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South African tax legislation: Key issues for US companies

In brief

New South African (SA) tax legislation released for public comment on July 5 -- the Taxation Laws Amendment Bill 2012 --includes several significant proposals that could affect US companies with investments in South Africa. ***Note:*** Because these are only proposals, they are subject to change prior to enactment.

Interest deduction for controlling-share acquisitions

Interest expense would be deductible with respect to debt that finances the acquisition of a 'controlled group' interest in a target company's equity shares, i.e., the purchaser group must end up owning at least 70% of the target. This would be a significant development; the current default rule in South Africa is that interest incurred in funding the acquisition of shares is non-deductible.

Hybrid debt and interest

Effective January 1, 2014, the proposals would extend the 'hybrid debt instrument' rules to include instruments that, among other characteristics, are redeemable only after 30 years or more, have a yield not determined with reference to time-value-of-money principles, or include payments that are subject to the borrower's solvency/liquidity. The 'interest' payments on such instruments would be deemed to be dividends for both the payer and the recipient. This would result in not only a non-deductible payment for the payer but also a SA dividend tax implication for the recipient.

Debt reduction

The proposed legislation includes a substantially restructured regime for debt reductions, especially for those reduced for less than full consideration. Among the key aspects of the new proposed regime are specific 'ordering' rules. For example, capital gains tax would not apply if the donation tax applies. In addition, tax-free debt relief may be possible.

Mismatched asset-for-share/debt transactions

Other proposed rules target situations in which there is a difference between the market value of a transferred asset and the shares/debt issued as consideration by the purchasing company. The impact of the proposed new rules would vary depending on whether the transferred asset or the consideration has the higher market value, and on whether the consideration is shares or debt.

Withholding taxes

The withholding tax on interest and royalties would both increase to 15%. The existing royalty rules and the not-yet-operational interest rules would be replaced by withholding regimes similar to the recently implemented dividends tax system.

Headquarter companies

The proposals would relax certain requirements of the existing regime for companies that are temporarily dormant. The proposals would also extend the transfer pricing exemption currently available for financial assistance to royalties.

Foreign investment funds

Other proposed amendments are designed to further ensure that foreign investment funds do not inadvertently become tax-resident (effectively managed) in South Africa.

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