TAX U-TURN ON SVDP ("SPECIAL VOLUNTARY DISCLOSURE PROGRAMME")

The latest Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill published on 19 July 2016 made substantial changes to the tax measures contained in the initial draft of this Bill.

One would have hoped that these changes would have provided clarity, but this is unfortunately not the case and although the changes may, at first glance, appear to simplify matters, the devil is unfortunately in the detail.

We will try to address the most relevant changes relating to the Tax side of the SVDP between the initial proposals and the latest proposals in the table below:

Tax relief – Initial Draft	Tax relief –Latest Draft
• Only 50% of the amount you used to buy offshore assets (also called 'seed money') before 1 March 2010 had to be included in taxable income and subject to normal tax. • No tax was payable on any investment returns or interest earned on these offshore assets before 1 March 2010. • Normal income tax was payable on investment returns and interest earned on undeclared foreign assets from 1 March 2010 to 28 February 2015.	• Only 50% of highest value of all assets situated outside SA between 1 March 2010 and 28 February 2015 which was derived from undeclared income whether partially or in full will have to be included in taxable income and become subject to tax. • The above amount must be included in taxable income in the first year of assessment ending on or after 1 March 2014. • The undeclared income that originally gave rise to the assets included above will be exempt from income tax, donations tax and estate duty that would have been payable on it in the past. • Future income or gains (as from 1 March 2015) will however be subject to all taxes as per normal. • The value of the 50% amount to be included in taxable income is the highest market value of the aggregate of all assets held at the end of the tax year, for the period between 1 March 2010 and 28 February 2015 • Taxpayers who may have had undeclared foreign assets which were extinguished due to losses etc., prior to 1 March 2010, may also apply under the SVDP.

From the above it is clear that many additional uncertainties are created, most notably for taxpayers who may have undeclared foreign assets which they derived from both pre and post-tax funds. This is due to the fact that the 50% calculation referred to above, is based on the total market value of the foreign assets irrespective that a portion of the asset may have been derived from post-tax funds. There is therefore no exemption provided for undeclared assets which have been derived from post-tax funds and where such post tax funds generated income. The income portion in relation to the post tax funds is often negligible, especially given the low interest environment experienced since the credit crisis in 2008. It would therefore seem that a single approach through the SVDP may turn out to be hugely punitive in such instances.

It would also appear in such cases that the SVDP must be used in conjunction with the current statutory VDP provided for in the Tax Administration Act. Such taxpayers would then be required to obtain separate information regarding offshore assets derived from declared income (i.e. post-tax funds) and assets derived purely from undeclared income (i.e. income that was never declared to SARS).

However, in most instances it would be impossible to segregate the funds in cases where a taxpayer has for example co-mingled both pre and post-tax funds to acquire foreign assets prior to 2010. This is due to the fact that many institutions only have a 5 year information retention requirement.

The SVDP also does not provide for a mechanism which allows for a credit for foreign taxes paid on the amounts of declared or undeclared income (i.e. to SARS) used to fund the offshore assets.
In trying to simplify the SVDP, the scope has been significantly narrowed and it would seem to make sense only in limited cases, e.g. where pre-tax funds alone gave rise to the offshore assets.

If a taxpayer elects to make use of the single SVDP process it may result in that taxpayer having to pay income tax on capital at the relevant marginal rate (41% maximum). This could result in the tax charge under the SVDP being far more punitive than the charge under the normal VDP, as under normal VDP only the actual income or gains are taxable plus the applicable interest and penalties (set at a maximum of 10%). In instances where the post-tax asset yielded minimal return the normal VDP appears to be more favourable. The SVDP however seems to favour the "more aggressive" noncompliant taxpayers.

This can surely not be the intention of Treasury and it is reported that in countries where disclosure programmes worked well, the cost to declare illegal funds was kept low and did not amount to more than 15% to 18% and if the cost is too high, taxpayers may view it as a disincentive to declare their illegal funds. Furthermore, for those noncompliant taxpayers who are in this predicament, the normal VDP may also have its limitations as this process requires that the taxpayer who derived undeclared offshore income or gains from post-tax funds must make full and complete disclosure of all material facts. This, in theory, would require the taxpayer to disclose all relevant offshore income since 1997 and capital gains since 2001, which is often impossible given that most jurisdictions are only required by law to keep records for a period of 5 years.

Added to this, one must also consider the Exchange Control side which could add another 12% (which is the maximum rate and calculated as 10% if assets are kept abroad plus 2% if the penalty is paid from SA funds) on the value of any unauthorised Exchange Control assets held abroad as at 29 February 2016.

As far as the Exchange Control side of the SVDP is concerned, thankfully this seems to remain relatively straight forward and for all practical purposes very similar to the 2010 VDP process with Regulation 24 (which was introduced for purposes of the 2010 VDP) basically having been brushed off and implemented again. One glaring difference however is the fact that no provisions is made to reduce the value of the unauthorised assets for levy purposes with any Exchange Control allowances as was previously the case. This position is confirmed in the latest Circular 6/2016 issued on 13 July 2016 and unauthorised assets held as at 29 February 2016 may accordingly be regularised for Exchange Control purposes.

There does however seem to be an anomaly between the Taxation side of the SVDP and the Exchange Control side as South African trusts may not apply for tax purposes, yet, for purposes of the Exchange Control side such trusts may indeed apply. One would hope that this is also an oversight and that the position will be clarified.

Hopefully the above uncertainties will be addressed as a matter of urgency in order for taxpayers with undeclared post tax funds or where the undeclared funds consisted of a mix between post- and pre-tax funds to be afforded the same benefits as would another taxpayer who accumulated offshore assets purely from untaxed income.

A possible solution may be to restrict the latest proposals regarding the SVDP to taxpayers with undeclared offshore assets which arose solely from pre-tax funds prior to 1 March 2015 and to specify that the Voluntary Disclosure Programme ("VDP") currently contained in the Tax Administration Act ("TAA") must be used by taxpayers who amassed offshore assets from post-tax funds, but where the proceeds from investment or interest has not been declared

The current VDP provisions in the TAA can temporarily be amended to restrict the application of the VDP for such purposes for the same window period as the SVDP (1 October 2016 to 31 March 2017) and that these amendments specify that for the purposes of making full disclosure of all material facts, the period will be limited to 1 March 2010 to 28 February 2015. Furthermore that only any undeclared income or gains for the tax years starting on 1 March 2010 to 28 February 2015 have to be declared for undeclared assets arising from post-tax funds. As mentioned above most countries keep records for 5 years, and obtaining the relevant information will then not be problematic and it will then allow these category of taxpayers to make a full disclosure of all material facts.

Given the many complexities foreseen as well as the remaining and additional uncertainties, we recommend that you seek professional advice if you have any undisclosed offshore assets.

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