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Personal Perspectives

South Africa | 2021 edition

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Introduction

Welcome to our 2021 edition of the KPMG Private Enterprise publication, Personal Perspectives.

For many, 2021 may have felt like an extension of 2020 and has imbedded a few key learnings that have to be passed on to the future generations. The resilience of people and businesses during such a disruptive period has shown the ability to respond and rebound from a crisis stronger and more resourceful than before. It is this resilience that has been the focus of many studies, one of which our global Private Enterprise team undertook with the Successful Transgenerational Entrepreneurship Practices (**STEP**) Project Global Consortium. The study provided experiences and insights from family businesses in the Americas, Asia, Europe and the Middle East and Africa have revealed a roadmap, not only for mastering a comeback in their businesses, but for leading a global economic recovery.

For 2021 many high net worth individuals and families have employed their 'patient capital' to plan and navigate the next step for the family or the business.

In this edition we consider these next steps, starting with what are the pertinent considerations for South African individuals or families looking to emigrate. Although the decision to set up home outside of South Africa is not easy for many, it has become a reality. The South African Revenue Service has implemented a formal process and documentation to ensure the confusion as to when one ceases to be a tax resident, is no longer especially in light of the misunderstanding of financial emigration, with the South African Reserve Bank. There are also some recent concerns raised regarding the tax implications of exiting any retirement funds on emigration. Although the majority of advisors are requesting more clarity on the proposed tax amendments, one should always be aware as to how new tax legislation may impact their emigration plans.

Although some individuals and families are looking to find a new home outside of South Africa, there are many successful business families that wish to remain in South Africa, adapting to the business conditions to seize opportunities to support their communities. There are many that wish to assist with rebuilding the South African economy, and given the fortune of financial capital reserves, many business family leaders are looking to invest in other South African businesses. In light of this, and also the peaked interest of offshore investors into South Africa, our second article provides some insight into the four key considerations when looking to invest into another business. As with any other decision a business or a family makes, the underlining principle of planning and evaluation will assist in mitigating the risk that the deal is not too good to be true.

Not only are high net worth families, and their family offices, looking to invest in mainstream investments like another business, listed equity or an interest-bearing instrument, although not a new concept on the block, the idea of a crypto-asset is still relatively unknown to many, albeit many seem to have made a lot of money off their investments into crypto assets. Following the crypto asset article we included in our 2018 edition of Personal Perspectives, our third article in this edition looks to provide some more insight into recent developments around the taxation of a crypto asset.

We have kept this year's edition focussed on the pertinent topics that have been at the forefront of the discussions we are a part of. I hope you enjoy this edition of Personal Perspectives.

If you have any comments, feedback or suggestions of what you would like us to cover in future issues, please do get in touch.

Creagh Sudding
KPMG Private Enterprise
Family Office and Private Client Lead South Africa
E: creagh.sudding@kpmg.co.za
T: +27 66 010 8755

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Implications of ceasing to be resident

Taxpayers who cease to be resident must comply with onerous SARS procedures and face the implications of proposed new legislation which deems the withdrawal of the value of their retirement fund interest on the day before ceasing to be resident.

Historically, South African nationals wishing to leave South Africa permanently were required to place their emigration on record with the South African Reserve Bank. The concept of emigrating from South Africa for exchange control purposes (also sometimes referred to as financial emigration) has been phased out and has been replaced by a mandatory tax process with effect from 1 March 2021.

The South African Revenue Service (**SARS**) has implemented new procedures in terms of which individuals ceasing to be resident for tax purposes are required to inform SARS of this. The procedures to be followed and supporting documents required by SARS depend on the manner in which the individual ceased to be a tax resident.

Who is a tax resident in South Africa?

The term "resident" is defined[1] in the Income Tax Act No. 58 of 1962, as amended (**the ITA**), and a person is considered to be tax resident in South Africa if he or she is either:

- Ordinarily resident in South Africa; or
- Physically present in South Africa for a specified number of days over 6 tax years (**Physical Presence Test**).

This definition specifically excludes any person who is deemed to be exclusively a resident of another country in terms of a Double Tax Agreement (**DTA**) concluded between South Africa and that other country.

The term "ordinarily resident" is not defined in the ITA; however, the courts have ascribed a meaning to this term. In the case, *Cohen v CIR* (13 SATC 362) the court interpreted the concept "ordinarily resident" to mean:

> *"… the country to which he would naturally and as a matter of course return from his wanderings; as contrasted with other lands it might be called his usual or principal residence and it would be described more aptly than other countries as his real home."*

This interpretation was confirmed in the case *CIR v Kuttel* (*54 SATC 298*).

1 Section 1 of the ITA

Although this concept is fairly subjective, it is important to note that SARS uses various objective factors to determine whether or not a person would be regarded as ordinarily resident in South Africa for tax purposes, as set out in its Interpretation Note 3 (Issue 2): *Resident: Definition in relation to a natural person – ordinarily resident.*

Generally, individuals born in South Africa, or foreign nationals who have immigrated to South Africa or obtained a permanent residence permit would be regarded as ordinarily resident in South Africa for tax purposes.

Where an ordinarily resident individual intends settling outside of South Africa permanently and no longer regards South Africa as his or her real home, SARS will determine whether that person has ceased to be ordinarily resident in South Africa based on that person's specific circumstances and intentions, as well as various objective factors, indicative of this intention having been or being carried out.

New SARS procedures on ceasing to be resident

A person will cease to be a resident in South Africa if he or she:

- Has an intention to settle outside of South Africa permanently and no longer regards him or herself to be ordinarily resident in South Africa.
- Is regarded as exclusively tax resident of another country in terms of a DTA between South Africa and that other country.
- Initially became a resident in terms of the Physical Presence Test and subsequently spends a continuous period of at least 330 full days outside South Africa.

With effect from 1 March 2021, individuals who cease to be tax resident in South Africa are required to inform SARS by way of one of the following channels:

- If an individual has ceased to be a tax resident of South Africa during the current year of assessment, the individual can inform SARS through the wizard on the income tax return (**ITR12**). The date on which the taxpayer ceased to be a tax resident must be provided. The relevant documents to support the disclosure that the taxpayer has ceased to be a resident will need to be submitted to SARS once he or she has submitted the tax return to SARS.
- Alternatively, the taxpayer can inform SARS by completing and submitting a declaration to SARS i.e. the "Declaration: Cease to be a Tax Resident" form, via email, together with the relevant supporting documentation.
- Individuals who previously informed SARS that they ceased to be resident also have an opportunity to confirm their status by submitting a letter to SARS setting out the background to the request, the basis on which they ceased to be resident, as well as the date and manner in which they informed SARS of this.

The documentation to be submitted by an individual when informing SARS that he or she has ceased to be resident, depends upon the manner in which the individual ceased to be resident. However, the standard requirements include a motivation letter setting out the facts and circumstances to support the disclosure that the individual has ceased to be a tax resident and a copy of the individual's passport and travel diary.

In addition to the standard documents, individuals who cease to be resident in terms of a DTA will need to provide a certificate of tax residence from the foreign revenue authority or a letter from the authority that indicates the individual's status as a tax resident in that country.

For individuals ceasing to be ordinarily resident, there are two different procedures that must be completed:

I. First they must inform SARS of this using one of the methods discussed above. In addition to the standard documents that must be submitted to SARS with all applications, there are specific requirements which include information relating to the individual's social and economic ties to South Africa which will be evaluated by SARS to determine whether or not the individual is still ordinarily resident in South Africa.

II. The second procedure is the completion of a Tax Compliance Status Request (**TCR01**) in respect of emigration using the Tax Compliance Status functionality on SARS Efiling. The process includes submitting the relevant documents requested by SARS to support the individual's emigration.

Implication of ceasing to be resident

In confirming an individual's tax compliance status, SARS will issue a TCS PIN letter to the individual. Should the individual wish to transfer funds abroad, the TCS PIN letter must be provided to the bank attending to the transfer of the funds.

Three-year rule applicable to retirement fund withdrawals for individuals ceasing to be resident

With effect from 1 March 2021, taxpayers wishing to transfer their retirement fund benefits abroad will need to provide evidence to the fund administrator that they have been non-resident for tax purposes in South Africa for an uninterrupted period of three years or longer.

From 1 March 2021, a member of a pension preservation fund or a provident preservation fund who has ceased to be a resident for an uninterrupted period of three years or longer may withdraw the full benefit before he or she elects to retire from that fund.

Furthermore, a member of a retirement annuity fund who has ceased to be a resident for an uninterrupted period of three years or longer on or after 1 March 2021 and who has stopped contributing to the retirement annuity fund, may also withdraw the full benefit before he or she elects to retire from that fund.

The Fund administrator must submit the relevant tax directive application to SARS, together with the following documents:

— A certificate of residence not older than six months issued by the Tax Authority of the country of residence.

— Documentation confirming cessation of residence:

  - The fund administrator must ensure that the member has been a non-resident for an uninterrupted period of three years or longer, from the date of ceasing to be a resident.
  - The documents that may be accepted by the Fund for this purpose are a copy of the individual's passport indicating the individual's entry/exit from South Africa, assessments issued by the country of residence, etc.

SARS has issued various external guides in relation to the completion of tax directive application forms. SARS states in its external guides that the taxpayer must inform SARS (as set out above) as soon as he or she has ceased to be a South African resident to enable SARS to update its system to reflect the taxpayer's correct residence status.

It is important to note that if the taxpayer has not informed SARS that he or she has ceased to be a tax resident and SARS' system has not been updated to reflect that the taxpayer is a non-resident, the tax directive application will be rejected.

Proposed tax on the deemed withdrawal of an individual's retirement fund interest on the day before ceasing to be a resident

National Treasury has proposed new legislation in the Draft Taxation Laws Amendment Bill issued on 28 July 2021 which will further impact individuals ceasing to be South African tax residents.

In terms of the proposed legislation, where an individual ceases to be a South African tax resident, he or she will be treated as having disposed of his or her interest in a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund on the day before ceasing to be a resident. Tax will be calculated on the value of the individual's retirement fund interest in accordance with the tax tables applicable to withdrawal benefits, however, the tax payment (including associated interest) will be deferred until a payment is receivable from the retirement fund.

The rationale for this proposed amendment, as explained in the Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill, 2021 is that withdrawals from retirement funds by individuals who remain tax resident in South Africa are taxable when the member either retires, dies or makes a pre-retirement withdrawal. However, where an individual ceases to be a South African tax resident, the member's interest in the retirement fund is not always subject to tax in South Africa as the application of a DTA between South Africa and the individual's new country of residence may in some instances result in South Africa forfeiting its taxing rights.

National Treasury goes on to state that Government wishes to ensure neutrality of tax treatment for all types of withdrawals (irrespective of the individual's tax residency status at the time of withdrawal) and that there is a mechanism in place to tax the correct value. National Treasury acknowledges that because a retirement fund withdrawal will only be possible once a taxpayer has been a non-resident for an uninterrupted period of three years, there will be a lag between the time when tax residency is ceased and the tax on withdrawals from the retirement fund will be due and payable.

It has therefore been proposed that regardless of the individual's intentions at the time, the value of the individual's interest in the retirement fund must be determined on the day before residency is ceased. The onus of ensuring that a valuation of the individual's interest in the retirement fund is obtained from the fund on that date, as well as notifying SARS that he or she has ceased to be a South African tax resident will rest with the individual.

The Draft Taxation Laws Amendment Bill proposes legislation[2] which will apply in the following two scenarios:

— When an individual ceases to be a South African tax resident, and withdraws his or her interest in the retirement fund from a South African retirement fund prior to retirement or death.

— When an individual ceases to be a South African tax resident, but retains his or her investment in a South African retirement fund, and only withdraws his or her interest in the fund when he or she dies or retires from employment.

In both scenarios the practical implications will be as follows:

— The individual will be deemed to have withdrawn from the fund on the day before he or she ceases to be a South African tax resident as envisaged in the Income Tax Act.

2 Proposed inclusion of section 9HC of the ITA

— The individual's retirement fund interest will be subject to tax in accordance with the tables applicable to withdrawal benefits, however, the tax payment (including associated interest) will be deferred until a withdrawal payment is receivable from the retirement fund.

— When the individual receives a payment from the retirement fund, the tax on the benefit will be calculated based on:

- the prevailing retirement fund withdrawal tax tables where the individual withdraws his or her retirement fund interest prior to retirement or death; or
- the prevailing retirement fund lump sum tax tables or on the annuity received, where the withdrawal only takes place on death or retirement.

— A tax credit will be provided for the deemed tax as calculated when the individual ceased to be a South African tax resident.

The proposed legislation raises many questions and concerns, as it could have far reaching consequences for South Africans who cease to be tax resident.

The main concern lies with the potential double taxation which may arise. South Africa has concluded a number of DTAs where sole taxation rights in respect of pension payments are granted to the country of residence. These DTAs include, amongst others, the DTAs that South Africa has concluded with the United Kingdom, Australia, New Zealand, Germany, Spain, Portugal, Italy, China and Hong Kong.

The proposed legislation appears to be an attempt to circumvent the provisions of the article in the DTA dealing with pension and annuities (Article 17 or 18 in the majority of DTAs) where the new country of residence should have sole taxation rights.

The proposed legislation may result in double taxation if the deemed disposal of the individual's retirement interest on the day before ceasing to be a South African tax resident is not recognised by the individual's new country of residence and this country seeks to tax the pension payment when it is actually paid out by the retirement fund.

In its Interpretation Note No. 18, (Issue 4) which relates to the rebate and deduction for foreign taxes on income in terms of the ITA[3] , SARS makes it clear that it will disallow a foreign tax credit claimed by a South African resident, on grounds that the tax was not validly imposed in the foreign country.

If tax is imposed by the individual's new country of residence at the time of receipt of the pension payment from the retirement fund, relief from tax in South Africa will not be available to the individual, as the rebate and deduction for foreign taxes[4] only applies to South African tax residents.

The other concerns raised are:

— That individuals ceasing to be resident who wish to withdraw their interest in a retirement fund are now forced to wait until they have been non-resident for an uninterrupted period of three years.

— Reference has also been made in the proposed legislation to interest being levied on any remaining balance, until the tax is paid in full. Since the tax will not be due and payable until the date and to the extent that an amount is receivable from the fund, it is uncertain how and when this will apply.

— Furthermore, the proposed amendments do not differentiate between individuals who cease to be tax resident in South Africa as a result of the application of a DTA and those who cease to be ordinarily resident in South Africa based on their intention to settle outside of South Africa permanently. This will impact individuals taking up a short-term secondment abroad who cease to be tax resident in South Africa in terms of a DTA as they will be deemed to have withdrawn from their retirement fund, regardless of the fact that they have every intention of returning to South Africa and ultimately retiring in South Africa. The question that arises is when does an amount become receivable from the fund and will interest be charged from that date, as opposed to the date on which the amount is actually paid out to the member?

3 Section 6quat of the ITA
4 *Ibid*

If the proposed legislation[5] is enacted it may result in individuals ceasing to be resident electing to withdraw their full retirement fund interest as soon as they are able to, as the risks of leaving these funds to grow in South Africa until retirement are also uncertain. It is also likely that individuals will seek alternative investment options for purposes of saving for their retirement rather than contributing to a South African retirement fund, which has longer terms implications for the South African pension/retirement fund industry.

In closing

KPMG, amongst other firms, has submitted its comments and recommendations to National Treasury in relation to the proposed amendments. We are of the view that further consultation is required with all stakeholders prior to finalisation of the proposed legislation in order to clarify how the abovementioned concerns will be dealt with.

Cecelia Madden
Associate Director
Global Mobility Services & Employment Tax Advisory
Family Office and Private Client South Africa

E: cecelia.madden@kpmg.co.za
T: +27 82 719 5658

5 Proposed inclusion of section 9HC of the ITA

What a business family[1] should consider before making an investment

A smart buyer is an informed buyer, no matter the size of the purchase.

When evaluating an investment decision, it is important to be aware that the path to an acquisition is marked by many crossroads. There are many questions and considerations involved, which include:

- what is the deal strategy?
- what acquisition options align to the intended target markets, technologies, products?
- how should one evaluate the deal and what is the asset worth to the business family?
- how should one execute an efficient deal process to financial close?

How each of these questions is addressed will guide the investment journey.

1 This relates to either an investment by the family business or the family office

The first stage of your journey is to determine the *deal strategy* – how shareholder value and returns are maximised?

The deal strategy should be aligned to the overall strategy of the business family, in order to deliver on key value drivers and improving or maintaining the competitive position of the family business/office.

The clearer one is on how an acquisition can best align with the business family's strategy, the more rapidly and effectively one can assess potential targets regardless of size or lifecycle - new venture/start-up/scale up/mature business.

Defining the desired risk and reward profile is key, as it is knowing what value drivers are most important to the business family. An important element of the deal strategy is to identify potential areas of investment, determining if the business family is prepared to do a deal and assessing what kinds of deals are right for the business family. This can include consideration of whether the aim is to be an active (majority) or passive (minority) investor.

Businesses that are earlier in their life cycle are often riskier investments that require growth capital and active strategic guidance to drive growth. In many instances it is an investment in the founders and management of the business as much as the underlying assets, with returns only being realised in the medium term. It is important to define the risk appetite and desired role as a prospective shareholder with reference to the life cycle and growth requirements of a prospective investment to ensure that one is only dedicating scarce resources to evaluate investments that meets your requirements.

As a business family, the experience of growing a new venture (i.e. the successful family business) is invaluable when making such an investment decision.

A robust capital structure and access to competitive and flexible funding provide the foundation for any strategic plan. Ensuring the capital structure and financing arrangements are consistent with both the objectives and risk appetite are critical to achieving the strategic plan and creating value for all the stakeholders. This is especially important for investors in start-up and scale-up businesses that often need to draw down on additional funding to drive growth as they mature and therefore it is important to understand what additional capital resources are available in an early-stage company and what additional capital may be required to meet the stated growth ambition.

Many successful family offices often also consider multi-family syndication as an appropriate strategy to share risk and ensure that portfolio investments have a broader capital provider to fund growth. Importantly the relationships between these business families are forged well before a deal, ensuring alignment of values and objectives.

Having decided upon the deal strategy and a desire for inorganic growth, the second stage is to identify the *options* – what businesses can be acquired in the target market(s)?

The starting point is to put together a list of potential targets, which can be stratified by product/service, market or geographical location. In formulating this list, one will also need to consider the lifecycle stage of the identified targets and the impact which this may have on the deal strategy as each stage brings with it different investment requirements and levels of risk:

— An early-stage company will typically be loss making due to a low level of sales and a high level of start-up costs being required, which contribute to an early-stage business potentially representing a higher level of risk.

— Conversely, a mature company may offer lower business risk but may also present lower growth opportunities.

In moving through this stage, the next step will be to identify a short list of targets to approach. The development of the short list should be based on the overall strategic objectives and how well the targets align with those.

Other important areas to consider (and potential roadblocks) at this stage will include financial, tax, cultural fit especially in a business family environment, ability to execute the deal, the stakeholder buy-in and the willingness of the target's shareholders to sell.

One may choose to approach one target at a time or several concurrently. Qualitative factors are especially important when considering an investment in an early-stage company. As discussed above the earlier a target company is in its life cycle, the more risk.

Equally important is understanding the motivations of potential sellers when prioritizing the targets. At this stage, one will also need to consider what sources of funding may be available to balance the risk appetite against the cost of funding. The most effective capital structure will balance a range of strategic and operational factors including the cost of funding and the ability to withstand performance, market or cyclical volatility.

Identifying the appropriate mix of financing options will involve assessing the credit profile of the target and the types of available funding, which may differ based on the lifecycle stage of the target. Early-stage companies are more likely to be reliant on equity, quasi equity funding and balance sheet support from shareholders as the company grows and is able to sustain traditional debt. These are likely to be more expensive than for a mature business and need to factored into the evaluation.

Having successfully navigated the journey to this point, the path brings one to the third stage: *evaluation* – what is the investment worth to the business family?

While one wants to be as realistic as possible and conduct thorough due diligence that includes an analysis of maintainable earnings, relevant benchmarking, cost structures and other hard metrics, one also does not want to overlook any potential synergies or hidden value that might not be recognized even by the target's current owners.

There are several key questions that one should consider:

- What are the key performance metrics for the sector and business?
- Are there any other similar (early-stage) businesses that have succeeded or failed?
- Is the product ready and if not at what stage is the product?
- Is company generating revenue and what is the revenue model?
- Is the business scalable?
- What is the current and expected cash burn and funding sources?
- Does the business have a realistic business plan?
- Are there comparable companies or transactions to benchmark?

An additional consideration for a business family, especially where the family office is considering an investment on behalf of the family, is whether there may be alignment with the shared purpose, values and mission of the family. Although not always easy to determine, it is a fundamental non-financial consideration.

Essentially, one needs to determine what the future value is to the business family. Knowing what questions to ask, the availability of information and the willingness of the target company to share necessary insights can prove to be a challenge at this stage and there is no one-size-fits-all approach to determining the value of a company.

The choice of valuation methodology will also be driven by the lifecycle stage of the target and the availability of information, which often correlate.

There are three approaches to performing a valuation:

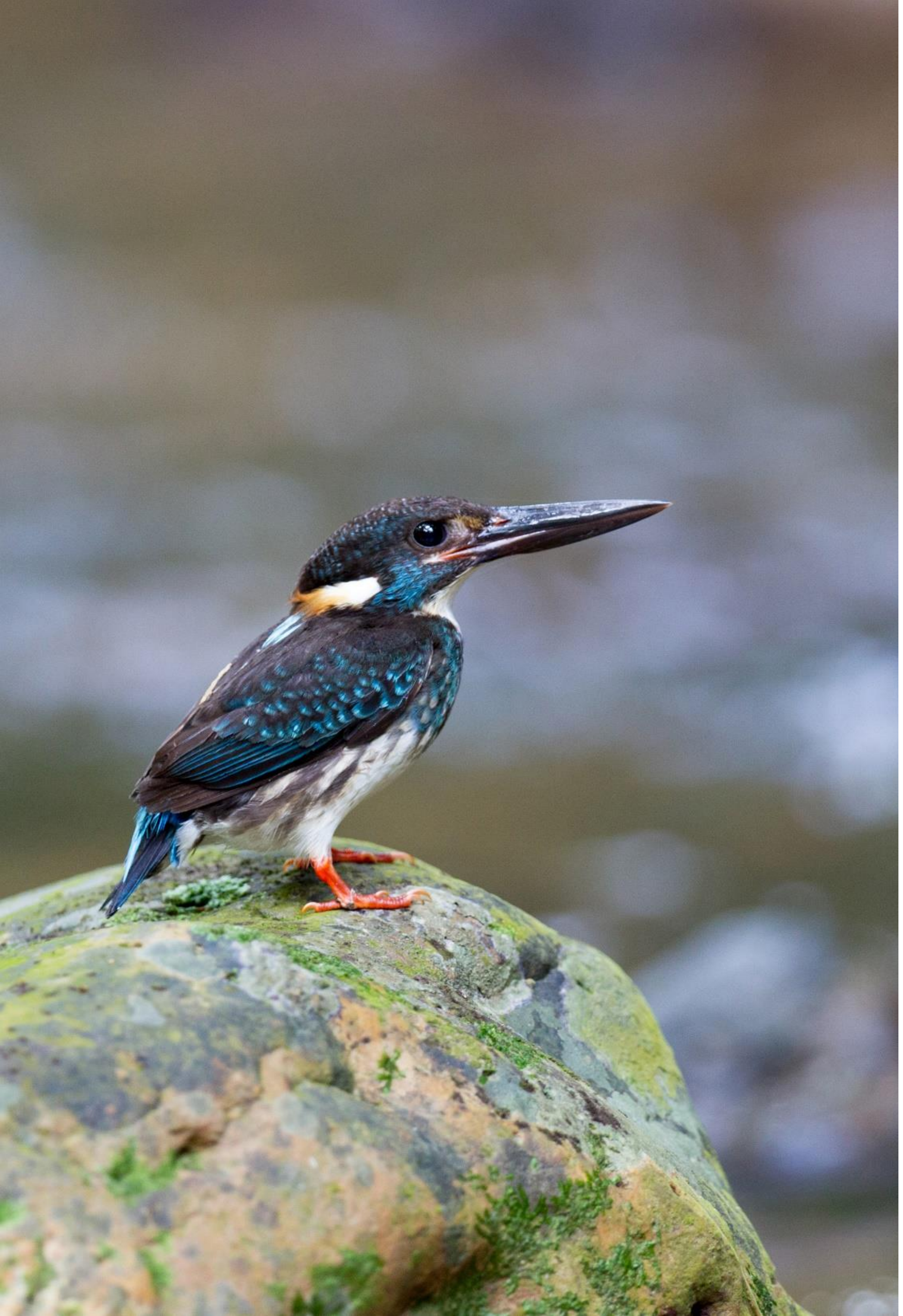
I. *Income*
Based on future cash flows (forward looking) This is often the most appropriate approach to valuing any company and it is particularly relevant to an early-stage company in a high growth phase but appropriate forecasts and discount rates need to be considered.

II. *Market*
Based on comparable transactions and/or comparable listed companies. Limited use as a primary method when valuing an early-stage company due to lack of comparable listed proxies and differing characteristics of comparable transactions.

III. *Cost*
Based on net asset value (backward looking) and doesn't consider future growth. This approach has limitations when valuing any company, especially early-stage companies, whose value is more closely linked to its future potential rather than its current balance sheet.

For the evaluation of early-stage businesses, constructing a data backed business plan and medium to long term cash flow forecast on both a top down and bottom up approach provides valuable insights for your investment decision. Broad categories to consider from the top down are: Potential Market; Target Market; Revenue Model; Cost Model and Investment Need.

It may be advantageous to seek the advice of specialists who can assist with your evaluation process and provide valuable insight in the lead up to deal execution, although such assistance does come at a cost.



Having identified the preferred target, the next stage is *deal execution* – how can one get the deal done at the right price?

This stage emphasises the need to do one's homework and enforces the benefit of proper due diligence – what is the post-acquisition value vs the value determined for negotiation. This process will help identify thorns that may await as one seeks to conclude on all issues identified and gain comfort over any risks which may impact deal negotiation. Asking the right questions is critical in determining whether you should walk away at this point or if any identified risks should either be accepted or adjusted for in the transaction agreements and deal structure.

Obtaining a clear understanding of the legal and tax structure, regulatory environment, people, incentives and rewards, systems and governance are essential in assessing the risk and opportunity with respect to any investment. It is especially important for investments in early-stage companies to understand what additional investment would need to be made in people, operations, systems and governance as the business matures and what impact this will have on the overall business model and ultimately the future value.

Successful deals are also reliant on understanding the objectives of the sellers and having a compelling and attractive deal structure. Most investments in early-stage companies are injections of new capital for growth, ensuring that the founders and key management retain meaningful participation or "skin in the game" to drive growth and ensure that their objectives are aligned with the investors.

The timeline and direction of the stages discussed above are unpredictable. One may end up taking a gentle stroll with a clearly defined outcome in mind or it may turn out to be an expedition consisting of various misdirects and backtracking before the preferred target and the right deal emerges. A smart buyer is an informed buyer, but information isn't always easy to obtain or to interpret, especially the non-financial considerations. Advisors and specialists can help you navigate the unchartered terrain, offering support and advice to help you achieve the best outcome for the business family and its stakeholders' growth ambition.

Mike Louw
Head of Mergers and Acquisitions
Deal Advisory

E: mike.louw@kpmg.co.za
T: +27 60 715 2417

Lauren Tuchman
Senior Manger
Deal Advisory

E: lauren.tuchman@kpmg.co.za
T: +27 82 726 6726

Demystifying Cryptocurrencies

It's been said to me many times, "I don't invest in cryptocurrencies because I don't understand it".

As a member of Gen-X, I feel that I need to get my head around the world of cryptocurrencies since these will likely be entrenched in my daughter's future or I will be left behind. One of the interesting things I am contemplating, is whether my 12 year old daughter will be remunerated via cryptocurrency in the future and whether, she will in fact have a choice. Given this, I was drawn to researching and writing this piece.

For high net worth (**HNW**) individuals and families and their family offices, the diversification of wealth is a key investment decision.

Most financial advisors would echo the words of the proverb "don't have all your eggs in one basket". When it comes to investing one must consider the "safe bet" versus the high risk, high reward opportunity. As to where cryptocurrencies lie in the investment spectrum will vary depending on who you talk to.

Due to the complexity of how cryptocurrencies operate, placing them on the spectrum of investment opportunities is a difficult undertaking. In this digital age, anyone, and everyone from pauper to prince can invest in cryptocurrencies – it's just so accessible to secure.

Setting aside what other HNW individuals/ families/ family offices are doing, the fundamental principles of any new investment remain constant, to ensure that the tax implications of the investment are understood. This planning is to ensure there are no tax shocks along the investment term.

This fundamental principle is a function of good wealth and investment governance, which is as simple as planning and understanding all aspects of the investment before diving in, in particular the relative unknown of digital assets.

What are cryptocurrencies?

A cryptocurrency is a digital or virtual currency designed to work as a medium of exchange[1]. You'll need to **exchange real currency** for the cryptocurrency which you will use to purchase/access goods or services[2] (everything from a coffee and car can be purchased using cryptocurrencies).

The most prominent cryptocurrency is currently Bitcoin. Although there are others, to name a few Ethereum, Dogecoin and USD Coin. They are the world's first new form of tender and is set apart from traditional currencies in a number of ways. Unlike the Rand or the Dollar which are fiat currencies (discussed below), the value of cryptocurrencies are determined and maintained exclusively by consumer demand, instead of government controls and interventions. The lack of fiduciary legacy and susceptibility to speculation is also the reason behind its instability. The honesty of the system is maintained by means of scarcity (there are only 21 million Bitcoin, for example) and a global ledger system (known as the Blockchain) that employs every computer used to trade the currency. This global network of computers log each transaction and together keeps the price universal.

What are Govcoins?

Although similar to the cryptocurrency discussed up to now, Govcoins are government backed digital currencies, being the key difference from the unsecured cryptocurrencies discussed above.

Govcoins help the unbanked i.e. instead of needing to apply to a bank to get an account to hold money physically, digital coins can be available instantly to anyone with a mobile phone (and spent just as easily).[3]

1 https://cointelegraph.com/bitcoin-for-beginners/what-is-cryptocurrency

2 https://www.nerdwallet.com/article/investing/cryptocurrency-7-things-to-know

3 https://www.techrepublic.com/article/top-5-things-to-know-about-government-digital-coins/

What is Fiat Money?

Then we need to bring in the conventional currencies many of us have grown up with, Fiat money. Fiat money is government-issued currency that is not backed by a physical commodity, such as gold or silver, but rather by the government that issued it.[4]

How does this affect transactions as we know it?

Now that we have explained the various currencies available to us, I can best explain how the cryptocurrencies affect transactions with an example. I buy a book from an online vendor. I pay the online vendor by using my conventional credit card (i.e. Fiat money) for this "peer to peer" transaction. Although it may appear to me (the consumer/the buyer) that there is no intermediary, there is in fact an intermediary – your bank, a clearing house or a Fintech company (like PayPal). With a payment from one person to a vendor in cryptocurrency, there is no intermediary and therefore the transaction fees are lower.

What's a wallet address?

For our Fiat money we all have our wallets or purses, but what about cryptocurrencies? A wallet address is similar to a bank account number. It's a unique 26-35 digit combination of letters and numbers and it looks something like this:
1ExAmpLe0FaBiTco1NADr3sSV5tsGaMF6hd

You can share your wallet address with others, which in turn enables them to send you cryptocurrency. This address can also be represented as a QR code*, and if somebody wishes to send or pay you in cryptocurrency, they can scan the code using their wallet and send cryptocurrency to your wallet. You may want to keep your personal and business transactions separate, so we also allow you to add unique addresses to your account.[5]

4 https://www.investopedia.com/articles/forex/042015/why-governments-are-afraid-bitcoin.asp

5 https://www.luno.com/

*The quick response, or QR, Code is a two-dimensional version of the Barcode able to convey a wide variety of information almost instantly with the scan of a mobile device.[6]

Excerpt from our 2018 article

There have been no changes to the taxation of crypto assets since our article in the 2018 Personal Perspectives Edition however there is definitely an increased focus by Revenue Authorities given the uptick in trade globally in recent times (see more regarding the Intergovernmental Fintech Working Group (**IFWG**) paper below).

The SARS's view

On 6 April 2018 [7], the South African Revenue Service (SARS) announced that it will continue to apply normal income tax rules to crypto assets and will expect affected taxpayers to declare crypto asset gains or losses. SARS indicated in its statement that crypto asset transactions are subject to the general principles of South African tax law. This means that any revenue received as well as gains made or losses, may either be regarded as revenue in nature and included in the taxpayer's income, or alternatively as capital in nature and subject to Capital Gains Tax (CGT).

In South Africa, the word "currency" is not defined in the Income Tax Act. No. 58 of 1962 (The Act). Cryptocurrencies are neither official South African tender nor widely used and accepted in South Africa as a medium of payment or exchange. As such, crypto assets are not regarded by SARS as a currency for income tax or CGT purposes. Instead, cryptocurrencies are regarded as assets of an intangible nature.

How will the tax be calculated – Capital vs Revenue test

Generally speaking, since cryptocurrency transactions are subject to the general principles of South African tax law, the income tax or CGT calculation will be the same as for any other revenue or CGT calculation. This is where the capital versus revenue test is important.

The primary test to determine the nature of the crypto asset transaction and whether the transaction is of a revenue or capital nature, takes into account the taxpayer's intention when acquiring, holding and disposing of the cryptocurrency. The intention of the taxpayer must be decided, considering the facts and circumstances of each case and may change over time.

If it was the intention of the taxpayer to obtain the crypto asset for the specific purpose of profit-making, the asset will be considered to be "trading stock" and of a revenue nature and the income derived must be included in the taxpayer's taxable income. There has been more focus by SARS on this 'test of intention' in recent times.

Tax compliance

Taxes on crypto assets will be payable as provisional taxes and/or assessed taxes. The transactions relating to crypto-assets will need to be included in the relevant annual tax return (form ITR12) to be prepared and submitted to SARS. The onus is on taxpayers to declare all income and gains, including crypto-asset-related taxable income in the tax year in which it is received or accrued. Failure to do so could result in interest as well as understatement penalties of up to 200%.

6 https://www.qr-code-generator.com
7 https://www.sars.gov.za/media-release/6-april-2018-sarss-stance-on-the-tax-treatment-of-cryptocurrencies/

In closing

With reference to the IFWG (Crypto Assets Regulatory Working Group)'s updated position paper on crypto assets dated 11 June 2021:

— There will be inter alia "a staged approach to bring crypto assets within the regulatory remit through the regulation of crypto asset service providers (CASPs)."

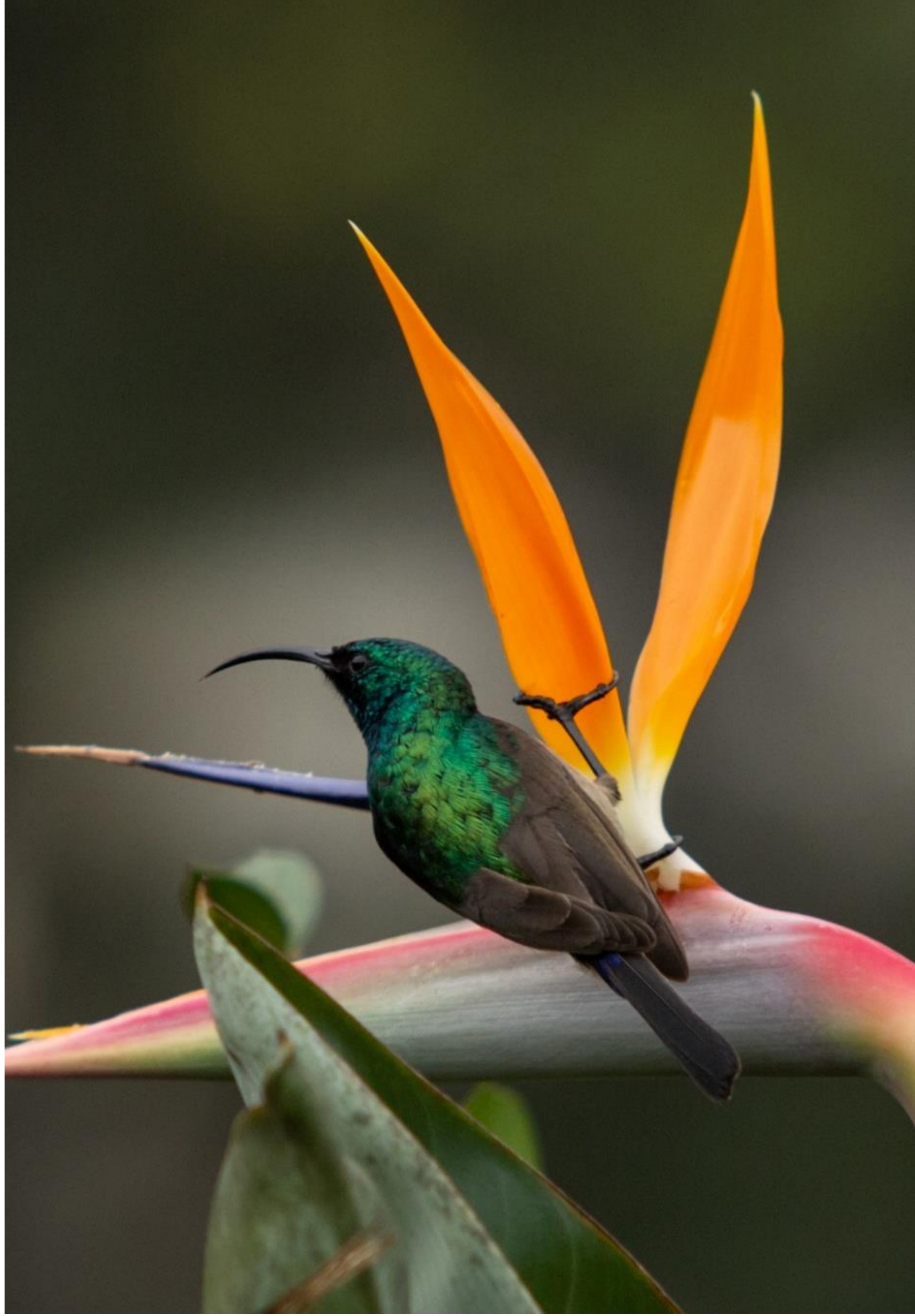
— It is also recommended in the position paper that the South Africa Reserve Bank should assume the supervisory and regulatory responsibility for the monitoring of cross-border financial flows of crypto assets and CASPs.

— It recommends that crypto assets be declared a financial product through the provisions of the Financial Advisory and Intermediary Services Act 37 of 2002 (the FAIS Act).

Due to the novelty of crypto assets and the constant rumours about individual windfalls, investing in crypto assets may be tempting. But like with any new technology, it is always prudent to be as informed as possible. So read the opinions of some of the industry's leading figures and consult financial experts widely, before making a decision.

Each person's circumstances and needs are different and each person has to make a decision based thereon, and ensure they have the evidentiary proof to justify such to SARS.

Melissa Duffy
Partner
Global Mobility Services & Employment Tax Advisory
Family Office and Private Client South Africa
E: melissa.duffy@kpmg.co.za
T: +27 82 448 1989



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