Dear Sir/Madam,

The South African Revenue Service issued a call for comments on draft Interpretation Note No. 18 on Rebates and Deductions for Foreign Taxes (Draft IN). Please find SAICA National Tax Committee’s response to the request for comments on the Draft IN.

Introduction

The Draft IN deals with the treatment of rebates and deductions on foreign taxes from foreign income by a resident of the republic. As a general observation the guide is well written and user-friendly to the extent that the technical nature of the topic permits.

We trust that the comments we have inserted below will assist to enhance the quality of the overall document.

Comments

Paragraph 2 - Background

The deduction method of relief for foreign taxes (page 6)
In example 1, scenario B, it is possible that a Double Tax Agreement (DTA) may determine that the source of management fees is the payer’s country of residence, which means the source of the fees will be outside SA even if the services were physically rendered in SA and section 6 quat(1) will also apply.

Order of deducting foreign tax rebates from the amount of normal tax payable (page 8)

The following paragraph seems to contain a contradiction in stating that rebates, including section 6 quat(1) exceeding the tax liability is forfeited but then immediately saying that the situation is different for section 6 quat(1): “The sum of the rebates available under sections 6, 6A, 6quat(1) and 6quin could potentially exceed the amount of normal tax payable. To the extent that the sum of those rebates exceeds the normal tax payable, any excess is forfeited and may not be refunded – see examples 1, 5 and 6 in Annexure B. In addition, the excess may not be carried forward to the next year of assessment for purposes of determining the final tax payable in that year. This is different to the situation in which the amount of the qualifying foreign taxes exceeds the amount of the section 6quat(1) rebate. In this situation paragraph (ii) of the proviso to section 6quat(1B)(a) specifically provides that the excess foreign taxes may sometimes be carried forward to the next year of assessment to potentially qualify for a foreign tax rebate in that year”.

We recommend that this paragraph be reworded in order to avoid confusion in this regard.

Paragraph 4.2.1 – Meaning of the term “source” for purposes of section 6quat(1) rebate

The last paragraph on page 12 states that:

“In applying this approach, if the source of an amount is held to be South African, it will be treated as South African-sourced for South African tax purposes irrespective of whether it comes from a foreign jurisdiction and is treated as being foreign-sourced under the foreign jurisdiction’s legislation.”

SARS fail to mention that such disputes may be resolved by way of mutual agreement where there is a treaty between South Africa and the relevant country.
We recommend that this be addressed in the final IN.

**Paragraph 4.2.2 – The definition of services**

The definition for “services” quoted in paragraph 4.2.2 is somewhat narrow, if one looks at other dictionary definitions for the word. It is, for example, possible to consider the renting of equipment, accommodation or cars to another person as being services. It is our understanding that section 6quin was introduced to assist taxpayers where other tax authorities levy tax in contradiction to treaties and also to provide SARS with information to address the problem (hence the FTW01). Some tax authorities also levy withholding tax on lease payments (for example), which falls within business profits and should therefore only be taxed in the non-resident state if there is a permanent establishment (PE). It is therefore submitted that the terms “services” should be interpreted widely to cover these situation as well and that the definition and examples in the draft IN is not wide enough.

**Paragraph 4.3.1 – The taxes must be payable on income**

Reference is made to the taxes currently levied by SARS on income (see page 19).

We recommend that SARS also note that there is a proposal to introduce a withholding tax on services and comment should be provided on the same – perhaps under the heading “Taxes levied on gross receipts” (see page 20).

**Paragraph 4.3.2 – The taxes must be proved to be payable to any sphere of government of any country other than South Africa in respect of any existing foreign tax liability**

We recommend that examples where the source of the income is South African yet subject to a withholding tax in a foreign country should be included in order to clarify this aspect.

**Paragraph 4.5 – Limitation on the amount of the rebate [section 6quat(1B)(a)]**

The following comment made on page 37, refers:
“The Act requires that taxable income be calculated per trade and then brings taxable income from a taxpayer’s various trades together whilst taking into account that foreign trading losses may not be set off against domestic trading profits.”

Whilst it is correct that foreign trading losses may not be set off against domestic trading profits, we do not agree with the general contention that taxable income needs to be calculated per trade. Our concern over the above comment is further heightened by the fact that the draft IN effectively becomes law in terms of section 5 of the Tax Administration Act, No. 28 of 2011. SARS should not use the introduction of interpretation notes to effect changes to legislation. The correct routes should be followed in this regard.

Paragraph 4.5.2 – Deductibility of foreign taxes against income in determining taxable income

As regards the extract from the *Port Elizabeth Electric Tramway Company Ltd v Commissioner for Inland Revenue* case, it is noted that expenditure such as commission payable to a sales representative is also an expense incurred on profits already earned – otherwise it would not be payable. There is no specific support in law that such expense is any different from a tax payable. If that was indeed the case, section 23(g) of the Income Tax Act serves no purpose.

The commentary in this section does not deal with withholding tax on fees which is levied on the gross fee and not income as defined. In addition, the argument that foreign taxes do not qualify as a deduction against income in all circumstances is not supported internationally. We request that these issues be addressed in the final IN.

Paragraph 6.1 - The translation of foreign taxes to rand [section 6quat(4)]

In relation to the translation of foreign taxes in SA Rand, the draft IN states that a resident may also use the rates available on [www.oanda.com](http://www.oanda.com) to calculate average exchange rates. It is unclear why specific reference is made to [www.oanda.com](http://www.oanda.com). We recommend that it be clarified in the final IN that rates available on other reputable websites will also be accepted by SARS.
as many businesses link their foreign exchange translation calculations to other reputable sources, which are used on a daily basis and is system driven.

**Paragraph 7.6 – Reporting requirements under section 6quin [section 6quin(3A)]**

A taxpayer wanting to use section 6quin has to submit a FTW01 within 60 days of incurring the foreign tax. Section 6quin is elective in certain situations (where both the requirements of section 6quat and section 6quin are met). Often a taxpayer is only at the end of the year of assessment able to make the election, for example, if it is only at the end of the year of assessment possible to determine whether the taxpayer has an assessed loss. The final IN should make it clear that a submission of the FTW01 does not bind the taxpayer to section 6quin and that, despite the form having been submitted, a taxpayer may still elect section 6quat if it applies.

**General**

We recommend that the final IN deal with foreign tax credits as it relates to imputed CFC income for CFC’s which are subject to group tax in their countries of residence. It is submitted that the section 6quat rebate be limited to the foreign taxes suffered before taking into account group tax provisions (for example, assessed losses transferred) as South Africa does not operate a group tax situation.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

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