

Synopsis

Tax today

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A monthly journal published by PwC South Africa providing informed commentary on current developments in the tax arena, both locally and internationally. Through analysis and comment on new law and judicial decisions of interest, it assists business executives to identify developments and trends in tax law and revenue practice that might impact their business.



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Dividends tax – get ready

It's official – dividends tax (DT) will replace secondary tax on companies (STC) on 1 April 2012.

The rate of tax will be 10% in respect of dividends distributed by companies that are resident for tax purposes and dividends distributed by non-resident companies in respect of shares listed on the JSE.

SA-resident companies will no longer have to account for STC going forward, although they may carry forward STC credits that will have to be allocated to their shareholders.

In the case of dividends declared by listed companies, the responsibility for managing the DT administration will in most cases fall on the regulated intermediaries (CSDs, brokers, nominees, etc.) — although in certain exceptional circumstances where the administration burden remains with the listed company. For unlisted companies, the responsibility for accounting for STC will be replaced by administration of DT. For regulated intermediaries, they will assume new responsibilities that have not previously affected them. These companies and regulated intermediaries will be required to withhold and pay the appropriate amount of the tax over to SARS. In the discussion that follows, the term “company” may be held to apply equally to regulated intermediaries who will administer the DT exposures of shareholders of listed companies.

STC close-off

As a starting point, the abolition of STC will trigger the termination of a final dividend cycle, i.e. which ends on 31 March 2012 (unless the company actually declares a dividend on 31 March 2012).

The purpose of this is to compute the value of unutilised STC credits available at that date. If no actual dividend is declared on 31 March 2012, the computation will reflect a dividend declared of zero and will record all dividends received during the final (deemed) dividend cycle plus unutilised dividend credits from earlier cycles. The STC credits recorded as unutilised will then remain available to alleviate the liability of shareholders to DT for a period of five years. Without this mechanism there would be a potential double tax on distributions.

It does not appear as if companies will be required to submit a return for STC purposes, as no STC will be payable as a result of the termination of the dividend cycle. However, it would be advisable that companies that may have unutilised STC credits determine the amount of credits that are available to relieve DT at that date without significant delay.

Payment of dividends tax

Any company that pays any dividend on or after 1 April 2012 is liable to withhold DT at the rate of 10% from the amount of the dividend and to pay the amount so withheld over to SARS.

The company is relieved from withholding the DT in the following circumstances:

If the beneficial owner is a company in the same “group of companies” as the declaring company;

If the recipient is a regulated intermediary;

If the company has received the requisite declaration confirming that the beneficial owner is exempt from DT;

If the company has received the requisite declaration confirming that the beneficial owner is entitled to relief from DT in terms of a valid double tax agreement (DTA), to the extent permitted in the DTA;

If the company has unutilised STC credits which are applied in reduction of the liability, to the extent that the credits are so applied.

Identification of persons entitled to relief

For the efficient administration of DT it will be vital that each company understands the composition of its shareholders, so that it can identify the circumstances in which it will have to comply with its statutory obligation to withhold the tax from payments to such shareholders.

The legislation incorporates a default position; every qualifying company must withhold tax at the rate of 10% on any dividend paid

In a sense, DT is regulated by evidence – a company must withhold the 10% tax from dividend payments unless it holds evidence that it is not required to do so.

on or after 1 April 2012, unless the beneficial owner of the share in respect of which the dividend is paid is exempt or subject to rate relief under a double tax agreement, or if the dividend is payable to a company in the same group of companies (as defined in section 41 of the Income tax Act) or a regulated intermediary.

The company may not of its own motive determine that a shareholder is exempt, but must have obtained a declaration in prescribed form stating that the beneficial owner is an exempt person and that the beneficial owner undertakes to notify the company in the event that such person ceases to be the beneficial owner of the share.

Similarly, in the event that the beneficial owner is not exempt but entitled to claim a reduction in the rate of tax in terms of a valid double tax agreement between that person’s state of residence and South Africa, the company must be in possession of a declaration in prescribed form stating that the beneficial owner is entitled to the relief and undertaking to notify the company in the event that such person ceases to be the beneficial owner.

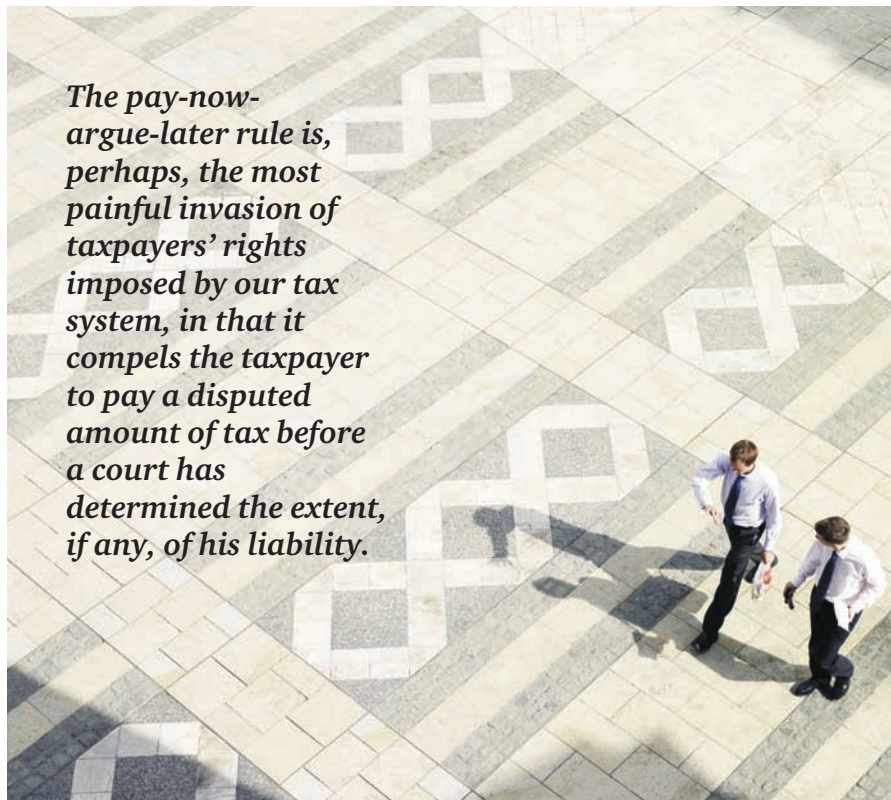
In a sense, DT is regulated by evidence – a company must withhold the 10% tax from dividend payments (to persons other than qualifying group companies and regulated intermediaries) unless it holds evidence that it is not required to do so.

SARS has issued draft documentation on its website (www.sars.gov.za/TaxTypes/DividendsTax) which provides examples of the forms that may need to be completed to enable companies and regulated intermediaries to comply with these requirements (see document entitled “Business Requirement Specification (BRS): Dividends Tax (Version 1.0.0)” pages 61 – 66).

Efficient DT administration will initially require that the companies obtain declarations from their shareholders/beneficial owners prior to payment of the first dividend payable on or after 1 April 2012. Thereafter, when changes in ownership of shares occur, it will be incumbent on the person who made the declaration to inform the company of the change in ownership.

In the event that a person entitled to exemption or relief provides evidence of such entitlement after

Unresolved aspects of the “pay now argue later” rule



SARS would have taxpayers believe that there is no room for discussion or debate on the existence or the scope of the rule, on the basis that, in *Metcash Trading Ltd v CSARS* 2001 (1) SA 1109 (CC) the Constitutional Court gave the rule its imprimatur, and declared that it did not infringe the Bill of Rights.

That is a convenient half-truth and, as a Yiddish proverb reminds us, a half truth is a whole lie.

The fact is that, in *Metcash*, the Constitutional Court pronounced on the constitutionality of the pay-now-argue-later rule in the context of the Value-Added Tax Act, but said nothing at all about its constitutionality in the context of the Income Tax Act.

Dividends tax cont/

the tax has been withheld and paid to SARS by filing the prescribed declaration within three years after the date of payment of the dividend, the company is obliged to refund the DT that has been overpaid and entitled to recover the amount by reducing its next subsequent DT declaration to SARS. If the company fails to refund the amount in full within one year, the beneficial owner may apply for a refund from SARS. However, the application for refund must be filed with SARS not later than four years from the date of payment of the dividend.

Utilising STC credits

After 1 April 2012, any company that has unutilised STC credits is obliged to apply the credits against dividends that it declares on or after that date. The liability to pay DT is reduced by the STC credits that are applied. In addition, the company paying the dividend will be obliged to provide each recipient of that dividend with a statement of the amount of STC credit that has been utilised. It should be noted that credits are applied pro rata to dividends distributed, regardless of whether the shareholder is exempt from DT.

Where a shareholder is a company that receives a dividend subject to

STC credits, it must increase its STC credit pool by the amount of credit that is reflected on the certificate that it receives.

Stay informed

Companies and regulated intermediaries would be well advised to keep themselves informed of the developments in this field. SARS is developing systems that will permit online payment of DT, which may require examination of existing systems and procedures for some companies and regulated intermediaries. With the implementation date now a little over eight weeks away, there is much to think about.

It is by no means a foregone conclusion that the court would have reached the same conclusion if income tax had been in issue, for there are many significant differences between the two taxes, not the least being that there is far more scope for genuine disputation about income tax liability than liability for VAT.

(b) If any person fails to pay any tax or any interest ... when such tax or interest becomes due or is payable by him, the Commissioner may file with the clerk or registrar of any competent court a statement certified by him as correct and setting forth the amount of the tax or interest so due or payable by that person, and such statement shall thereupon have all the effects of, and any proceedings may be taken thereon

terms of section 91(1)(b), but must await the determination of the objection and any appeal to the Tax Court or the superior courts.

The decision in *Capstone* held that this conclusion rested on an incorrect interpretation of the Income Tax Act; that a “judgment” taken by SARS in terms of section

The decision in Capstone is much more persuasive than that in Mokoena, but they are both judgments of a single judge of the High Court, and therefore both have the same precedential authority, which means that lower courts in their respective areas of jurisdiction - including the Tax Court - are bound by these two disparate decisions.

On-going confusion and misunderstandings

If anyone doubts the level of confusion and misunderstanding regarding the pay-now-argue-later rule in the context of income tax, he need only look to the two High Court decisions, a mere year apart, in *Mokoena v CSARS 2011 (2) SA 556 (GSJ)* and *Capstone 556 (Pty) Ltd v CSARS [2011] ZAWCHC 297*, which came to diametrically opposite conclusions on key aspects of the rule.

In the context of income tax, the crux of the pay-now-argue later rule lies in the interplay between section 88(1) and section 91(1) of the Income Tax Act

Section 88(1) provides that
‘Unless the Commissioner otherwise directs ..

a) the obligation to pay any tax chargeable under this Act; and

b) the right to ... recover any tax chargeable under this Act, shall not be suspended by any objection or appeal or pending the decision of a court of law ...’

Section 91(1) provides that
(a) ...

as if it were, a civil judgment lawfully given in that court in favour of the Commissioner for a liquid debt of the amount specified in the statement.

(c) The Commissioner may institute proceedings for the sequestration of the estate of any taxpayer and shall for the purposes of such proceedings be deemed to be the creditor in respect of any tax due by such taxpayer or any interest payable by him ...

The conflicting decisions in two recent High Court judgments

Thus, the nub of section 88(1) is that a taxpayer’s obligation to pay tax is not suspended merely because he has lodged an objection or appeal against an income tax assessment, and section 91(1)(b) says that, if a person fails to pay tax when it is due (namely, on the date for payment set out in the relevant assessment), SARS can take “judgment” against that person merely by filing a statement, certified as correct, with a clerk or registrar of the court setting out the amount of tax that is due.

However, the decision in *Mokoena* held that, if a taxpayer lodges an objection against an assessment, SARS cannot thereafter take “judgment” against that taxpayer in

91(1)(b) was not a true judgment at all, in that it did not resolve any dispute between SARS and the taxpayer, does not have “the rights-determining character of a judicially delivered judgment” and is a mere recovery provision, no different from the other recovery provisions in the Act. Consequently, a taxpayer had no legal basis for interdicting SARS from taking “judgment” in terms of section 91(1)(b) because, as a matter of law, the amount of tax, as recorded in the assessment, was in fact legally payable.

The decision in *Capstone* is much more persuasive than that in *Mokoena*, but they are both judgments of a single judge of the High Court, and therefore both have the same precedential authority, which means that lower courts in their respective areas of jurisdiction - including the Tax Court - are bound by these two disparate decisions.

Strangely, SARS has apparently not taken the *Mokoena* decision on appeal. Indeed, the reported judgment in *Capstone* makes the extraordinary observation (at para [34]) that “there was no appearance on behalf of the Commissioner” when *Mokoena*’s

Unresolved aspects of the “pay now argue later” rule

case was argued in the High Court and that Spilg J “was therefore deprived of the benefit of argument” in those proceedings from any party other than the taxpayer.

Suspension of the obligation to pay a disputed amount of income tax

The real issue on which neither of these decisions provides any guidance is the way in which the courts are going to interpret the provisions of section 88(3), in terms of which the Commissioner is required to decide, on the basis of the stipulated criteria, whether to grant the taxpayer’s request to suspend the obligation to pay the disputed tax until the issue has been judicially determined.

In its current form, section 88(3) provides that

The Commissioner may suspend payment of the disputed tax having regard to-

- a) the compliance history of the taxpayer;*
- b) the amount of tax involved;*
- c) the risk of dissipation of assets by the taxpayer concerned during the period of suspension;*
- d) whether the taxpayer is able to provide adequate security for the payment of the amount involved;*
- e) whether payment of the amount involved would result in irreparable financial hardship to the taxpayer;*
- f) whether sequestration or liquidation proceedings are imminent;*

g) whether fraud is involved in the origin of the dispute; or

h) whether the taxpayer has failed to furnish any information requested by the Commissioner in terms of this Act for purposes of a decision under this section.

The Act gives no guidance as to the relative weight of these criteria. The relevance of some criteria – for example “the amount of tax involved” is not clear; is a large amount of disputed tax a pointer toward granting a suspension or refusing a suspension of the obligation to pay?

The probable attitude of the courts toward suspending the obligation to pay a disputed amount of income tax

It seems likely that if the Commissioner makes a decision adverse to the taxpayer, in other words, decides not to suspend the obligation to pay the disputed tax, and the taxpayer then takes that decision on review in terms of the Promotion of Administrative Justice Act the court will take as its starting point the base principle that tax is payable despite any objection or appeal, and that the pay-now-argue-later rule must prevail unless there is a substantial reason to deviate from the rule.

The most obvious example of a substantial reason to deviate from the rule is that immediate payment of the disputed tax would cause “irreparable financial hardship” to the taxpayer. The adjective “irreparable” sets the bar very high, and it is probably an inappropriate word anyway, since any amount of

financial loss is inherently reparable by an award of damages.

The court is likely to take the view that the contrary interpretation is untenable – namely that the default position, as it were, is that the obligation ought to be suspended unless there is substantial reason to decide otherwise, for example, if there is a significant risk of the dissipation of assets during any period of suspension.

In the *Metcash* decision the court took cognisance of “the public interest in obtaining full and speedy settlement of tax debts in the overall context of the Act” and the “public policy considerations in favour of a general system whereby taxpayers are granted no leeway to defer payment of their taxes”.

If the general rule were that a request for suspension of the obligation to pay a disputed amount of income tax should be granted, many taxpayers would probably leap on the bandwagon and procure the postponement of the obligation to pay months or years until judgment had been given in the final appeal against the assessment.

The detrimental impact on tax collections if a postponement of the obligation to pay disputed tax was, in effect, there for the asking, is beyond doubt, and this is a factor that is likely to weigh heavily with a court.

Vodafone successful in Indian tax dispute

In the July 2010 edition of Synopsis we reported on the attempt by the Indian Tax Authorities (“ITA”) to impose tax on a non-resident company that had entered into a transaction which took place outside of its jurisdiction, and involved the acquisition of shares in a holding company incorporated in the Cayman Islands that held an indirect investment in an Indian company. This matter has finally been decided in the Supreme Court of India, which delivered judgment in favour of Vodafone on 20 January 2012.

The facts

In 2007, Vodafone International Holdings BV (Vodafone), a Netherlands company acquired an interest in CGP Investments Holdings Limited (CGP), a Cayman Islands company, from Hutchison Telecommunications International Limited (“HTI”), a Hong Kong company in a transaction that was concluded outside India. CGP controlled a substantial interest in an Indian mobile communications company, Hutchison Essar Limited (HE) indirectly through a wholly-owned Mauritian subsidiary. HE was a joint venture company between the Hutchison Group and the Indian based Essar Group.

The Indian Foreign Investment Council approved the transaction subject to the condition that Vodafone should comply with the Indian domestic laws. As a result of the transaction the name of HE was changed to Vodafone Essar Limited.

Section 9 of the Indian Income Tax Act treats any income derived, *inter alia*, from the transfer of a capital asset in India as income arising in India. The Indian tax authorities (ITA) took the view that the disposal by HTI was a transfer of an interest in Indian assets. They then contended that, in terms of section 195 of the Income Tax Act, a purchaser is required to withhold and pay over capital gains tax arising on the disposal, and issued a notice on Vodafone to show cause why it should not be regarded as an



“assessee-in-default” for failing to withhold Indian tax on the capital gain from the purchase consideration paid to HTI. Interestingly, the ITA did not seek to recover tax from the seller, but targeted the purchaser, presumably because they could exert pressure on the Indian interests indirectly controlled by the purchaser to exact payment.

Vodacom made the payment (which was in excess of US\$2 billion) and appealed against the decision to the Bombay High Court, which refused its appeal. The matter was then taken on appeal to the Supreme Court in New Delhi.

The issues

There were two issues that assumed major importance:

The interpretation of the charging section (section 9); and

The common law anti-avoidance rules applicable in India.

The charging section

Section 9(1)(i) of the Indian Income Tax Act imposes tax on non-residents as follows:

“The following incomes shall be deemed to accrue or arise in India :—

...

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.”

The ITA sought an interpretation that the term “directly or indirectly” entitled it to look through the corporate structure and treat the transfer of the shares of a foreign company holding shares in an Indian company as equivalent to the transfer of the shares in the Indian company.

To this the Supreme Court had two responses. First, the intent of the section is to tax the transfer of assets situate in India. If it were to be applied to indirect transfers, the words “situate in India” would be meaningless. Secondly, the words “directly or indirectly” apply to the term “income” and not to the term “transfer of a capital asset”. The judgments reaffirmed the principle that the situs of a share is the place where it is registered and/or where it can be dealt with. From this it followed that the shares of CGP were situated in the Cayman Islands where the share register was maintained.

The anti-avoidance argument

The essence of the anti-avoidance argument was that Hutchison had undergone a significant restructure

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in the course of 2005 and had interposed CGP in the structure in the course of this exercise in order to avoid exposure to Indian tax.

The Court found that the commercial structure adopted by HTIL for its investments into India was a genuine business arrangement and that sound commercial purposes existed for the use of CGP in the structure. The disposal of the shares in CGP was not a pre-ordained transaction with no commercial purpose. There were two possible disposal routes available and the alternative route would not have resulted in the payment of tax, by reason of treaty protection. Therefore there could not be a motive of tax avoidance in the sale of the CGP shares.

The Order

The Court ordered the ITA to refund the tax that had been paid by Vodacom together with interest. Of considerable interest is the Court's requirement that the amount to be refunded must be deposited in the appellant's bank account within two months of the date of the judgment. In this way the appellant has been given an enforceable right to ensure that payment of the refund is not delayed.

In recent years, with the growth of SA investment in and trade with sub-Saharan Africa, many SA companies have been subjected to withholding taxes that are imposed by foreign jurisdictions on remittances to them by residents of a jurisdiction where the payment was in respect of services rendered from South Africa. Typical examples are professional fees of consulting engineers and management fees levied on subsidiaries by the holding company.

The law relating to the allowance of a rebate of foreign taxes has permitted the credit of the foreign taxes paid against SA taxes payable only if the source of the income is outside the Republic. This left the SA recipient with penal double tax exposure on these remittances, having incurred withholding tax and being liable to declare the income for SA purposes as well.

No rebate – but a deduction was allowed

SARS and National Treasury were not unsympathetic to the plight of the SA residents who were caught in this scenario and caused legislation to be enacted in 2007, which provided a partial solution to the problem. In effect, they said, taxpayers in this position may claim a deduction in respect of the foreign taxes, and pay tax on the net amount that was remitted to them. On this basis the maximum relief that could be enjoyed was 28% of the taxes withheld at source.

New provisions – rebate or deduction

The Taxation Laws Amendment Act 2011, introduced legislation

that is yet more beneficial with effect from 1 January 2012.

The taxpayers may now claim a rebate in respect of foreign taxes incurred, not only where the amount payable in respect of services rendered in South Africa is subject to withholding taxes at source imposed by a jurisdiction with which South Africa has a valid double tax agreement, but also where tax is imposed on the amount in any other circumstances by any foreign government.

The rebate is limited to the lesser of the SA tax attributable to the relevant amount or the foreign taxes incurred in respect of the amount.

The relief cannot be claimed in addition to the deduction that was previously available – but taxpayers have the right to elect deduction or rebate in each case.

The rand equivalent of the foreign taxes is determined by translating the foreign tax at the average exchange rate for the year of assessment.

No rebate without proof

A further amendment to these provisions comes into effect on 1 April 2012. This will deny the right to claim a rebate in respect of taxes withheld by a treaty partner jurisdiction, unless declaration in prescribed form of the amount withheld is submitted to SARS within 60 days of the date on which the amount was withheld.