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**COMPANIES**

**2460. Preference share funding**

Binding Private Ruling No 191 (Ruling) was released by the South African Revenue Service (SARS) on 26 March 2015. The Ruling relates to the refinancing of debt by means of preference share funding.
Having regard to the terms and conditions of the preference shares and the proposed cash-flows of the transaction, the applicant sought a ruling confirming that:

- The preference shares to be issued would not constitute ‘hybrid equity instruments’ and ‘third-party backed shares’, as respectively defined in sections 8E(1) and 8EA(1) of the Income Tax Act of 1962 (the Act).
- The issue of the preference shares would fall within the definition of a ‘qualifying purpose’ as defined in section 8EA(1), read together with section 8E.
- The voluntary redemption of the preference shares by the issuer, whether partially or in full, would not create a new date of issue as defined.
- The provisions of section 19 and paragraph 12A of the Eighth Schedule would not be applicable to the repayment of the existing loans.

For the purposes of this article, we focus on the last two issues, which have caused (and will most likely continue to cause) some debate amongst tax practitioners.

**New date of issue**

When analysing whether preference shares constitute ‘hybrid equity instruments’ for purposes of section 8E, it is important to have regard to the definition of ‘date of issue’, as it does not only include the date on which the preference shares were issued to the holder. In particular, the 'date of issue' includes the date on which:

“(b) the company [issuer] at any time after the share has been issued undertakes the obligation to redeem that share in whole or in part; or

(c) the holder of the share at any time after the share has been issued obtains the right to require that share to be redeemed in whole or in part, otherwise than as a result of the acquisition of that share by that holder.”
To the extent that a new ‘date of issue’ arises (e.g. the issuer, after the issue of the shares, undertakes the obligation to redeem that share), it could result in the preference shares becoming ‘hybrid equity instruments’, which would result in any dividends received by or accrued to the holder during that year of assessment in respect of those shares being deemed to be income in the hands of the recipient.

In the Ruling, the salient features of the preference shares included the following:

- The issuer may redeem the preference shares in part or in full at any time after the date of issue.
- The exercise by the issuer of its option to redeem the preference shares (or part thereof) would not create an obligation on the issuer to do so, nor would it give the holder the right to call on the issuer for the redemption.
- The exercise of the option to partially redeem would not alter any of the remaining preference share terms.

Having regard to the issuer's rights to voluntarily redeem the preference shares at any time and the wording in paragraphs (b) and (c) of the 'date of issue' definition, the applicant in the Ruling would have been concerned that, once the issuer decides to voluntarily redeem the preference shares, either the issuer undertakes the obligation to redeem that share (in whole or in part) or the holder thereof acquires the right to call on the issuer for the redemption, thereby triggering a new 'date of issue'. If one attributes an ordinary meaning to the wording in the 'date of issue' definition, it appears that the voluntary redemption by the issuer could well create a new 'date of issue'.

However, the interpretation of the wording in the 'date of issue' definition, which has generally been preferred by tax practitioners, is that no new 'date of issue' should arise on the voluntary redemption of the preference shares on the
basis that the undertaking to redeem the preference share should be seen to arise whenever the enforceable obligation arises, irrespective of the fact that the obligation can only be enforced at a later stage. If an issuer undertakes to redeem the preference share after, say, four years, the date of issue will be the date upon which the undertaking is given, i.e. on day one, and no new revised date of issue will arise.

It appears that the Ruling may support this view where it was specifically indicated that “the voluntary redemption of the preference shares by the Co-Applicant, whether partially or in full, will not create a new 'date of issue' as defined in section 8E(1)”. The Ruling does, to some extent, clarify the uncertainty surrounding the interpretation of the wording in the definition of 'date of issue' in section 8E in the context of a voluntarily redeemable preference share.

**Failure to discharge the debt**

Subject to certain exemptions, the provisions of section 19 and paragraph 12A of the Eighth Schedule can find application to the extent that there is a reduction of debt owed by a person. To the extent that there is a reduction of debt, these provisions could trigger income tax and/or capital gains tax consequences for the debtor being relieved of its debt obligations.

If we consider the application of these provisions in the context of the Ruling, we note that:

- The issuer held 26% of the ordinary shares in a private company, incorporated in and a tax resident of South Africa. The issuer had subscribed for these shares in the Company on loan account (subscription loan).
- As a result of the issuer's subscription for shares in the Company, the holder's interest in the Company had been diluted to 74%. To compensate
the holder, the Company had declared a dividend equal to the subscription loan to the issuer, which remained outstanding on loan account (subscription dividend).

- The issuer and holder wished to refinance the respective loans, which would be implemented on the following basis:
  - The holder would utilise cash to subscribe for the preference shares in the issuer, which cash proceeds would be utilised by the issuer to fully settle the subscription loan owing to the Company.
  - The Company would utilise the funds received from the issuer to fully settle the outstanding balance on the subscription dividend.

If one has regard to the flow of funds in the proposed transaction in the Ruling, there would be a circular flow of funds between the holder, issuer and the Company.

The question that often arises in these circumstances is whether there must be an actual flow of funds or whether an alternative payment mechanism can be implemented to alleviate the need to use cash? For example, could the proposed transaction have been implemented on the basis that, firstly, the holder discharges its obligation to the issuer by discharging the issuer’s obligation to the Company (referred to as a payment *solutionis adiectus gratia*)?

Thereafter, the holder and the Company could set off their respective obligations, negating the need for there to be a flow of funds.

It is assumed that it was this potential set-off of the parties' obligations which caused the applicants to seek the Ruling and implement the proposed transaction through means of an actual flow of funds. Pursuant to *C:SARS v Labat* [2011], 72 SATC 75 concerns have been raised that a mere set-off does not necessarily constitute a valid discharge of a debt.
If one adopts this interpretation of the *Labat* case and the proposed transaction in the Ruling had been implemented through means of set-off, there would not necessarily have been a valid discharge of a debt, which would trigger the debt reduction provisions contained in section 19 and paragraph 12A of the Eighth Schedule.

On the basis that the proposed transaction in the Ruling was implemented through means of an actual flow of funds, SARS ruled that “the provisions of section 19 and paragraph 12A will not be applicable to the repayment of the subscription loan and subscription dividend loan”.

When implementing preference share transactions, taxpayers must give careful consideration to the provisions of sections 8E and 8EA as the wording of these provisions is often unclear, which can lead to disputes with SARS. Furthermore, taxpayers must give careful consideration to their particular circumstances before deciding to set off their respective obligations as they may have unintended tax consequences.

Cliffe Dekker Hofmeyr

ITA: Sections 8E, 8EA, 19 and Paragraph 12A of the Eighth Schedule

*Editorial Comment: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they (and articles discussing them) should be treated with care and not simply relied on as they appear.*

DAVIS TAX COMMITTEE

2461. Estate duty and capital gains tax
Introduction
This article deals with the recommendations made in the DTC First Interim Report on Estate Duty (DTC Report) dealing with estate duty, capital gains tax (CGT) and donations tax.

The Minister of Finance instructed the DTC to enquire into “the progressivity of the tax system and the role and continued relevance of estate duty to support a more equitable and progressive tax system”, specifically taking into account the interaction between CGT and estate duty. To this end, the DTC Report was released for public comment on 13 July 2015.

General tax principles

Estate duty

Estate duty is payable in respect of the estate of every person who was ordinarily resident in South Africa at the date of his or her death as well as the South African situated assets of a person who was not ordinarily resident in South Africa at the date of his or her death.

Currently, in terms of section 4(q) of the Estate Duty Act of 1955 (the Estate Duty Act), the value of all property which accrues to the surviving spouse, either in terms of a will or by intestate succession, is deductible from the gross estate of the deceased.

The Estate Duty Act further provides for a deduction of the value of any right in or to property situated outside South Africa which was acquired by the deceased before he or she became ordinarily resident in South Africa for the first time; after he became ordinarily resident by way of donation or inheritance from a person not ordinarily resident in South Africa; or out of profits and proceeds of any such property acquired out of such profits or proceeds.
The dutiable amount of any estate is calculated by deducting a R3,5 million primary abatement from the net value of the estate (primary abatement). The dutiable amount of the estate is subject to 20% estate duty. The deceased estate of a surviving spouse is permitted to utilise the unused portion of the primary abatement of any pre-deceased spouse (portable abatement).

**CGT**

South African residents are subject to CGT on capital gains arising from the disposal of any asset. Non-residents are subject to CGT on capital gains arising from the disposal of immovable property or an interest in immovable property situated in South Africa. CGT is levied at a maximum effective rate of 13.65% in respect of individuals. An annual exclusion of R30 000 is available to a natural person in the year of assessment.

In terms of paragraph 40 of the Eighth Schedule to the Income Tax Act of 1962 (the Act), a deceased person will be deemed to have disposed of his or her assets to his or her estate for an amount equal to the market value on the date of death. Assets disposed of to the surviving spouse of a deceased person, will however, be exempt from CGT.

Paragraph 67 provides that a disposal by the estate, of the first-dying spouse to the surviving spouse, of any asset, will also be exempt from CGT.

**Donations tax**

Donations tax at a rate of 20% is payable on the value of any property disposed of under any donation by a South African ‘resident’ as defined in the Act. The first R100 000 of property donated in each year by a natural person is exempt from donations tax.
Section 56(1) of the Act exempts, *inter alia*, the following donations from donations tax:

- A donation to or for the benefit of a spouse of the donor not separated from the donor.
- A donation of property or a right in property situated outside South Africa if such property was acquired by the donor prior to becoming a South African resident; if the property was inherited or donated to a South African resident by a person not ordinarily resident in South Africa; or out of funds from the disposal of the aforementioned property.

**Recommendations in the DTC Report**

The DTC recommends, inter alia, that the following amendments be made to the existing tax legislation:

- The repeal of the exemption in terms of section 4(q) in respect of assets devolving on a surviving spouse should be considered.
- The repeal of the portable abatement should be considered. The primary abatement of the surviving spouse may then be offset in the estate duty computation of the first-dying spouse. The estate of the surviving spouse would, as a consequence, forfeit some or all of the primary abatement in the future. The DTC acknowledges that double taxation may occur if a dutiable bequest is received by a surviving spouse who subsequently dies. This could be prevented by the development of a table excluding certain dutiable inheritances from the estate duty computation of a surviving spouse over a period of up to 10 years.
- The primary abatement should be increased to R6 million per taxpayer. The surviving spouse will then be in a position to increase the total abatement to R12 million by electing to use the primary abatement in the computation of the estate duty of the first-dying spouse.
• The exemption of donations between spouses should be amended to exclude all interests in immovable property or companies from its application.
• The exemption in respect of donations of offshore assets acquired prior to becoming tax resident in South Africa must be revisited in the light of South Africa’s change to a residence basis of taxation in 2001.

Property left to surviving spouse
Section 4(q) was originally put in place to alleviate the hardship faced by spouses who may rely on the assets held in the name of the first-dying spouse for support. In the event that those assets fell within the first-dying spouse’s estate, estate duty was leviable at the death of the first-dying spouse. This created liquidity problems in the first-dying’s estate and, as a result, certain assets had to be realised in order to cover the estate duty liability in the event that the surviving spouse was not in a position to pay that liability out of his or her own funds.

The removal of the exemption in relation to property left to a surviving spouse could, effectively, result in estate duty being payable by the first-dying’s estate in the event that the portable abatement is elected and the deceased’s estate exceeds R12 million. As mentioned above, this could create liquidity problems in the case of the first-dying’s estate in the event that such estate consists mainly of illiquid assets. Accordingly, the withdrawal of this exemption could give rise to the hardship that such exemption served to avoid in the first instance.

This recommendation also does not seem to be in line with the CGT exemptions relating to disposals of assets between spouses.

The estate duty payable is, in our view, in any event, leviable on the surviving spouse’s estate. Taking into account that the recommendation merely
accelerates the timing of the payment of estate duty, such recommendation could create unnecessary complications for spouses.

*Portable abatement*
In our view, in the event that the first-dying spouse has the larger estate, electing to use the total abatement in the amount of R12 million in the estate of the first-dying, could be advantageous for such first-dying’s estate. However, as acknowledged by the DTC, the estate of the surviving spouse could, as a consequence, forfeit a portion of his or her entire primary abatement.

*Donations between spouses*
Donations between spouses of interests in immovable property or companies could be for reasons other than saving tax. For example, where a spouse has contributed to the repayments on a mortgage bond over immovable property, the other spouse may ‘donate’ a portion of the ownership in such property to that spouse.

*Donation of offshore assets*
The current position where donations of offshore assets are exempt from donations tax make sense in light of the fact that such assets were originally acquired as a non-resident of South Africa and is not sourced from South Africa, therefore, such property should not fall within the donations tax net.

As acknowledged by the DTC, this exemption is consistent with a similar exemption contained in the Estate Duty Act. Therefore, in our view, revisiting this exemption does not seem to be in line with the estate duty exemption.

**Conclusion**
The DTC Report specifically states that ‘the tax system…is one of the most
important government tools to redistribute income and address inequality’. Although this statement follows the instructions received by the Minister of Finance, in our view, it does not take into account the diverse and far-reaching implications the recommended changes to the tax system may have on, not only high-net worth individuals, but all South Africans planning their estate.

The DTC Report was, however, released in draft and is, therefore, open to comment. Following the process of consultation, the recommendations in the DTC Report may not necessarily find their way into draft tax legislation.

ENSafica
ITA: Section 56(1), Paragraphs 40 and 67 of the Eighth Schedule
Estate Duty Act: Sections 4(e) and (q)
DTC: First Interim Report on Estate Duty (DTC Report)

Editorial Comment: Under the chairmanship of Judge Dennis Davis, the committee has been tasked with an enquiry into the role of the tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability.

A number of reports have already been issued by the committee and more will follow. While we will be publishing articles on the work and reports of the committee, it must be recognised that not all of its recommendations will be accepted by our Minister of Finance and find their way into our tax legislation.

GROSS INCOME

2462. Voluntary severance package
Loss of employment through retrenchment (forced or voluntary) is a reality many employees face in the current economic climate. Over the last number of years, various tax concessions have been made to ease the financial burden on employees facing retrenchment, mainly in the form of tax free thresholds which apply to certain lump sum employer payments.

Navigating the tax pitfalls of retrenchment is important, as it is not necessarily guaranteed that all forms of payment upon retrenchment will qualify for preferential tax treatment.

Currently, the Income Tax Act of 1962 (the Act) provides for a R500 000 lifetime exemption (effective 1 March 2014) in respect of a ‘severance benefit’. A ‘severance benefit’ for the purposes of the Act is, essentially, any employer paid amount (excluding retirement fund lump sums) received by or accrued to a person by way of a lump sum in respect of the relinquishment, termination, loss, repudiation, cancellation, or variation of office or employment, provided at least one of the following requirements is satisfied:

- The person has attained the age of 55.
- The termination or relinquishment of office is due to sickness, accident, injury, or incapacity through infirmity of mind or body.
- The termination or loss is due to the employer having ceased, or intending to cease, carrying on the trade in respect of which the person was employed.
- The termination or loss is due to the person having become redundant in consequence of a general reduction in personnel or a reduction in personnel of a particular class.

Qualification of an amount as a ‘severance benefit’ needs to be carefully considered where the termination or loss is due to the person having become ‘redundant’ in consequence of a general reduction in personnel or a reduction in
personnel of a particular class. In certain cases, the affected employees are offered a voluntary severance package (VSP) and the following question arises: Does a payment in the form of a VSP pursuant to redundancy, qualify for tax preferential treatment?

There is no definition of ‘redundant’ in the Act and as such, it should take on its ordinary meaning for tax purposes, bearing in mind that the concept of redundancy bears its own meaning for labour law purposes.

Based on the fact that a VSP process is essentially a bilateral negotiation between the employer and the employee, there is a school of thought that any payment resulting from the voluntary termination process does not fall within the definition of ‘severance benefit’. The reason being, that the payment was not as a result of the employee's position becoming ‘redundant’. In other words, in order for an amount to (seemingly) qualify as a ‘severance benefit’ (incorrectly, in our view), it needs to be paid as a result of an employer's unilateral decision or, stated differently, a forced retrenchment.

It is arguable that, but for the general reduction of personnel by the employer, there would have been no payment and that the structure of the ‘severance benefit’ definition is such that it contemplates a process (i.e. a legislated labour law process), which ultimately culminates in a particular employee being regarded as ‘redundant’, which then results in the payment of an amount taking the form of, among other possibilities, a VSP.

When an employer embarks on a VSP process, the employer has already made a decision to effect a general reduction in employees. It follows that, once an employee elects to receive a VSP, the employee accepts that he or she is ‘redundant’ and the payment made by the employer, as a consequence of the
VSP, is a payment that the employee would not have received, had he or she not been affected by the proposed redundancy.

The interpretation that being ‘redundant’ only contemplates the result of a forced retrenchment is, in our view, too narrow, as the decision to make a ‘general reduction’ in personnel is part of a wider process that, by implication, includes a voluntary element. It may, however, be required by the particular employer to completely remove the affected position and function from its organisational structure, despite the process being inherently voluntary.

Employers, therefore, need to tread carefully and plan accordingly where a retrenchment process is contemplated, so as to ensure that a VSP results in the most tax effective outcome for affected employees. Employers should also be careful not to oversell a VSP where the VSP arguably does not fall within the requirements of a tax-free ‘severance benefit’.

Cliffe Dekker Hofmeyr

ITA: Section 1 definition of ‘severance benefit’
Rates and Monetary Amounts and Amendment of Revenue Laws Act No. 42 of 2014: Paragraph 7(c) of Appendix I

INTERNATIONAL TAX

2463. MoU with Mauritius
SARS signed a Memorandum of Understanding (MOU) with the Mauritius Revenue Authority (MRA) on 22 May 2015.

The MOU followed the new Double Taxation Agreement (DTA) between South Africa and Mauritius, which was signed in Maputo on 17 May 2013. Both
countries have now ratified the DTA, which is expected to come into effect on 1 January 2016.

The current DTA decides the tie-breaker to determine the residence of a juristic person to be the ‘place of effective management’, whereas the new DTA determines that, in the case of a juristic person resident in both Contracting States, the Competent Authorities will settle or agree residence mutually.

The Competent Authorities will also determine the mode of application of the Agreement to such a person. In the absence of such an agreement, this person will be considered to be outside the scope of the DTA except for Exchange of Information provisions. In Mauritius, the term ‘Competent Authorities’ means the Director General of the Mauritius Revenue Authority or an authorised representative of the Director General, whereas in South Africa it refers to the Commissioner for the South African Revenue Service or authorised representative.

The MOU, in determining the residence status of a juristic person, considers ‘place of effective management’ to be one of a number of factors to decide residence. Where agreement is not reached, the benefits of the DTA cannot be used, except to the extent and manner agreed on by the Competent Authorities. SARS may take a different view on the new tie-breaker clause. The tie-breaker clause does not impact South Africa's domestic tax law, which provides that a juristic person who is incorporated, established or formed outside SA and has their place of effective management outside of SA is not a resident as defined. The new tie-breaker provisions are contained in the MOU and should be taken into account in addition to the place of effective management and the place of incorporation to determine the residence. Determining ‘place of effective management’ is imperative to determine residence for South African Income Tax purposes and is in addition to the tests contained in the DTA.
The term ‘place of effective management’ is not defined for South African income tax purposes but has been considered in many international tax cases. The Commentary on the OECD Model Tax Convention on Income and on Capital (OECD Commentary) provides that ‘place of effective management’ is where key management and commercial decisions necessary for the conduct of the entity's business as a whole are made in substance.

On 3 November 2015 SARS published the second issue of Interpretation Note 6 (IN6 second issue), which deals with the meaning of ‘place of effective management’. IN6 second issue interprets the term not vastly different from the OECD Commentary. In terms of IN6 second issue:

“The term ‘place of effective management’ is not defined in the Act and must be ascribed its ordinary meaning, taking into account international precedent and interpretation. It does, however, not have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it.”

As a result, if a juristic person (which is not incorporated and does not have its place of effective management in SA) earns income from a non-South African source, the company is not a ‘resident’ for South African income tax purposes and no liability arises, regardless of the additional ‘place of effective management’ factors in the MOU. A company incorporated in South Africa with a place of effective management in Mauritius would be resident for South African income tax purposes.

Where the central management and control are in Mauritius, it would also constitute a resident for Mauritian tax purposes. The new DTA would then require that the Competent Authorities determine residence by applying the
MOU. The same would apply if the company is incorporated in Mauritius but its place of effective management is in South Africa.

SARS will, in all likelihood, not interpret the tie-breaker clause as overriding the South African Income Tax definition of ‘resident’ or interpret the other factors in the MOU as tests to determine place of effective management of a juristic person. Albeit that some of these other factors may be relevant, it would be a separate enquiry. SARS and the MRA will probably need to agree the place of residence for purposes of the tie-breaker on a case-by-case basis.

The other factors listed in the MOU in addition to ‘place of effective management’ and the place in which the juristic person is incorporated, to determine residence for purposes of the DTA, include:

- where the meetings of the Board of Directors or equivalent body are held;
- where the Chief Executive Officer and other Senior Executives perform their activities;
- where the senior day-to-day management is carried out;
- where the headquarters are located;
- which country's laws govern the legal status of the person;
- where its accounting records are kept;
- other factors in the OECD Commentary (paragraph 24.1); and
- other factors identified and agreed on by the Competent Authorities.

BDO

SARS: Issue 2 of Interpretation Note 6

OECD: Model Tax Convention on Income and on Capital (OECD Commentary)

Memorandum of Understanding between the South African Revenue Service and the Mauritius Revenue Authority
2464. Place of effective management

Earlier this year, the South African Revenue Service (SARS) released issue 2 of Interpretation Note 6 (the draft Interpretation Note) on the “place of effective management” (POEM). Comments were due by 31 July 2015. POEM is often of critical importance in determining the tax residency of an entity.

Editorial comment: Issue 2 of Interpretation Note 6 was published by SARS on 3 November 2015.

The interpretation previously put forward by SARS in terms of Interpretation Note 6 issued during 2002 (IN6) in this regard, did not accord entirely with international precedent and the approach followed by SARS was that the POEM is:

- the place where the company is managed on a regular or day-to-day basis by directors or senior managers of the company, irrespective of where the overriding control is exercised or where the board meets; and
- Management by these directors or senior managers refers to the execution and implementation of policy and strategic decisions made by the board and it can also be referred to as the place of implementation of the entity’s overall group vision and objectives.

2011 Discussion Paper

During 2011, SARS released a discussion paper (Discussion Paper) to invite taxpayers and tax practitioners to comment and raise any concerns in relation to the concept of POEM in South Africa, so as to provide a potential framework for possible amendments to IN6.

The Discussion Paper noted that IN6 had been subject to criticism in a number of areas. In particular, the ‘general approach’ followed therein, namely to focus on the place where strategic decisions and policies are executed and
implemented, as opposed to the place where those decisions are taken or adopted, was criticised. It was acknowledged in the Discussion Paper that IN6 had caused uncertainty by “adopting an approach that appears to conflict with the weight of international authority insofar as the general approach focuses on the place where strategic decisions are ‘executed and implemented’ rather than on the place where the decision-making, in substance, takes place.”

**Draft Interpretation Note**

The draft Interpretation Note provides that since POEM is not defined in the Income Tax Act of 1962 (the Act), the ordinary meaning must be ascribed to the phrase, taking into account international precedent and interpretation. The draft Interpretation Note purports to be in line with the Organisation for Economic Cooperation and Development (OECD) principles and guidelines for the determination of the POEM when used as a tie-breaker rule in a double taxation agreement (DTA).

The draft Interpretation Note confirms that a company may have more than one place of management, but it can only have one POEM at any one time. The POEM will be at the place where key management and commercial decisions affecting its business as a whole are primarily or predominantly made. In our view, this approach is consistent with the OECD’s guidance provided in paragraph 24 of the Commentaries on the Articles of the Model Tax Convention on Income and on Capital (OECD Commentary).

In determining a single dominant POEM, the draft Interpretation Note provides for certain facts and circumstances that need to be taken into account. The determination looks at where the key management and commercial decisions are regularly and predominantly made. According to SARS, some of the facts and circumstances that should be considered on a case-by-case basis include the following:
• The place where a company’s head office is located (i.e. the place where a company’s senior management and support staff are predominantly located) is often representative of the place where key company decisions are made and forms an important consideration in determining where the POEM is located.

• Where a company’s board has chosen to delegate some or all of its authority to a committee, the location where the members of the committee are based will be considered in establishing the POEM.

• SARS states that the location where the company’s board meets and makes decisions may be indicative of a company’s POEM, depending on the role of the board in the key management and commercial decisions of the company. Where a board delegated authority to senior management, the POEM will ordinarily be where those senior managers are located.

• With advances in technology, the physical location of a board meeting may not be where the key management and commercial decisions are, in substance, being made. Therefore, no undue focus should be placed on the location of board meetings without considering the facts and circumstances such as who was physically present and who joined via video-conference.

• Some decisions are reserved for the shareholders of a company, but such decisions generally affect the existence of the company rather than its business and are therefore not relevant in determining the POEM. However, shareholder involvement can influence the POEM where a shareholder may usurp the powers of the directors of a company. This situation normally arises where there is only one shareholder. Usurpation should be distinguished from influence exercised by a shareholder.

• The relevance of operational management decisions (i.e. oversight of day-to-day business operations) are generally limited in determining the POEM and should be distinguished from the key management and commercial decisions (i.e. broader strategic and policy decisions).
• Where support functions are centralised, the managers in charge of those support functions are generally not directly involved in making key management and commercial decisions that affect the company’s business as a whole. Accordingly, the location where the support services are located is generally of limited relevance in determining the POEM of a company.

The move by SARS of its focus away from the execution and implementation of strategic decisions is welcomed. Since determining the POEM of an entity is a fact-specific enquiry, it is useful that there should now only be one test, namely to identify the place where the key management and commercial decisions are, in substance, made. SARS’ statement that it does not anticipate that the application of the second issue of the Interpretation Note (as opposed to IN6) should result in many, if any, companies previously having had their POEM outside South Africa now being effectively managed in South Africa, or vice versa, is also encouraging.

ENSafica
SARS: Issue 2 of Interpretation Note 6, Discussion Paper: Interpretation Note 6 – Place of Effective Management, Issue 1 of Interpretation Note 6 OECD: Paragraph 24 of the Commentaries on the Articles of the Model Tax Convention on Income and on Capital (OECD Commentary)

TAX ADMINISTRATION

2465. SARS powers to interview taxpayers and employees
Section 47 of the Tax Administration Act of 2011 (the TAA) allows SARS, by notice, to require a person (whether or not chargeable to tax) to be interviewed by a SARS official in relation to his or her tax affairs, so as to clarify issues of
concern to SARS on whether to render further verification or audit unnecessary and is not for purposes of a criminal investigation.

Currently, this provision does not allow SARS to require a third party to attend an interview in respect of the tax affairs of a taxpayer under investigation, and the purpose of this provision is to expedite and end the process of verification or audit, instead of being used in the on-going information-gathering process.

There is uncertainty about whether the current provision applies to juristic persons. In light of this, the Tax Administration Laws Amendment Bill 2015, Bill 30 of 2015, (TALAB) proposes an amendment to section 47 that allows SARS to not only require the taxpayer whose tax affairs are under verification or audit to be interviewed, but also, where the taxpayer is a company or other legal entity, to require third parties such as current employees of the taxpayer or persons who hold an office in the taxpayer to be interviewed.

The proposed amendment also removes the current limitation concerning the purpose of the interview by providing that the interview must be intended to obtain relevant material to clarify issues of concern to SARS regarding the verification or audit. This has the effect of the interview forming part of the on-going information gathering process.

The TAA currently allows SARS to have witnesses subpoenaed and cross-examined under oath or solemn declaration, using the formal process of an inquiry provided in terms of Part C of Chapter 5 of the TAA.

The inquiry procedure is subject to certain requirements which safeguard taxpayers from over-zealous SARS officials. These requirements are that:

- SARS must obtain the permission of a judge.
- The scope of the inquiry must be limited.
• The inquiry must be in the presence of a presiding officer.
• The right against self-incrimination must be observed.

According to the SARS Short Guide to the TAA (the Short Guide), at paragraph 5.3.3, the purpose of section 47 “from the perspective of the person being interviewed”, is “to possibly avoid more intrusive and potentially protracted verification and audit.”

The implications of the proposed amendment to section 47 are that —
• Incorrect or incriminating information may be gathered by SARS or incorrect or incriminating information may be disclosed by third parties (who do not have the necessary knowledge or skill) in relation to the tax affairs of the taxpayer without the consent of the taxpayer and without the protections that are available in relation to inquiry procedures. This is an intrusive mechanism for obtaining relevant material in that it is a violation of the taxpayer's constitutional right to privacy and may further be a violation of the right against self-incrimination.
• SARS will be able to effectively hold an inquiry without the above-mentioned safe-guards.
• The verification and audit process may be protracted.

The above implications essentially nullify the initial purpose of section 47, as set out in the Short Guide.

The taxpayer bears the onus of proving that an assessment is incorrect. It should be left to the taxpayer to present witnesses who have actual direct knowledge of the taxpayer's affairs. If the proposed amendment is promulgated, it will place an unfair burden on the taxpayer to prove the correctness or otherwise of unreliable and inadmissible ‘evidence’ gathered by SARS in the interview process.
TRANSFER DUTY

2466. Nomination clauses

A nomination clause in a sale agreement of property often seems like a very good idea in complex business structures, but unwanted consequences may stem from the Transfer Duty Act of 1949 (the Act). Notwithstanding the VAT status of an entity, it is possible that a sale of property transaction is subject to transfer duty and not VAT, due to either the seller not being a registered VAT vendor, or due to the property not being part of the seller's VAT registered enterprise, thus attracting transfer duty. It is within this context that we shall have a look at some of the unwanted consequences and possible solutions arising from the use of nomination clauses.

An agent's duty to disclose

Section 16 of the Act states that:

“(1) Where property is sold to a person who is acting as an agent for some other person, the person so acting as agent shall disclose to the seller or his or her agent the name and address of the principal for whom he or she acts, and furnish the seller or his or her agent with a copy of the documents appointing him or her as agent-
(i) if the sale is by auction, on the day of acceptance by the auctioneer of his or her offer; or
(ii) if the sale is otherwise than by auction, on the day of conclusion of the agreement of sale.

(2) Any person who has been appointed as an agent, but fails to furnish the documents contemplated in subsection (1) and the name of the person on whose behalf he or she is acting to the seller or his or her agent on the date specified in subsection (1) shall, for the purpose of the payment of the duty payable in respect of the acquisition of the property in question, be presumed, unless the contrary is proved, to have acquired the property for himself or herself.”

Presumption that the agent is the purchaser

Section 16 of the Act effectively forces an agent to make a nomination by midnight on the same day of the sale, by disclosing details and providing documents of the principal to the seller, failing which the property in question is presumed to have been acquired by the person who entered into the sale agreement of property.

The implication of this presumption is that if an agent is acting on behalf of a principal with the ultimate intention to transfer the property to the principal (i.e. a company, trust or other entity), there would be two transactions for transfer duty purposes. The first being to the agent (first purchaser) and the second being to the principal that is now seen as a successive purchaser and not an alternative purchaser. However, this is a rebuttable presumption, which means that the agent and principal bear the burden of proving to the Commissioner of the South African Revenue Service that the requirements in section 16 have been met, and that consequently, the presumption is incorrect.

Nominating a principal
The three essentials for a sale agreement of property are: the clear identification of the property, an agreed purchase price and the identities of the parties. Accordingly, once an agent has signed and presuming that the other two elements have been met, the sale agreement has effectively been concluded and is binding on the parties thereto. A verbal nomination will not have an effect on the sale agreement of property as more fully discussed in *Du Toit Group (Pty) Ltd v Van Breda and Others* (3128/08) [2009] ZAWCHC 152 (16 October 2009).

The common law prescribes that the principal must exist when the agent concludes the juristic act. Thus, a party cannot be said to be an agent if the ultimate purchaser is formed only after the conclusion of the sale agreement. Therefore, it is not permitted to nominate a trust as the principal unless the trust is already registered. It is, however, possible to enter into a sale agreement of property with a company in the process of formation, so long as the board of directors ratifies the agreement. Such an agreement is seen as a pre-incorporation contract and should the board of directors choose not to ratify the agreement, the person who entered into the pre-incorporation contract is personally liable on a joint and several basis with ‘any other such person’ (if there is another person) for any liabilities created while acting in this capacity. If the board of directors fails to take any action within three months from the date of formation, the company is deemed to have ratified the pre-incorporation contract.

**When does liability for transfer duty arise?**

In terms of section 5(2)(a), “if a transaction whereby property has been acquired, is, before registration of the acquisition in a deeds registry, cancelled, or dissolved by the operation of a resolutive condition, duty shall be payable only on that part of the consideration which has been or is paid to and retained by the seller and on any consideration payable by the buyer for or in respect of
the cancellation thereof, provided that on cancellation or dissolution of that transaction, such property completely reverts to the seller and the original buyer has relinquished all rights and has not received nor will receive any consideration arising from such cancellation or dissolution.” This means that notwithstanding the termination of a sale agreement, transfer duty is still payable on that portion of consideration which has been paid to and retained by the seller.

**Escaping the unwanted consequences of nomination clauses**

In order to overcome the possibility of ‘double-tax’, a substitution clause can be used instead of a nomination clause. Such a clause provides that should the principal wish to enter into the sale agreement of property, the sale agreement of property is to be cancelled by written request of the purchaser (agent) before the purchase price is secured and on condition there is no default of any obligation by the purchaser. In such instances, section 5(2)(a) will also be applicable. To avoid any delays, the conclusion of the new sale agreement must coincide with the cancellation of the previous sale agreement.

Where an agreement refers to a cession and assignment or benefit for a third party clause, double-tax consequences are still possible. In these circumstances we would suggest the insertion of a substitution clause, subject to the above considerations.

**Cliffe Dekker Hofmeyr**  
Transfer Duty Act: Sections 5(2)(a) and 16  
Companies Act: Section 21(5)

**VALUE-ADDED TAX**

2467. Zero-rating of movable goods
In order to provide the necessary legislative amendments required to implement the tax proposals that were announced in the 2015 National Budget on 25 February 2015, the National Treasury published the Draft Taxation Laws Amendment Bill, 2015 (DTLAB), on 22 July 2015 for public comment.

*Editorial comment: The Taxation Laws Amendment Bill, 29 of 2015 was introduced into Parliament on 27 October 2015 containing the amendment referred to above.*

One of the proposed amendments relates to the zero-rating of movable goods physically delivered by a cartage contractor, in terms of a sale or instalment credit agreement, to a customs controlled area enterprise or an Industrial Development Zone (IDZ) operator in a customs controlled area.

By way of background, the South African value-added tax (VAT) system is destination based which means that only the consumption of goods and services in South Africa is taxed. VAT is therefore levied at the standard rate of 14%, on the supply of goods and services in South Africa as well as on the importation of goods into South Africa, unless an exemption or exception applies.

The primary mechanism to ensure that only local consumption is taxed in South Africa is through the zero-rating (0%) of certain exported goods and services. In other words, where goods or services are exported from South Africa, the goods will be consumed outside of South Africa and accordingly, the supply of such goods or services should not attract VAT in South Africa.

The main consideration in respect of zero-rating under South African VAT law is the application of section 11(1)(a) of the Value-Added Tax Act of 1991 (VAT Act). In essence, section 11(1)(a) provides for the zero-rating of the
supply of goods, where the goods are exported from a place in South Africa to a place in an export country.

The term ‘exported’ is defined in section 1 of the VAT Act and includes, among others:
- goods consigned or delivered by the vendor to the recipient at an address in an export country as evidenced by documentary proof acceptable to the Commissioner for the South African Revenue Service (direct export); or
- Goods removed from South Africa by the recipient or the recipient's agent for conveyance to an export country in accordance with any regulation made by the Minister of Finance (indirect export).

Section 11(1)(m) deals with the zero-rating of the supply of movable goods, in terms of a sale or instalment credit agreement, to a customs controlled area enterprise or an IDZ operator in a customs controlled area being delivered by a registered cartage contractor. Currently, section 11(1)(m)(ii) provides that the movable goods must be delivered by a registered cartage contractor, whose ‘main activity’ is transporting goods and who is engaged by the supplier to deliver the goods and that supplier is liable for the full cost relating to that delivery. The South African Revenue Service (SARS) defines a cartage contractor in Interpretation Note 30 (Issue 3) of 5 May 2014 (IN 30) as

“a person whose 'activities include' the transportation of goods, and includes couriers and freight forwarders”.

Having regard to the above, the term ‘cartage contractor’, as defined in IN 30, has a wider application than the VAT Act’s current requirement pertaining to zero-rating. IN 30 requires that in order for the transaction to be zero-rated, the cartage contractor’s ‘activities must include’ the transportation of goods,
whereas the VAT Act requires that the transaction will only be zero rated if the ‘main activity’ of the cartage contractor is the transportation of movable goods.

In order to align the VAT Act with IN 30, the DTLAB proposes that the words ‘main activity’ in section 11(1)(m)(ii) be replaced with ‘activities include’ (as defined in IN 30) to allow for the zero-rating of goods physically delivered by a registered cartage contractor whose activities include that of transporting goods.

The proposed amendment will seemingly relax the adherence to the strict requirements imposed by the VAT Act pertaining to the zero-rating of the supply of movable goods where such goods are physically delivered by a cartage contractor to an offshore entity in a customs controlled area. This, in turn, will assist vendors in avoiding the pitfalls associated with the aforementioned transactions.

The proposed amendments will come into operation on 1 April 2016. Public comments on the proposed amendments were due by close of business on 24 August 2015.

Cliffe Dekker Hofmeyr
VAT: Section 1 definition of ‘exported’, 11(1)(a) and (m)(ii)
SARS Interpretation Note 30 (Issue 3) of 5 May 2014

*Editorial Comment: Draft legislation should always be treated with care as there is no certainty that the final legislation approved by Parliament will be identical to the publicly issued draft.*

SARS NEWS

2468. Interpretation notes, media releases, rulings and other documents

Readers are reminded that the latest developments at SARS can be accessed on their website [http://www.sars.gov.za](http://www.sars.gov.za).
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