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# ***Taxation Laws Amendment Bill, 2017: Expansion of application of CFC rules***

*17 November 2017*

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## ***In brief***

Included in the Taxation Laws Amendment Bill, 2017 (“the TLAB, 2017”) are amendments that effectively expand the definition of a “controlled foreign company” in section 9D of the Income Tax Act, 1962 (Act No 58 of 1962) (“the Act”) by making use of IFRS 10 to determine whether foreign companies held by South African residents should be regarded as CFCs. It is proposed that these amendments come into operation on 1 January 2018, and apply in respect of years of assessment commencing on or after that date.

This Tax Alert gives a brief overview of the proposed amendments.

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## ***In detail***

### ***Background***

In terms of section 9D of the Act, the “net income” of a CFC is required to be included in the income of its South African-resident shareholders. Generally, a CFC is a foreign company (i.e. not a resident of South Africa) where more than 50 per cent of the “participation rights” of that foreign company are directly or indirectly held (or more than 50 per cent of the voting rights are directly or indirectly exercised) by South African residents.

For some time, Government has been concerned that taxpayers are making use of interposed trusts (especially discretionary trusts) and/or foundations in order to break the link between the South African residents and the

foreign company (which would, in the absence of the interposed trust or foundation, otherwise be a CFC).

### ***The proposed change***

In order to partially address the above concern of Government, the TLAB, 2017 proposes the following two amendments to section 9D of the Act:

(1) The definition of “controlled foreign company” is expanded to include any foreign company where the financial results of that foreign company are reflected in the consolidated financial statements, as contemplated in IFRS 10, of any company that is a resident.

(2) An amendment that effectively provides that, where a foreign company is a CFC as a result of consolidation in terms of IFRS 10, the percentage of the participation rights held by a resident in relation to that CFC will be equal to the net percentage of the financial results of the foreign company that are included in the consolidated financial statements of the resident, as contemplated in IFRS 10.

The above amendments accord with the final report on Action 3 of the OECD BEPS Action Plan (Designing Effective Controlled Foreign Companies Rules) and effectively extend the concept of a CFC to a control test in

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addition to a participation test. The result is that a foreign company could now be a CFC if it is controlled by a South African resident company, regardless of the extent of its economic interest in the foreign company.

### *The take-away*

Many of the practical issues relating to the use of financial reporting standards to determine whether a foreign company should be regarded as a CFC (and to determine the amount of the net income of such a CFC that is to be attributed to South African residents) will only become

apparent as the proposals take effect.

Taxpayers should carefully consider the implications of the amendment for any foreign companies that are not currently CFCs and which are or may be consolidated in the financial statements of a resident company.

### *Let's talk*

For a deeper discussion of how this issue might affect your business, please contact:

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