2008

New reportable arrangements legislation takes effect

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1. Background

Pretoria 09 April 2008 -- Around the world tax administrations find themselves at a disadvantage when responding to transactions that exploit the tax system. The inevitable delays between the conclusion of the transactions, submission of the related annual returns, and the returns' assessment and audit mean that years may pass before the transactions are detected, analysed, and challenged. One measure to improve response times, which is increasingly being adopted worldwide, involves the advance reporting of transactions meeting criteria that indicate that they may give rise to concern.

South Africa's reportable arrangements legislation came into force in 2005 and provided for the reporting of two classes of arrangement. The first related to arrangements that resulted in a tax benefit and were subject to an agreement that provided for the variation of interest, fees, etc. if their actual tax benefits differed from the anticipated tax benefits. The second related to certain hybrid debt and equity instruments. The legislation was intended to give the South African Revenue Service (SARS) early warning of arrangements that were potentially tax driven. SARS would then be in a position to take appropriate action to counter abuse more quickly than would otherwise have been the case.

Unfortunately, the number and nature of the transactions disclosed to SARS proved disappointing. Fewer than 150 transactions, most of them involving well known hybrid instruments, were reported in the 25 months the legislation was in force. Some taxpayers raised technical points to avoid reporting or restructured their transactions to avoid the triggers for reporting. More encouragingly, some commentators indicated they had encountered fewer transactions that they believed would give rise to concern.

The adoption of a new General Anti-Avoidance Rule (GAAR) in 2006 provided the opportunity to revise the reportable arrangements legislation and to link it to the factors that are indicative of a lack of commercial substance for GAAR purposes.

2. New legislation

Following extended consultations with key commentators on the legislation, the new reportable arrangements legislation contained in section 80M to 80T of the Income Tax Act, 1962, was brought into force on 1 April 2008.

2.1 Reportable arrangements

The new reportable arrangements legislation is generally triggered where an arrangement gives rise to a tax benefit and—

- provides for interest, fees, etc. that are partly or wholly dependent on the assumptions relating to the tax treatment of that arrangement (other than a change in law);
- has any of the characteristics of, or characteristics which are substantially similar to, the indicators of a lack of commercial substance in terms of the GAAR;
- is or will be disclosed by any participant as a financial liability for purposes of Generally Accepted Accounting Practice but not for income tax purposes;
- does not result in a reasonable expectation of a pre-tax profit for any participant; or
- Results in a reasonable expectation of a pre-tax profit for any participant that is less than the value of those tax benefits to that participant on a present value basis.

Specific reporting of hybrid equity and debt instruments is retained but the five year redemption threshold previously set has been extended to ten years. The change is intended to make restructuring these instruments to fall outside the scope of the legislation more commercially challenging. The Minister of Finance's authority to include or exclude arrangements for disclosure by way of regulation has also been retained.

2.2 Excluded arrangements

The previous exclusions for arrangements that are unlikely to be tax driven, such as ‘‘plain vanilla’’ loans, leases, share transactions and collective investment scheme investments have been retained. Following consultations between commentators and SARS, as well as a review of international experience, the Minister has also excluded any arrangement where the tax benefit from the arrangement—

- does not exceed R1 million; or
- is not the main or one of the main benefits of the arrangement.

2.3 Responsibility for reporting

The responsibility for disclosing a reportable arrangement is principally placed on its promoter, as this is the person most likely to have full insight into its operation. In the absence of a promoter who is a resident, the responsibility falls on all the participants, although the responsibility falls away for participants that have written confirmation that the required disclosure has been made by another. This approach ensures that disclosure is comprehensive while minimising duplication. Disclosure must be made within 60 days of funds flowing or liabilities being incurred in terms of the arrangement. It is the first flows or incurrals that are most relevant for the purposes of the legislation, so arrangements where they took place before 1 April 2008 need not be reported in terms of the new legislation but may well be reportable in terms of the previous legislation. The first disclosures in terms of the new legislation will thus be due by 31 May 2008.

2.4 Information to be disclosed

The information to be disclosed is similar to that previously required, except that a list of the arrangement’s agreements is required instead of a complete set of agreements. This will reduce the compliance cost with respect to the initial disclosure of an arrangement. Once the required information has been disclosed, SARS will issue a reportable arrangement number to each participant in an arrangement for administrative purposes only. Additional information, including agreements, may be requested if an arrangement is selected for further analysis.

2.5 Penalties for non-disclosure

Finally, a clear penalty provision has been introduced to serve as a deterrent for non-disclosure of reportable arrangements, which typically involve substantial amounts. A penalty of R1 million is imposed for non-disclosure but may be reduced where—

- there are extenuating circumstances and the non-disclosure is remedied within a reasonable time; or
- the penalty is disproportionate in relation to the tax benefit from the arrangement.

3. Enquiries

Enquiries with respect to the new legislation may be directed by e-mail to reportable@sars.gov.za or by telephone to Lucy Maeko at 012-422-6592 or Deleen Weys at 012-422- 5573.