Wierda Valley, 2196
Private Bag X10046
Sandton, 2146
T +27 (0)11 384-8000
E info@za.gt.com

Nelspruit
Billy de Jager
Director
No 2 Cherato Place
36 Murray Street
Nelspruit, 1201
T +27 (0)13 752-8084
E info@za.gt.com

Polokwane
Yugen Pillay
Director
130 Marshall Street,
Marshall Chambers Office 16A
Polokwane, 0699
T +27 (0)15 297-3541
E yugen.pillay@za.gt.com

Port Elizabeth
David Honeyball
Partner
125 Cape Road, Mount Croix
Port Elizabeth, 6001
P O Box 63814
Greenacres, 6057
T +27 (0)41 374-3222
E pe@za.gt.com

Pretoria
Johan Blignaut
Managing Partner
Building A, Summit Place
Garsfontein Road
Menlyn, 0181
P O Box 1470
Pretoria, 0001
T +27 (0)12 346-1430
E infopta@za.gt.com

Rustenburg
Seth Radebe
Director
234-2 Beyers Naude Drive,
Rustenburg, 0300
T +27 (0)14 592-1028
E seth.radebe@za.gt.com

National marketing
Pamela Grayman
Partner and Head of National Marketing
and Business Development
137 Daisy Street
Sandown, 2196
Private Bag X28
Benmore, 2010
T +27 (0)860-GTLINE
E info@za.gt.com

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