BUSINESS LAW & TAX

Sars taking a closer look at offshore arms

● Receiver implements steps against SA companies that avoid paying tax by using overseas businesses

Mohammed Mayet
PKF Octagon

Given the SA Revenue Service's (Sars') intensified approach with regard to taxpayers who are structuring their businesses offshore, it would be prudent for these taxpayers to seek proper advice to ensure their offshore structuring does not affect them negatively should they be audited or investigated by the receiver.

As and when SA taxpayers consider planning offshore structuring, they must primarily give consideration to the provisions set out in the double tax agreement (DTA) between the resident country, namely SA, and the country in which they intend doing their offshore structuring. Insofar as there is a limitation or nullity in terms of the provisions set out in the applicable DTA, subsequent reference and application must then be given to the domestic law of each contracting state.

Typically, Article 7 of the DTA sets out the manner in which business profits of an enterprise are to be taxed.

Article 7 states as follows:

"The profits of an enterprise of a contracting state shall be taxed only in that state unless the enterprise carries on business in the other contracting state through a permanent establishment."

In other words, the taxing rights on business profits from income originates in the jurisdiction where the source of income is created and a permanent establishment (PE) can be attributed to that source.

SARS HAS PROACTIVELY RESPONDED ... THROUGH THE IMPLEMENTING OF ANTI-AVOIDANCE PROVISIONS

Practically speaking, a shift in the source of income and PE from an SA resident company to a foreign company has become common practice in today's global business environment, and results in the elimination by Sars to have a right to tax such business profits on income in terms of Article 7 of the DTA.

Sars has identified a trend in SA resident companies, which have adopted an attitude whereby they make use of complex tax structures to minimise or eliminate their tax liability in SA through the exploitation of gaps and discrepancies in the tax rules of contracting jurisdictions, thus receiving a taxable benefit.

Sars has responded proactively to this sort of attitude through the implementing of various anti-avoidance provisions and one which is relevant when considering offshore structuring is discussed below.

Section 9D of the act is among the various sections which must be considered when setting up these complex offshore structures.

It is an anti-avoidance provision and the purpose for its implementation is to prevent SA resident companies from shifting tainted forms of taxable income outside the SA taxing jurisdiction by investing in or transacting through a controlled foreign company (CFC).

TWICE THE PAIN

123RF — ANDREIASKIRKA

A CFC refers to any foreign company where more than 50% of the total participation rights in that foreign company are held by, or where more than 50% of the voting rights in that foreign company are directly or indirectly exercisable by, one or more residents of SA.

The mischief at which the CFC rules are targeted generally arises in situations where an SA resident company sets up or acquires existing shares in a foreign company located in a low-tax jurisdiction outside its home country.

THE PURPOSE OF A DTA IS TO AVOID DOUBLE TAXATION AND DETERMINE THE TAXING RIGHTS BETWEEN TREATY PARTIES

The SA resident company then uses this foreign company to conduct activities that could have been carried on from its home country, ie the sole or primary reason for housing the activities in the foreign company is to avoid tax in the home country on the income they produce.

CFC legislation taxes the resident shareholders of the CFC, and not the CFC itself. As the same resident is not being taxed twice on the same amount, no double taxation arises. It therefore cannot be said the CFC legislation overrides any DTA.

Where the SA resident shareholder is taxed on foreign amounts that are calculated according to proportional holdings in the CFC, this would amount to economic double taxation in the absence of the granting of appropriate foreign tax credits and not juridical double taxation.

We note that the purpose of a DTA is to avoid double taxation and determine the taxing rights between treaty parties. We further note that the DTA does not prevent treaty partners from protecting their tax base.

Therefore, by implementing CFC legislation, Sars is mitigating the shift in tainted forms of taxable income outside the SA taxing jurisdiction by investing in or transacting through a CFC and this legislation is, according to the Organisation for Economic Co-operation and Development, not inconsistent with the spirit of DTAs.

CONSUMER BILLS

Less combative language only benefits a client

Lawyers of all types have been notorious for centuries for the use of anything but ordinary language.

The persistent excuse for legalese up to the present day is that legal language must not be ambiguous despite ambiguity being a synonym of obscurity.

A recent report by the UK Family Solutions Group set up by a judge in 2020 has highlighted another important reason why the use of language can make the law hostile and inaccessible.

The group was set up to examine the use of language in family law and has called for an end to combative language, particularly where the interests of children are at stake. The group points out

PATRICK BRACHER

that the words we use shape our mindset, which in turn affects how we think and how we behave. Where spouses and parents compete against each other for what they each see as justice, the outcome has effects on the wellbeing of the children.

The use of words that are part of the daily vocabulary of lawyers, such as custody, versus, opponent, rights and dispute, are considered by family law professionals to be harmful to family relationships. The word "custody" disappeared from the UK statute with the passing of its Children Act 1989 and is considered to be 30 years out of date in the UK, but the word is still used in SA. A "custody battle" is the language of fights between spouses and parents competing for the control of their children. The plea of the group is to lead parents away from a tug-of-war mentality of a "custody battle" and towards a shared responsibility for their children's wellbeing.

The language legal professionals use on behalf of their clients can be intentionally or unintentionally intimidating. Acronyms and legal speak are not easily understood by anyone not legally trained. Add to this clients who are emotionally charged and distressed, and you end up with barriers, and not solutions.

The problem becomes even more acute when the language used is English and it is not the first language of those involved.

Family problems should not be escalated into legal issues by unnecessarily using legal terminology and jargon. People need help, not justice. The group's appeal is therefore not only for plain language but for language that preserves the dignity of all the parties, language proportionate to the issues, problem-solving language and a future-focused mindset avoiding past recriminations and substituting creative positive solutions.

Interestingly, the group criticises the descriptions of lawyers commonly used in legal directories as promoting the language of aggression and war — like describing a lawyer as a "robust advocate who will fight their client's corner", or when up against a particular lawyer "you know it's fists up and a fight". These descriptions come from other legal professionals who are seemingly of the view that battle terminology is appropriate, and that aggression is something to be admired in lawyers.

ACRONYMS AND LEGAL SPEAK ARE NOT EASILY UNDERSTOOD BY ANYONE NOT LEGALLY TRAINED

The group has been looking at legal language in relation to family law, but the lesson is not limited to family law cases. Shifting language to promote mindsets that are solutions-focused and focused on an outcome that does not destroy relationships would be helpful in any legal context.

Stoking the fire of battle is in no client's interests.

● *Patrick Bracher (@PBracher1) is a director at Norton Rose Fulbright.*