



15 September 2023

6.2023

Editor's Note:

In this sixth newsletter for 2023 we consider the following:

Section 9D(9)(b) Foreign Business Exemption for Controlled Foreign Companies.

Practice Note 31 revisited.

Distributions of income to non-resident beneficiaries to be taxed in resident trusts

Phala Phala Riddle Revisited.

Section 7C revisited: Exclusion of primary residence owned by a trust/company, from the application of the anti-avoidance measure, expanded.

Proposed New Advance Pricing Agreement Rulings for international transactions.

SARS Interpretation Note (IN) 6 (Place of Effective Management of a Company) revised.

SARS Interpretation Notes (INs), BGRs, and Guides Noter-Up.

Tony Davey – Editor

Duncan McAllister – Co-Editor

tonyd@harding.co.za / www.tonydavey.com

To subscribe free (or unsubscribe) please email cherylh@harding.co.za

**SECTION 9D(9)(b) FOREIGN BUSINESS EXEMPTION (FBE) FOR
CONTROLLED FOREIGN COMPANIES (“CFC’S”) –
THE SCA CORONATION CASE TRANSFORMS INTO LEGISLATION**

In Newsletter 4.2023 we considered one of the exemptions available to a CFC, being the ‘foreign business establishment’ (FBE) exemption, the effect of which is that a foreign

company that has an FBE, (as defined in Section 9D(1)) will not have its income and capital gains attributed to its RSA shareholders. A practice has developed by which CFCs, whilst retaining their management functions, are outsourcing certain core important business functions to other countries, including back to their foreign jurisdiction, South Africa.

It is thus proposed that a CFC's core important business functions (i.e. its 'primary operations') should either be carried out by the CFC itself or carried out by another CFC in the same group of companies that is located in the same foreign tax jurisdiction as the CFC, in order to qualify for the FBE.

Simply put, this would thus exclude the current practice of RSA Asset Management Companies operating through their international foreign-based entities, of outsourcing the investment analysis function back to the RSA.

The proposed amendment is to take effect from 1 January 2024 and will apply to all foreign tax years of CFC's ending on or after 1 January 2024.

Postscript: On 1 September the Constitutional Court issued a directive that it will hear Coronation's application for leave to appeal to it against the SCA judgment. (See Davey's Locker 4.2023). A date for the hearing has yet to be set.

PRACTICE NOTE (PN) 31 REVISITED

In Newsletters 1.2032 and 3.2023 we discussed SARS proposed withdrawal of PN31. The purpose of PN 31 was to offer a concession to taxpayers that borrow to on-lend and earn interest income, by granting them a deduction in respect of the cost of borrowing, notwithstanding that the taxpayer is not carrying on a trade but merely earning passive interest income from the loan investment.

Under the new restrictive proposal effective 1 January 2024, which applies in respect of years of assessment commencing on or after that date, only companies which form part of the same 'group of companies' (as defined in section 1) will be allowed to deduct

expenditure incurred in the production of interest income earned from another group company, subject to certain requirements as follows:

- The expenditure incurred by that company must be in respect of amounts owing for purposes of providing funding directly or indirectly to one or more companies that form part of the same group of companies as that company;
- The other company must use or have used the funds advanced or credit made available by that company for purposes of its trade to produce income; and
- The deduction of the expenditure incurred by that company during any year of assessment must be limited to the interest income accruing directly or indirectly from that other company during that year of assessment.

Thus, in summary, other than in the limited context of inter-company loans between companies comprising a group of companies, PN 31 is to be abolished.

(Bear in mind that as per IN58 (Brummeria Case) the right to use an interest-free loan (as distinct from the charging of interest) in the context of a group of companies, is unaffected).

DISTRIBUTIONS OF INCOME TO NON-RESIDENT BENEFICIARIES TO BE TAXED IN RESIDENT TRUSTS

Until now, when a trust vested income in a non-resident beneficiary, it was deemed to accrue to that beneficiary under section 25(1). Thus, any income from a non-South African source was not taxable in the hands of the non-resident beneficiary, and interest income would probably have been exempt under section 10(1)(h). This treatment was out of step with the treatment of capital gains under paragraph 80 of the Eighth Schedule, which did not permit attribution to a non-resident beneficiary, with the result that the capital gain was taxed in the trust or in the hands of a resident donor.

The Draft Taxation Laws Amendment Bill, 2023 proposes amendments to section 25(1) and (2) which will result in income vested in a non-resident beneficiary being taxed in the trust or being attributed to a donor. What we would like to highlight is that it is proposed

that these amendments come into operation on 31 July 2023. If this effective date is confirmed when the legislation is promulgated, it will potentially result in a significant increase in the tax liability of the trust on or after 1 August 2023, which will need to be factored in when the trust makes its second provisional tax payment for the 2024 year of assessment.

PHALA PHALA RIDDLE REVISITED

The SA Reserve Bank's (SARB) short statement in a Media release, 21 August 2023 is to the effect that as the sale of prize cattle was not perfected, due to certain conditions precedent not being satisfied, there was in law, no finalized sale transaction and no legal entitlement to the foreign currency. Thus, the conclusion is that there was no beneficial ownership receipt of the foreign currency.

The other Regulator, however, SARS, previously stated on 10 March 2023 that the taxpayer (Ntaba Nyani Estates CC) was tax compliant and had disclosed all income from the sale of game, which we assumed meant the receipt of such foreign currency monies was disclosed to SARS.

If, however, SARB is correct in finding there was no beneficial receipt, then there is accordingly, no receipt nor accrual for tax purposes and thus disclosure of such foreign currency monies to SARS was not required as no tax transaction occurred.

The Tax cases *SIR v Smant*, 1973(A) and *Geldenhuis v CIR* 1947(C) confirmed this requirement that a receipt must be for beneficial ownership, in order to constitute a tax transaction.

SECTION 7C REVISITED: EXCLUSION OF PRIMARY RESIDENCE FROM THE APPLICATION OF THE ANTI-AVOIDANCE MEASURE, EXPANDED

A deemed donation is not triggered under section 7C of the Act when certain exclusions contained in the section apply. For example, there is an exclusion from the operation of Section 7C, in circumstances in which the low-interest or interest-free loan, advance or credit is used by a trust or company to facilitate the acquisition of a primary residence for

a person or a spouse of such person advancing that low interest or interest free loan, advance or credit. The current wording of the exclusion in respect of a primary residence does not, however, fully encompass what constitutes a primary residence under the Eighth Schedule to the Income Tax Act.

Thus, it is proposed in the draft Taxation Laws Amendment Bill (TLAB), 31 July 2023, that the current exclusion also include funding of improvements to the primary residence which, by cross referencing to paragraph 46 of the Eighth Schedule, clarifies that this also includes adjacent land upon which the primary residence is situate, as does not exceed two hectares.

The proposed amendment will come into effect on 1 January 2024 and applies in respect of any amount owed by a trust or company in respect of a loan, advance or credit provided to that trust or that company before, on or after that date.

ADVANCE PRICING AGREEMENT (APA) PROPOSAL

In line with creating certainty for taxpayers who engage in international transactions with consequent transfer pricing implications, a legislative framework will be inserted in the Income Tax Act to complement Section 31.

In essence, SARS intends to provide to eligible applicants, Advance Tax Rulings on transfer pricing. We shall consider this in future newsletter issues.

SARS INTERPRETATION NOTE (IN) 6 (PLACE OF EFFECTIVE MANAGEMENT OF A COMPANY) REVISED

SARS has issued a slightly revised IN6 (Issue 3) dated 30 June 2023 pertaining to the Place of Effective Management for Companies. We have compared this issue 3 to the previous issue and note the following additions considered below. (It would be useful for ease of reference if SARS, in a preamble to revised IN issues, briefly summarise the significant amendments).

In essence, the IN pertains to a company's place of effective management. This is an important determinant of RSA tax residency or otherwise, as the definition of 'resident' in section 1 of the Income Tax Act, includes a company which is either incorporated in the RSA or which has its place of 'effective management' in the RSA.

Paragraph 4.2.4 (Modernisation and global travel) has been expanded to consider, *inter alia*, audio-visual communications with reference to OECD guidelines as follows:

'If senior managers adopt conferencing through the Internet, for example, as a key medium for making management and commercial decisions and those managers are located throughout the world, it may be difficult to determine a place of effective management. In such cases, a place of management might be regarded as existing in each jurisdiction where a manager is located at the time of making decisions, but it may be difficult (if not impossible) to point to any particular location as being the one place of effective management.'

A new paragraph 4.3 has been inserted and pertains to the effect of the COVID-19 Pandemic as follows:

'According to the OECD document "Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic", it is stated that the pandemic may raise concerns about a potential change in the "place of effective management" of a company owing to relocation, or inability to travel, of board members or other senior executives. The concern is that such a change may result in a change in a company's residence under relevant domestic laws and affect the jurisdiction where a company is regarded as a resident for tax treaty purposes.

The OECD suggests that it is unlikely that the COVID-19 pandemic will create any changes to a company's residence status under a tax treaty, because a temporary change in location of senior executives would most likely be seen as 'an extraordinary and temporary situation due to the COVID-19 crises and such change of location should not trigger a change in residency, especially once the tie breaker rule contained in tax treaties is applied'.

In conclusion, SARS's view (which is the same as the previous IN issue 2) is as follows:

A 'place of effective management', in determining the tax residence of a company, is only one of the considerations under the tie-breaker rule in a tax treaty that adheres to Article 4 of the OECD Model Tax Convention and its accompanying Commentary.

A company's place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made. This approach is consistent with the OECD's commentary on the term 'place of effective management'.

A company may have only one place of effective management at any one time. There are normally multiple facts that need to be taken into account, often involving multiple locations, and from those facts and locations it is necessary to determine a single dominant place where effective management is located.

Definitive rules cannot be laid down in determining the place of effective management, and all relevant facts and circumstances must be examined on a case-by-case basis.

The place of effective management test is one of *substance over form*. It therefore requires a determination of those persons in a company who actually 'call the shots' and exercise 'realistic positive management'.

INTERPRETATION NOTES

Date of issue	IN	Tax	Section	Description
16.08.2023	110 (Issue 2)	IT	Para (h) of the definition of 'gross income', s 11(g) and (h)	Leasehold improvements
16.08.2023	109 (Issue 2)	IT	Para (g) of the definition of 'gross income', s 11(f) and (h)	Lease premiums
16.08.2023	107 (Issue 2)	IT	13quin	Deduction in respect of commercial buildings
14.07.2023	106 (Issue 2)	IT	13sex	Deduction in respect of certain residential units

DRAFT INTERPRETATION NOTES

Date of issue	IN	Tax	Section	Description
24.08.2023	-	MPPRR	4(2) and Second Schedule	Determining the calorific value of coal for purposes of the royalty
21.07.2023	78 (Issue 2)	IT	24C	Allowance for future expenditure on contracts

BINDING GENERAL RULINGS

Date of issue	BGR	Tax	Section	Description
28.08.2023	65	VAT	21(1), (3), (5), 16(2) AND (3)	Value-added tax treatment of rounding difference in cash transactions

GUIDES

Date of issue	Description
24.08.2023	Guide to the voluntary disclosure programme
24.08.2023	Guide for tax rates / duties / levies (Issue 16)
16.08.2023	VAT Rulings Process Reference Guide (issue 4)
16.08.2023	VAT Section 72 Decisions Process Reference Guide (Issue 2)
25.07.2023	Transfer Duty Guide (Issue 6)
14.07.2023	Guide to the Exemption from Normal Tax of Income from Films (Issue 2)