16 August 2013

Mr Allen Wicomb
Parliamentary Standing Committee on Finance
3rd Floor
90 Plein Street
Cape Town
8001

By e-mail : Allen Wicomb, SCOF (awicomb@parliament.gov.za)

CC : Ms Nomfanelo Mpotulo, National Treasury (nomfanelo.mpotulo@treasury.gov.za)
Ms Adele Collins, South African Revenue Service (acollins@sars.gov.za)

Dear Sir

Comments on the Draft Taxation Laws Amendment Bill 2013 (TLAB) and Draft Tax Administration Laws Amendment Bill 2013 (TALAB)

We present herewith our main written submissions on the above-mentioned bills.

In this set of submissions, we include only what we consider to be the most critical matters. We comprehensively covered the bulk of our representations in our submissions directly to National Treasury.

We have deliberately tried to keep the discussion of our submissions as concise as possible, which does mean that you might require further clarification. In this respect, we have requested the opportunity to present oral submissions at the hearings scheduled for 20 August 2012.

Although National Treasury has requested that we should present our submissions to them in a sequence that mirrors their Explanatory Memorandum ("EM"), we have —*for the purposes of our submission to this Committee*— simply listed them in no particular order.

Our initial representations relate to the following areas:

PricewaterhouseCoopers Tax Services (Pty) Ltd, Reg. no. 1983/008289/07
2 Eglin Road, Sunninghill 2157, Private Bag X36, Sunninghill 2157
T: +27 (11) 797 4000, F: +27 (11) 797 5800, www.pwc.com/za

General submissions

1. The submissions process
2. Retrospective legislation
3. Growing administrative burden on taxpayers
4. Proposals welcomed

Specific submissions

5. Monetary cap on retirement deductions
6. BEPS general
7. VAT e-commerce
8. Hybrid debt
9. Acquisition debt
10. Deferral of incurral of expenditure for untaxed related party expenditure
11. Untaxed related party interest
12. Withholding taxes
13. R&D
14. share issues for foreign shares
15. understatement penalties

Yours sincerely

Kyle Mandy
Head: National Tax Technical
Director
Tax Practitioner: PR – 0FD1940

Attached:
- Detailed Submissions (xx pages)

pwc

General Submissions

A. The legislative process: Opportunity for interaction with the Committee

1. Every year for the last few years we have submitted that the period from the initial release of the draft legislation to the deadline for submitting representations is insufficient. Insofar as the 2013 proposals are concerned, we are deeply concerned that the period for comment has again been grossly inadequate to familiarise ourselves with the proposed changes, fully consider the effects thereof and make considered comments thereon.

2. Many of the proposals contained in the TLAB are complex and have potentially far-reaching implications for taxpayers and the economy.

3. Whilst we appreciate and value the ever-improving direct interaction with National Treasury, we remain concerned about the limited opportunity that the public has to express their views to National Treasury and the Committee. Specifically, we note that:

3.1 The time period given for comment on the TLAB and TALAB was a little over 4 weeks while the draft legislation issued for comment comprised of some 234 pages and 291 clauses (many of which contain numerous separate amendments).

3.2 Furthermore, there are expected to be new or substantially altered provisions in the final Bills that do not appear in the initial draft Bills, in respect of which there is currently no opportunity at all for submissions to be presented to National Treasury, SARS or the Committee.

4. On the one hand, we applaud the processes that National Treasury and SARS have initiated from their side, including (for example) :

4.1 National Treasury's "Annexure C Workshops" held towards the end of 2012; and

4.2 The public workshops to discuss taxpayer submissions on the proposed legislation.

5. On the other hand, however:

5.1 the time between the public release of the draft bills and the deadline for submissions to National Treasury and the Committee remain grossly inadequate; and

5.2 taxpayers still only have a single opportunity to present their perspectives to the Committee (and thus to Parliament).

6. This inadequate consultation process is likely to result in many unintended consequences, the need for significant amendments in subsequent legislation to rectify errors and anomalies and the resultant uncertainty in our tax law that stems from that. The TLAB contains a significant number of technical corrections to previous amendments to correct numerous anomalies and errors arising from those changes. Many of those anomalies and errors arose from an inadequate consultation process in 2011 and 2012 and we are deeply concerned that the 2013 amendments will result in further technical corrections in 2014.

7. The implications are potentially significant-

7.1 Most importantly, the increasing volume of anomalies and errors results in significant uncertainty for taxpayers. This uncertainty is a deterrent to investment and economic activity in general, with consequential implications for the economy as a whole;

7.2 The need to correct errors in subsequent years requires the resources of National Treasury to be diverted from planned tax reform projects, resulting in other urgent tax reforms either being deferred or rushed through without sufficient time being given for thorough consideration by National Treasury or stakeholder participation, ultimately resulting in a snowball effect of growing errors and anomalies and uncertainty.

8. These matters have been raised several times in past years, and several assurances have been received that they would be addressed. Although we have not duplicated here the detail of our submissions from previous years, they remain in point this year again.

9. Notwithstanding all of the above, we fully acknowledge that there are numerous conflicting pressures and complications in the legislative and drafting process, from National Treasury's perspective. For sake of completeness, we list below some of the relevant factors:

9.1 National Treasury has its own policy objectives and design/structural objectives as regards the SA tax law and system. The specifics of these objectives must be implemented and must not be delayed unnecessarily.

9.2 Taxpayers and tax practitioners are constantly lobbying SARS and National Treasury for changes, and these requests need to be considered (and implemented if appropriate).

9.3 Perceived tax avoidance schemes typically need to be attacked as a matter of urgency as soon as they come to light.

9.4 Taxpayers and tax practitioners do not always respond to "discussion papers" with the same urgency and diligence as they do to actual draft legislation, which increases the desirability of the latter.

9.5 In some cases it is possible to attach an extended future effective date to draft legislation, but there are also many cases when this is not appropriate.

9.6 The resource pressures in National Treasury's tax design unit are well recognised by everyone in the tax discipline.

9.7 The burden on the annual Parliamentary time-table is also well-understood, so National Treasury's "hands are tied" when it comes to fitting in with Parliament's demanding schedule.

9.8 The complexity of SA's tax legislation, although undesirable, is generally accepted as inevitable.

9.9 It is undeniable that there are many technical corrections which will only become apparent from the actual practical application of the law to real-life transactions. That is, they are unlikely to be picked up in the initial consultation process no matter how long the consultation period is, although a truncated consultation period undeniably results in a greater volume of technical corrections.

10. A further concern that arose this year was the distraction generated by the uncertainty over whether Keith Engel would be leaving National Treasury. This clearly had an impact on the extent of consultation prior to the drafting of legislation and the drafting process itself. There has been a significant decline in the quality of the drafting of the legislation this year and which has significantly contributed to the volume of submissions required to be made and added further pressure to the constrained period for comments on the draft Bills.

11. From all of the above, it is clear that there is no single or simple answer to the problem of the unreasonable (in our view) consultation period. It is therefore submitted that an important focus of National Treasury should be to limit the *volume* of annual amendments —and perhaps the starting point should be to prioritise only critically important new initiatives. Thus the focus of the annual legislative cycle should be on

consolidation and technical corrections (etc.) and only a very limited amount of *prioritised new initiatives*. If the volume of new initiatives is lower, the drafting of the initial draft bills can be completed and published much earlier —creating space for longer consultation and hopefully also the possibility of a "rebuttal" session for taxpayers in front of the Committee.

12.	Submissions:
12.1	There should be a greater consultation period between the initial release of the proposals and the deadline for submissions.
12.2	There should also be an opportunity for "rebuttal" hearings before the Committee, after National Treasury has presented its Response Document.
12.3	National Treasury should aim to limit the volume of annual amendments, by prioritising new initiatives.

B. Retrospective and retroactive legislation

13. Numerous of the proposals contained in the TLAB and the TALAB are proposed to have effective dates prior to the date on which the legislation is to be promulgated and which will impact on the vested rights and obligations of taxpayers.

14. The continuing extensive use of retrospective and retroactive legislation by National Treasury is concerning, especially where it imposes additional obligations on taxpayers or affects vested rights of taxpayers. In this year most of the TAA amendments have been made retrospective to 1 October 2012 (Draft Bill error 1 October 2011).

15. The principles which underlie retrospective and retroactive legislation were clarified by the constitutional court in *President of the Republic of South Africa v Hugo* 1997 (4)(SA 1 (CC), when dealing with retrospective legislation the court held that:

"The need for accessibility, precision and general application flow from the concept of the rule of law. A person should be able to know of the law, and be able to conform his or her conduct to the law."

16.	Submission: As a matter of principle, all legislation should operate prospectively unless justifiable reasons can be advanced therefore and the vested rights and obligations of taxpayers are not negatively affected by such legislation.

C. Growing administrative burden on taxpayers

17. Although SARS states in its Strategic Plan 2018 (see par 3.2 and 4.2.2) that in principle it intends to strive for a reduced taxpayer administrative burden and more simplistic tax regime, the legislation and requirements introduced in the last few years are doing exactly the opposite.

18. Examples include the following.

Dividends tax

19. The administrative burden arising from the dividends tax is significant and far greater than would normally be expected with regard to a withholding tax. Generally, withholdings taxes should result in a reduced administrative burden. However, this is not the case with the dividends tax due to the onerous reporting requirements. Proposals in the TALAB are set to significantly increase that burden by imposing reporting requirements on the recipients of dividends in addition to the existing reporting requirements on payers or dividends.

New withholding tax regime

20. It is expected that similar reporting requirements will now be introduced for payers of service fees, royalties and interest that are liable to the respective withholding taxes.

IT14SD supplementary return

21. The introduction of the IT14SD has significantly increased the burden on taxpayers required to submit this return.

New ITR14

22. While the new income tax return for companies will result in a streamlined return for different companies, it requires significantly more information to be provided and will increase the compliance burden and costs for taxpayers.

IT3 returns

23. The information required to be submitted by third parties in relation to certain types of income has been significantly increased and expanded. The result is that companies

have had to invest significant time and expenditure in order to meet the requirements of SARS in this regard.

24. These are just some of the examples of the increasing administrative burden being imposed on taxpayers. There are many other examples.

25. While the need for SARS to obtain information in order to verify and audit the tax affairs of taxpayers is understood, there needs to be a clear and rational need for any information required to be provided to SARS and the use to which such information is to be put. In many respects, that need is not clear.

26. Submission: steps need to be taken to relieve the increasing administrative burden being placed on taxpayers and unneeded reporting obligations eliminated.

Notification to SARS on legal proceedings

27. This proposal imposes an obligation on taxpayers not only to notify C:SARS 72 hours before any high court application but also to enable C:SARS to specify an address at which such notification must be made.

28. This proposal is made under the guise that similar rights are afforded to other state organs in terms of the stated legislation. However, the proposal exceeds the rights afforded to other organs of state by providing for pre-notification and it applying to all applications and not only those that involve executions for debt claims against the organ of state.

29. The requirements of that act does not require pre-notification of legal proceedings, but merely requires that the organ of state be given a 30 days "letter of demand" for the debt before proceeding with any legal proceedings.

30. This proposal seems to have been driven by administrative inefficiency at SARS rather than SARS requiring additional protection from taxpayer litigants and will add to the administrative burden on taxpayers.

31. It is unclear why taxpayers should also not be able to serve documents on the SARS office which is the subject of the legal proceedings as it is SARS as an entity and not the CSARS who administers the tax acts under the TAA.

32. Submission: This proposal should be deleted.

D. Proposals welcomed

33. Despite our primary focus in this letter being on our concerns in respect of certain of the new proposals, we do also wish to record our support for many of the initiatives contained in the draft TLAB and TALAB.

34. The proposals we applaud include:

34.1 The revised tax regime for contributions to retirement funds (but note our concern on the proposed monetary cap);

34.2 Tax incentives for special economic zones (provided that actions are taken to address other impediments to investment);

34.3 The tax proposals for domestic treasury management companies;

34.4 The exemption for international shipping companies;

34.5 The removal of restrictions on cross-issues of shares;

34.6 The attempts to streamline the VAT registration process (although we still have some concerns in this regard); and

34.7 The relaxation of understatement penalties.

pwc

Specific Submissions

E. <u>Retirement savings</u>

35. The further simplification of the tax proposals for retirement fund contributions is welcomed. However, it should be noted that we still have serious concerns with the proposed monetary cap on deductible contributions.

36. Although we have previously made submissions to National Treasury in this regard, we believe that these have not been adequately addressed and we repeat our concerns on this matter below.

<u>Model of taxation of retirement savings</u>

37. The general model of taxation adopted for retirement savings in South Africa is the exempt, exempt, tax model, i.e. income used to contribute to retirement funds is exempt from personal income tax (indirectly through a deduction for contributions), growth in the retirement funds is exempt in the hands of the funds and withdrawals from retirement funds are taxed.

38. The proposed monetary cap effectively introduces a dual model of taxation of retirement savings, the above for contributions below the cap and a tax, exempt, exempt/tax model for contributions above the cap where the income from which contributions are made is taxed and relief is given at the time of withdrawal from the retirement fund for non-deductible contributions, although the growth in the fund is taxed on withdrawal.

39. <u>Submission</u>: This dual model adds unnecessary complexity to the system and undermines the stated policy to simplify the tax regime.

<u>The equity argument</u>

40. The rationale advanced for placing a monetary cap on deductible retirement fund contributions is to improve equity in the tax system. However, far from improving equity in the tax system, a cap will actually result in higher-income earners making contributions in excess of the cap being treated inequitably when compared to lower-income earners.

41. It should be appreciated that the granting of deductions for contributions to retirement funds does not serve as permanent relief from tax, but rather, in general, defers tax to a

later date when amounts are withdrawn from the fund (the exception is in relation to lump sum withdrawals where a portion is tax-free, although this is irrelevant in relation to contributions in excess of the proposed cap as these amounts are likely to be taxed at the maximum marginal rate of 40%).

42. The implication of the proposed cap is that the same rationale is applied to the tax deductibility of contributions to retirement funds as is applied in the case of, for example, contributions to medical schemes where there is not a deferral of tax to a later date, but rather permanent relief from tax. The fundamental difference between contributions to retirement funds and contributions to medical schemes is that contributions to retirement funds are savings which will be taxed at a later date, whereas tax relief for contributions to medical schemes amounts to tax relief for consumption expenditure. To treat the two in a similar manner is to fundamentally misunderstand the difference.

43. It is entirely equitable that higher-income earners should not benefit through the tax system for consumption expenditure at the expense of lower-income earners. However, this principle should not apply to savings. Any contributions below the cap will result in real relief from tax for the taxpayer. The deduction will be enjoyed now, but on withdrawal the taxpayer will be taxed on both the contributions and the growth thereon at rates applicable to income.

44. However, in the case of contributions in excess of the cap no relief from tax will be enjoyed at the time of the contributions. Instead, relief for non-deductible contributions will be given to the extent of the nominal amount of such contributions when withdrawn, either in the form of a lump sum or as a compulsory annuity. The result is that a taxpayer making contributions to a retirement fund in excess of the monetary cap will be left worse off in real terms than a taxpayer making contributions below the cap.

45. The above is best illustrated by way of a simple example. Assume that a taxpayer makes a contribution of R1 000 to a retirement fund. The investment grows at an inflation rate of 6% per annum and is withdrawn 15 years later on retirement. If the taxpayer obtains a deduction at the time of the contribution, he or she will enjoy real tax relief on R1 000 and will be taxable on a nominal amount of R2 397 in 15 years' time. The real value of that amount in 15 years' time is R1 000 today and the taxpayer will therefore ultimately pay tax on an amount of R1 000 in real terms and will therefore be neutral in that regard.

46. However, if the taxpayer does not obtain a deduction at the time of the contribution, but instead is relieved from tax on the nominal amount of R1 000 at the time of the withdrawal, the taxpayer will pay tax on R1 000 at the time of the contribution and will pay tax on a nominal amount of R1 397 at the time of the withdrawal. In real terms, the amount of R1 397 equates to R583 with the result that the taxpayer suffers tax on an amount of R1 583 in real terms in comparison to the taxpayer that enjoyed a deduction for the contribution. In other words, the taxpayer who only enjoys relief on withdrawal is taxed on inflationary growth and is left worse off in real terms when compared to the taxpayer who gets a deduction for retirement fund contributions. The result is that the taxpayer who did not enjoy the deduction is treated inequitably compared to the taxpayer who does enjoy the deduction.

47. The argument that higher-income earners' deductible contributions should be capped because they enjoy greater relief than lower-income earners as a result of the progressive tax rates is also not valid as a result of the deferral nature of relief for contributions to retirement funds. Higher-income earners may enjoy tax relief at a rate of 40% for contributions to retirement funds as compared to lower marginal rates for taxpayers with incomes below the top tax bracket; however, these higher-income earners will also likely be taxed at higher rates when these amounts are withdrawn from the fund. Amounts withdrawn in the form of an annuity are taxed at marginal rates of up to 40%.

48. National Treasury suggests that the deduction regime for contributions to retirement funds is an incentive. While this is true to some extent in that a favourable tax regime encourages savings, it is not entirely an accurate representation. Aside from the portion of lump sum withdrawals exempted or taxed at preferential rates, the regime is merely a mechanism whereby the taxation of retirement savings is deferred until withdrawal of the savings. This, however, comes at a price as the withdrawal of the funds will be taxed at income rates and taxpayers will be forced to take a portion of withdrawals in the form of an annuity. This should be compared with the situation where savings are made outside of the retirement fund system. In such a situation, the bulk of the investment return would be taxed at the lower CGT rates. This is particularly the case insofar as equity investments are concerned and where the bulk of long term savings are ordinarily invested. In addition, the taxpayer would be free to withdraw the full amount of the savings at any stage.

49. To suggest that contributions in excess of the monetary cap are tantamount to an abuse of the regime by that reason alone is a gross exaggeration of the facts.

50. While it is acknowledged that the regime is open to abuse in exceptional circumstances through excessive contributions, as a general rule it is rarely abused by higher-income earners and only the ultra-wealthy can afford to make contributions to retirement funds far in excess of their retirement needs. It cannot be suggested that reasonable contributions to retirement funds proportional to an individual's earnings amounts to abuse of the regime. Such contributions are directed merely at preserving such an individual's lifestyle on retirement.

51. Submission: It is our position that the percentage based cap is adequate to counter any perceived abuse related to excessive contributions to retirement funds, ensuring that a reasonable ratio is maintained between earnings taxed now and those deferred to be taxed on retirement.

Perverse incentive not to preserve retirement savings

52. As tax relief on non-deductible contributions is deferred until withdrawal and there is no preservation of the real value of those deductions, as illustrated above, there is a perverse incentive to withdraw retirement funds early in order to access the deduction and thereby preserve the real value of contributions from a tax perspective. For example, where an employee with accumulated non-deductible contributions of R300 000 changes jobs, it would be a reasonable and rational course of action for the employee to withdraw that amount from retirement savings. Such a withdrawal is tax free and the employee could then invest those amounts in savings regimes outside the formal retirement savings industry, e.g. by investing the amount in unit trusts. The tax incentive to do so extends beyond merely accessing the non-deductible contributions, but also extends to the more favourable tax rates applicable to capital gains compared to those on withdrawals from retirement funds.

53. The financial benefit of this perverse incentive can be illustrated by way of example. If the employee in the above example withdrew the R300 000 from a retirement fund tax free and invested the amount in unit trusts providing an annualised gross return of 9% per annum for 10 years, the tax on the growth in that investment in the form of CGT at the end of the investment period (assuming the return in the form of dividends and interest is negligible) would amount to R54 557 at an effective rate of 13.3%. This is compared with the tax that would be paid were that amount to be withdrawn from the retirement fund after 10 years, in which case tax of R147 675 would be paid at a rate of 36% (assuming the withdrawal is taxed at the maximum rate).

54. This perverse incentive runs counter to one of the key objectives of the package of retirement reform measures, being the improvement of preservation of retirement savings. While, in our example, the level of savings is not impacted, it must be borne in mind that these savings now fall outside the formal retirement savings sector and can be withdrawn at any time, with consequential implications for savings levels.

55. Submission: The withdrawal of the monetary cap ensures that taxpayers remain incentivised to invest in preferred savings vehicles in accordance with government policy.

The impact on retirement savings

56. South Africa has an extraordinarily low net household savings rate. A low savings rate has the implication that more reliance has to be placed on foreign borrowings at higher interest rates in order to fund infrastructure projects and other expenditure, translates into higher costs of production and reduced competitiveness. Ultimately, lower savings rates translate to lower growth rates and lower growth rates translate to fewer jobs. Given South Africa's exceptionally high unemployment rate and low growth rates relative to its peers, it is essential that everything is done to improve savings levels and certainly no steps should be taken that potentially negatively impact on savings.

57. It is therefore imperative that any steps taken to reform retirement savings have the added effect of promoting savings and, more importantly, do not act as a perverse incentive not to save or to save outside of the retirement funding system.

58. We are concerned that the proposed cap to be placed on deductible contributions to retirement funds will constitute precisely such a perverse incentive or, at best, will result in reduced levels of retirement saving and a switch to alternative savings vehicles that are not specific to retirement and do not have the benefit of forced preservation, with the result that such savings could be reversed at any time. Ultimately, this could lead to even lower levels of household savings in the economy.

59. While the proposed monetary cap is aimed at limiting the deduction of retirement fund contributions for higher-income earners, in our view it will have a detrimental impact on the savings levels of those persons. Higher-income earners are precisely those persons that can most afford to save and they should be encouraged to save as much as possible, this ultimately being in the best interests of the country as a whole. The cap effectively sends the message to higher-income earners not to save more than the

capped amount for retirement and will reduce the amount that such persons contribute to retirement funds.

60. The result is that many taxpayers are, in the absence of tax relief for contributions, likely to curtail their contributions to retirement funds. In fact, this would be a perfectly logical and rational thing to do for the reasons set out below.

61. A person who is contributing R1 000 to a retirement fund from after-tax income (disposable income) of R1 000 as a result of tax relief enjoyed under the current dispensation will face a significant impediment in the event that the contribution is disallowed as a deduction by virtue of the monetary cap. Such a person's disposable income will be reduced by 40% as a result of the tax suffered on the income out of which the contribution is made. If our hypothetical taxpayer is to maintain the contribution of R1 000 to the retirement fund they will have to do so out of a disposable income that has been reduced by R400. The result is that many higher-income earners will have to reduce their contributions to retirement funds as a result of a reduction in their disposable income. For example, our hypothetical taxpayer may have to reduce the contribution to the retirement fund to R600 in order to maintain existing consumption spending power.

62. Alternatively, taxpayers could suspend any contributions to retirement funds in excess of the cap and invest in alternative savings vehicles such as collective investment schemes where returns will largely have the benefit of being taxed as capital gains at lower rates than withdrawals from retirement funds being taxed at high rates. As illustrated above, there is a tax benefit to investing outside of retirement funds if no deduction is provided for the contributions due to the returns being taxed at far lower rates. It would therefore be irrational for taxpayers to contribute amounts to retirement funds in excess of the cap as they would be better off investing outside of retirement funds from an income tax perspective.

63. The result is that contributions to retirement funds will inevitably be reduced as a result of the cap with consequential implications for the savings rate and level of savings in the economy.

64. At worst, the cap could see higher-income earners not seeing any benefit of saving amounts in excess of the cap and instead spending the amounts, leading to increased consumption expenditure and even worse savings levels in the economy.

65. While National Treasury has attempted to dismiss these concerns as invalid or as likely having a negligible effect on savings, in our view their reasoning in this regard is flawed. We address each of these arguments below:

- Firstly, National Treasury notes that non-deductible contributions will be rolled forward to subsequent years and ultimately withdrawals will be exempt from tax to the extent of such non-deductible contributions. However, as noted above, the real value of these non-deductible contributions is not preserved with the effect that it is more beneficial to invest amounts in excess of the deductible contributions outside of retirement funds due to the lower tax rates applicable to such investments. Investments in retirement funds are not competitive in the absence of an upfront deduction as withdrawals are taxed at rates applicable to income, in effect resulting in gains on capital investments in retirement funds being taxed at far higher rates than those applicable to other savings vehicles.

- Secondly, National Treasury has attempted to analyse the expected impact and draw conclusions on the likely impact on savings from SARS statistical data relating to contributions to pension funds and RAFs. However, this analysis is fundamentally flawed and the conclusions drawn are dangerous for the following reasons:

  - The SARS statistics contain no information with regards to contributions to provident funds. According to the discussion paper "Enabling a better income in retirement", defined contribution provident funds have nearly 4.5 million members and have assets under management of R308 billion. The membership of such provident funds is more than double that of defined contribution pension funds and about 25% more than RAFs. If defined benefit funds were to be included these numbers would obviously increase further. The number of members of defined contribution provident funds alone is roughly equivalent to the number of taxpayers according to SARS statistics. Were contributions to provident funds to be taken into account, this would likely substantially increase the average contribution for taxpayers who earn in excess of R1 million per annum.

  - The manner in which the average taxpayer contributions have been determined is flawed. In reality it is entirely possible that the range of deductions could be extremely broad with lower contributors or non-contributors significantly skewing the average. This is particularly likely in the case of contributions to RAFs where, unlike pension funds and

provident funds which generally have minimum contribution rates, no minimum contribution rates apply.

- National Treasury has failed to take into consideration that many taxpayers contribute to more than one type of retirement fund. For example, many employees supplement their retirement savings in pension or provident funds with further savings in RAFs. This is readily apparent when consideration is given to the proportion of taxpayers earning in excess of R1 million who are members of pension funds or RAFs. This equates to 72%. Given that the membership of provident funds is at least equivalent to that of pension funds, when these are taken into consideration the aggregate percentage is likely to be well in excess of 100%. It is therefore flawed to consider contributions to each type of retirement fund individually.

- It is assumed that the amounts reflected in the tax statistics relate to deductions for contributions to retirement funds claimed. This is, however, incorrect. The amounts reflected in the tax statistics relate to deductions allowed. As such, the actual contributions to retirement funds are likely to be substantially in excess of these amounts, particularly insofar as contributions to RAFs are concerned.

66. The conclusion by National Treasury that the cap is not likely to have a significant effect on savings levels is therefore not supported by valid evidence.

67. Submission: Even if the conclusions reached by National Treasury are correct (and we doubt they are), it is dangerous to make policy decisions that have a potentially negative impact on household savings levels without a full and complete understanding of the potential impact of those decisions.

68. Submission: Furthermore, it is submitted that, given South Africa's poor levels of household savings, no policies that have a potentially negative effect on saving levels should be introduced, regardless of how small the expected impact is. Doing so will simply serve to undermine other policy initiatives directed at increasing savings levels.

International practice

69. A glaring omission from National Treasury's research on this matter is any consideration of international examples of monetary caps placed on tax relief for retirement savings. Consideration should be given to how other countries with comparable systems of taxation of retirement savings treat contributions to retirement funds.

70. It is difficult to find other countries with comparable retirement systems and tax regimes due to the widely varying nature of these and we have struggled to find many comparable regimes where a monetary cap is placed on tax relief for retirement contributions.

71. The one exception is the United Kingdom which places a cap on tax-relieved contributions to retirement funds. However, this cap is set at £50 000 (and was previously far greater). This equates to approximately R775 000 and is therefore more than double the cap proposed by National Treasury. Furthermore, the UK does not have a percentage based limitation for tax relief on contributions to retirement funds and it is therefore possible to obtain a deduction of up to £50 000 if the taxable earnings are at least equal to this amount. The UK also allows unutilised contributions below the cap from prior years to be used against later contributions.

72. However, the UK also has a lifetime allowance of £1.5 million in terms of which withdrawals from retirement funds in excess of this amount are subject to an additional tax charge.

73. Submission: International practice should be considered before monetary caps on deductible contributions to retirement savings are proposed.

Roll forward of unutilised cap

74. It often happens that in some years caps are not fully utilised, but in subsequent years caps are exceeded. This is particularly relevant in the case of taxpayer's with volatile earnings and older taxpayer's who have to contribute at higher rates in order to compensate for low savings rates when they were younger.

75. An appropriate mechanism to address such a situation, apart from the higher allowed contribution rates for older taxpayers, is to allow unutilised caps from earlier years to be rolled forward to later years. For example, the UK allows unused annual allowances

from the 3 previous years to be carried forward and used to increase permissible deductions in subsequent years. As another example, Canada allows a roll forward of unutilised caps extending back to 1990.

76.	Submission: We note that the discussion document indicated that unused deductions may be rolled over. This has, however, not been incorporated into the draft legislation and we recommend that this should be the case.

F. Base Erosion and Profit Shifting (BEPS)

77. A number of initiatives, both domestic and international, have recently been announced that impact on the proposed legislation relating to this topic and which should be taken into account in determining the path that should be adopted in this regard.

78. The composition of the Tax Review Committee and the terms of reference thereof were announced on 17 July 2013. Part of the mandate of the committee is to review the corporate tax system with special reference to, inter alia, tax avoidance, including base erosion, income splitting and profit shifting, the tax bias in favour of debt financing and e-commerce.

79. On 19 July 2013 the OECD published its action plan on base erosion and profit shifting. One of the action points contained in the action plan is to make recommendations in relation to the model tax treaty and changes to domestic laws to address hybrid mismatch arrangements. The proposals related to hybrid debt instruments again fall squarely within that action point. The OECD has been at pains to warn against countries taking unilateral action as this could make matters worse, whether creating further opportunities for double non-taxation or potentially resulting in double taxation. At a recent meeting of the Forum on Tax Administration, of which South Africa is a member, the tax commissioners of the 45 member countries committed in a communique to coordinated action in relation to, inter alia, the tackling of aggressive tax planning and which included a reference to base erosion and profit shifting. The OECD initiative on BEPS is supported by the G20, of which South Africa is a member.

80. The proposals in the TLAB related to hybrid debt instruments, deductible interest limitations for acquisition debt, deductible interest limitations on loans between exempt persons and domestic companies, deferral of deductions of expenditure between domestic taxpayers and exempt persons, the introduction of the withholding tax on

service fees and the requirement for foreign supplier of digital services to register for VAT fall squarely within that remit.

81.	Submission: New legislation should not be introduced in relation to the various matters to be considered by the OECD prior to the OECD having issued its report and the Tax Review Committee having made its recommendations in relation to these issues. Although this is our primary submission in relation to these matters, we make other comments on the specific proposals below.

G. VAT e-commerce

82. The new rules essentially seek to include in the VAT net non-resident suppliers of e-commerce services. In practice SARS' ability to enforce compliance will be limited due to the fact that most non-resident organisations conducting e-commerce with SA residents have no physical presence in SA neither do they conduct any physical activity in SA.

83. As far as the potential VAT leakage is concerned, it will be closely linked to the recipient's ability to claim an input tax credit in respect of the services acquired. In the case of Business to Business supplies (B2B) the SA recipient would generally be entitled to an input tax deduction. It is therefore not clear why supplies to business customers, even where supplies are made to a business that is partially/wholly exempt, would necessitate a non-resident entity to register for South African VAT.

84. As the definition of e-commerce services is very broad, it appears that a plethora of non-resident suppliers would be liable to register for VAT albeit where there is little risk of tax leakage in the case of B2B supplies.

85. Given the above, we are of the opinion that compelling reasons exists why the introduction of legal provisions specifically dealing with e-commerce services in the SA VAT Act at this point in time are premature. We recommend that the introduction of such rules be deferred until the OECD issues its report on BEPS relating to electronic transactions. A co-ordinated approach will ensure that SA is aligned with global action and best practice and that the incidence of double taxation will be limited. As you are aware, double taxation could have a negative impact on inward investment into SA. This could also be an opportune time to consider introducing comprehensive place of supply rules to augment and support the e-commerce services specific legislation.

86. To avoid potential VAT leakages in the interim, consideration should rather be given to limiting registration requirements to Business to Consumer (B2C) supplies only, pending the introduction of comprehensive VAT e-commerce rules. Registration requirements should further be aligned with the normal registration threshold of R1 million per annum.

Onus of proof

87. To expect of a foreign business to know whether a person placing an order electronically is a resident or not, is unrealistic and impractical. Not only is the VAT definition of 'resident of the Republic' based on the income tax definition, which requires, at the end of the income tax year of assessment, a calculation of the number of days that an individual was inside South Africa, but the onus is now placed on the foreign business to determine whether the person ordering the services is an SA resident or not.

88. Furthermore, the additional requirement that a payment through an SA bank account will also create a VAT registration liability might also not solve the residency problem, as payments are often made through other mechanisms.

89. In addition, the foreign business will not know, until payment is received through a SA bank account that it is in fact dealing with a SA customer. Thus, if the customer did not inform the foreign business, it means that VAT would not have been added to the price. An additional charged would then has to be made for VAT.

No minimum level of activities required

90. The fact that no minimum level of activity in South Africa is required, technically has the absurd result that the foreign business will become liable for VAT registration at the end of the month during which one e-commerce supply of services was made, even for a minimal amount, and even if there is no expectation that such sales will in the future be made to SA customers.

91. The lack of a minimum scope of SA activity also has the effect that there are no clear guidelines as to when the foreign business must or may be deregistered as VAT vendor.

92. Submission: We submit that the introduction of the proposed e-commerce services legislation would be premature at this point in time. We recommend that concerns with potential VAT leakages be dealt with in terms of the general provisions of the VAT Act until the position has been finalised globally.

H. Hybrid debt

93. The selection of a period of 30 years as a threshold appears to have been selected on an arbitrary basis rather than any rational or scientific approach. It is not uncommon for arm's length third party debt to be issued for periods in excess of 30 years even though this may be relatively uncommon in South Africa. In particular, the issue of debt with longer maturity periods may be entirely appropriate in certain circumstances, for example, the financing of infrastructure projects (e.g. power stations, ports, railways, etc.) with long lifespans and payback periods.

94. Caution should be exercised that tax impediments are not placed in the way of legitimate commercial funding arrangements. Ideally, the term of an instrument should not be used in isolation to determine whether an instrument should be classified as debt or equity for tax purposes. Rather, it should be used only as a factor that may be indicative of debt being equity in substance in conjunction with other factors.

95. It is worth noting that, in terms of international accounting standards, even perpetual debts are not classified as equity purely on the basis that they are not redeemable.

96. Submission: It is submitted that the threshold should be increased to at least 40 years.

97. It is unclear why the definition of hybrid debt instrument is limited to debts owed by resident companies. Firstly, from a policy perspective, it is questioned why, for example, a South African branch of a foreign resident company should not be subject to the same rules as a resident company. Secondly, the unequal treatment of these companies raises questions of unfair discrimination against resident companies and may be in conflict with s9 of the Constitution.

98. Submission: the definition of hybrid debt instruments should not be limited to debt owed by residents.

I. Acquisition debt

Effective date

99. It is proposed that s23K be replaced by the new provisions effective from 1 July 2013. In terms of the amendments made in the 2012 legislation, s23K was meant to operate until 31 December 2013. By proposing to effectively repeal s23K and replace it with s23N and s23O retrospectively to 1 July 2013, taxpayers have been left in the invidious position of

the tax position in relation to the deductibility of interest on acquisition finance being uncertain.

100. As a result, until such time as the legislation is promulgated taxpayers have no certainty as to how to structure the funding of acquisition transactions.

101.	Submission: the effective date for the replacement of s23K with s23N and s23O should be 1 January 2014.

Excessive interest

102. We are disappointed that the written submissions to National Treasury on the media statement and the discussions at the workshop have apparently not fully been taken on board in the final design of the interest limitation. Most importantly, the view was strongly stressed that the use of an income statement ratio in isolation was not appropriate for a variety of reasons. While some concession has been made by limiting the restriction on deductibility to a period of 5 years and allowing for an upward adjustment in the percentage where interest rates increase significantly, these do not go far enough in order to alleviate the concerns. the following principle concerns still remain:

102.1 Many projects by their very nature result in losses in early years (or at least generate low profits) before becoming profitable at a later stage. Limiting the interest deduction (effectively to nil) in the early years of the project could result in such projects being unviable leading to reduced investment or, worse, disinvestment. For example, infrastructure projects have investment horizons of at least 20 years and are often unprofitable in the early years. Another example is the forestry industry where a plantation can take 30 years before it is ready for harvesting and generates no profits before then. The proposed 40% limitation effectively results in no deductions for interest being available for the first 5 years of the lives of such projects acquired by way of a reorganisation of acquisition transaction.

102.2 Businesses are often cyclical in nature and may be highly profitable in some years, but loss making in others. Mining and agriculture are good examples of such businesses. The result is that such businesses may be penalised in the first 5 years notwithstanding that the debt may not be excessive when viewed commercially.

102.3 The use of any income statement ratio in isolation will result in significant uncertainty in relation to the deductibility of interest. For example, start-up businesses will invariably be penalised due to losses in early years while businesses with volatile earning patterns will also be exposed. Recent history in the mining sector is a good illustration of how volatility could impact on earnings and the deductibility of interest if only an income statement ratio is used to determine whether debt is excessive or not.

103. The proposed 40% of adjusted taxable income cap is unworkable. A more appropriate mechanism is required to regulate the deduction of interest. For example, a combination of debt : equity ratios along with an adjusted taxable income ratio may be a more appropriate test.

104. Generally, where countries provide safe harbours they do so on the basis of a debt : equity ratio (e.g. Australia and Canada) or an interest to EBITDA ratio. Both Australia (proposed reduction from 3:1) and Canada (recently reduced from 2:1) provide for a debt : equity safe harbour ratio of 1.5:1. France uses a combination debt : equity ratio of 1.5:1 and an interest cover ratio of 25% of adjusted net income, both of which must be exceeded before the safe harbour is breached and interest disallowed as a deduction.

105. Submission: it is submitted that a dual test should be applied as a proxy for excessive debt in the form of a debt : equity ratio and a percentage of interest to adjusted taxable income where interest is only disallowed to the extent that both ratios are exceeded. In this regard it is submitted that a debt : equity ratio of 2:1 may be appropriate in most circumstances. It is submitted that the debt : equity ratio should be measured at the time of issue of the debt taking into account the market value of the assets at that time and should not be re-measured on an annual basis. However, this ratio may be too low in relation to certain low risk businesses with quality assets or relatively certain income streams, such as immovable property and infrastructure projects where higher ratios (or even a complete exclusion) may be appropriate.

Recognition of increased earnings

106. Interest is frequently incurred in respect of an investment where increasing annual earnings are expected to arise, such that the present value of the future interest cover is expected to exceed the present value of the interest expenditure over the term of the loan. It is therefore artificial to limit the amount of interest in the initial year of assessment and the next succeeding 5 years of assessment on an annual basis and deny deduction of amounts in excess of the annual limitation. The taxpayer has no control

over the timing of deduction of the interest expenditure – this is legislated. It is therefore prejudicial and out of touch with commercial reality to deny deductions to the extent that the initial profits are insufficient to permit full deduction. Interest in excess of the limitation should be allowed to be carried forward and any amount not deductible at the end of the sixth year of assessment should be disallowed finally.

107. Submission: The amounts that are denied deductions annually should be deemed to be interest actually incurred in the next succeeding year of assessment, provided that any amount of interest not allowed as a deduction at the end of the fifth year after the year of assessment in which the debt was incurred shall not be deemed to be interest actually incurred in any year of assessment that succeeds such year of assessment. This provides a more realistic matching of the cash flows involved in the financing decision. It is also consistent with the proposed section 23P.

Assumed debt

108. S23N applies to both newly issued debt and to assumed debt. Debt is frequently assumed as part of a reorganisation transaction and this assumed debt is often interest-bearing. For example, in the acquisition of a business secured debt such as instalment sale agreements may be assumed. The assumption of such debts does not in any way result in any increase in the amount of debt associated with the business and no interest limitation should apply in relation to such debt (or at least in relation to such debt that arose in the ordinary course of business).

109. It may, however, be appropriate to take such debt into consideration in determining the interest limitation in relation to any newly issued debt.

110. S23O also applies to both newly issued debt and to assumed debt. Debt is frequently assumed as part of a reorganisation transaction and this assumed debt is often interest-bearing and there is nothing sinister associated with such assumptions.

111. For example, in the acquisition of a business secured debt such as instalment sale agreements may be assumed. The assumption of such debts does not in any way result in any increase in the amount of debt associated with the business and no denial of the interest deduction should apply in relation to such debt (or at least in relation to such debt that arose in the ordinary course of business).

112.	Submission: the interest limitation should apply only to newly issued debt and not to assumed debt for both s23N & s23O.

Transactions between persons in a controlling relationship

113. By definition, any reorganisation transaction will involve the acquiring company and the acquired company being part of the same group of companies preceding the transaction taking place. The effect is that a deduction will only be available for interest related to debt pushdowns following a third party acquisition.

114. However, reorganisation transactions are frequently entered into for a variety of other legitimate commercial reasons that may require funding in the form of debt outside of third party acquisitions. For example, s45 is frequently used to facilitate the entry of a BEE partner into a business and to leverage the business so as to make the equity acquisition affordable. In such scenarios, the business would be disposed of a to a newly formed company held, say, as to 74% by the group and 26% by the BEE partner for market value. The purchase price of the business would be funded to an appreciable extent by either vendor debt or third party debt.

115. There are a number of legitimate commercial reasons why a company may wish to introduce debt as part of a reorganisation transaction. Placing a restriction on businesses in such scenarios will have a negative impact by reducing the flexibility of business.

116.	Submission: our submission is that s23O is misplaced and should be deleted.

Corresponding relief

117. Although it is proposed in s23N and s23O to permanently disallow a deduction of interest where such sections apply, no corresponding relief is provided from taxation for the recipient of such disallowed interest. The result is that the tax system will not be neutral in this regard.

118.	Submission: exemptions from income tax and withholding tax on interest should be provided for any interest disallowed as a deduction. As a second best alternative an exemption should apply where the recipient of the interest is a connected person.

pwc

J. Deferral of incurral of expenditure for untaxed related party expenditure

119. This proposed amendment will place an additional substantial financial, accounting and administrative burden on taxpayers. In many large multinational groups, inter-company charges are often raised as part of the year-end process. The taxpayer would therefore not have adequate time available prior to year-end to settle a debt, even though it may have the necessary cash flow to pay the fees.

120. Taxpayers that are not settling debts due to a lack of available cash flows would be put under additional financial strain as the proposed amendments may result in the taxpayer being in a taxable position, even though the company is making losses.

121. It also frequently happens that within groups amounts are settled through loan accounts rather than actual payment.

122. Even though the incurral of the expenditure would be deferred until such time as the expenditure has been settled, in most scenarios, the recipient would be still be fully taxed on the income in another country. This would result in economic double taxation until such time as the amount is settled.

123. The proposed amendment applies to all expenditure incurred on or after 1 July 2013. This would effectively result in retrospective legislative amendments which cause uncertainty for taxpayers.

124. Submission: This proposal should be deferred for proper consultation and await the outcome of the OECD process on BEPS and the recommendations of the Tax Review Committee.

K. Untaxed related party interest

General

125. Submission: our main submission is that new legislation should not be introduced in relation to excessive interest prior to the OECD having issued its report and the Tax Review Committee having made its recommendations in relation to this issue.

Scope of provision

126. It is questioned why the provision only applies to interest incurred by resident debtors. In this regard, non-residents carrying on business in South Africa are placed at an advantage to SA residents as they will not be subject to the same limitations on deductions of interest.

127. Submission: if the provision is to be introduced, it should apply equally to residents and non-residents.

Written submissions not considered

128. We are disappointed that the written submissions on the media statement and the discussions at the workshop have apparently not fully been taken on board in the final design of the interest limitation. Most importantly, the view was strongly stressed that the use of an income statement ratio in isolation was not appropriate for a variety of reasons. While some concession has been made by limiting the restriction on deductibility to a period of 5 years and allowing for an upward adjustment in the percentage where interest rates increase significantly, these do not go far enough in order to alleviate the concerns. the following principle concerns still remain:

- Many projects by their very nature result in losses in early years (or at least generate low profits) before becoming profitable at a later stage. Limiting the interest deduction (effectively to nil) in the early years of the project could result in such projects being unviable leading to reduced investment or, worse, disinvestment. For example, infrastructure projects have investment horizons of at least 20 years and are often unprofitable in the early years. Another example is the forestry industry where a plantation can take 30 years before it is ready for harvesting and generates no profits before then. The proposed 40% limitation effectively results in no deductions for interest being available for the first 5 years of the lives of such projects acquired by way of a reorganisation of acquisition transaction.

- Businesses are often cyclical in nature and may be highly profitable in some years, but loss making in others. Mining and agriculture are good examples of such businesses. The result is that such businesses may be penalised in the first 5 years notwithstanding that the debt may not be excessive when viewed commercially.

129. The use of any income statement ratio in isolation will result in significant uncertainty in relation to the deductibility of interest. For example, start-up businesses will invariably be penalised due to losses in early years while businesses with volatile earning patterns will also be exposed. Recent history in the mining sector is a good illustration of how volatility could impact on earnings and the deductibility of interest if only an income statement ratio is used to determine whether debt is excessive or not.

130. The proposed 40% of adjusted taxable income cap is unworkable. A more appropriate mechanism is required to regulate the deduction of interest. For example, a combination of debt: equity ratios along with an adjusted taxable income ratio may be a more appropriate test.

131. Generally, where countries provide safe harbours they do so on the basis of a debt: equity ratio (e.g. Australia and Canada) or an interest to EBITDA ratio. Both Australia (proposed reduction from 3:1) and Canada (recently reduced from 2:1) provide for a debt: equity safe harbour ratio of 1.5:1. France uses a combination debt: equity ratio of 1.5:1 and an interest cover ratio of 25% of adjusted net income, both of which must be exceeded before the safe harbour is breached and interest disallowed as a deduction.

132. Submission: it is submitted that a dual test should be applied as a proxy for excessive debt in the form of a debt : equity ratio and a percentage of interest to adjusted taxable income where interest is only disallowed to the extent that both ratios are exceeded. In this regard it is submitted that a debt : equity ratio of 2:1 may be appropriate in most circumstances. It is submitted that the debt : equity ratio should be measured at the time of issue of the debt taking into account the market value of the assets at that time and should not be re-measured on an annual basis. However, this ratio may be too low in relation to certain low risk businesses with quality assets or relatively certain income streams, such as immovable property and infrastructure projects where higher ratios (or even a complete exclusion) may be appropriate.

133. It is proposed that excessive interest may only be carried forward for a period of 10 years. While this will to a large extent neutralise the negative effect of the provision for cyclical business, it will not be of assistance for projects with a long lead time to profitability. Examples previously highlighted include those relating to infrastructure projects (e.g. renewable energy projects), forestry and mining. Such projects are expected to be unprofitable for the first number of years of their lives before ultimately becoming profitable. The proposed provisions will be a significant impediment to the viability of such businesses.

134. Submission: any excessive interest should be allowed to be carried forward indefinitely.

135. It is proposed that the effective date of s23P is interest incurred on or after 1 July 2013. The effect is that taxpayers will be placed in a position where interest will potentially be non-deductible with retrospective effect. Taxpayers should be afforded an opportunity to rearrange their affairs so as to fall outside the provisions of s23P.

136. Submission: s23P should apply only to newly issued debt. As a second best alternative, the effective date should be deferred to at least years of assessment commencing on or after 1 January 2014 so as to allow taxpayers an opportunity rearrange their affairs.

L. Withholding tax on service fees

137. The proposed withholding tax on services fees will apply only to those service fees derived by non-residents from a source in South Africa. In effect, this means that it will apply only where the services in question are physically provided in South Africa. As a general rule, South Africa will have no taxing rights in relation to such service fees under the tax treaties concluded by it unless the services fees are attributable to a permanent establishment of the non-resident situated in South Africa. Insofar as residents of non-treaty countries are concerned, South Africa already has the right to tax such service fees in terms of existing law.

138. The result is that the proposed tax will add little to South Africa's tax revenues. However, it will create a substantial administrative burden for the payers of such fees.

139. We understand that the primary objective of National Treasury in introducing this tax is to obtain information in order to identify service fees attributable to permanent establishments in South Africa. As such, this initiative is closely related to the work being undertaken by the OECD in relation to BEPS.

140. Submission: we recommend that the introduction of the withholding tax on service fees be put on hold until such time as the OECD has concluded its work on BEPS and the Tax Review Committee has considered and made recommendations on this proposal.

M. Research and Development

141. It is submitted that the proposed amendments to s11D are inappropriate and do not clearly indicate whether a change in policy regarding R&D expenditure is intended.

Although the Explanatory Memorandum refers to the proposals as "refinements", we submit that these are in fact a fundamental departure from the original regime.

142. One of our major concerns is with the proposed paragraph (f) of the proviso to the definition of "research and development" in s11D(1). It is submitted that this paragraph will unfairly exclude the majority of innovative R&D in SA.

143. The draft wording of para (f) disqualifies any R&D —irrespective whether it is initial creation/development or whether it is the subsequent improvement— if it is for an activity for the purpose of IP that is known or used by others. With respect, it is submitted that this ignores the fact that the vast majority of R&D activities in SA (and, indeed, in the world) are focussed on the enhancement and improvement of existing IP.

144. The effect of para (f) of the proviso is to completely remove any incentive for "significant and innovative improvement", i.e. completely contradicting and negating the main part of the "research and development" definition. For example consider the following three scenarios:

- If the taxpayer is the original developer of the IP, and it had previously transferred or licensed the IP for use to someone else then the taxpayer has no incentive to undertake improvements, because the IP is "*already utilised or known by other persons*"; or

- If the taxpayer is a licensee/purchaser who acquired the sole and exclusive ownership of the IP then he too would have no s11D incentive for enhancement, because the IP is already known to the seller/licensor, i.e. original developer; or

- If the original developer retained the IP solely for use then he would in any event be excluded because the IP was not made available to the "*general public*" as now contained in the proposed amendments.

145. The proposed proviso would make the entirety of s11D almost irrelevant.

146. Submission: In the s11D(1) definition of "research and development", para (f) of the proviso should be completed deleted. We submit that the disqualification in para (f) is inappropriate and unfairly ignores the reality of where exactly the bulk of innovative R&D activity takes place in the world today.

Discrimination against specific industries

147. For inexplicable reasons, the clinical research trial industry and generic manufacturing industry appear to be subject to a different set of rules and standards which seems unusual and without reasonable or justifiable reason.

148. As a general rule, in the pharmaceutical industry, the development of generic medicines, by their very definition, exhibits an exceptionally low level of technological innovation, if any at all. This appears to be entirely contrary to the spirit of the legislation, which seeks to reward high levels of innovation, rather than low.

149. Thus all these forms of R&D would be excluded by the proposals.

150. Submission: We recommend that the specific focus on a particular industry be deleted in its entirety.

The "general public" requirement

151. The requirement that the intended result of the R&D must be IP that is for "sale to, or for use by the general public" is too broad and thus creates an unrealistic restriction. This phrase is proposed to makes its appearance in several places in the definition of "research and development" in s11D(1).

152. First, there is an interpretational problem with "general public". There are numerous applications designed for end users who might not necessarily be considered to be "general public". For example:

- Payroll software designed exclusively for employers;
- CAD (computer-aided design) inventions designed exclusively for architects or for engineers;
- Excavation equipment designed exclusively for mining companies;
- Sophisticated medical equipment (e.g. neurosurgery technology, cardiac-related equipment, and so forth), which will be used solely by medical practitioners;
- Enterprise and accounting software designed solely for companies and businesses;
- Military equipment.

153. Secondly, there are many IP applications that are designed for the indirect benefit of the general public, but which are not actually sold to or used by the general public. For example:

- The background design and security —which is designed to improve the customer experience— of a website which offers online sales;
- Technology to measure carbon emissions;
- Technology used in manufacturing equipment.

154. Submission: The requirement that R&D outputs must be intended for either sale to, or use by, the general public should be completely removed or substantially refined.

N. Share issues for foreign shares

155. The proposal that an issue of shares by a resident company in exchange for shares in a foreign company be a disposal event will have serious implications for cross-border mergers and the ability of SA multinationals to make foreign acquisitions. In effect, the proposal will result in such acquisitions only being able to be made for cash, regardless of the size of the acquisition.

156. For example, where a SA resident company issues 10% of its shares in exchange for 100% of the shares in a foreign company, it can hardly be said that ownership of the SA company now lies with non-residents and that the company has indirectly migrated.

157. While the concern with regard to migration of SA corporates and the loss of their SA identity is understood, it must be questioned whether the tax system is the appropriate instrument to deal with this concern given the distortions and impediments for business that will result.

158. Further consultation and consideration is required before this proposal is implemented.

159. Submission: the proposal should be withdrawn for further consultation.

O. Understatement penalties

Bona fide errors

160. The proposed amendment to exclude bona fide errors from the understatement penalty is welcomed as this was clearly an oversight in the initial provisions and not a policy change as taxpayers should not be burdened with excessive penalties for bona fide errors. It is however of concern that that this amendment is proposed to take effect only from the date of promulgation of the amendment and not retrospective to the effective date of the TAA to ensure that the policy is consistently implemented. This is also contrary to the position adopted in respect of most other amendments to the TAA, which clarify certain positions and do not constitute policy changes, as they are retrospective to the effective date of the TAA.

161. Taxpayers that have made inadvertent errors since the TAA was introduced should be entitled to relief as no policy objection to this principle exists.

162. Submission: The effective date for the amendment to provide relief from understatement penalties for bona fide errors should apply from the effective date of the TAA.

Retroactive penalties

163. With the introduction of the TAA from 1 October 2012, a new penalty regime for understated tax was introduced to replace additional taxes that could be levied in terms of the Income Tax Act and VAT Act. The understatement penalty regime imposed in terms of the TAA is far more onerous than the old additional taxes in that it applies fixed amount penalties regardless of the circumstances that gave rise to the understatement of tax, whereas the additional tax was discretionary and, in the case of VAT, could only be levied in the event of intentional tax evasion.

164. The transitional provisions of the TAA currently imply that the new understatement penalties may only be imposed in relation to tax positions adopted on or after the date that the TAA came into effect and that the old additional taxes would apply to tax positions adopted prior to that date. Notwithstanding this, in practice SARS applies the understatement penalties to tax positions adopted prior to the TAA having come into effect.

165. Numerous challenges by taxpayers to this practice are currently under way. These challenges are not only being brought on the grounds of the transitional provisions as they currently stand, but also on the grounds that any attempt to levy the understatement penalties in relation to tax positions adopted by taxpayers prior to the TAA having come into effect are unconstitutional and offend the principle of the rule of law.

166. An analogy for the manner in which SARS has implemented the understatement penalties is for the speed limit on a road to be lowered with retroactive effect and for all cars that exceeded that reduced speed limit in the past to be fined.

167. An amendment to the transitional provisions in s270(6) is proposed by SARS retrospective to the date that the TAA came into effect which will have the effect of negating one of the grounds on which the challenge to the validity of such understatement penalties is being brought (this will, however, have no effect on the constitutional challenge).

168. In this regard, the statement in the MO to the TALAB to the effect that the proposed amendment to s270(6) is merely a clarification is misleading. In its current form, the only reasonable interpretation of s270(6) is that it requires that any additional tax, penalty or interest that could have been levied under a Tax Act but for the repeal of the relevant provisions must be levied notwithstanding such repeal. Furthermore, on such an interpretation, it is clear that any understatement penalties, administrative penalties or interest under the TAA in relation to defaults that took place prior to the effective date may not be levied.

169. The proposed amendment fundamentally changes this position by making the levying of the additional tax, penalties or interest under the repealed provisions of a Tax Act subject to the non-levying of the equivalent under the TAA.

170. SARS is well aware that taxpayers are challenging the levying of understatement penalties under the TAA in respect of tax positions adopted prior to the TAA coming into effect. The proposed amendment is therefore a less than subtle attempt to eliminate such an argument with retrospective effect. That said, we remain of the view that, even should the proposed amendment be promulgated, SARS will not be entitled to levy understatement penalties for tax positions adopted prior to 1 October 2012 on the fundamental principle of the rule of law.

171. Notwithstanding that, SARS should not be given free reign to act in this manner and to walk over the rights of taxpayers. A clear message needs to be sent to SARS that behaviour of this nature and the abuse of power will not be tolerated.

172. If anything, the transitional provisions should be made abundantly clear that any new penalties or other sanctions imposed by the TAA will only apply to actions that took place subsequent to the TAA having come into effect.

173. Submission: The proposed amendment to s270(6) should be withdrawn.