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TAX & EXCHANGE CONTROL ALERT

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Crypto assets: Current and future tax and exchange control considerations

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In South Africa the regulation of crypto assets is the terrain of several role players. The South African Reserve Bank (SARB), as the overarching regulator of the South African financial system and transactions in currency, is the lead regulatory entity. The South African Revenue Service (SARS) is brought into the regulatory matrix, because crypto assets represent economic value being traded in, received by taxpayers and disposed of by investors – triggering the Commissioner's taxing authority and taxpayers' obligation on any income or capital events related to crypto assets.

While the regulation of crypto assets is a nascent part of South African regulatory landscape, the various role players have put in place some concrete requirements within the current legislative framework. These stakeholders have also joined together in the Intergovernmental Fintech Working Group – Crypto Assets Working Group (IFWG) to formulate a collective policy position on crypto assets and the financial service providers facilitating the crypto asset market. The IFWG released a position paper on 21 June 2021 setting out its recommendations on policy positions and regulatory measures for the crypto asset market.

This alert briefly covers some of the tax and exchange control compliance requirements where South African tax residents invest in or trade crypto assets. It then notes some of the policy proposals made by the IFWG for the regulation of crypto assets.

Tax and crypto assets

SARS' position has historically been that normal income tax and capital gains tax principles apply to crypto assets. In a media statement in 2018, SARS stated that it would "continue to apply normal income tax rules to cryptocurrencies and will expect affected taxpayers to declare cryptocurrency gains or losses as part of their taxable income".

In our [alert on 6 August 2020](#), we noted that the 2020 Taxation Laws Amendment Bill proposed replacing references in the Income Tax Act 58 of 1962 (ITA) to "cryptocurrency", with "crypto asset". This implies that the position SARS has taken regarding cryptocurrencies will be applied to crypto assets more generally. These amendments came into force on 1 March 2021.

Therefore, where a taxpayer is engaged in a trade related to crypto assets the receipt or accrual of such crypto assets by the taxpayer could constitute gross income for that taxpayer. Similarly, where a crypto asset is held as a capital investment, the capital gain or loss on the disposal of that crypto asset would have to be accounted for by a taxpayer under the prescripts of Eighth Schedule to the ITA.

Exchange control and crypto assets

The SARB's historical position has been that crypto assets do not constitute currency or capital under the Exchange Regulations, 1961 (Excon Regulations).

Crypto assets: Current and future tax and exchange control considerations

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Tax evasion and revenue collection risks were identified given the anonymous and non-institutionalised nature of crypto assets. The IFWG has proposed several interventions aimed at ensuring that CASPs are subject to licencing and reporting requirements that would ensure the necessary information is provided to regulatory institutions.

However, individuals can make use of their single discretionary allowance of R1 million, or their individual foreign capital allowance of up to R10 million, to purchase crypto assets using foreign currency.

South African exchange control residents are not permitted to elect to receive outstanding foreign payments in the form of a crypto asset, as the transaction is currently not reportable on the FInSurv Reporting System. Furthermore, a non-resident crypto asset service provider (CASP) who introduces crypto assets into the South African market and receives payment in Rand, is not able to transfer the sale proceeds abroad. This is in line with section G.(C)(i) of the Currency and Exchanges Manual for Authorised Dealers.

Proposals by the IFWG

The nature of crypto assets, including the maturing of the market, and its misalignment with aspects of South Africa's applicable regulatory framework, have led to a set of policy proposals by the IFWG for the regulation of crypto assets and CASPs.

While no explicit tax proposals have been made, tax evasion and revenue collection risks were identified given the anonymous and non-institutionalised nature of crypto assets. The IFWG has proposed several interventions aimed at ensuring that CASPs are subject to licencing and reporting requirements that would ensure the necessary information is provided to regulatory institutions. These proposals include the following:

- Inclusion of CASPs as an accountable institution in Schedule 1 of the Financial Intelligence Centre Act.
- Declaration of crypto assets as a "financial product" by the Financial Sector Conduct Authority for the purposes of the Financial Advisory and Intermediary Services Act 37 of 2002.

These proposals would ensure that know-your-client and other important information regarding the taxpayers involved in crypto asset transactions, including the source of their funds and the scale of their transacting, is captured by regulatory institutions and available to SARS to pursue any non-compliance with tax legislation.

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The IFWG has made several proposals on the exchange control regulation of crypto assets by the SARB. These proposals seek to enable increased formal regulation of the marketing of crypto assets, and cashflows which facilitate crypto asset trading and investments. The proposals by the IFWG in this regard focus on amendments to the Excon Regulations and include:

- Empowering the Financial Surveillance Department of the SARB to assume the supervisory and regulatory responsibility for the monitoring of cross-border financial flows in respect of crypto asset services.
- Amending Excon Regulation 10(4) to include crypto assets in the definition of "capital" for the purposes of Excon Regulation 10(1)(c).
- Explicitly permitting individuals in the Excon Regulations to purchase crypto assets using their single discretionary allowance or foreign capital allowance.
- Expanding the authorised dealer with limited authority regime to include crypto asset trading platforms (CATPs) to facilitate cross-border crypto transactions and trading in crypto assets in South African rand.

- Introduction of requirements for CATPs to report crypto transactions to the SARB.
- Amending the Excon Regulations to allow licenced CATPs to source or buy crypto assets offshore for the purpose of selling to the local market.

The proposals by the IFWG would assist in filling the regulatory vacuum that currently prevails over the crypto asset market. Recognising that ordinary tax principles are largely sufficient to capture the exchange or receipt of value in the form of crypto assets, the IFWG has made proposals which aim to limit the possibility for tax evasion by introducing reporting requirements for CASPs and CATPs.

The more significant proposals relate to the exchange control environment. Here, the IFWG has proposed moving towards a formal regulation of the crypto asset market which has been absent to date. This formal regulation would ensure that relevant stakeholders have an express regulatory mandate regarding the crypto asset market and provide the crypto market with the ability to operate in a compliant manner, which will lead to better protection for consumers and greater certainty for market participants.

Tsanga Mukumba overseen by Louis Botha

Exit charge on retirement fund interests when ceasing residency

In terms of the new proposed section 9HC, an individual ceasing South African tax residency will be subject to South African tax on the value of their retirement fund interest(s) irrespective of whether that individual withdraws or retains their interest in a South African retirement fund upon ceasing residency.

On 28 July 2021, National Treasury and the South African Revenue Service (SARS) published the 2021 draft Taxation Laws Amendment Bill (2021 Draft TLAB), which includes proposed changes to the Income Tax Act 58 of 1962 (ITA), in relation to the tax treatment of an individual's interest in a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund (retirement fund) upon that individual's cessation of residency.

In terms of section 9H(2) of the ITA, when an individual ceases to be South African tax resident during any year of assessment, there is an automatic capital gains tax charge which is calculated on certain assets held by that individual. In terms of this section, that individual will be treated as:

- having disposed of their qualifying assets to a resident person;
- on the date immediately before the day on which that individual ceases residency;
- for an amount equal to the market value of those assets on that date; and
- having reacquired each of those assets on the day on which that individual ceases residency, at an expenditure equal to that market value.

Typically, the exit charge applies to a range of assets, but does not apply in respect of assets specified under section 9H(4) of the ITA. Currently, and in terms of the Explanatory Memorandum to the 2021 Draft TLAB (Memo), when an individual ceases to be a South African tax resident, their membership interest in a retirement fund may not be subject to South African tax due to the provisions of certain double tax agreements concluded between South Africa and foreign jurisdictions.

National Treasury has proposed the insertion of wording in section 9H to clarify that the deemed disposal rule in 9H(2) will not apply in respect of an asset of a person ceasing residency where that asset constitutes any amount representing the value of the interest in any retirement fund, as well as the insertion of a new proposed section 9HC in the ITA to provide for the "disposal of retirement fund interest[s] on change of residence". In terms of the new proposed section 9HC, an individual ceasing South African tax residency will be subject to South African tax on the value of their retirement fund interest(s) irrespective of whether that individual withdraws or retains their interest in a South African retirement fund upon ceasing residency. In either scenario, as outlined in the Memo, the treatment of that individual's retirement fund interest will be as follows:

1. If that individual, upon ceasing residency, withdraws their interest prior to retirement or death:
 - The individual will be deemed to have withdrawn from the retirement fund on the day before they cease to be a South African tax resident.
 - The interest in the retirement fund will form part of the assets of the individual subject to tax applicable to withdrawal benefits, however, the tax payment, including associated interest, will be deferred until a withdrawal payment is receivable by that individual from the retirement fund.
 - When the individual receives a payment from the retirement fund, the tax on the withdrawal benefit will be calculated based on the prevailing withdrawal tax tables.

Exit charge on retirement fund interests when ceasing residency

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The proposed amendments are intended to come into operation on 1 March 2022 and will apply in respect of any year of assessment commencing on or after that date.

- A tax credit will be provided for the deemed tax as calculated when the individual ceased to be a South African tax resident.
2. If that individual, upon ceasing residency, retains their interest and only withdraws upon retirement or death:
- The individual will be deemed to have withdrawn from the retirement fund on the day before he or she ceases to be a South African tax resident.
 - The interest in that retirement fund will form part of the assets of the individual subject to tax applicable to withdrawal benefits, however, the tax payment, including associated interest, will be deferred until payments are receivable by that individual from the retirement fund.
 - When the individual ultimately receives payments from the retirement fund, the tax on those payments will be calculated based on the prevailing retirement fund lump sum tax tables or in the form of an annuity.
 - A tax credit will be provided for the deemed tax as calculated when the individual ceased to be a South African tax resident.

As indicated in the Memo, the responsibility of the individual ceasing South African tax residency will be to firstly, ensure that a valuation of the interest in the retirement fund is obtained on the day preceding that individual's cessation of residency and secondly, notify SARS that they have ceased South African tax residency.

The deferral of the tax payment to when payment is receivable from the retirement fund is in line with the recent changes to the ITA, which allow individuals ceasing residency to withdraw lump sum amounts from their retirement funds if they have remained non-tax resident for at least three years on or after 1 March 2021 (discussed in our [Tax Alert](#) on 23 October 2020).

The proposed amendments are intended to come into operation on 1 March 2022 and will apply in respect of any year of assessment commencing on or after that date.

Comment

The due date for public comments on the proposal was 28 August 2021 and as expected, a number of submissions were received from the public. These submissions were considered and discussed during the National Treasury workshop on the 2021 Draft TLAB on 9 September 2021.

The submissions made seem to suggest that many are against the proposal. One of the issues raised was, for example, that the proposed amendment would contravene South Africa's obligations under international law, in that it would be inconsistent with some of South Africa's double tax agreements with other countries.

It remains to be seen how National Treasury will respond to the submissions received. It is likely that in the coming weeks, National Treasury will release a response document, summarising its responses to the submissions received. This will give some idea as to whether the proposed amendment will be implemented or not.

Ursula Diale-Ali overseen by Louis Botha

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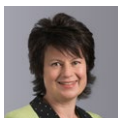
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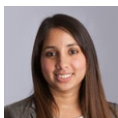
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