South Africa case sheds light on exit tax

By DONALEE MOULTON

A court decision on another continent could have implications for Canadian companies and their accountants.

In *Commissioner for the South African Revenue Service v. Tradehold Ltd* [2012] ZASCA 61, the Supreme Court of Appeal of South Africa upheld a tax court finding that a South Africa company that became managed from Luxembourg did not have to pay capital gains. The dispute arose out of the tax bill that was levied when the company switched its country of residence. In 2000, South Africa and Luxembourg signed a double taxation treaty to ensure governments didn't double dip and taxpayers didn't evade paying their bills.

The South African Revenue Service found that Tradehold Ltd., an investment holding company, was considered to be a resident of South Africa by virtue of having been incorporated there. When it was no longer legally found to be a resident in the country, a deemed disposition — as opposed to an actual accounting — of all its assets arose as a result of South Africa's "departure" or "exit" tax. The question that arose in court was whether the company was exempt from the South African tax as a result of the capital gains clause included in its tax convention with Luxembourg.

"The court noted that the treaty did not draw a distinction between capital gains arising from actual or deemed dispositions, despite the drafters of the convention having been aware that the provisions of South Africa's domestic taxing statute could result in deemed dispositions," said Jesse Brodlieb, an associate in Toronto with the law firm Fraser Milner Casgrain LLP.

"The court found that the language of the treaty covered deemed dispositions and, therefore, the taxpayer was treaty exempt at the time that the exit tax was applied for South African tax purposes," he added.

Tradehold argued that even if there was a deemed disposal of the investment by the company during the taxation year in question, the resulting capital gain was not taxable in South Africa but in Luxembourg because at the time the capital gain arose Tradehold was considered to be a resident of Luxembourg under the terms of double tax agreement (DTA).

The Commissioner for the South African Revenue Service disagreed contending that the exemption in the tax convention with Luxembourg, which excluded "gains from the alienation of property," did not apply to a deemed disposition as was the case here.

The Supreme Court of Appeal of South Africa, the highest court in the country for non-constitutional matters, found the government's position didn't hold up under legal scrutiny. "I am of the view that the term 'alienation' as it is used in the DTA is not restricted to actual alienation. It is a neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains," Justice P. Boruchowitz said in his 14-page decision.

"It follows therefore that … when Tradehold relocated its seat of effective management to Luxembourg, the provisions of the DTA became applicable and that country had exclusive taxing rights in respect of all of Tradehold's capital gains."

The court also pointed out that the treaty in question is not unique to South Africa and Luxembourg. It is based upon the Model Tax Convention on Income and on Capital, agreed to by the Organisation for European Economic Co-operation and Development

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Switching CPP amount per pay period

PAYROLL CONNECTION

By Janet Spence

The questions below are from payroll professionals looking for information on switching from semi-monthly to bi-weekly payroll, this year's automobile expense deduction limit and maintaining benefits during an employee's notice period.

Question: My organization will be switching from a semi-monthly payroll to a bi-weekly payroll this September. Do I need to do any special calculations regarding the new calculation of CPP?

Answer: Employers must ensure that the accurate amount of employee's CPP/QPP contributions has been deducted. The best way to ensure compliance under the new payroll frequency when the change occurs mid-year is to apply the following formula to calculate the per pay period CPP/QPP exemption: A minus (B multiplied by C) then divided by D.

In this formula, A is the CPP/QPP annual exemption ($3,500 for 2012). B is the per pay period CPP/QPP exemption under old payroll frequency. C is the number of pay periods processed under old payroll frequency. D is the number of pay periods remaining under new frequency

So, for example: Pierre has received 16 semi-monthly pay periods before being switched to a bi-weekly payroll. His previous semi-monthly CPP exemption was $145.83. There are 9 bi-weekly pay periods before the end of the year.

The new per pay period CPP/QPP exemption under the new payroll frequency is equal to: $3,500 - ($145.83 x 16) / 9 = $129.63

Employers must remember to change the per pay period CPP/QPP exemption for the first pay of the following year according to the regular exemption under this new frequency. In the example above, Pierre's bi-weekly exemption effective pay period 1 in the following year would be $134.61. (If there happened to be 27 pay periods in the next year, the exemption would be $129.62.)

Please see the CPA's Changing Payroll Frequency Guidelines for more information, including the phenomenon of having a 27th bi-weekly or 53rd weekly pay in the year. All of the CPA's guidelines can be accessed from the resources section after signing in to the CPA's website www.payroll.ca.

Question: What are the changes in automobile expense deduction limit for this year?

Answer: The Department of Finance confirmed the automobile expense deduction limits. The prescribed rates for the automobile operating expense benefit that will apply in 2012 will be increased as follows:

- The limit on the deduction of tax-exempt allowances, paid by employers to employees using their personal vehicle for business purposes for 2012, will be increased from 52 to 53 cents per kilometre for the first 5,000 kilometres driven, and from 46 to 47 cents for each additional kilometre.
- For the Yukon Territory, Northwest Territories and Nunavut, the tax-exempt allowance will increase from 56 to 57 cents for the first 5,000 kilometres driven and from 50 to 51 cents for each additional kilometre.
- In addition, the general prescribed rate used to determine the taxable benefit relating to the personal portion of automobile operating expenses paid by employers for 2012, will increase from 24 to 26 cents per kilometre. For employees employed principally in selling or leasing automobiles, the prescribed rate will increase by from 21 to 23 cents per kilometre.

Employers may access a copy of the Department of Finance news release announcing the rate changes at the following website: http://www.fin.gc.ca/n11/11-146-eng.asp

Question: Do we have to maintain benefits during the period of lieu of notice when an employee is terminated?

Answer: Ontario is the only jurisdiction in Canada that requires employers to maintain an employee's benefits for the notice period, as required by law, in the event of an employer initiated termination.

The legislation addressing the issue of the employer's requirement to maintain an employee's benefits during the legislated notice period is addressed in the *Ontario Employment Standards Act 2000*, and can be located in the following section of the legislation: Pay instead of notice — 61. (1) an employer may terminate the employment of an employee without notice or with less notice than required under section 57 or 58, if the employer:

- Pays the employee termination pay in a lump sum equal to the amount the employee would have been entitled to receive under section 60, had notice been given in accordance with that section; and
- Continues to make the required benefit plan contributions in order to maintain the benefits to which the employee would have been entitled had he or she continued to be employed during the period of notice that he or she would otherwise have been entitled to receive.

More information may be obtained in the *Ontario Employment Standards Act, 2000*

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Case may have implications for Canada

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(OECD), and is the foundation for similar agreements that exist between many countries, including Canada.

"In interpreting its provisions one must therefore not expect to find an exact correlation between the wording in the DTA and that used in the domestic taxing statute," said Justice Boruchowitz. "Inevitably, they use wording of a wide nature, intended to encompass the various taxes generally found in the OECD member countries."

That reality brings the reach of the South Africa court's decision to the global stage. "The potential implications for other OECD countries will depend on whether they have an exit tax and the way that tax is constructed," said Brodlieb, a member of FMC's taxation group.

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Jesse Brodlieb, Fraser Milner Casgrain

"Canada's exit tax system generally results in the exiting corporation having a deemed year end immediately before the loss of residence and a deemed disposition of assets immediately before the deemed year end. This may make it difficult to argue that the exit tax is treaty-exempt."

But this may not always be the case, especially given the often ambiguous wording of tax treaties. "[S]ome treaties have less-than-clear residency tie-breaker rules that may override the source country's attempt to claim the right to tax on the basis of residency if under the treaty the exiting corporation is a dual-resident," Brodlieb said.

This case may convince some countries to clarify their existing language, he added. "It may be the case that OECD countries will add specific provisions to their treaties to ensure the enforcement of their domestic exit taxes."

The South Africa government may also be taking legislative action to counteract the court's finding. "Not taxing capital gains accumulated while a taxpayer was a resident would be unfair. Taxpayers are therefore deemed to have sold their assets, except those with a particularly close connection to South Africa, at market value on the day before the change in their residence," the country's Minister of Finance Pravin Gordhan said in a statement following the release of the judicial decision.

The National Treasury and South African Revenue Service are studying the judgment, he said. If necessary, the government will propose amendments to further clarify the country's tax position. "Measures such as the immediate termination of a taxpayer's year of assessment on the day before becoming non-resident, as is the practice in Canada, are being explored," Gordhan said.

In the aftermath of the South Africa appeal court's decision, companies in Canada and their accountants may wish to take a closer look at any plans to uproot their operations.

"The decision to move jurisdictions should consider many factors, including whether or not an exit tax would be applicable," Brodlieb said. "In light of this decision, there may be planning opportunities for companies looking to change jurisdictions without paying an exit tax where the treaty and the domestic legislation operate in a similar way to the South African regime under consideration in the case."

Lack of visibility may hurt funds

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lottetown.

"Islanders can now invest in Island businesses that have the potential to foster growth in the local economy. We know that when local businesses prosper, the entire community benefits."

Other provinces are thinking the same thing and looking at some form of community economic development investment fund to help grow the local economy. In 2010, the Ontario Social Economy Roundtable recommended the provincial government establish a program similar to Nova Scotia's CEDIF.

The Newfoundland and Labrador Regional Economic Development Association has made a similar recommendation. "[We] feel that CEDIFs are very important for the exploitation of local opportunities. This is particularly true of co-operative developments and developments in the environmental sector," said Ted Lomond, the association's executive director in St. John's.

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Ted Lomond, The Newfoundland and Labrador Regional Economic Development Association

While the popularity of CEDIFs is growing, accountants and their clients need to take a close look at the investment opportunity, which is often driven more by a desire to buy local than return on investment. Of particular significance is the length of time the investment has to be retained. In Nova Scotia, it must be held for five years, Himmelman said.

He also pointed out that the success of CEDIFs may ultimately be limited by a lack of visibility and incentive to sell them. "There's no market for these types of things. They are not listed on the stock exchange. You can get a list from government. "

As well, Himmelman said, "there is no commission, so it's not a product the banks will pick up."