Pieter van der Zwan & Associates
Technical Advisory Services
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Reportable arrangements: The new regulations

Taxpayers and their advisors often devise clever structures to make transactions more tax efficient. Some of these structures may venture very close to being impermissible tax avoidance schemes. A mechanism that could enable SARS to identify such transactions, which has been in the Income Tax Act and more recently the Tax Administration Act for a while, requires that taxpayers and/or their advisors report certain transactions as reportable arrangements. This newsletters provides a brief overview of the reportable arrangement requirements and the transactions that need to be reported in terms of the noitice that was issued on 16 March 2015.

Basic principles of the reportable arrangement system

An arrangement may be reportable for two reasons. Firstly, it could be listed by the Commissioner as a reportable arrangement by public notice. The new items listed are discussed in the second part of this newsletter.

Alternatively, an arrangement could be reportable if it contains certain elements listed in section 35(1) of the Tax Administration Act (hereafter the TAA).[1] Despite falling into this category, certain arrangements may be excluded. Section 36 of the TAA lists a number of specific exclusions for plain loans or leases.[2] The notice issued on 16 March 2015 also sets out the criteria for further excluding arrangements from the reporting requirement. Paragraph 3 of the Notice states that any arrangement that would otherwise be reportable in terms of section 35(1), does not have to be reported if the aggregate tax benefit which is or may be derived by all participants does not exceed R5 million. The notice removes the exclusion previously afforded for arrangements where the tax benefit derived was not the main or one of the main benefits of the arrangement, which was often relied upon by taxpayers and advisors as the reason why an arrangement need not be reported.

The duty to report an arrangement to SARS rests on a participant to the arrangement. This term is defined to include any person who derives a tax benefit in the form of the avoidance, reduction or postponement of a tax liability but also the promotor, who was principally responsible for organising, designing, selling, financing or managing such an arrangement. The advisor who assists a client with the structuring of a transaction is therefore likely to fall within this category. Such a participant has to report the transaction within 45 days from the date when the transaction qualifies as a reportable arrangement, unless that person has obtained a written confirmation that another participant has reported the arrangement. Failure to report an arrangement could lead to monthly penalties between R50 000 and R150 000 for a participant other than the promotor and R100 000 to R300 000 for the promotor under section 212 of the TAA. Such penalties can accumulate for a period of up to 12 months, resulting in a potential exposure of R3,6 million for the promotor if the arrangement is not reported.

Specific reportable transactions listed in the notice

The remainder of this newsletter sets out the specific reportable transactions listed in the notice issued on 16 March 2015. It is important to note that this notice took effect from 16 March 2015 and replaces the notices previously issued. As these transactions specifically listed fall outside section 35(1), and are rather listed under section 35(2), the exclusion for an arrangement resulting in a tax benefit not exceeding R5 million does not apply. Transactions should therefore be reported based on the characteristics, rather than the value of the tax benefit.

The reportable transactions are:

Hybrid instruments

Instruments that would have been classified as hybrid debt or equity instruments, had the prescribed period in sections 8E or 8F been 10 years. Some debate exists whether the 10 year period refers to the 3 year period in the previous version of section 8F or the 30 year period referred to in the current version of section 8F. If the latter is the case, this may require any loans with a duration of longer than 10 years to be reported.

[1] These elements are not considered in further detail in this newsletter, but it is important to take note of it.
[2] Again, these transactions are not considered in further detail but would be important to take note of.

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Share buy-backs within a 12 month period from a share issue

Where a company buys back its own shares for an aggregate amount exceeding R10 million on or after 16 March 2015 *and* such company issued or is required to issue shares within 12 months of entering into the arrangement or of the share buy-back in terms of the arrangement, this requires reporting.

Given that a share issue does generally not result in capital gains tax and a dividend paid (which includes a share-buy back) to a resident company is exempt from dividends tax, a change in shareholders can be achieved through a combination of a share buy-back and a share issue without triggering capital gains tax. It is submitted that such an effective disposal of shares may come under close scrutinty in future and the commercial rationale for entering into this type of transaction will be of critical importance.

Resident contributions to a non-resident trust

The trigger for a reporting event is:

- a contribution by a resident to a non-resident trust on or after 16 March 2015 where the contributor has or acquires a beneficial interest in such trust and
- the amount of all such contributions, both before and after 16 March 2015, exceeds or will reasonably exceed R10 million.

Contributions to foreign collective investment schemes and foreign investment entities will not fall within this category.

It is submitted that this reporting event targets transactions to set up offshore wealth structures for the benefit of residents. It may be important to view this reporting event in light of the announcement in the recent Budget Review of the intention to develop stricter rules in respect of interests in foreign companies held by South Africans through foreign trusts when it comes to CFC legislation.

Acquisition of interest in companies with assessed losses

Where a person enters into an arrangement to acquire a controlling interest (by means of voting rights, shares or a combination) on or after 16 March 2015 in a company that has carried forward a balance of assessed losses or is reasonably expected to carry forward assessed losses exceeding R50 million or is expected to have an assessed loss exceeding R50 million during the current year in which the interest is acquired, this would have to be reported. Similarly, an arrangement where a controlling interest in a company which has a controlling interest in a company as described above is acquired, this should be reported.

The reason for requiring this transaction to be reported in probably closely linked to the application of section 103(2) of the Income Tax Act, which may disallow the utilisation of such an assessed loss.

Premiums paid to foreign insurers

Lastly, an arrangement in terms of which a resident pays or is required to pay or has paid an amount which exceeds or is reasonably expected to exceed R5 million to a foreign insurer and any amount is payable on or after 16 March 2015 by such insurer to any beneficiary is to be determined with reference to the value of a particular category of assets held by the foreign insurer for purposes of that arrangement is listed as reportable.

It is submitted that this is likely to target insurance premiums or other payments that are deductible from tax in South Africa when paid, but which may be give rise to amounts that come back into the country tax free in the form of insurance proceeds or dividends, in the case of certain captive insurance arrangements.

Concluding thoughts

To date the perception has widely existed, correctly so or not, that SARS did not seriously monitor compliance with the requirement to report certain arrangements. As has been the experience of taxpayers and advisors with many other aspects of the TAA, the enforcement thereof has improved once guidance and clarification existed. It is submitted that reportable arrangements is likely to be no exception in this regard. Following the publication of the notice, arrangements that fall within the amibt of section 35 may receive much closer attention from SARS than before. It is important to realise that this does not mean such transactions are taboo under all circumstances; it does however mean that taxpayers need to consider the commerciality of the transactions and their tax positions with extreme caution.

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