Fair value taxation

Professor Pieter van der Zwan
Traditional income tax base

• Bases for imposing income tax:
  – Cash basis
  – Accrual basis
  – Unrealised basis
Financial accounting

- **Historical purpose**
  - Stewardship function

- **IFRS current purpose**

  “The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.”
Views on fair value accounting

- Relevance
- Reliability
Alignment of financial reporting and taxation

• Similarities
  – Accounting profit used as basis for tax computation

• Differences
  – Mainly timing
  – Classification and rates
  – Group concepts
Moving towards fair value and IFRS-based taxation

• Section 24JB introduction
  – Applies to years of assessment ending on or after 1 January 2014

• International trends
Mechanics of section 24JB

- **Entities affected** – ‘Covered person’
  - any authorised user as defined in section 1 of the Financial Markets Act that is a company
  - SARB
  - Any bank, branch, branch of a bank or controlling company as defined in section 1 of the Banks Act
  - Company or trust that forms part of a banking group
Mechanics of section 24JB

- **Instruments covered**
  - To be included or deduct from income for YOA
  - Amounts that are recognised in profit or loss in the statement of comprehensive income
  - in respect of financial assets and financial liabilities of that covered person that are:
    - recognised at fair value in profit or loss in terms of International Accounting Standard 39 of IFRS or any other standard that replaces that standard or,
    - in the case of commodities, at fair value less cost to sell in profit or loss in terms of IFRS for that year of assessment

Section overrides any amount relating to the above instruments that another section requires to be taken into account
Mechanics of section 24JB

- Instruments not covered by implication
  - Financial instruments measured through equity (long term share investments, etc.)
  - Financial instruments measured at amortised cost (loans, etc.)
Mechanics of section 24JB

- Example of impact:

Start Y1
- Buy instrument at 10
- Instrument valued 50

End Y1
- Instrument valued 100
- Sell instrument at valued R150

IFRS
- Gain 90

Cash
- (10)
- (11,2)

Gain 50
- (14)
- (14)
- 150
Mechanics of section 24JB

• Amounts excluded
  – (a) a financial asset that is—
    (i) a share;
    (ii) an endowment policy;
    (iii) an interest held in a portfolio of a collective investment scheme;
    (iv) an interest in a trust; or
    (v) an interest in a partnership, if that financial asset was upon initial recognition designated because it is managed and its performance is evaluated on a fair value basis; or
  – (b) a dividend or foreign dividend received by or accrued to a covered person
Design criticism of section 24JB

- Hedging discrepancies
  - Commodity contracts – instruments treated as if financial instruments for IFRS
  - Foreign exchange risk on loans to fund infrastructure not within scope of this section
Design criticism of section 24JB

• Trigger for application – entity or instrument
  – Member for specific transaction ‘taints’ all financial instruments at fair value through P/L
Design criticism of section 24JB

• Exposure of tax laws to changes/elections in IFRS requirements
  – IFRS 9 – election to accounting for certain equity instruments through equity
Design criticism of section 24JB

- Implications of transactions between group entities
  - Timing mismatch on two sides of transaction
  - Anti-avoidance rule only applies if transaction entered into solely or mainly for purpose of tax benefit
Concluding thoughts

• Overall impression of section 24JB
  – Cash flow timing
  – Interaction with remainder of legislation and scope
Thank you

Pieter van der Zwan

pieter.vanderzwan@nwu.ac.za
pieter@pvdz.co.za