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Editor's Note:

In this third newsletter for 2024 we consider the following:

Soft Loans to Non-Resident Trusts revisited – Budget Review 2024

Constitutional Court judgments eagerly awaited in *Thistle Trust* and *Coronation* cases

Foreign Employment PAYE Limitations

Global Minimum Tax Bill

Loopbacks – Distributions from non-resident trusts to RSA beneficiaries

SARS BCRs and guides Noter-Up

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SOFT LOANS TO NON-RESIDENT TRUSTS REVISITED – BUDGET REVIEW 2024

In the late tax doyen Costa Divaris's era of his *Tax Shock Horror* newsletter, I canvassed the interaction between Sections 31, 7C and 7(8) of the Income Tax Act in the context of interest-free loans to *inter alia*, non-resident trusts. This matter has now been raised in the 2024 Budget Review. The brief extract in the Review states as follows:

'The Income Tax Act contains an anti-avoidance measure aimed at curbing the tax-free transfer of wealth to trusts using low-interest or interest-free loans, advances or credit arrangements (including cross-border loan arrangements). The transfer pricing rules in

the act also apply to counter the mispricing of cross-border loan arrangements. To avoid the possibility of an overlap or double taxation, the trust anti-avoidance measures specifically exclude low or no-interest loan arrangements that are subject to the transfer pricing rules. It has come to government's attention that the above-mentioned exclusion does not effectively address the interaction between the trust anti-avoidance measures and transfer pricing rules where the arm's length interest rate is less than the official rate on these cross-border loan arrangements. It is proposed that amendments be made to the legislation to provide clarity in this regard.'

Whilst somewhat vaguely worded, our interpretation of this extract in the context of soft loans to non-resident trusts is that an arm's length interest rate (as per Section 31 of the Income Tax Act) is difficult to determine, given that there are so many investment and risk variables. The best objective approach in our view to provide certainty is to cross-reference to the 'official rate of interest' as defined in Section 1 of the Income Tax Act. For cross-border loans denominated in a foreign currency, this is the foreign equivalent of the RSA repo-rate plus 100 basis points.

We await further clarity on the amendment.

CONSTITUTIONAL COURT JUDGMENTS EAGERLY AWAITED IN THISTLE TRUST AND CORONATION CASES

On 8February 2024 the Constitutional Court heard the appeal and cross-appeal in the matter of *The Thistle Trust v C:SARS*. Unfortunately, the case was not made available on YouTube so we are unable to comment on the proceedings. However, the heads of argument and supporting affidavits of both parties were available on the Constitutional Court's website. As previously reported in Newsletter 1.2024, this case dealt with the issue whether capital gains can flow through multiple discretionary trusts under paragraph 80(2) of the Eighth Schedule. On a plain reading of the provision, it is only the trust that disposes of the asset that can attribute the resulting capital gain to a resident beneficiary. Faced with this limitation, the taxpayer argued that the capital gain could flow through multiple trusts under section25B(1) or under the common law conduit principle. SARS's argument was that section25B applied only to income and that the

conduit pipe principle fell away when a trust was made a person with effect from 1986, which is also when section 25B was introduced.

We note that paragraph80(2) was subsequently split into paragraph 80(2) and (2A), with (2A) dealing with non-resident trusts. Unlike paragraph 80(2), paragraph 80(2A) is specifically worded to allow a capital gain to flow through multiple offshore trusts until it reaches a resident beneficiary. In addition, the wording of paragraph 80(2) was amended in 2008 to prevent a capital gain from flowing through multiple trusts. One can speculate why SARS did not want the capital gain to travel more than one step, but the simplest reason is probably that it wanted it to be consistent with paragraph 80(1) which also adopts the one-step approach for the vesting of an asset. Other reasons could be to prevent income splitting or to make it easier for SARS to audit an attributed capital gain instead of having to go through a tracing exercise. The point is that the outcome of limiting attribution to one step is not absurd or ambiguous, requiring a resort to the purposive approach to interpretation. As the court stated in Natal Joint Municipal Pension Fund v Endumeni Municipality (2012, SCA), 'Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation ...'.

The cross-appeal by SARS, concerns the SCA’s remission of the 50% understatement penalty on the basis that Thistle had made a *bona fide* inadvertent error envisaged in section 222(1) of the Tax Administration Act 28 of 2011 (TAA).

It is, in our view, a debatable point whether an error in interpretation can be classified as ‘inadvertent’. In this case, the taxpayer had consulted the late David Meyerowitz SC, whose advice must have been carefully considered, taking into account SARS's contrary view. The taxpayer would have had a sound argument that it had reasonable grounds for its tax position taken and thus did not deserve a 50% penalty under item (iii) of the penalty table in section 223(1) of the TAA. That would then mean a 10% penalty for the substantial understatement under item (i) of the table. The taxpayer presumably did not have an opinion from a registered tax practitioner, otherwise it could have relied on section 223(3) to have the entire penalty remitted. Instead, it went for section 222(1) on the basis that it had made a *bona fide* inadvertent error and the SCA agreed with it.

Another case that was heard by the Constitutional Court on 13 February 2024 was that of *Coronation Investment Management (Pty) Ltd (CIMSA) v C: SARS* which we reported on in Newsletter 4.2023. This case concerned whether CIMSA qualified for the foreign business establishment (FBE) exemption in section 9D(9) on its activities in Ireland. CIMSA appealed against the SCA's decision that its Irish operations did not constitute an FBE, while SARS cross-appealed the SCA's decision to remit the understatement penalties on the grounds that the taxpayer had made a *bona fide* inadvertent error.

CIMSA stated that it had relied on an opinion from a leading tax expert in the country but did not disclose its contents or make it available to SARS. The SCA stated that it was not incumbent on CIMSA to disclose its tax opinion.
On the SCA's interpretation, taxpayers can avail themselves of either the bona fide inadvertent error defence under section 222 or obtain an opinion from a registered tax practitioner under section 223(3) to have penalties remitted involving disputes on law interpretation issues. It will be interesting to see whether these choices are still available to taxpayers after the Constitutional Court has ruled on the matter.
Judgment is eagerly awaited in both these cases

FOREIGN EMPLOYER PAYE LIMITATIONS

The draft Tax Administration Laws Amendment Bill published July 2023 proposed that all foreign employers register as an employer for PAYE purposes and withhold tax on their RSA resident employees. This has now been modified and limited under amendments contained in the Tax Administration Laws Amendment Act 18 of 2023, promulgated on 22 December 2023 and effective from that date. Paragraph 2(1)(*b*) of the Fourth Schedule, now limits the requirement to circumstances only in which the foreign employer conducts business through a permanent establishment in the RSA.

The term 'permanent establishment' is defined in Section 1 of the Income Tax Act and cross-references to Article 5 of the Model Tax Convention of the OECD. In essence this includes an RSA-situate place of management, branch, an office, factory or workshop.

In the absence of such a presence in the RSA, a foreign employer need not deduct PAYE from their RSA resident employees.

GLOBAL MINIMUM TAX BILL

On 21 February 2024 the Minister of Finance published a 'Draft Global Minimum Tax Bill'.

The Bill's proposal is for the RSA to adopt the OECD/G20 Global Anti-Base Erosion Rules by introducing the global minimum top-up tax (15%) to be beneficially collected by SARS, effective 1 January 2024 and applying to tax years on or after this date. Affected taxpayers in the RSA context comprise multinational enterprise groups which have a permanent establishment in the RSA with a parent company in another jurisdiction, if the annual revenue of the multinational enterprise group exceeds 750 million Euros.

This Bill cross-references to the "Global Model Rules" and can thus be meaningfully interpreted having regard only to the latter Model Rules of the OECD.

We await details in an Explanatory Memorandum to be published by the RSA Treasury, according to the Budget Review publication.

LOOPBACKS – DISTRIBUTIONS FROM NON-RESIDENT TRUSTS TO RSA BENEFICIARIES

The SARB relaxed its Excon rules governing loop structures in Circular 1.2021. This relaxation has enabled RSA residents with authorised funds abroad usually housed in foreign trusts and/or Companies, to re-invest into the RSA, subject to approval by an authorised dealer. This has attendant tax consequences, some of which are considered in this article.

A typical 'loop 'structure would be a RSA Company whose shares are held by a non-resident (foreign) company whose shares in turn are held 50% or more by a non-resident (foreign) trust, both latter entities situate in a low-tax jurisdiction. The flow of funds is a local dividend from the RSA Company to the foreign Company which in turn declares a foreign dividend to its shareholder, being the foreign trust. If the foreign trust makes a distribution to or vests a right in RSA resident beneficiaries, effectively comprising the

foreign Company dividend (originally emanating from the RSA Company) the following tax issues arise:

Distribution in the same year of assessment

If the foreign dividend is distributed in the same year of assessment, it will comprise a foreign dividend in the resident beneficiary's hands under section 25B(1). However, it would not qualify for the participation exemption under section 10B(2)(*a*) unless the resident beneficiary held at least 10% of the equity shares and voting rights in the foreign company, which is generally not the position as the foreign trust usually owns 100% of the foreign company. The Section 10B(3) partial exemption of 25/45 of the foreign dividend (effective 20%), however, remains available.

Section 25B(2B)

Section 25B(2B) deals with the situation in which the foreign dividend is distributed by the foreign trust in a subsequent year of assessment.

Under Section 25B(2B) inserted into the Income Tax Act and effective 1 March 2019, the participation exemption under Section 10B(2)(*a*) pertaining to a foreign dividend, is not allowed in circumstances in which the distributed amount by the non-resident (foreign) trust:

- comprises a dividend from a foreign company, and
- more than 50% of the shares are held by the foreign trust, and
- The RSA resident beneficiary is a connected person in relation to the foreign trust.

It follows that this full participation exemption is inapplicable, as the above three criteria apply to deny it.

The Section 10B(3) partial exemption of 25/45 of the foreign dividend (effective 20%) remains available. An exception to the foreign dividend partial inclusion is if the foreign dividend is derived from an amount that is included in a RSA resident's (or 'connected person's') income. (Simply put, this is when Section 7(8) or paragraph 72 of the Eighth Schedule applies in the circumstances of a donation or soft loan when all the income/gains are attributed to the donor).

<u>Dividend Withholding Tax (DWT)</u>

Dividend Withholding Tax (DWT) is levied under Section 64E at the rate of 20% on any dividend paid (or due and payable if from a private company). The Section 64F dividend exemption applies only to a recipient RSA Company and not a foreign company. A Double Tax Treaty (DTA) may affect this tax position, Mauritius being a good example in which the DTA reduces the DWT to between 5% and 10% dependent upon certain criteria.

It follows that there are tax inefficiencies to this loop structure in interposing a foreign company between the RSA company and the foreign trust in that there is both DWT at source when the RSA company distributes a dividend to the foreign company and again partial dividends tax when the same amount (now being a foreign dividend from the foreign company) is distributed by the foreign trust to a RSA beneficiary.

If, however, the RSA Co distributed directly to a foreign trust as the direct shareholder (as distinct from the interposition of a foreign company), and this foreign Trust in turn distributed the dividend to the RSA beneficiaries, there would (subject to a DTA) be DWT withheld by the RSA Co, but because of the conduit principle (under which the amount retains its nature as a dividend) there is no further dividends tax when the foreign trust distributes it to the RSA beneficiaries in the same tax year.

If the dividend is distributed in a subsequent year of assessment, it will comprise a return of trust capital which is not subject to income tax or CGT in the beneficiary’s hands. Section 25B(2A) will not apply as the amount would not have constituted income of the foreign trust had it been a resident as a result of the section 10(1)(*k*) exemption for local dividends.

BINDING CLASS RULINGS

Date of issue	BCR	Tax	Section	Description
22.02.2024	088	IT	12B(1)(*h*), 24H, 20(1)(*b*) and 20(2A)	En Commandite partners investing in solar assets

GUIDES

Date of issue	Description
08.03.2024	Guide on the Solar Energy Tax Credit Provided under Section 6C

Note: This guide was released in draft form for comment on 26 January 2024.