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Dear Sir/Madam

**RE: CALL FOR COMMENTS ON DRAFT TAXATION LAWS AMENDMENT BILL  
AND THE DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL, 2013.**

We refer to the call for comments on the above-mentioned documents. Set out below please find the SAICA National Tax Committee's submission. As requested, the comments are arranged such that they follow the sequence of the Explanatory Memorandum. In our comments we will use "DTLAB" when we refer to the draft Taxation Laws Amendment Bill, 2013 and "DTALAB" when the reference is to the draft Tax Administration Laws Amendment Bill, 2013.

**GENERAL COMMENT**

A number of the amendments proposed by the DTLAB have retrospective commencement dates. We submit that Andrea Minnaar explains the issue well in the following extract:

"Retrospective or retroactive legislation ... makes it impossible for a taxpayer to arrange its affairs and to comply with the relevant legislation. The position may have been more tenable if the draft legislation released by National Treasury ... could be



relied upon to be the final version of the legislation. However, more often than not, these drafts undergo various changes before being promulgated with the effect that it is impossible for a taxpayer to predict what the rules are that it has to comply with.”

“... bringing legislation into effect retrospectively or retroactively conflicts with two key South African constitutional principles, being the rule of law and the principle of separation of powers.”

(The extract was taken from an article that was published in May 2012 and is available at [http://www.ens.co.za/news/news\\_article.aspx?iID=629&iType=4](http://www.ens.co.za/news/news_article.aspx?iID=629&iType=4))

### ***Recommendation***

Our general recommendation is that the rule of law be observed and that changes to tax legislation should in general not have retrospective effect. It is submitted that many of the amendments simply cannot have retrospective effect. In our submission that follows we have indicated some of these instances.

## **SPECIFIC COMMENTS**

### **1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT**

#### **1.1 Bursaries or scholarships to employee relatives**

We welcome the proposed changes to the monetary amounts in section 10(1)(q), but several uncertainties still remain within this area.

#### ***Issue 1 – Definition of “remuneration”***

We welcome the fact that the word “remuneration” in the current legislation is to be replaced by “remuneration factor” which in essence is based on remuneration derived by an employee from an employer during the year of assessment immediately preceding that year of assessment. Remuneration for this purpose is defined in paragraph 1 of the Fourth Schedule to the Income Tax Act.



In terms of this definition certain specific amounts of income are included. Examples include leave pay, bonus, gratuity, commission and certain other lump sums. Some of the amounts mentioned above are not part of an employee's guaranteed package (or normal remuneration) and are often paid at the discretion of the employer. Furthermore, such amounts are also mostly paid in lump sums and therefore only paid once or twice per annum.

### ***Recommendation***

In this regard we wish to draw your attention to the SAICA submission to National Treasury on "SCHOLARSHIPS AND BURSARIES AWARDED TO EMPLOYEES AND RELATIVES OF EMPLOYEES" made on 17 September 2012. It was proposed then that remuneration for purposes of section 10(1)(q) is defined more narrowly than in the Fourth Schedule by restricting remuneration to the cost of the employer and excluding any lump sum payments, share gains and variable payments.

### ***Issue 2 – Timing***

Clarity needs to be provided in terms of the application of the proposed changes. It is not clear when the determination of the remuneration needs to be considered.

*For example:* When an employer provides the relative of the employee with a bursary or scholarship in the first month of a year, will the remuneration factor of the employee then be determined on that specific date (in order to see whether such employee qualifies for the tax exemption), or should the employer refer to the remuneration derived from the employee in the immediate preceding year of assessment?

### ***Issue 3 – Monetary limits***

The monetary limits for each relative (i.e. R10 000 and R30 000) will in most instances only cover the basic tuition fees and will not necessarily cover any additional expenses (e.g. uniforms, books, stationary and other devices required per subject).

In keeping with the Government's commitment to increase the skills base within South Africa and alleviate poverty, there should be no limit placed on the amount an employer can spend



on educating employees, who earn below R250 000, and their relatives. The cost of education is extremely high, especially private education and limiting the amount that an employer can spend, is essentially prohibiting a low income earner from receiving a more expensive education which is generally considered more beneficial to learners.

### ***Recommendations***

It is suggested that consideration be given to align the monetary limit on “remuneration” to the current tax return threshold (R250 000).

We also suggest that the monetary limits be increased to R15 000 and R50 000 respectively to enable the additional expenses to fall within the exemption.

The budget speech had announced that the proposed changes would come into effect 1 March 2013, however the DTLAB proposes an effective date of 1 March 2014. We propose that it remains at 1 March 2013.

## **1.2 Alignment of the tax treatment of individual-based insurance policies**

### ***Issue 1***

The proposed alignment of disability insurance plans to income protection plans was based on the reasoning that both such insurances have the same objective – to protect the financial future of an individual and his/her family through insurance against an adverse personal event (e.g. death or disability).

There are however many distinctive differences between these two types of insurance policies, which begs the question why the tax treatment should be aligned if only one of the objectives has a considerable resemblance.

Even though it is proposed that the proceeds will be tax free in the hands of the beneficiary, it should be understood that people may be discouraged to contribute to such policies as they will have less net pay monthly, and for a benefit that depends on the occurrence of some future event that may or may not occur.



The proposed change will also create an administration burden on both the insurers and insured; as such change will oblige both parties to amend their policies to ensure that the employee is not over-insured. This will be due to the fact that most policies accounted for the tax payable on pay-out and took it into account on the insured amount; therefore the employee would receive his insured amount (usually 75% of what he was earning before becoming disabled) together with additional money to account for the tax. If the proceeds are to be tax free, the employee must amend the policy otherwise he or she would have contributed for a benefit that would be limited to 75% (as above) on pay-out.

It was also understood that parity was sought between employer provided policies and independently acquired policies. It is submitted that creating a fringe benefit for the employee, while denying a deduction for everyone, does not create this parity.

This creates the situation where employers who provide these benefits will look to cancel these benefits for the employees as the employees will be worse off on a monthly basis and will not wish to participate. The individuals may not necessarily take these policies out privately and this may lead to uninsured persons that may have to depend on government support should severe illness or disability occur.

### ***Recommendation***

It is proposed that the change be deleted from the DTLAB, as the additional tax revenue that can be generated from this will be minimal but the effect on the taxpayer, employers and insurers will be phenomenal.

If the deduction is going to fall away then the fringe benefit under paragraph 12C should be repealed.

It is understood that Treasury seek to align all insurance policies, however, alignment cannot occur on something that will negatively impact the savings for future events as important as death, disability etc., and which could result in having more uninsured South Africans in the future relying on government grants for income.



Keeping the current tax treatment will be in line with international tax authorities, such as Australia, New Zealand, Ireland and Canada.

### ***Issue 2***

SAICA notes that National Treasury ('NT') intends to remove the deductibility of premiums paid in respect of income protection policies and correspondingly exempt benefits from normal tax in the hands of the recipient. This is a fundamental change in the current tax treatment of these policies and may have a negative impact on the retention of existing policies and the continued viability of such policies in the future - particularly insofar as employee structured policies are concerned.

We note that the proposed tax treatment is not in line with basic tax principles and not consistent with the international tax treatment of similar policies in jurisdictions such as Australia, Canada, New Zealand and Ireland.

### ***Recommendation***

In this regard, SAICA supports the submissions by the Association of Savings and Investment of South Africa ('ASISA'), dated 16 April 2013 and 19 June 2013. SAICA reiterates ASISA's concerns of the financial, economic and social impact of the removal of these policies' deductibility and consequently requests further engagement in this regard - particularly since the changes impact existing employer schemes that cannot be easily unwound.

## **1.3 Rollover treatment for excess deductible donations**

### ***Issue***

The proposed changes has the effect that taxpayers who makes donations in excess of the amount of 10% of the taxable income will never be able to make use of the roll-over relief until such time where they either make no donation in a year of assessment, or the amount of the donations is reduced.



### ***Recommendation***

It is proposed that the deduction limit be increased from 10% to 15% in order to encourage more donations.

We would also suggest that a specific event be linked to the receipt of the roll-over relief, in other words, that the taxpayer enjoys the benefit of the relief upon occurrence of a certain event (such as after a specific time period or on retirement).

## **1.4 Revised contribution incentives for retirement savings**

### ***Issue***

Section 11(l) currently contains a deduction for employer contributions to pension, provident funds or medical schemes. The proposed revision to section 11(l) excludes medical schemes. It is not clear why these contributions are to be excluded from the ambit of section 11(l).

### ***Legal nature***

The exclusion of medical schemes from the section 11(l) deduction will effectively require employers to make the deduction in respect of contributions to such benefit funds in accordance with section 11(a).

### ***Recommendation***

It is requested that section 11(l) includes contributions to medical schemes to be consistent with current legislation.

## **1.5 Valuation of fringe benefit for defined benefit process**

### ***Issue 1***

The valuation of this benefit appears to be complex, since an actuary is required to determine the value to be included as a fringe benefit. Employees may not understand how this value is determined and employers will be required to provide training sessions for their employees on this, which may be costly.



### ***Recommendation***

The methodology for the valuation of this benefit should be simplified so that the employees contributing to these funds understand how it is determined.

### ***Issue 2***

The fringe benefit is to be included on a monthly payroll. This may increase payroll costs as the actuary has to provide the value in respect of each employee prior to the company's payroll cut-off date. Payroll deadlines are non-negotiable for most businesses as salary payments must be made on a specific date. Actuarial valuations may take time to finalise and this may well create unacceptable delays in the finalisation of payroll figures.

### ***Recommendation***

The methodology for the valuation of this benefit should be simplified, with a view to keeping payroll costs down and the assured attainment of monthly payroll deadlines.

### ***Issue 3***

The fringe benefit is included on a monthly basis and the employee can claim a deduction of 27.5% on the greater of remuneration or taxable income. As the employee can claim the company contribution and his/her own contributions up to this limit, it is likely that the inclusion of the fringe benefit may not result in additional tax payable by the employee.

Consequently, employers may undertake a costly exercise of obtaining actuarial valuations which may have no impact on the employees' tax calculation.

### ***Recommendation***

The methodology for the valuation of this benefit should be simplified.

## **1.6 Provident fund post-retirement annuity alignment**

### ***Issue***

With the proposed amendment to section 11(k) and the proposed deletion of section 11(n), members of retirement funds who exceeded their deductible limits prior to the proposed



amendments will not be able to obtain the necessary tax relief on retirement/withdrawal in terms of paragraphs 5 and 6 of the Second Schedule.

### ***Legal nature***

As section 11(k) is amended and deemed to coming into operation on 1 March 2015 and apply in respect of amounts contributed on or after that date and as section 11(n) is repealed, members of retirement funds making contributions prior to 1 March 2015 in terms of sections 11(k) and 11(n) will be precluded from deducting their non-deductible contributions prior to 1 March 2015 from the taxable lump sum paragraphs 5 and 6 of the Second Schedule.

### ***Recommendation***

It is requested that paragraphs 5 and 6 be amended to allow deductions for non-deductible contributions made in terms of sections 11(k) and 11(n) prior to 1 March 2015.

## **1.7 Employer provided accommodation – low-cost housing**

### ***Issue***

The word “remuneration” referred to in “remuneration factor” will be as defined in the Fourth Schedule to the Income Tax Act. This definition specifically includes payments such as leave pay, overtime, bonus, gratuity, commission, etc.

Many of the amounts mentioned above are never part of an employee’s guaranteed package as it is paid at the discretion of the employer. Furthermore, such amounts are also mostly paid in lump sums and therefore only paid once or twice per annum.

Including such amounts in the “remuneration factor” for determining the taxability of this benefit will negatively impact the employees who were theoretically supposed to benefit from this proposal, as they will be regarded as “low-income” earners but earning a non-guaranteed annual payment (many times linked to a performance above expectations) will make this benefit taxable in their hands and reduce their net take home pay significantly.



### ***Recommendations***

It is proposed that the definition of “remuneration factor” be amended to rather refer to a guaranteed remuneration package / basic salary structure, as opposed to the wide definition of “remuneration” as per the Fourth Schedule.

We further propose that the monetary limit set on “remuneration” in this proposal be aligned to the current tax return threshold limit of R250 000 as there is no reason to create an inconsistency between the amounts which could lead to potential confusion on all the limits set within the Act.

In light of the latter comment, we further propose that the monetary limit not only be aligned to the tax return threshold limit, but also linked thereto. Countless times a tax incentive is brought into legislation with the aim of assisting low-income earners, however the value of money within South Africa (and Internationally) constantly decreases and the cost of living constantly increases, therefore the employee will not always remain a “low-income earner” with only R200 000 per annum (e.g. five (5) years from now the cost of living could have increased significantly, making a low-income earner someone who earns less than R350 000 per annum).

Such link will ensure that the correct group of employees keeps on enjoying the tax incentive and the administration of effecting such change in the legislation will be reduced for SARS going forward.

### **1.8 Share schemes income recognition**

The draft EM seeks to assert that the dividends which are sought to be taxed operate as salary, regardless of the features of the underlying share. This assertion fails to consider a main feature of such share schemes, which is the participation of the participant in the equity of the company, and a shared alignment of (often executive) interests with the interests of the shareholders.



### ***Issue 1***

It is proposed that Section 8A of the Act be repealed from any years of assessment commencing on or after 1 January 2015.

There are currently share incentive schemes subject to section 8A still in operation and there are, still options that have not been exercised or options which have still not been implemented that would qualify for treatment under this regime. In addition, there may be taxpayers who elected to defer the payment of tax on exercised options due to further restrictions (although the tax charge has crystallised) in terms of section 8A(1)(b) of the Act.

As drafted, this amendment will have the effect of retrospectively removing existing rights of taxpayers. The constitutionality thereof is questionable as the law, at the time of grant, would have entrenched rights for the participants.

If this were to be passed into law, it is not clear how awards granted prior to 26 October 2004 would be taxed or the deferral of payment dealt with as there is no relevant proposed change to section 8C and repeal of the section may unintentionally subject implementations to tax in terms of the Seventh Schedule of the Act.

The Explanatory Memorandum of the TLAB 2013 does not provide an explanation.

### ***Recommendation***

Taxpayers' rights in terms of their existing participation in section 8A schemes should be maintained. As a consequence, section 8A should be retained in order to secure the rights of members that have not exited such schemes. Section 8A should consequently not be repealed.

### ***Issue 2***

The reclassification of dividends as income in these circumstances has practical implications for dividend declarers and recipients participating in such schemes. For instance, it would need to be clarified who would be responsible for withholding and reporting of these payments and how this would be processed via payroll and under what code.



South African dividends are currently exempt from income tax in the hands of South African resident natural persons but are subject to 15% withholding tax on dividends. Subjecting a specific class of natural persons to income tax on their dividends (as proposed) will require specific exemption declarations to be signed by these persons and submitted and stored to the relevant institutions.

Currently no such process exists. NT needs to consider the current administration processes in the dividend withholding tax ('DWT') regime if the intention is to carve these dividends from the DWT regime and subject them to income tax. Currently, all companies do not require exemption declarations for recipients receiving dividends who are currently fully subject to DWT. A differentiation would have to be made for these recipients, exemption declarations would have to be signed and stored and all necessary processes would have to be updated before such a change could be practically implemented.

There are also concerns regarding the deduction of the expense. It appears that the deduction is only available to the entity paying the dividend however in many cases this is not the entity where the cost of employment lies.

The very nature of this change will also directly impact many current broad-based employee schemes which due to the nature of the plans currently fall into section 8C (rather than section 8B). The particular issues here being:

- There are many participants that have already left employment of the company granting the broad-based offer and would no longer be on payroll.
- These schemes may be supporting a number of orphans and widows who may now be subject to higher rates of tax and are also not on the company's payroll.
- These schemes, designed in terms of legislation in place at the time, often have interest payments (on the loan used to purchase the shares) linked to dividend payments.
- Generally broad-based schemes are not designed to provide a form of disguised remuneration but rather to promote employee ownership, and are therefore likely being grouped together with schemes that are designed to lower effective tax rates



because of the limitations of section 8B. It does not appear that an impact study has been undertaken to quantify the effect of this change and the increase in taxes (and this would likely also be subject to UIF and SDL) on a labour force that is already experiencing unrest should be taken into consideration.

In addition, it appears that this change in legislation has not been carried through to the Dividend Withholding Tax legislation.

It is not clear whether this will be applicable to both local and foreign dividends. Although it would appear that this only applies to local dividends as the company would then be able to claim the corresponding deduction. However, if this does not apply to foreign companies then this may incentivise company to rather grant foreign shares to employees and would therefore be prejudice against local companies.

### ***Recommendation***

The changes that have been suggested to the legislation which is relevant to share schemes appears to be ad hoc in nature and perhaps somewhat premature given the need for a full review of the provisions relating to share plans.

We therefore submit that a review of all provisions relating to employee related share schemes be undertaken to provide effective and clear tax laws and to work with interested parties to understand the real and practical constraints.

This review should include a revamp of section 8B to provide legislation that provides real benefit and value for broad-based employee participation to effectively incentivise companies in an effort to promote employee ownership in both local and foreign entities.

### ***Issue 2***

NT proposes to tax dividends from share schemes as ordinary income because it sees them as 'disguised low-taxed salaries' without the employees every obtaining direct control of the underlying shares. The reason for taxing such dividends in the case of share schemes offering participating in listed companies however should remain exempt.



Listed companies have scheme rules and governance structures that ensure true participation in underlying shares. The potential for paying dividends to participants without ever transferring ownership therefore cannot apply to listed companies if they comply with existing regulatory requirements.

### ***Recommendation***

It is proposed that dividends paid to participants in share schemes linked to listed shares retain their exempt nature/status.

### ***Issue 3***

In listed companies it is not possible to manipulate dividend flows in the manner suggested due to their inherently large numbers of shareholders. The likelihood of employee share schemes being used to effectively “dividend strip” is also decreased significantly within the context of listed companies.

Often the underlying shares awarded in terms of the employee share scheme are in a holding company and not the employer company. As a result of this the deduction afforded to the company declaring the dividend is at the wrong level / incorrectly matched. The amendment contemplates a deduction for the grantor of the dividend, which in a group structure is often a holding company for the investments in its subsidiaries (the employer company/ies). Such a holding company may be a non-operating company, or shell company, with minimal or no income against which to deduct the allowed deduction.

### ***Alternate Recommendation***

- The matching deduction for the company should be for the employer company, not the company declaring the dividend.
- Exclusion for dividends relating to shares held in public companies.

### ***Administrative implications***

Under the current system, STRATE withholds the dividend tax payable, and the net dividend is paid to the shareholder. Under the new proposed system, it is unclear how STRATE will



distinguish between normal dividends paid which are subject to normal dividend tax, and dividends paid in terms of shares awarded in terms of employee share schemes, which will be subject to income tax.

All-in-all we do not support the proposed amendments.

#### ***Issue 4***

An amendment is proposed in terms of which section 11(t) is introduced to the effect that:

*“...there shall be allowed as deductions from the income so derived:*

*(a) ...*

*(t) an amount equal to any dividends declared by a company, to the extent that those dividends are included in that year of assessment in the income of another person in terms of paragraph (c) or (d) of the definition of ‘gross income’;”*

This, we are told, is designed to allow a deduction for dividends, which are included in the hands of employees involved in a share incentive scheme by virtue of changes to the gross income definition and section 10(1)(k)(dd).

It should also be noted that it is not clear what the legislator is attempting to achieve with this provision. The tax effect of the payment of a dividend to an employee is 38.8% (tax in company of 28% plus 15% dividends tax on distribution of balance is a further effective 10.8%). When measured against the marginal rate of 40% there is a small benefit to the fiscus. However, some employees may be on a rate lower than 40% and the fiscus will lose.

Furthermore, many share incentive schemes involve shares, being held by the employees, in the holding company of a group, whereas the employees are employed by an operating company. Thus, dividends will flow to the holding company from the operating company, which will be exempt from tax in the hands of the holding company, and a dividend will on-flow to the shareholders of the holding company, including the employees who are the subject of a share scheme and who will be taxed on the receipt of the dividends. In terms of the proposed section 11(t), the holding company will qualify for a deduction of this portion of the dividend, but will have no taxable income against which to offset the deduction.



### ***Recommendation***

Since there is little benefit to the fiscus the provisions should be removed and the standard tax on dividends would then remain.

Alternatively, in order to ensure that it is the operating company that ultimately benefits from the deduction in respect of the dividends, which are ultimately received by the employees, the section needs to read to the effect of the following:

*“(t) an amount equal to any dividends declared by a company, to the extent that those dividends are **directly or indirectly, as dividends**, included in that year of assessment in the income of another person in terms of paragraph (c) or (d) of the definition of ‘gross income’;”;*

## **1.9 Removal of dividend character overlap**

### ***Issue***

The amendment to the gross income definition does not deal with the timing for the inclusion of the dividend.

### ***Recommendation***

We submit that the wording should clarify whether this inclusion should be based on the earlier of receipt or accrual of that dividend or similar.

### ***Issue***

The combined narrowing of section 10(1)(k)(i) and paragraph (k) of the section 1 “gross income” definition creates unintended consequences. Most dividends should be viewed as ordinary revenue under common law with paragraph (k) applying only where the dividend is “of a capital nature” (a rare circumstance). Hence, most dividends will now fall outside of the section 10(1)(k) exemption.



What was presumably intended was an exclusion only of dividends that could be characterised as other forms of income (e.g. amounts received in exchange for services or some other form of consideration).

## **2. INCOME TAX: BUSINESS (GENERAL)**

### ***General comment***

The DTLAB defines Value-Added Tax Act, 1991 (Act No. 89 of 1991) in section 1(1) of the Income Tax Act, by dropping the part in brackets. But then the part in brackets is used in clauses 12 and 173.

### ***Recommendation***

The part in brackets should be dropped from the amendments in clauses 12 and 173.

## **2.1 Anti-hybrid debt instrument re-characterisation rules**

### ***Issue 1***

Both section 8F and 8FA taint the interest payments on instruments where payment of amounts in respect of the instrument is conditional on the market value of the assets exceeding the liabilities of the company. Firstly, it appears that the test in both sections is identical, the distinction in earlier drafts between amounts payable under the instrument being conditional (section 8F) and interest payable under the instrument being conditional (section 8FA) having been removed.

Secondly, and, more crucially, the scope of both these clauses is unclear. In particular it is not clear whether the conditionality is limited to the terms of the agreement, or whether, say, the Companies Act provisions, which impose a solvency test on the payments under subordinated shareholders loans, would result in the provisions of section 8F and section 8FA applying to the loan.



### ***Recommendation***

We recommend that the wording of section 8F(1)(c) and section 8FA(1)(b) are amended to stipulate that, in terms of the loan agreement, the obligation to pay an amount is conditional or alternatively to stipulate the obligation is conditional, whether in terms of the loan agreement or by operation of law.

### ***Issue 2***

In principle it is sensible to link the exclusion in sections 8F(3)(a) and 8FA(3)(a) to entities that are small business corporations (SBC) in terms of section 12E. The definition of section 12E(4)(a) however contains certain elements that were intended to prevent investment entities and professional service entities from qualifying for the concession granted to smaller businesses. It is questionable whether there are grounds for including entities into the provisions of sections 8F and 8FA based on these criteria.

The specific requirements in section 12E(4)(a) which are questionable for purposes of the section 8F(3)(a) and 8FA(3)(a) are:

- The requirement that all the shareholders must be natural persons. Small groups of companies will therefore be subject to sections 8F and 8FA.
- The requirement in section 12E(4)(a)(iii) regarding the composition of the entity's income (not more than 20% of total receipts and accruals must be from investment income and personal service).
  - This would mean that a small company with a few rental properties may be subject to sections 8F and 8FA. Companies set up for purposes of trading in immovable property may similarly (based on the definition of investment income in section 12E(4)(c)(iii)) fall within the scope of sections 8F and 8FA.
  - Similarly, companies where mainly connected persons are involved in services that meet the definition of a 'personal service' in section 12E(4)(d) may, based on the nature of their income, be subject to sections 8F and 8FA.
- It may also be questionable whether an entity should be included within the scope of sections 8F and 8FA by reason of the entity being a personal service provider (section 12E(4)(a)(iv)).



### ***Practical examples***

The following small entities would be subject to sections 8F and 8FA:

- Property development companies (that are not SBC's based on earning income from trading in immovable property);
- Rental property owning companies;
- Investment companies (investments either in interest-bearing instruments or shares);
- Entities involved in rendering personal services.

### ***Recommendations***

The elements of the definition of section 12E(4)(a) should be critically considered, specifically to determine the purpose of each requirement in the context of section 12E concessions. The exclusion from section 8F and 8FA should be linked only to certain requirements in section 12E(4)(a) that relate to the size of the business, not those that relate to the nature of the activities or income.

An exemption from section 8F and 8FA should be included for instruments held between companies that form part of the same group of companies. It is suggested that the definition of 'group of companies' as contained in section 41(1) should be used here to exclude any potential abuses.

### ***Issue 3 – Pension-owned property companies***

Many property companies are partially or completely owned by private or government controlled pensions (including the PIC). Under the proposal, only fully-pensioned owned vehicles are excluded (sections 8F(3)(d) and 8FA(3)(d)). It was anticipated that these entities would be covered under a second version of the REIT legislation. Untaxed funds of four-fund insurers are also a problem.

### ***Recommendation***

A specific temporary exclusion should exist for debt issued by companies wholly or partially owned by pension (and untaxed policy holder) funds. The exemption should apply until the



FSB investment regulatory criteria are determined, which will probably take at least two years (i.e. until 1 January 2016). Relief needs to exist for debts issued by all creditors of these property entities because the exempt pension and policyholder funds will indirectly bear part of the cost of the property entity's non-deductibility. If concerns exist that this temporary relief should be narrowed, we suggest that the exclusion be limited solely to dual-linked debentures issued before the 1 January 2014 effective date.

#### ***Issue 4***

REIT-owned "associated companies": The removal of the special rules for REIT-owned associated companies (i.e. less than controlled entities) in section 25BB creates serious problems for the REIT industry. Many REIT groups have interests in entities that fall below the more than 50 per cent threshold. Firstly, the loss of deemed rental treatment throws-off the qualifying distribution formula, and secondly, the loss of the deduction at the associated company level creates a significant added cost for entities of this nature.

#### ***Recommendation***

Like the situation for pension-owned property entities, a specific temporary exclusion should exist for debt issued by companies wholly or partially owned by REITs (or by REIT-owned controlled companies). The exemption should apply until the FSB investment regulatory criteria are determined, which will probably take at least two years (i.e. until 1 January 2016). Relief needs to exist for debts issued by all creditors of these property entities because the REIT will indirectly bear part of the cost of the non-deductibility. If concerns exist that the relief should be narrowed, we suggest that the exclusion be limited solely to dual-linked debenture issued before the 1 January 2014 effective date.

## **2.5 Deductible donations of appreciated immovable property**

#### ***Issue***

The ability to carry forward any excess donations not claimed is welcomed. The amendment to the section should however be extended to also allow deductions of donations made where the section 18A certificate is only obtained in a subsequent tax year and after the tax return for the tax year in which the donation was made has been submitted.



## **2.6 Deductible interest limitation in respect of acquisition indebtedness**

### ***Issue 1***

The proposed sections 23N(3) and (4) refer to interest incurred in respect of reorganisation/acquisition transactions “entered into and for 5 years of assessment immediately following that year of assessment”.

### ***Legal nature***

The wording of these sections states that the limitation of the interest deduction will only apply for the first five (5) years (i.e. after year 5 the taxpayer will be able to claim the full interest deduction going forward). Further, these sections do not provide for the carry forward of the excess interest not claimable as a deduction in the first five years of assessment.

The draft EM is silent on the above considerations, which differ from the request for public comment document, released on 29 April 2013, in which it was proposed that the limitation of the deduction would apply for the term of the financing, and the excess interest could be carried forward for up to five years.

### ***Recommendation***

Clarity is to be provided in the explanatory memorandum in order to explain the deviations from the provisions proposed in the public comment document released on 29 April 2013.

### ***Issue 2***

The proposed sections 23N(3)(b) and (4)(b) advise that these sections are subject to subsection (7).

### ***Legal nature***

The proposed section 23N does not contain a subsection (7).



### ***Recommendation***

Sections 23N(3)(b) and (4)(b) should be amended to advise that they are subject to subsection (6).

### ***Issue 3***

The proposed section 23N(4) provides that when calculating the excessive interest, the proposed calculation methodology is with reference to the adjusted taxable income of the entity being acquired.

### ***Legal nature***

With specific regard to foreign investment into South Africa and the development and growth of the South African economy, the calculation methodology could create further disincentive for foreign investment, especially in South African companies, which are in a start-up/development phase.

Generally, companies, which are in a start-up/development phase, are not in a taxable income position. Thus, an investor, who obtains financing in order to acquire shares in company, which is still in the start-up phase, may not be able to claim an interest deduction in respect of such financing, due to the application of the adjusted taxable income definition and the provisions of section 23N(4). Such situations are likely to occur where multinational firms expand their business operations into South Africa and where the acquisition of the shares in the start-up operating company is funded from offshore.

In our view, rather than forcing the foreign investor to invest directly in South African companies, which are in the start-up/development phase, the current proposal will serve as a disincentive for indirect foreign investment (in the form of loan financing), via a South African intermediary company, into new and developing South African companies.

The disincentive is further exacerbated by the fact that the current wording appears to limit the deduction for the initial five years, which are generally the years during which the South African company will be in its start-up/development phase. Further, given that there is no



apparent carry forward of the excess interest costs, the interest will never be claimable as a tax deduction.

It is also noted that the current proposals also provide for a disincentive for foreign direct investment in South African companies in the start-up/development phase (please refer to the comment on section 23P).

### ***Recommendation***

We are aware of the concern regarding the potential loss to the *fiscus* caused by financing schemes developed to maximise a taxpayer's tax benefit, but consideration of the above significant disincentive for foreign investment in the South African economy needs to be factored into the proposed interest limitation provisions.

It could be considered that such limitations only be made where the recipient or ultimate recipient pays tax at a rate lower than 75% of the South African rate. Furthermore, the proposed withholding tax on interest should cater for this problem.

### ***Issue 4***

For purposes of the application of the proposed section 23N, a definition of "adjusted taxable income" has been included. In determining the "adjusted taxable income", there are specific additions to be considered for purposes of paragraph (b) of this definition. One such adjustment is that 75% of gross income from the letting of immovable property should be considered.

The example in the explanatory memorandum, however, reflects that 175% of the gross income from letting of immovable property is taken into account for purposes of calculating the interest limitation with reference to the "adjusted taxable income".

### ***Recommendation***

Either the definition of "adjusted taxable income" or the example in the draft EM should be amended to reflect the correct percentage of income from letting of immovable property in the calculation.



***Issue 5 – Section 23K(10) read with section 23N***

Certain taxpayers have obtained section 23K rulings in respect of transactions which have yet to be implemented. In some instances legal agreements in respect of these transactions are still in draft form. The effective dates of section 23K(10) and section 23N appear to render such rulings obsolete.

***Recommendation***

Taxpayers, who have obtained rulings under section 23K but who have not yet implemented the transaction, should be permitted to claim interest deductions in accordance with the section 23K ruling.

***Issue 6 – Proposed section 23K(10)***

Section 23K(10) as well as section 23N make reference to transactions “entered into” on or after 1 July 2013. It is unclear whether a transaction where agreements were signed on, say, 1 June 2013 but subject to conditions which are fulfilled on, say, 30 July 2013 would fall within section 23K or section 23N.

***Recommendation***

The term “entered into” should be replaced by the words “was contracted for” or the meaning of the term clarified.

***Issue***

There are circumstances in which a section 24O acquisition may precede the liquidation of a company in terms of section 47. It is not clear whether one would apply the 40 % calculation to the taxable income of the acquired company or the acquiring company?

***Recommendation***

It is suggested that the application of the 40% calculation under these circumstances be clarified.



### ***Issue 7 – Proposed section 23O***

The denial of the interest deduction for all intra-group acquisitions between historic group members is problematic. Whilst a number of intra-group acquisitions are funded via interest free loans, there may be instances where interest is charged for commercial reasons. Section 23O has the effect of disallowing the deduction in the hands of the debtor but no provisions have been put in place to exclude the accrual of interest in the hands of the creditor.

The deduction of interest in respect of intra-group acquisition between historic group members would, in the absence of section 23O be limited by the provision of section 23N.

### ***Recommendation***

We submit that the denial of any deduction should be limited to instances where the creditor is not taxed on the amount, say as a result of being in an assessed loss position or has low effective tax rate.

Alternatively, the interest accrual should be exempt in the hands of the creditor where the provisions of section 23O have been applied.

### ***Issue 8 – Proposed section 23O***

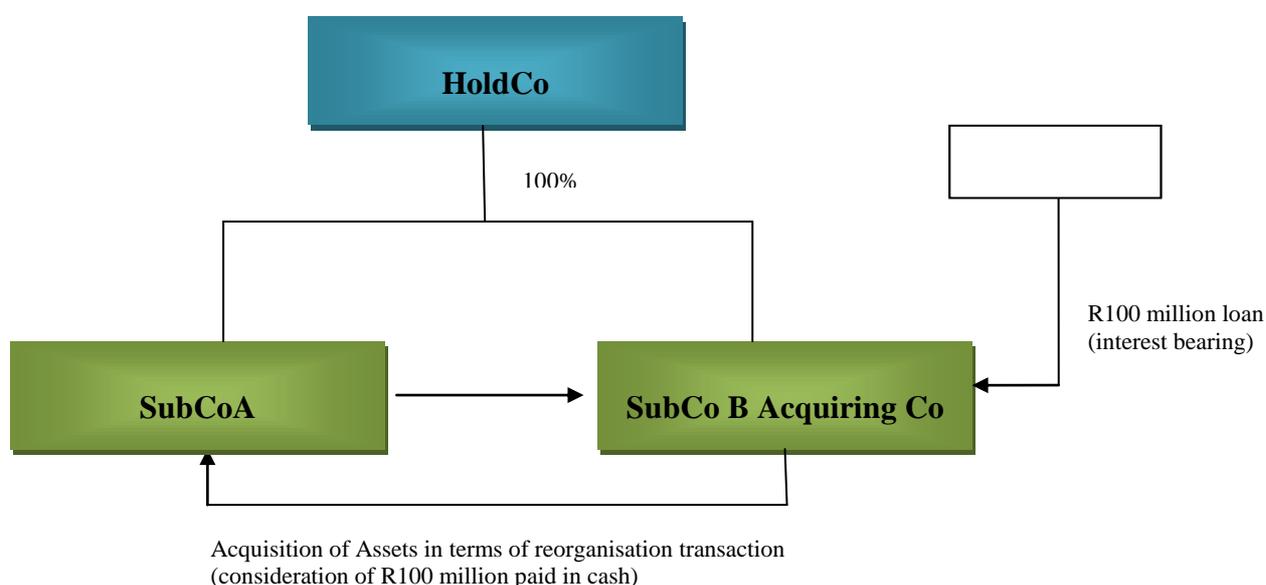
The term “controlling relationship” is defined with reference to section 23M. Section 23M deals with a debtor/creditor relationship, whilst section 23O envisages a purchaser/seller relationship. The wording of the definition in section 23O requires amendment to reflect the language of the section.

### ***Recommendation***

The term “controlling relationship” in section 23O should be specifically defined to refer to the purchaser and seller or to the purchaser and party funding the reorganisation transaction (see comment below).

**Issue 9 – Proposed section 230**

Despite the use of the term “directly or indirectly” in section 230(2) it is not clear whether the provisions would apply where the purchaser obtains funding from a third party (connected or otherwise) to acquire the assets of a company in a controlling relationship in terms of a reorganisation transaction. By way of example:



**Recommendation**

It is recommended that it be clarified whether section 230(2) would apply in the above circumstances.

**Issue 9 – Proposed section 230**

There is the requirement of a controlling relationship in the proposed section 230 between the acquiring and acquired companies during “...any 18 month period in the 36 months period ...” This wording is unclear.



### ***Recommendation***

We propose that this requirement be clarified to state that the acquiring and acquired companies must be in a controlling relationship “during any continuous period of 18 months in the 36 month period preceding the period in which the debt is applied or assumed”.

### ***Issue 10***

The proposed wording to section 23O(2) disallows a deduction of interest incurred by an acquiring company in respect of debt to fund the acquisition of shares in an acquired company that would otherwise be allowed as a deduction if the acquiring company and acquired company are in a controlling relationship during any 18 month period in the 36 months preceding the period in which the debt is applied. For these purposes reference is made to a controlling relationship as defined in section 23M.

The first comment relates to the definition of a controlling relationship in the context of section 23O: Section 23M defines a controlling relationship as one where the debtor directly or indirectly holds more than 70% of the equity shares in the creditor, or vice versa.

As the relationship between the acquiring company and acquired company is not required to be that of a debtor and creditor as contemplated in section 23M, it is submitted that this cross-reference is inappropriate and could be confusing to apply.

Section 23O applies amongst other to acquisition transactions contemplated in section 24O. Section 24O however requires that the acquiring company must, after the acquisition, be the controlling group company in relation to the acquired company in order for that provision to apply.

As the proposed section 23O is currently worded, the interest expenditure incurred by a controlling group company (acquiring company in section 23O) on an interest-bearing instrument to acquire the remainder of the shares of the controlled group company (acquired company), which was a controlled group company prior to the acquisition of the additional interest, would be disallowed based on the fact that the parties were in a controlling relationship prior to the transaction.



### ***Practical example***

Company A acquired 75% of the shares of Company B previously. If Company A borrows money to acquire the remaining 25% of the shares of Company B, section 23O would disallow the interest deduction in respect of the funds borrowed to acquire the remaining 25% as the acquiring company from a third party as the acquired company was in a controlling relationship prior to the acquisition. Commercial transactions with no intention to misuse the interest deduction where additional shares are acquired from outside the group of companies will suffer from the interest deduction being fully disallowed.

### ***Recommendations***

A separate definition of controlling relationship should be drafted for purposes of section 23O without reference to a debtor and creditor in a controlling relationship.

The provisions of section 23O should be limited to the acquisition of shares in an acquired company by an acquiring company from another entity that forms part of the controlling relationship or group of companies prior to the acquisition of the additional interest. Interest in respect of instruments to fund the bona fide acquisition of shares from a party external to the controlling relationship or group of companies (i.e. a transaction that is not an internal restructuring) should be excluded from the scope of section 23O.

### ***Issue 11***

The definition of ‘acquiring company’ in section 23O refers to an acquired company as contemplated in section 23N. This should be ‘acquiring company’ as contemplated in that section.

The term ‘acquired company’ in section 23N is defined in the context of both sections 45 and 47 as well as section 24O transactions. This term is however only used in section 23N(4) in the context of section 24O transactions.

### ***Recommendation***

The definition of ‘acquired company’ should be amended to remove this inconsistency.



### ***Issue 12***

Adverse impact on standard commercial debt financing (section 23N): The main purpose of the amendments is to curtail debt owed to exempt persons (e.g. foreign persons) or in respect of debt that has mezzanine characteristics. Local bank debt has none of these features. Local bank debt usually is redeemable in a 5-to-7 year period, is fully amortizing, carries a prime-related interest rate unrelated to profitability and carries technical and credit default events. None of this debt would ever be viewed as equity under an economic analysis (e.g. none of this debt carries suspect features, such as no pay-when-you-can or payment-in-kind features). At issue is whether the formula indirectly creates problems for this form of debt. While the rental uplift is helpful, it is by no means comprehensive. Banks will sometimes lend above the normal thresholds if the income stream is predictable and secure and/or where the history of the company indicates a strong credit rating (even when no commercial property is involved). It should also be noted that banks are fully taxable entities (and back-to-back arrangements with the bank itself are not allowed by virtue of banking regulation (unlike bank special purpose vehicles)).

### ***Recommendation***

Some form of safe harbour should exist for debt with no equity features. By focusing on the debt itself, this determination could be made solely from the debtor's perspective. This safe harbour would also be treated as "other debt" under section 23N so that interest in respect of other forms of excessive debt would be indirectly reduced in scope if this debt is large (i.e. the good debt still counts against the 40 per cent test in respect of the other debt). Perhaps, this safe harbour could be further limited to local banks and certain other regulated stakeholders.

### ***Issue 13 – Repo formula (section 23N(6))***

The repo adjustments are highly welcome as a safeguard against high interest rates. However, a number of confusions exist as to the formula's operation. One key issue is whether the repo rate is the current 5.5 per cent repo rate publicly announced or is the rate something else. If so, a request will be made that the formula apply at a lower level.



### ***Recommendation***

The repo rate should begin to adjust upwards at a slightly lower level if the current intended repo rate is at 5.5 per cent. The repo rate also needs to be adjusted for mid-year changes.

## **2.7 Deferral of incurred expenditure between taxable payors and exempt payees**

### ***Issue 1 – Section 23M***

The proposed section 23M(1) defines the term “creditor” to mean:

*“a creditor that is not subject to tax under Chapter II”. (Chapter II comprises the taxing sections of the Act).*

This definition, due to the reference “not subject to tax”, is unclear and open to interpretation.

### ***Legal nature***

The words “subject to tax” cause confusion. For example, it is unclear whether a non-resident taxpayer, who receives South African sourced income (i.e. “gross income”, as defined in section 1 of the Act), but is exempted from South African normal tax as a consequence of the application of the provisions of a Double Taxation Agreement (DTA) would still be considered “subject to tax under Chapter II”, since the relevant income falls within the South African tax net.

Similarly, going forward, a non-resident, who will be subject to interest withholding tax on interest accruing from a South African source, but where the application of the relevant DTA removes South Africa’s taxing rights in favour of the taxpayer’s country of residence, may still be regarded as “subject to tax”, when applying this term within an international context.

### ***Recommendation***

The definition of “creditor” should thus be expanded in order to clearly define the circumstances in which the provisions of section 23M would apply. In particular, the impact of the application of DTAs should be clarified in the legislation itself, in order to give expression to the intention of the legislator.



### ***Issue 2***

The definition of creditor currently reads “a creditor that is not subject to tax under Chapter II”. This could be interpreted to require that the creditor must not be subject to any tax in South Africa. As currently worded, section 23M and 23P would not apply if the creditor is taxed on any amount in South Africa, even though this amount may not be the interest or other expenditure in question for these sections.

### ***Practical example***

A wholly-owned South African subsidiary of a foreign company pays interest in excess of the limit in section 23P to the foreign company. If the foreign parent is taxed in South Africa on any other income (for example, a small amount of rental income from a South African source), it is subject to tax under Chapter II and therefore not a ‘creditor’ as contemplated in the proposed definition. The result is that the application of section 23M and 23P as the term is currently worded can easily be manipulated by the payment of any other amount subject to tax in terms of Chapter II.

### ***Recommendation***

The definition of ‘creditor’ should focus on the relevant income streams for sections 23M and 23P, rather than to require the creditor as a person or entity not to be subject to tax in terms of Chapter II.

### ***Issue 3***

There are circumstances in which both section 23P and 23N appear to apply, for example if a section 24O acquisition is financed by an interest-bearing loan from a non-resident tax exempt person that is in a controlling relationship with the acquirer.

### ***Recommendation***

It is suggested that the application of either of the sections be clarified where these circumstances apply?



#### ***Issue 4***

There are many companies where ownership of assets and other operations are separated and these structures are needed for various non-tax reasons. For practical reasons the asset owning entities or service providing entities do not have their own bank accounts. The provision will cause these entities to open bank accounts purely to enable the paying entity to obtain a tax deduction where such bank account is not required for any other business purpose.

This provision has a further complication as the company receiving the income will be subject to income tax on the receipt even though no payment was received. This is clearly a mismatch and not acceptable.

### **2.8 Deductible interest limitation in respect of loans between exempt persons and domestic companies**

#### ***Issue 1 – Proposed section 23P***

The proposed section 23P(3) provides that when calculating the excessive interest, the proposed calculation methodology is with reference to the adjusted taxable income of the debtor.

#### ***Legal nature***

With specific regard to foreign investment into South Africa and the development and growth of the South African economy, the calculation methodology creates a further disincentive for foreign direct investment, especially into South African companies in the start-up /development phase.

Generally companies in the start-up/development phase will not be in a taxable income position. Accordingly, a South African company, which is in the start-up phase and whose business operations are funded by controlling foreign investors/shareholders, as is often the case with multi-national firms, may not be able to claim an interest deduction in respect of such financing, by virtue of the application of the adjusted taxable income definition and the provisions of section 23P(3).

In our view, the current proposal is a disincentive for direct foreign investment into new and developing South African companies (i.e. into enterprises, where investment is most needed).

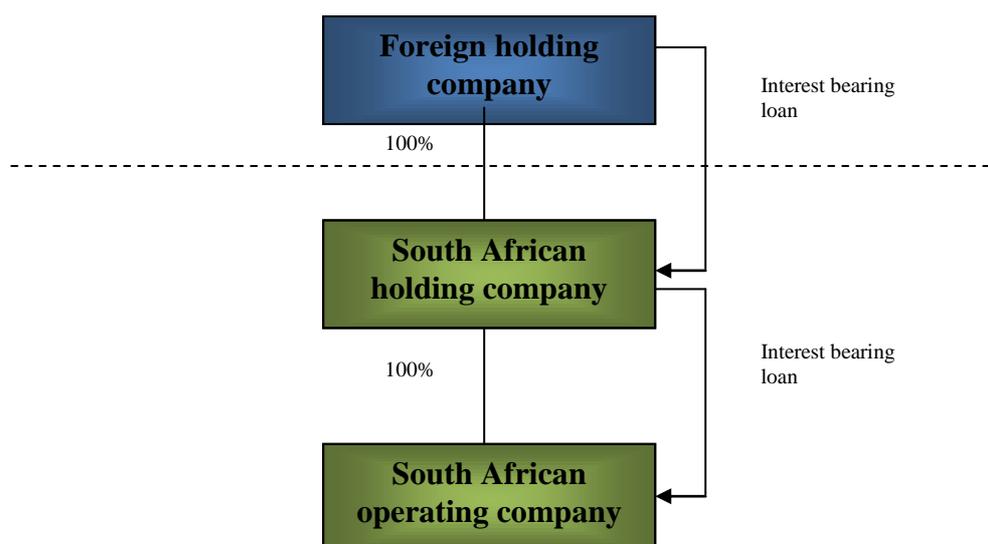
It is noted that section 23P(4) does provide for a carry forward period (not exceeding 10 years), which may mitigate the disincentive discussed above to a limited degree.

### ***Recommendation***

We are aware of the concern regarding the potential loss to the *fiscus* caused by financing schemes developed to maximise a taxpayer's tax benefit, but consideration of the above significant disincentive for foreign investment in the South African economy needs to be factored into the proposed interest limitation provisions.

Application of the limitation could be limited to situations where the beneficial recipient is taxed at a rate, which is less than 75% of the South African rate.

### ***Issue 2***





In the above example, common in cross border structures, the foreign holding company funds the South African operating company through a South African holding company. The South African operating company would be able to claim a deduction of the full amount of the interest with the South African holding company being taxed on the full amount of the interest received. The interest payment from the South African holding company to the foreign holding company would, however, be subject to the provisions of section 23P.

Where the South African holding company is purely an investment holding company with only interest income, the adjusted taxable income of the company may be nil and the South African holding company would not be entitled to claim any deduction in respect of the interest. The South African *fiscus* would therefore be neutral.

If the foreign holding company were to advance the loan directly to the South African operating company, the South African operating company would be subject to section 23P. The South African operating company would however have adjusted taxable income and would therefore be able to claim 40% of that amount. The South African *fiscus* would not be in a neutral position.

### ***Recommendation***

The ultimate user needs to be the entity which is subject to the adjusted taxable income calculation.

### ***Issue***

Tax base erosion in the form of profit shifting through excessive interest deductions, with income being shifted to low-tax (or zero-tax) jurisdictions, or the conversion of interest income into a different type of income in another jurisdiction has been of global concern.

In respect of hybrid debt instruments, the proposals focus on two elements:

- (1) the debt instrument itself, and
- (2) the yield



The proposal dealing with the instrument denies the interest deduction for the payor and treats the interest payments on the instruments as dividends if the debt satisfies one or more of the following characteristics:

- (i) it is unlikely to be redeemed within 30 years,
- (ii) it can be converted into shares, or
- (iii) Payments in respect of the instrument are subject to the solvency of the issuer.

The proposal dealing with the yield also denies the deduction and treats the interest as dividends if the interest payment is not determined with reference to a specified interest rate or the time value of money, or the payment obligation is conditional upon the solvency of the debtor.

The proposal dealing with connected person debt limits the interest deduction to 40 per cent of the debtor's taxable income (with certain adjustments) if the creditor (together with related parties) holds more than 70 per cent of the equity shares or voting rights in the creditor company. The proposal dealing with the limit for acquisition debt (taxable acquisitions) will be based on 40 per cent of the adjusted taxable income of the acquired company, while the limit for debt used in re-organisation transactions (tax-free acquisitions) will be based on 40 per cent of the adjusted taxable income of the acquiring company.

The National Treasury media statement (29 April 2013) suggested the possibility of a safe harbour ("C" in the Media Statement). The draft legislation does not contain a transfer pricing safe harbour of any kind.

### ***Recommendation***

It is further recommended that permanent measures to address the concerns of tax base erosion be introduced.

A safe harbour should be implemented in the revised draft guidance.



### **3. INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)**

#### **3.2 Annual fair value taxation of financial instruments in respect of banks and brokers**

##### ***Issue 1***

The draft Taxation Laws Amendment Bill, 2013 ('the Bill') proposes a new section 24JB to deal with the taxation of financial assets and financial liabilities for bank groups. This section will come into operation on 1 January 2014.

The new section 24JB applies to covered persons and provides that all amounts in respect of financial assets and financial liabilities of that covered person that are recognized at fair value in profit and loss in terms of IFRS must be included income in or deducted from the income for a particular year of assessment.

The concept of 'covered person' includes, amongst others, any company or trust that forms part of a banking group as defined in section 1 of the Banks Act, excluding a company that is a long-term insurer as defined in section 1 of the Long-term Insurance Act.

##### ***Legal nature***

In the definition of a covered person the conceptual exclusion has already been made with reference to a company that is a long-term insurer as defined in section 1 of the Long-term Insurance Act. Unfortunately this exclusion does not go far enough, as it does not extend to subsidiaries of an insurance company. An insurance group is be predominantly engaged in banking or any associated activities per se.

Insurance groups are by virtue of the definition of covered persons included within the ambit of section 24JB notwithstanding the fact that they hold investments on capital account and are not engaged in banking activities.

Furthermore, insurance groups have separately undertaken organisational restructures in anticipation of the implementation of Solvency II in South Africa to avoid any negative



impact the Regulations may have on the amount of capital that they must hold. In this regard the insurance group and other related group subsidiaries would be held directly by a controlling company. The insurance group would typically not hold any other subsidiaries.

A “controlling company” is defined in the Long-term Insurance Act Amendment Bill and means a holding company that is a public company whose only business is the acquiring, holding and managing of another company or other companies, including an insurance group.

The controlling company and the insurance group will also be subject to the supervision of the Registrar of Long-term Insurance.

### ***Recommendation***

Notwithstanding the exclusion in section 24JB(2), it is proposed that the current exclusion of a long-term insurer be extended so as to refer to a controlling company, as defined in the Long-term Insurance Act Amendment Bill, and any company that is held directly or indirectly by the controlling company. A covered person should therefore not extend to the insurance group that is governed separately in terms of the Long-term insurance Act and should consequently be specifically excluded from the definition of covered person as contemplated by section 24JB(1) of the Taxation Laws Amendment Bill.

### ***Issue 2 – Section 24JB***

The definition of a “covered person” has been expanded in section 24JB. It is still not broad enough to include a scenario where a financial services group (without a banking licence) has a group company that deals in debt instruments, interest rate swaps and/or option contracts and, which relied on the provisions of section 24J(9) in the past. Such a company would not be able to rely on the proposed provisions of section 24JB.

### ***Recommendation***

We recommend that the definition of “covered person” be broadened to include companies that in the past had received approval from SARS to apply the provisions of section 24J(9) of the Act, or that deal in instruments and are not part of a banking group.



### **3.3 Simplification of tax regime for collective investment schemes in non-property investments**

#### ***Issue 1 – Section 10(1)(dA)***

The overall simplification of the legislative dispensation for collective investment schemes, including hedge funds, has the effect that the investment vehicle is generally exempt while the tax is levied at the investor level.

Hedge funds are generally set up as a partnership, rather than as a trust structure. Accordingly, the proceeds from the disposal of any investments held by the hedge fund accrue directly to the partners. The proposed exemption of non-property collective investment schemes in section 10(1)(dA) is intended to keep the investment vehicle neutral. However, in the context of a hedge fund structured as a partnership this will not be possible as amounts accrue directly to the partners in the partnership.

#### ***Recommendation***

It is proposed that the tax treatment of a particular type of hedge fund should be consistent irrespective of whether the fund is a partnership or a trust.

#### ***Issue 2 – CIS distributions of interest and foreign dividends***

The flow-through rules of section 25BA(2) for CIS distributions are too narrow. Flow-through treatment applies only to domestic dividends – not to interest or foreign dividends. Flow-through treatment for interest is important so that taxpayers can relief in the case of de minimis interest and so foreign taxpayers can be free from tax on the CIS interest. Flow-through treatment for foreign dividends is important so that foreign dividends can obtain potential relief under section 10B (typically partial tax relief for portfolio foreign dividends).

Recommendation: The 12-month flow-through rule should be extended to include interest and foreign dividends received by a CIS and passed-through to unit holders within a 12-month period.



### ***Issue 3 – Simplified CIS dividend withholding***

The need for the 12-month rule in the case of domestic dividends received by CISs is questionable. A CIS should be required to withhold dividends taxes for dividends received even if the amount is left undistributed. Normal income tax treatment is unnecessary in respect of subsequent CIS distributions of CIS dividends received.

### ***Recommendation***

Dividends received by a CIS should be subject to dividends tax upon receipt by the CIS (with relief if the dividends allocable to exempt (or treaty) unit holders). Subsequent distributions allocable to CIS dividends received should be free from tax when actually on-paid to unit holders via subsequent CIS distributions.

### ***Issue 4 – Effective date***

The proposed amendments may have a significant impact on CIS tax systems in relation to unit holders. The amendment should be slightly delayed.

### ***Recommendation***

The proposed amendments should be effective for years of assessment commencing from 1 July 2014. The sixth month delay should be sufficient for an orderly transition.

## **3.4 Deemed ordinary treatment in the case of certain disposals of participatory units in collective investment schemes**

### ***Issue 1 – Section 9C***

In terms of the proposed amendment to section 9C, an equity share now includes a portfolio of a collective investment scheme in a retail hedge fund. Thus, where an investor holds a participatory interest in a retail hedge fund for a continuous period of at least three years then the amount received by that investor on the disposal of its investment will be deemed to be of a capital nature.

It is unclear when the three year holding period commences, i.e. at the time when the investment in the retail hedge fund is made or at the time the retail hedge fund becomes



regulated by the Collective Investment Scheme Act (given the reference to a portfolio of a collective investment scheme in a retail hedge fund in the definition of “equity share”).

### ***Recommendation***

We propose that it be clarified that the three year holding period commences on the date when the investment is made and not only from the time that the fund is declared to be a collective investment scheme.

### ***Issue 2 – Taxation of Real Estate Investment Trust (Section 25BB)***

A Real Estate Investment Trust (REIT) is currently defined in section 1 of the Act to mean a company:

- that is a resident; and
- whose shares are listed on an exchange as shares of a REIT, as defined in the JSE Limited Listing Requirements.

The proposed definition presupposes that the property loan stock (PLS) and property unit trust (PUT) entities that the legislature wishes to consolidate under the REIT umbrella are listed entities. In our experience, this is not the case in all instances and, consequently the proposed definition of a REIT is too narrow.

### ***Recommendation***

We recommend that the definition of a REIT be expanded to include both listed and unlisted property investment schemes.

### ***Issue 3 – Taxation of Real Estate Investment Trust (Section 25BB)***

The definition of “qualifying distribution” in section 25BB of the Act has been amended to exclude a dividend received by a REIT or a controlled company from a company that is not a REIT or a controlled company.

The wording used is unclear to give effect to the changes to the definition: “Provided that a dividend received or accrued from any company that is not a REIT or controlled company at the time of that disposal must not be taken into account”. [Our emphasis]



### ***Recommendation***

The word “disposal” does not appear to be within the context of the amendment to the definition of a “qualifying distribution” and we therefore recommend that the phrase “at the time of that disposal” be replaced with “at the time that the dividend is received or accrues”.

## **4. INCOME TAX: BUSINESS (INCENTIVES)**

### ***General comment – Allowances not introduced in the Bill***

It is common knowledge that the power supply in South Africa is under serious threat. The uncertainty associated with this critical situation is of major concern for many industrial and manufacturing operations and is having a negative effect on expansion plans.

It is therefore disappointing that the Bill does not include allowances which will incentivise entities which are able to embark on co-generation projects and therefore produce their own power for manufacturing purposes and even produce sufficient to also supply electricity to communities and other manufacturing concerns.

### **4.1 Refinements to the research and development incentive**

#### ***Issue 1 – Retrospective application***

The draft 2013 TLAB contains a number of amendments to section 11D of the Act, which fundamentally changes the nature of the existing legislation. This is therefore not a “streamlining” of the legislation as noted in the Explanatory Memorandum.

Of primary concern is that the proposed legislation is noted as to apply with retrospective proposed date of commencement (i.e. 1 October 2012), the effect of which is the back-dating of the proposed legislation. We submit that the back-dating of amendments to the legislation creates huge uncertainty and is considered unfair and contrary to the promotion of judicial administration.



The proposed retrospective amendment will create an immense burden on all applicants who submitted pre-approval applications to the Department of Science & Technology (**DST**) as they would need to resubmit their applications, or prepare additional information, to account for the proposed changes in the legislation. At the time of submitting their pre-approval application forms, we note that taxpayers were basing their application on established tax legislation at the time and furthermore the actual application forms used by taxpayers did not at the time (and currently do not) cater for the proposed changes to the legislation.

In addition, companies that did not apply for pre-approval would have claimed the “normal 100%” section 11D deduction in not only their tax returns for periods of assessment ended post 1 October 2012 – but also taken this into account in their provisional tax calculations. Retrospective application of the proposed changes would result in such tax positions being needed to be revaluated and potentially being incorrect as well as having a potentially negative cash flow impact.

We are also aware that pre-approvals have already been granted to certain applicants since 1 October 2012, by the DST. Due to the substantial change in the nature of the legislation, we submit that applying the changes with retrospective effect would render such pre-approvals null and void due to the fact that the basis of legislation would be substantially changed and the evaluation of the eligibility thereof by the DST would not have taken the proposed changes into account. Again, this would prejudice taxpayers who have taken tax positions based on existing legislation.

### ***Recommendation***

Any proposed change to the section 11D legislation should apply to pre-approval applications that are received by the DST *after* the date of promulgation of the Taxation Laws Amendment Act, 2013.

### ***Issue 2 - Special dispensation for industry sectors***

In the media statement, which was released on 4 July 2013, mention is made of the Information and Communication Technology (**ICT**) sector. However, the ICT sector is not mentioned in the draft legislation. Further, in the media statement and the draft legislation,



there is specific legislation that supposedly provides a special dispensation for the pharmaceutical (generic medicine and clinical trial) industry.

***Recommendation***

We caution against introducing legislation that has one set of rules for a particular industry sector and another set for other sectors. The very aim of the Research and Development (**R&D**) incentive is to encourage investment in R&D across *all* sectors of the South African economy. We also question whether the proposed changes to the section 11D legislation have been fully considered as there is, currently, no draft guideline on what is proposed for the ICT or for the pharmaceutical industry sectors.

We therefore recommend that National Treasury conducts broad-based consultative workshops prior to drafting any changes to the current section 11D legislation.

***Issue 3 – Proposed section 11D(1)(a) contains the wording “carried on”***

This appears to be irrelevant as the legislation relates to prospective R&D and therefore would entail that the activities are being carried on OR are to take place.

***Recommendation***

The insertion of the term “*carried on*” should be deleted.

***Issue 4 – Proposed section 11D(1)(a)(i)(cc) contains the word “innovative”***

The term “innovative” is not defined. The current references to the term within the section 11D legislation result in a very ‘subjective’ interpretation by the legislature.

It is not clear what the intention of the legislator is here especially when a definition of R&D already exists.

***Recommendation***

The term “innovative” should be defined or removed due to its subjective quality.



### ***Issue 5 – Section 11D(a)(i)(cc) contains wording “generic public”***

Section 11D(1)(a)(i)(cc) contains the wording “*general public*” and proviso (f) to section 11D(1) refers to R&D that “... *is already utilised or known by other persons within a market inside or outside the Republic...*”

The term “general public” is not defined. The current references to the term within the section 11D legislation also limits the application of the legislation, as often groups of companies undertake R&D for the group as a whole, and we are also aware that some industries (e.g. the defence industry and medical industry amongst others), also undertake R&D, the result of which is marketed directly to governments or institutions.

The term “general public” therefore would preclude such R&D from the proposed incentive regime and is not in keeping with the stated aim of incentivising total R&D expenditure in the country. We also question whether this is indeed the intention of parliament.

Limiting the applicability of the incentive to R&D that is in effect “world-beating” is directly contradictory to the policy intention of parliament to encourage and stimulate home-grown investment.

### ***Recommendation***

The term “general public” should be defined or alternatively removed.

Proviso (f) should be removed, since, in our view, it would only be suitable in a first world economy, where investment in R&D no longer needs to be incentivised. South Africa is clearly not a first world economy and this proviso, if enacted, would substantially jeopardise local South African companies’ R&D efforts to compete globally.

### ***Issue 6***

The original R&D legislation relating to the pre-approval application form was supposed to be introduced from April 2012. However, the legislation was only introduced with effect from



1 October 2012. Therefore, there was enough time to consider the R&D legislation and the impact thereof.

The media statement, which was released on 4 July 2013, states that the “*proposed amendments will streamline and accelerate the adjudication process...*” The proposed changes to section 11D, as discussed in more detail below, are more complex, confusing, subjective and open to interpretation than the previous legislation. In an article published by Engineering News on 19 July 2013, the DST confirmed that it will, by 15 December 2013, indicate which companies that had applied, in terms of the pre-approval application system, have been successful.

The draft legislation, if enacted in its current form, will be implemented with effect from 1 October 2012 (i.e. retrospectively). Entities relied on and undertook investments in projects based on the current legislation. All the pre-approval applications were submitted on the basis of current legislation.

In an article dated 17 May 2013 in Nature – International Weekly Science Journal, the following was stated: “*The country’s total R&D spending as a percentage of gross domestic product (GDP) decreased for the third consecutive year, standing at 0.87% for 2009–10. South Africa had planned to increase R&D spending to 1% by 2008, but failed to meet this goal. A second goal, to reach 2% of GDP by 2018, now seems increasingly out of reach.*”

The proposed draft legislation in its current form will not assist in increasing the GDP as it limits the amount of R&D claimable even further. We submit that the changes to the section 11D legislation appears to be premature, without having undergone a broad-based, inclusive, consultative process. Therefore, we recommend that the Draft 2013 TLAB and draft EM thereto be aligned with the intention of parliament, so as to provide a meaningful incentive for companies undertaking R&D in South Africa.



### ***Issue 7 – Medicines as an invention***

Pharmaceuticals are an invention, but the costs are largely incurred afterwards. In the typical scenario, the company identifies the appropriate molecule/formula with the follow-up testing and preparation being the bulk of the cost.

### ***Recommendation***

R&D should specifically include the knowledge follow-up after the medicinal invention is discovered.

### ***Issue 8 – “Sale or use” limitation***

The “sale or use” restrictions may be overly harsh in the case of genuine R&D intended to assist product sales. Oftentimes, R&D is used and incorporated into products for sale. In addition, R&D items are sometimes sold to a group member with the group member selling or offering the product to the general public.

### ***Recommendation***

The test should be expanded to include R&D incorporated in the sale or use of products intended for the general public (i.e. “mainly intended for the purposes of use in the development of goods which are for sale to the general public”). We also recommend a similar inclusion for technological knowledge and relief for transfers to a group member for subsequent sale or use by the general public.

### ***Issue 9 – Ancillary computer programmes***

Under the proposal, computer programmes must be offered for sale and use to the general public. However, computer programmes are often integral to an invention or a functional design.

### ***Recommendation***

Computer programmes should fall within the relief if ancillary to the creation or development of inventions or functional designs. This relief should apply even if the computer programme is not for sale to or use by the general public.



### ***Issue 10 – New Functions***

Medicine is often adjusted for new uses (i.e. to treat different illnesses). However, the legislation now fails to account for this change in function.

### ***Recommendation***

The term “new” should not be removed from the improvement test of section 11D(1)(paragraph (b) “research and development” definition).

### ***Issue 11 – Denial of deductions for regulatory or legal conformance (section 11D(2)(b)(ii))***

The proposal seeks to eliminate section 11D deductions for expenses used solely to satisfy regulatory or other legal requirements. This test appears problematic in relation to clean energy products because most R&D in this area is aimed at satisfying regulatory or legal criteria of particular countries. Concerns also exist that this exclusion will be misapplied to the detriment of taxpayers because R&D typically contains an element dedicated to regulatory and legal compliance.

### ***Recommendation***

Environmental “clean energy” research should be excluded from the regulatory/legal limitation.

### ***Issue 12 – Excessive subjectivity of approvals (section 11D(9)(a))***

New rules have been added that essentially add unnecessary subjectivity with the Minister of Science and Technology to determine whether the R&D performed is innovative enough to add substantial value to the industry or market sector. This soft language will make the regime far too discretionary with eventual uneven treatment between companies based on personal preferences.

### ***Recommendation***

If additional guidelines are needed, these additional guidelines should be industry specific. These guidelines should be by way of regulation to allow for further detailed consultation.



### ***Issue 13 – Retroactive effective date***

The 1 October 2012 effective date is clearly retrospective application. Companies with approvals already obtained should be given the certainty provided by the approval. It is also questionable whether the rules can be changed mid-game once the application is submitted (i.e. the applications assumed a stable playing field).

### ***Recommendation***

The proposed amendment should be prospective, beginning at least for expenses incurred as from 1 January 2014.

### ***General comment***

The proposed amendments have significant consequences if limited to inventions, designs, computer programmes or knowledge “for the purpose of sale to or for use by the general public of that invention, design, computer programme or knowledge”. This clearly defeats the object of the introduction of the allowance and may discourage a significant number of research and development initiatives currently undertaken or to be undertaken in the future.

## **4.2 Tax incentives for special economic zones**

### ***Issue***

The applicable provision states new section 12Q. This should be Sections **12R** and **12S**.

## **4.4 Oil and gas incentives**

### ***Issue***

The TLAB proposes that a definition of “fiscal stability agreement” be inserted into the Tenth Schedule. However, the proposed definition, as it currently reads, refers only to a binding agreement as contemplated in section 13 of the Mineral and Petroleum Resources Royalty Act (Royalty Act).



### ***Recommendation***

The proposed definition should be amended so as to refer both to a binding agreement under the Royalty Act and a binding fiscal agreement under paragraph 8 of the Tenth Schedule to the Act.

## **5. INCOME TAX: INTERNATIONAL**

### **5.1 Exit charge on interests in immovable property**

#### ***Issue***

The deletion of section 9H(4)(b) of the Act, as proposed, will lead to unnecessary hardship for persons, who retain South African “immovable property interests” upon ceasing to be South African residents. This is because the proposal will result in such taxpayers, in the vast majority of cases, being subjected to South African tax in respect of unrealised gains on assets, which remain within the South African tax net, subsequent to such taxpayer ceasing to be South African residents.

#### ***Legal nature***

The draft EM advises that the existing exclusion of an “interest in immovable property” from the exit charge, in effect, exempts exiting residents from South African tax upon the ultimate disposal of “an interest in immovable property”. In this regard, it is stated that “the tax treaty eliminates future source taxation as a result of the narrow “immovable property” definition”.

In our view, such an interpretation is not supported by an analysis of the international tax treaties that have been concluded by the South African government. The vast majority of tax treaties allocate taxing rights to the source country in respect of “immovable property interests” (i.e. shares in companies that derive a large percentage (usually more than 50%) of their value from immovable property situated in the source country). Only the treaties with Mauritius, Luxembourg and the Netherlands are exceptions to this rule and the Mauritius treaty has already been renegotiated, whilst it is understood that the latter two treaties will be renegotiated soon, in order to also ensure the allocation of such taxing rights to the source country.



Furthermore, the draft EM does not acknowledge the fact that exiting residents may migrate to a country, which has not concluded a tax treaty with South Africa. If they dispose of their South African immovable property interests while resident in such other country, they would not be afforded treaty protection from any South African tax that may arise on the ultimate disposal of such interests, even though they had already been subjected to the exit charge.

Thus, in our view, in the vast majority of instances, the proposed deletion will result in unnecessary hardship for exiting residents, because the proposal will result in such taxpayers being subjected to South African tax in respect of unrealised gains on assets, which remain within the South African tax net, subsequent to such taxpayer ceasing to be South African residents.

### ***Recommendation***

The proposed legislative change should be withdrawn.

## **5.7 Uniform cross-border withholding regime to prevent base erosion**

### ***Issue 1***

It is proposed that Part IA of Chapter II (i.e. sections 37I to 37O) of the Act is to be deleted with effect from 1 October 2014. It is then proposed that Part IVA of Chapter II (i.e. sections 49A to 49H) be inserted into the Act with effect from 1 January 2015. These sections deal with the withholding tax on interest, which is to be levied at 15%.

### ***Legal nature***

Part IA of Chapter II (i.e. sections 37I to 37O) was inserted into the Act, by section 69(1) of the Taxation Laws Amendment Act, No 22 of 2012, with effect from 1 July 2013. Since it has been proposed that these sections only be deleted with effect from 1 October 2014, the withholding tax on interest is to apply (at a rate of 15%) during the period 1 July 2013 to 30 September 2014. Further, the withholding tax on interest is to be repealed with effect of 1 October 2014, only to be reintroduced with effect from 1 January 2015, by the insertion of in Part IVA of Chapter II (i.e. sections 49A to 49H) into the Act.



### ***Recommendation***

Based on our understanding that it is the intension of the legislator to only implement the withholding on interest with effect from 1 January 2015, it is suggested that Part IA of Chapter II (i.e. sections 37I to 37O) be repealed *ab initio*.

### ***Issue 2 – Definition of “interest” for purposes of section 49B***

“Interest” is not defined in Part IVA for the purposes of section 49B. However, the proposed section 49B requires that the interest is regarded as being sourced in the Republic in terms of section 9(2)(b). Section 9(2)(b) in turn refers to interest as defined in section 24J. It is unclear whether interest for purposes of section 49B should be read as interest contemplated in section 9(2)(b) or section 24J.

### ***Recommendation***

A definition of “interest” should be included in section 49A.

### ***Issue 3 – Exemption from withholding tax on interest***

Section 37K(1)(c) of the Income Tax Act provides for an exemption from interest withholding tax in respect of interest deemed to have accrued to any foreign person in terms of section 25BA(a). The exemptions in the proposed section 49D do not include an exemption for interest accruing to foreign persons in terms of a collective investment scheme. The rationale for the change is not clear.

### ***Recommendation***

The reason for the omission of the exemption in relation to interest accruing to foreign persons from collective investment schemes should be clarified.

### ***Issue 3***

Section 35 of the Act currently regulates the imposition of the withholding tax on royalties, which is levied at 15%. It is proposed that Part IVB of Chapter II (i.e. sections 50A -50H), which also deals with the withholding tax on royalties, be introduced with effect from January 2015, as part of the unified withholding tax regime.



### ***Legal nature***

The proposed amendments to the Act do not provide for the repeal of section 35.

### ***Recommendation***

It is suggested that section 35 of the Act be repealed with effect from 1 January 2015.

### ***Issue 4***

Service fees are defined as amounts received or accrued in respect of technical services, managerial services and consultancy services. The draft EM states that “Less technical services (such as hair stylists, real estate commissions and the like) should not be viewed as falling within the withholding paradigm”.

It is submitted that it may be unclear whether amounts received in respect of a less technical activity, such as administrative services, would fall within the scope of this provision – in particular if it is less technical but routine activity.

### ***Practical example***

It is unclear whether fees paid in respect of administrative services that are not of a technical but rather a routine nature would be ‘service fees’ and subject to the withholding tax.

### ***Recommendation***

It should be considered whether the definition of service fees should refer to specific types of service income rather than generally amounts received or accrued in respect of all services. If the definition of service fees that refer to specific types of income is retained, it would be useful for amounts in respect of certain service that should not be included in this definition to explicitly be listed to provide certainty in this regard.

### ***Issue 5***

Provision is made in several of the sections for a non-resident to claim a refund from the Commissioner where there was an overpayment of the withholding tax. These provisions should be amended to allow the South African resident to claim a refund and pay the same to



the non-resident. As it is, dealing with SARS is challenging at best as no names are published and taxpayers are generally not able to track the status of submissions made by them, other than tax returns, as SARS does not acknowledge receipt of any documentation other than tax returns.

Non-resident are also not familiar with SARS's processes and this, together with possible language barriers, can only result in seriously frustrated non-residents and a consequential deterioration of relations between the South African resident and the non-resident. The non-residents are most likely going to demand that the South African resident resolve the issue.

The withholding tax on services s defies the principles of international law and can seriously harm South Africa's reputation. It is a barrier to entry and, bearing in mind that South Africa would like to be seen to be the gateway into Africa, will have a negative impact on any efforts of South Africa to become that gateway into Africa. It also adds additional costs to doing business with South African residents. It also has significant transfer pricing implications are the mark-up on service fees between connected parties are often limited.

#### ***Issue 6 – Royalty relief for headquarter companies***

The cross-border withholding rules contain an exception for headquarter companies (section 49D(b)). However, this exception is not contained in the current cross-border withholding regime (under section 35). The on-going delay of the new cross-border withholding regimes (now set for 2015) means that the headquarter company regime is not receiving the proposed relief from royalty withholding.

#### ***Recommendation***

Relief from cross-border withholding should apply to the current royalty regime under section 35 under the same conditions as the pending cross-border royalty regime.



## **5.10 Share issues in exchange for foreign shares as a means of corporate migration**

### ***Issue***

The wording of the proposed paragraph 11(3) currently reads: “The amount of the proceeds from the disposal of a share under circumstances contemplated in subparagraph (2)(b) by a company that is not a resident in exchange, directly or indirectly, for shares in a foreign company must be treated as an amount equal to the fair market value of the shares in the foreign company”. This should read by a company that is a resident.

Paragraph 11(2)(b) results in a disposal if shares are issued in the manner contemplated in that section. The proposed paragraph does however not make it clear who the person deemed to make the disposal will be. It is submitted that in cases of legitimate cross-issues between resident and non-resident companies, these transactions may be hindered if the resident company is deemed to make a disposal for proceeds without having any base cost.

### ***Practical example***

Resident Shareholder acquired 100% of the shares of Resident Company for R1 000 000. Resident company now issues shares equal to 20% of its issued shares after the transaction to a non-resident company in exchange for shares in the non-resident company. The value of the non-resident company shares is R250 000.

If the resident company is subject to capital gains tax on the proposed paragraph 11(2)(b) disposal (which appears to be the case from the explanatory memorandum) with proceeds equal to R250 000 (proposed paragraph 11(3)), the capital gain will be R250 000.

If however the proposed paragraph 11(2)(b) is introduced as a measure to tax the shifting of the Resident Shareholder’s assets abroad, the proceeds would still be R250 000 but the Resident Shareholder would be entitled to a deduction for the base cost of the shares.

As the issue of shares effectively reduces the interest of the Resident Shareholder and the purpose proposed paragraph 11(2)(b) seems to be to curb the misuse of the current paragraph



11(2)(b) for purposes of moving value abroad without being subject to tax, the latter approach would appear to be the more correct one.

As the proposed paragraph 11(2)(b) is widely written (not only for avoidance schemes where control is shifted), it is submitted that the disposal should take place in the hands of the shareholder, rather than that of the company, in order not to affect bona fide exchanges negatively and curb such transactions unnecessarily.

### ***Recommendation***

It should be made clear that the disposal in the proposed paragraph 11(2)(b) will be a disposal by the shareholders of the resident company. This will result in them being able to deduct a base cost against the proposed paragraph 11(3) proceeds.

The base cost in 8.3.1 should be determined in terms of the principles applicable to a part disposal (in accordance with paragraph 33) or a principle similar to a value-shifting arrangement's base cost.

Alternatively, if the intention was that this provision should only apply as an anti-avoidance provision, the circumstances in which it applies should be limited to those where control passes to the foreign company that issued shares in the cross-issue.

## **6. INDIRECT TAX**

### **6.2 Supply of services for contingent consideration**

#### ***Issue – Section 176(a) – supplies of services for contingent consideration***

We are in agreement with and welcome the proposed amendment to include services in section 9(4) where the consideration cannot be determined at the time of the supply.

However, the examples of the transactions listed in the Explanatory Memorandum exclusively deal with instances where the *quantum* of the consideration apply to group companies, in particular joint ventures, partnerships and companies established for BEE



purposes. It does not seem to serve any purpose that an exception is made in this regard for unrelated parties, but not for transactions between connected persons.

### ***Recommendation***

We recommend that the provisions of section 9(4) also be made applicable to supplies between connected persons where both the supplier and the recipient are registered vendors and the recipient is entitled to a full input tax deduction. In these circumstances there is no risk of manipulation.

We propose that the proviso to section 9(2) be amended to read as follows:

“Provided that this paragraph shall not apply if the recipient is a vendor that is entitled to a full input tax deduction in respect of the supply, or in any case where an invoice is issued in respect of that supply or any payment is made in respect of that supply on or before-”

## **6.6 Streamlining of VAT registration**

### ***General comments***

The Explanatory memorandum stipulates the reason for the proposed amendments to the VAT registration requirements that SARS must be certain that persons entering the VAT net represent genuine viable businesses, as it is not unknown for certain persons to seek VAT registration to reduce the VAT cost for disguised personal consumption or to operate as an entry point for fraudulent VAT refund claims.

It is not clear if and how the proposed amendments to section 23 will eliminate or reduce the risks stipulate as the reasons for the change. The current level of proof required for VAT registration will be increased even further by the proposed amendments as opposed to the process being streamlined. The proposed deferral of claiming input tax will place an unbearable cash flow burden particularly on small businesses.

### ***Recommendations***

The current provisions of section 23 do not give rise to or increases the risk of vendors claiming non-qualifying or fraudulent refunds. These risks could be reduced by more efficient



VAT refund audit procedures, and the managing thereof by legislating for restrictive VAT registration amendments is questionable. The SARS VAT registration procedures and policies should rather be reviewed to streamline the process.

For example, we currently have one VAT registration form and the same documentary requirements for all types of businesses, whereas the risk profile in relation to an established business acquired as going concern is totally different from that of a voluntary start-up operation, or from a compulsory VAT registration for a foreign entity with no physical presence in South Africa.

Different registration criteria should also apply in respect of businesses involving continuous activities that are only expected to generate income sometime in the future such as mining exploration companies, property developers (e.g. shopping malls) and plantations. The VAT registration risk of the different categories of vendors should rather be addressed by revising SARS registration procedures and requirements and should not be attempted by legislation amendments as such amendments are unlikely to address the risks for SARS relating to refunds, and it will only frustrate the registration process further.

We recommend that the current registration requirements of section 23 should remain intact and the risks regarding fraudulent or non-qualifying refunds should be addressed by the SARS audit procedures.

***Clause 189(d) – refund requirements***

The requirement that a vendor must make taxable supplies with a value of at least R100 000 in a 12-month period before VAT refunds can be made to the vendor goes against the scheme of the VAT Act and the general principles of taxing value added at each level of production. The Commissioner's normal audit processes should be sufficient to verify the validity of the claims.

Essentially the new paragraphs (b) and (d) ring fences input tax on the first R5 million expenses until actual taxable supplies are made. This approach goes against the scheme of the VAT Act.



The recovery of VAT incurred prior to registration is also a concern. Where expenses consist of operating expenses (as opposed to capital expenses), no input tax credit will be available when registration is ultimately allowed.

### ***Recommendation***

Where input tax credit refunds are deferred as a result of insufficient levels of taxable supplies, interest should be payable when the input tax is ultimately refunded. The current legislation does not provide for interest payable.

## **6.7 Registration of e-commerce suppliers**

### ***General comments***

Essentially the Commissioner seeks to introduce place of supply rules for a specific category of supplies (i.e. e-commerce services as defined). It does not appear to be an anti-avoidance measure, but seeks to address the current inability of the imported services provision to effectively tax the consumption in South Africa in respect of these services.

Where the intention is to create a place of supply rule (potentially a forerunner to the introduction of formal and comprehensive place of supply rules), the rules applicable to the new category of vendors should neither be more restrictive nor broader ranging than the general governing rules in the VAT Act.

The new rules essentially seek to include in the VAT net non-resident suppliers of e-commerce services. Presently the SA VAT system contains the imported services mechanism to cater for what is now sought to be achieved via the draft proposals on e-commerce.

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. 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.



E-commerce services as defined in the draft legislation is very wide and could include, but not limited, to the services listed below, where the order and delivery is made electronically:

- i. Website supply, web-hosting, distance maintenance of programmes and equipment;
- ii. The supply of digitised products generally, including software and changes to or upgrades of software;
- iii. Supply of images, text and information and making available of databases;
- iv. Services providing or supporting a business or personal presence on an electronic network, in response to specific data input by the recipient;
- v. Services automatically generated from a computer via the Internet or an electronic network, in response to specific data input by the recipient;
- vi. Internet service packages (ISP) of information;
- vii. Supply of distance teaching;
- viii. The transfer for consideration of the right to put goods or services up for sale on an Internet site operating as an online market on which potential buyers make their bids by an automated procedure on which the parties are notified of a sale by electronic mail automatically generated from a computer;
- ix. The supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events.

Items (i) to (vi) could potentially be supplied to business customers, whereas more than likely items (vii) to (ix) would be supplied to private individuals.

In the case of Business to Business supplies (B2B) the South African 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. As the definition of e-commerce services is very broad a whole plethora of non-resident suppliers would be liable to register for VAT albeit where there is little risk of tax avoidance in the case of B2B supplies.



In this regard guidance can be taken from global best practice dealing with B2B and B2C (business to consumer) supplies.

Further to the above the OECD is currently in the process of developing VAT rules around e-commerce. A report on the recommendations is expected towards the end of 2013.

This is a very complex topic and care should be taken to ensure alignment with global VAT practice to avoid the SA VAT system being out of sync with same.

***Clause 174(1)(d) – the definition of e-commerce services***

The current definition of e-commerce services states that it entails “the supply of any services where the placing of an order and delivery of those services is made electronically”.

The definition contains various terms that could result in interpretational difficulties in practice if taken at face value. Some of these difficulties are:

What is meant by the placing of an order? Does it have to be a formal electronic ordering system, or will email requests for information suffice?

What is meant by “delivery” of the service? Has the service been delivered once the electronic data string has been placed on a platform from where the recipient can access it, or must the recipient successfully access the data string before it can be said that delivery has taken place?

What is meant by “electronically”? At its most basic level of enquiry, does a telephone conversation constitute electronic communication? What about email communication?

The definition furthermore includes a requirement that the placing of the order must be made electronically. This seems to be a restrictive condition which would envisage only services which originate by way of an electronic placing of an order, followed by electronic delivery of the ordered services.



It seems to imply that the provision of continuous (as opposed to transactional) type of services such as web-hosting or the provision of services may not be included in the absence of any electronic order (albeit an initial order would still presumably suffice at the conclusion of the agreement between the parties). The electronic placing of an order may be one of the restrictive requirements which could circumvent the effective implementation of these provisions.

### ***Recommendations***

We recommend that the proposed requirement to register for VAT be limited to business to consumer (B2C) transactions. For B2B supplies the option must be available to register voluntarily.

We further recommend that the reference to placing of orders electronically be reconsidered as this may create evasion opportunities.

### ***Clause 174(1)(d) – the extension of the definition of enterprise***

The current definition refers to services supplied by a person that is not a resident of the Republic.

### ***Recommendation***

We recommend that proviso (vi) not be limited to non-residents. Limiting the application to non-residents could lead to VAT leakage with regard to residents providing e-commerce services from facilities located off-shore. This recommendation should be read in conjunction with our recommendation with regard to the registration threshold.

### ***Clause 187(b) – new VAT registration requirements – R5 million rule***

The registration requirement for any person who makes supplies of e-commerce services goes against the general framework of the VAT Act. A registration requirement may arise where a person does not conduct an enterprise for VAT purposes (in the absence of the proposed new deeming provision) as the transaction may be a once-off event.



From a practical point of view the Commissioner will have great difficulty to police that every person making supplies of e-commerce as defined are registered. It may also lead to a large number of registrations with very little benefit to the fiscus.

### ***Recommendation***

Over and above the general comment above, we recommend that the general registration thresholds be made applicable to suppliers of e-commerce services.

We recommend that only supplies of e-commerce services to private individuals should oblige the supplier to register for VAT. B2B supplies should continue to be accounted for under the imported services rules, to the extent that the services are used or consumed in the Republic, otherwise than for the purpose of making taxable supplies( with the option to register in respect of B2B transactions).

Also note that a failure to amend the definition of imported services could lead to double taxation under the proposed draft wording. The definition of imported services should exclude B2C transactions and B2B voluntary registered vendors.

### ***Clause 187(d) – new VAT registration requirements – R5 million expense rule***

A person that will only make taxable supplies at some future date will now only be allowed to register if he/she has incurred expenditure of at least R5 million in the past or have contracted to incur such expenditure.

The person must furthermore commence making actual taxable supplies within a period of 12 months from the date of registration.

The R5 million threshold can result in a loss of input tax where such expenditure consists of operating expenses (i.e. not capital expenses on which a change-in-use adjustment may be made once the goods are brought into the enterprise).

Would capital goods qualify as expense for the purposes of the R5 million thresholds?



The voluntary registration requirement is still subject to taxable supplies being made within a period of 12 months. In certain industries this cannot be achieved, for example mining, timber, farming, property development, etc.

### ***Recommendation***

We recommend that the above approach be reconsidered as it deviates from the basic activity and purpose test governing VAT enterprises.

We further recommend that wider discretion be given to the Commissioner to register vendors operating in certain industries notwithstanding the actual level of taxable supplies and expenses incurred.

## **6.8 The supply of services by a home owners association**

### ***Issue***

The proposed amendment may lead to cash flow implications for associations that are now required to deregister for VAT due to the deemed supply provided for in section 8(2) of the Act. There are several of these types of associations that have accumulated significant assets over the years and as they are generally of a non-profit nature would not have accumulated sufficient cash balances to cover the resultant VAT liabilities.

With most similar amendments in the past where the deregistration for VAT purposes is a direct consequence, SARS has allowed for some form of relief relating to the payment of the VAT liability.

### ***Recommendation***

We recommend that SARS provide relief for the typical Home Owners Association to allow them extension to pay off the VAT liability resulting directly from this amendment. SARS may also provide a relief threshold as it allowed in the deleted section 8(2C) of the VAT Act relating to the turnover tax regime.



***Issue – Clause 179 (d) – wording of the section***

The wording of the paragraph preceding (A) and (B) could be confusing. Consider rewording the paragraph to clearly identify the exclusions and inclusions.

**6.9 Surrendering goods in terms of a credit agreement**

***Clause 182 – Documentary proof required – importation VAT***

This proposed amendment sets the time of the import to the time when the import VAT is paid to SARS (not the earlier of the bill of entry or payment of the VAT to SARS as is currently the case).

***Recommendation***

In practice an importer will not always know whether the VAT on importation has been paid by the clearing agent. We request that it be considered to expand the current measures detailed in section 54(3) of the VAT Act to require the import agent to reflect the date by when the payment of the import VAT will (where in terms of a deferment scheme) or had been made to SARS on its statement to the importer. This should then also meet the requirement envisaged in section 16(2)(d) which will require an amendment to this section.

***Clause 182(1)(a) – proposed amendment to section 16(2)***

Section 16(2) provides for the documents that will support the deductions to be made under section 16(3). It is only section 16(3)(a) or (b) that allows the vendor to make a deduction of input tax. Section 16(3)(c) to 16(3)(n) allows for the other deductions.

When section 16(2)(f) was introduced it was specifically stated in the Explanatory Memorandum that a “vendor is entitled to certain deductions in terms of section 16(3) of the VAT Act which are not subject to the documentary requirements contemplated in section 16(2) of the VAT Act.”

Section 16(2) before this amendment provided no detail of what proof SARS would need in respect of the deductions made in terms of section 16(3)(c) to 16(3)(n) and the amendment to section 16(2) then provided for the other documentary proof, which had to be acceptable to



SARS, to support the deductions where the documents listed in section 16(2)(a) – (e) would not be applicable.

These other deductions are in fact not input tax or the supporting document may not be a document listed in section 16(2)(a) – (e). Take for example the instance where an adjustment must be made in terms of section 18(5) due to the vendor having been registered by SARS as a vendor. The tax paid by the person prior to becoming a vendor will not be input tax and the deduction is made in terms of section 16(3)(f).

The wording in section 16(3)(f) confirms this when it states that the deduction is “the amounts calculated in accordance with section 18(4) or (5)” - section 18(5) in this instance. So, for instance, where this adjustment is calculated on the open market value the valuation document will not be a document a document mentioned in section 16(2)(a) to (e). Other examples where the section 16(2)(a) – (e) documents will not be applicable are indemnity payments, where the deduction is made in terms of section 16(2)(c), or prizes, where the deduction is made in terms of section 16(2)(d).

SARS exercised its discretionary powers with regard to acceptable documentary proof, granted in terms of section 16(2)(f), by issuing Interpretation note 49. With respect to section 16(3) deductions they require a tax invoice in respect of deductions to be made in terms of section 16(3)(f), (g) and (h).

According to the 2013 EM “The proposed amendment clarifies when VAT input can be claimed in special circumstances.” It is not clear why “documentary proof as contemplated in paragraphs (a) to (e)” must be excluded in section 16(2)(f). The intention (of section 16(2)(f)) is to require of a vendor to base a deduction, in instance where the documents listed in section 16(2)(a) – (e) are not applicable, on documents other than the ones listed there.

### ***Recommendation***

We recommend that words “...in any other case...” be deleted. The fact that the items in section 16(2) are separated by an “or” already assures that the documentary proof dealt with in section 16(2)(f) would then have to be in the possession of the vendor. It is, in our view,



then not necessary to add the “other than any documentary proof as contemplated in paragraphs (a) to (e)”.

## **7. MISCELLANEOUS AMENDMENTS**

### ***CLAUSE 37 – Section 12C amendments.***

There is a problem with the layout of the proviso (allowing the 40% first year write off) for S11D. Paragraph (d) of the proviso refers to paragraph (gA) but the 40% rule appears above (d) after proviso paragraph (c).

#### ***Recommendation***

If the 40% is not to be permitted then paragraph (d) of the proviso must be removed or the 40% rule must be moved to below paragraph (d).

### ***CLAUSE 49 – Deduction in respect of buildings in special economic zones***

#### ***Section 12S(2)***

The third line should be “.....*building owned by the or that qualifying company...*”

### ***CLAUSE 71 – Limitation of excessive interest***

#### ***Section 23P(2)(b)***

The last sentence should read “...*the deductible amount of interest may not exceed the amount determined in subsection (3).*”

### ***CLAUSE 83 – Expense relief ratio applicable to long-term insurers***

#### ***Section 29A(11)(a)(ii)(C)***

#### ***Issue***

The amendments to section 29A of the Bill appear to require the inclusion of cumulative unrealised gains (“difference between market value and base cost”) in the denominator of the expense relief formula. In other words, for every year a gain remains unrealised, the cumulative unrealised gain is included in the formula - because the base cost does not change.



The inclusion of these cumulative unrealized gains will result in multiple-counting. In addition, where an asset is disposed of and the realised gain is included in the formula, the formula does not make provision for the reversal of the unrealised gain previously included.

The draft legislation proposes that it becomes effective on 1 January 2013. This is the same effective date as the 2012 amendment to the expense relief ratio.

### ***Legal nature***

Cumulative unrealised gains are included in the denominator of the expense relief formula with no portion being included in the nominator of the formula. This will negatively impact relievable expenses and will negatively impact policyholders after-tax returns. Furthermore, the proposed ratio would not be equitable and representative of the deductible amount of expenditure and will result in even less tax relief in respect of policyholder fund expenses than the relief obtained using the formula that existed before it was amended in the 2012 TLAA. SAICA is also concerned that this change will lead to unintended consequences - life assurers will attempt to realise their investments before year end in order to avoid the negative impact of the unrealised capital gain in the proposed format.

Life assurers sell policies to clients giving them opportunity to buy units in a wide range of unitized investment portfolios. Unit prices allocated to clients are credited with investment income and gains on the underlying investments, less charges and tax. The crediting mechanism varies depending on the type of investment portfolio chosen as well as the systems and processes used by each assurer. These crediting mechanisms allow life assurers to recover taxes from their policyholders over the term of the policy contract fairly as they allow prices to be determined daily and independently of the actual sale and investment income earned on the underlying assets.

The retrospective nature of the proposed amendment has an impact on tax accruals that might have been understated with effect from 1 January 2013. Life assurers have applied the current expense relief ratio, as embodied in section 29A(11)(a)(ii) of the Income Tax Act to determine unit prices and tax accruals. The change would have a retrospective application for life assurers due to the daily recovery of tax in the unit prices. This will result in existing



policyholders having to carry the increased tax accruals attributable to policyholders who exited from their policies. Life insurers don't have the ability to recover from policyholders that have left and received the policy benefit of the current expense relief ratio. Furthermore, there is no equitable way to recover these tax accruals from existing policyholders. Each policyholder will have benefitted to different extents from past investment gains and thus have different amounts built into their policy values.

### ***Recommendation***

SAICA proposes that unrealised gains still be included in the denominator, but limited to the annual movement in the gains instead of the difference between market value and base cost. In this way multiple counting will be avoided and any future increases in the value will be captured as part of the realized capital gains tax inclusion.

Furthermore, the equivalent amount to be included in taxable income (for example 33,3% in the case of the individual policyholder fund) should be included in the nominator of the expense relief ratio to avoid negative variances from year-to-year. In this way the expense relief ratio will capture the capital gain and spread it over the lifetime of the investment until it is eventually realised.

In order to further eliminate fluctuations, unrealistically high ratios or even negative ratios from year-to-year it is proposed that unrealised capital losses be limited to nil.

The amendment should further be effective from years of assessment commencing on or after the promulgation of the Taxation Laws Amendment Bill in order to avoid any inequity between policyholders.

### ***CLAUSE 167 – Withholding taxes***

#### ***Paragraph 3 of the Tenth schedule***

In Clause 167(c)(2) Notwithstanding Part IVA of Chapter II should be Part IA of Chapter II.



## **DRAFT TAX ADMINISTRATION AMENDMENT BILL, 2013 (“DTAAB”)**

### ***General comment - Commencement date***

It is proposed that any amendments to the TAA, as proposed in the draft 2013 TALAB, be deemed to come into operation on 1 October 2011. However, the TAA itself only came into operation on 1 October 2012.

We recommend that the proposed amendments to the TAA be deemed to come into operation on 1 October 2012, in order to align the effective date of the amendments with that of the TAA itself.

### **SPECIFIC COMMENTS**

#### ***Clause 2 – section 6quin(3A)***

The proposed addition of section 129(5) is questionable. The draft Explanatory Memorandum states the following:

“The proposed amendment clarifies what is the effect of the decision of the tax court in a test case designated under section 104(6).”

#### ***Clause 39 – introduction of section 129(5)***

It is generally accepted that Tax Court Judgments apply *inter partes* and are only of persuasive value in respect of other tax cases. To provide that the decision of a tax court in a case involving a third party is determinative of another taxpayer’s objection or appeal undermines the constitutional principles of access to justice and the right to be heard. As a further matter, the proposed provision fails to take into consideration that a decision of the tax court is automatically appealable to a high court and that any decision of a court is only relevant to another case insofar as the facts are comparable.

All taxpayers should have the right to have their cases heard before the courts.



### ***Recommendation***

Section 129(5) should not be added.

### ***Clause 62 – understatement penalties***

The proposed amendment to exclude bona fide errors from the understatement penalty is welcomed. It is of concern that this amendment is proposed to take effect only from the date of promulgation of the Act. This is contrary to the position adopted in respect of most other amendments to the TAA which are retrospective to the effective date.

Taxpayers that have made inadvertent errors since the TAA was introduced should be entitled to relief.

### ***Recommendation***

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.

### ***Clause 64 - Section 224 – Remittance of understatement penalties***

We submit that the section should be changed as underlined:

*“The imposition of an understatement penalty under section 222 OR a decision by SARS not to remit an understatement penalty under section 223(3), is subject to appeal under Chapter 9.”*

### ***CLAUSE 68 - Section 240(2)(d)(ii) – Interpretation of “direct supervision”***

#### ***General comment***

It is our view that staff who are not finally responsible for any tax advice or completion of tax returns should be regarded as qualifying for the exclusion on the basis that their work is conducted under the supervision of a person who is a registered tax practitioner and who is finally responsible for such tax advice or completion of returns.

In our view, this was the intended purpose of the exclusion supported by the EM relating to the insertion of section 67A of the Income Tax Act which used the example of trainees or



articled clerks qualifying for the exclusion. Ordinarily, such persons would report firstly to a manager, although a partner or director (now a tax practitioner) may be finally responsible for their work.

***The problems that we have with “direct supervision” in the current legislation***

Direct supervision is a term that is commonly used to refer to situations in which a supervisor is present at all times. The supervisor will then oversee activities as they occur and will provide constant direction, feedback, and assistance.

Tax practitioners routinely employ staff at varying levels of expertise to assist them with the preparation of advice and or returns which would not in all instances amount to direct supervision as we understand it. Whilst these persons (who are subject to control) might arguably be seen to be providing advice or completing returns they are not acting as tax practitioners in the true sense of the term as they earn no fees for their activities. These are earned by the practitioner who is responsible for the advice or returns.

SARS website itself seems to support the foregoing conclusion in that it is only practitioners who provide advice or prepare returns for fees that are required to register as tax practitioners:

• **How to register as a Tax Practitioner**

- **Top tip:** Every practitioner who provides tax advice or completes returns for the payment of a fee must be registered with SARS as a tax practitioner. In terms of the new process, practitioners must be registered by 1 July 2013 with one of the recognised controlling bodies. [Click here for more info.](#)

Therefore employees of practitioners would seem to be excluded from the intended meaning of tax practitioners, unless of course they had actual authority to issue the advice or return.

We agree with the view taken by SARS (in response to our initial request) that the exclusion would not apply where tax related services are provided to or in respect of a third party. The exclusion in section 240(2)(d)(i) therefore does not apply.



SARS recognised that the exclusion in section 240(2)(d)(ii) “does not require an employment relationship between the person providing tax related services and the registered tax practitioner.”

It is therefore our view that “direct supervision” should not be the criteria to be used in this regard.

***The problems that we have with “accountability” in the proposal:***

The word “accountability” generally means the delegation of authority and responsibility to qualified persons to initiate, process, and review business transactions and holding those persons responsible for the validity, correctness and appropriateness of their actions.

In that sense persons under the supervision (direct or otherwise) would be accountable to a firm or the tax practitioner who delegated authority to that person. The proposed addition of sub-section (2A) to section 240 has the effect of making a natural person (not the firm) who is a tax practitioner accountable.

***Our view***

It is our view that the proposal to regard the tax practitioner as accountable for the actions of the person (albeit for purposes of a complaint to a recognised controlling body only) is not the appropriate way to address the issue at hand. A tax practitioner who will normally be responsible for tax advice or returns where these were provided by staff acting in terms of authority delegated by the tax practitioner; and as such the tax practitioner would be the one that a SARS official would lodge a complaint to. One would assume that the “actions of the person” will refer to actions that relate to the provision of advice or the completion or assistance in completing in a return only.

***Recommendation***

We propose the following wording:

“The provisions of this section do not apply in respect of a person who—

(d) provides the advice or completes or assists in completing a return solely—



- (i) to or in respect of the employer by whom that person is employed on a full-time basis or to or in respect of the employer and connected persons in relation to the employer; or
- (ii) **[under the direct supervision of a person who is a registered tax practitioner]** where the person provides the advice or completes or assists in completing a return under the supervision of a registered tax practitioner who is finally responsible for the provision of such advice or completion of such return."

There would then be no need for the addition of subsection (2A).

### **Removing the word solely**

We notice the intention to remove the word “solely” where it appears in section 240(2)(a)(d) which we are in support of.

### ***Clause 72 - Section 270(6) – Application of Act to prior or continuing action***

The extent of the application of this section should be clarified to confirm when an understatement penalty, administrative non-compliance penalty or interest cannot be imposed, levied, assessed or recovered in respect of an understatement, non-compliance or failure to pay that occurred before the commencement date of this Act.

### ***Sections 270(6) and 270(6A)***

There appears to be a contradiction between these two sections for the following reasons: Section 270(6) states that to the extent to which understatement penalty cannot be imposed in respect of an understatement that occurred before the commencement date, SARS may impose additional tax in accordance with the provisions of the repealed sections in the relevant tax Acts, as if the repeal had not been effected.

Section 270(6A) deals with the remittance of an understatement penalty imposed under the TAA where a return was due prior to the commencement of the TAA.



It would appear from the above that SARS still has discretion to impose understatement penalties on understatements that occurred before the commencement of the TAA, despite section 270(6). We request that the application of these two sections be clarified.

***Issue - Section 212 and section 236 affidavit***

***Clause 28 of the 2013 DTALAB: Section 46(7) of the TAA***

Clause 28 of the 2013 DTALAB proposes to incorporate section 212 and section 236 of the Criminal Procedure Act, 1977 (Act No. 51 of 1977) into the TAA.

Section 236 of the Criminal Procedure Act, deals with the proof of entries in accounting records and documentation of banks. It reads as follows:

“(1) The entries in the accounting records of a bank, and any document which is in the possession of any bank and which refers to the said entries or to any business transaction of the bank, shall, upon the mere production at **criminal proceedings** of a document purporting to be an affidavit made by any person who in that affidavit alleges-

- (a) that he is in the service of the bank in question;
  - (b) that such accounting records or document is or has been the ordinary records or document of such bank;
  - (c) that the said entries have been made in the usual and ordinary course of the business of such bank or the said document has been compiled, printed or obtained in the usual and ordinary course of the business of such bank; and
  - (d) that such accounting records or document is in the custody or under the control of such bank,
- be prima facie proof at such proceedings of the matters, transactions and accounts recorded in such accounting records or document.

(2) Any entry in any accounting record referred to in subsection (1) or any document referred to in subsection (1) may be proved at criminal proceedings upon the



mere production at such proceedings of a document purporting to be an affidavit made by any person who in that affidavit alleges –

- (a) that he is in the service of the bank in question;
  - (b) that he has examined the entry, accounting record or document in question;  
and
  - (c) that a copy of such entry or document set out in the affidavit or in an annexure thereto is a correct copy of such entry or document.
- (3) Any party at the proceedings in question against whom evidence is adduced in terms of this section or against whom it is intended to adduce evidence in terms of this section, may, upon the order of the court before which the proceedings are pending, inspect the original of the document or entry in question and any accounting record in which such entry appears or of which such entry forms part, and such party may make copies of such document or entry, and the court shall, upon the application of the party concerned, adjourn the proceedings for the purpose of such inspection or the making of such copies.
- (4) No bank shall be compelled to produce any accounting record referred to in subsection (1) at any criminal proceedings, unless the court concerned orders that any such record be produced.
- (5) In this section –

*“document” includes a recording or transcribed computer printout produced by any mechanical or electronic device and any device by means of which information is recorded or stored; and*

*“entry” includes any notation in the accounting records of a bank by any means whatsoever.”*

Professor Angela Itzikowitz writes the chapter on South African law in Neate’s book on Bank Confidentiality, Fourth Edition. Professor Itzikowitz, referring to section 236 (4) of the Criminal Procedure Act, comments as follows on page 611:



*“Information obtained under compulsion of a court order is always subject to an implied (and sometimes express) undertaking that it will only be used for the purposes of the action. The undertaking applies to all documents disclosed under specific orders, as well as documents produced under discovery.”*

The key words here are “under compulsion of a court order”. In our view, what section 236 is saying as far as banks are concerned is this: banks are only obliged to produce any accounting record at any **criminal proceedings** if compelled to do so by a Court and if so compelled, they can do so by way of an affidavit, which affidavit must allege inter alia the matters specified in subsections (1) and (2).

It is submitted that the requirements of sections 46 of the TAA, on the one hand, and section 236 of the Criminal Procedure Act on the other is confused. These sections are there for different purposes. Section 46 is there to assist the Commissioner in his task of administering the tax Acts. The information requested is information to be given to the Commissioner. On the other hand, section 236 of the Criminal Procedure Act contemplates criminal proceedings taking place and it is the “court concerned” in those proceedings that must issue the order to a bank to produce. The Commissioner does not have the power to issue that order.

We are therefore of the view that National Treasury cannot statutorily mandate the provision of such an affidavit without a court order in place and certainly cannot do so prior to criminal proceedings being instituted. The role of SARS is to administer the various tax Acts under its purview. It cannot seek to administer the Criminal Procedure Act.

### ***Recommendation***

The proposed Clause 28 of the 2013 DTALAB attempts to legislate a rule of evidence and should be deleted.



***Issue – SARS confidential information***

***Clauses 30 and 31 of the 2013 DTALAB: Section 68(1) and section 73(1) of the TAA***

Clause 30 of the 2013 DTALAB proposes an amendment to the definition of ‘SARS confidential information’ contained in section 68(1) of the TAA. The draft proposes to include as paragraph (k) “information relating to the examining or auditing procedures or method used by SARS, the disclosure of which could reasonably be expected to jeopardise the effectiveness thereof.”

Essentially it appears that SARS is seeking the power to refuse to provide the taxpayer with the procedural steps taken to arrive at the total on a tax assessment. In this regard, Clause 31 of the 2013 DTALAB amended section 73(1) of the TAA to substitute paragraph (c) with the following – “A taxpayer is entitled to obtain (c) information, other than SARS confidential information, on which the taxpayer’s assessment is based.”

The reason for SARS’ refusal, when requested by the taxpayer to provide them with the procedural steps taken to arrive to the total on the tax assessment, would then undoubtedly be that disclosure of audit or examination methods used to arrive at the assessment would jeopardise the effectiveness of such assessment in the hands of SARS. This is contrary to the objectives stated for the introduction of the TAA which includes the promotion of a better balance between the powers and duties of SARS and the rights and obligations of taxpayers and to make this relationship more transparent.

***Recommendation***

The proposed Clause 30(c) of the 2013 DTALAB should be deleted.

***Issue – Prescription periods of assessments***

***Clause 34(e) of the 2013 DTALAB: Section 99(3) of the TAA***

The proposed clause 34(e) of the 2013 DTALAB refers to subsection 2 however it appears that subsection 1 is the correct provision affected.

It is proposed that the relevant prescription periods referred to in subsection (2) [*sic*] be extended “for the period that a taxpayer without just cause fails to submit relevant material



requested by SARS for purposes of verification, inspection or audit under Chapter 5 (Information gathering), commencing on the day that the relevant material was required to be submitted and ending on the day that the taxpayer submits the relevant material.”

Having regard to specific timelines required for submission of information to the SARS, the relevant three and five year prescription periods set out in section 99(1) of the TAA are reasonable periods for SARS to complete any tax audits. Where no fraud, misrepresentation or non-disclosure of material facts are present, the current prescription periods provide certainty to both SARS and taxpayers and to extent the relevant periods would jeopardise the objective of section 99.

Further to the above, the proposed amendment would provide SARS with excessive power and the ability to keep an assessment open for an unlimited period of time should these powers be abused.

It is our view that current legislation already sufficiently empowers SARS to appropriately combat situations where taxpayers fail to respond to SARS’ queries in an attempt to force prescription. SARS can either disallow the expenditure under query/ include into taxable income potential income under query by raising a valid additional assessment before prescription or alternatively by raising an estimated assessment. This action by SARS would place the ball straight back into the court of the taxpayer that will be forced to object to such assessment should the taxpayer wish to do so.

If the proposed changes are accepted, SARS may obtain unintended power which may be abused. SARS might have the ability to raise various generic queries just before prescription in order to artificially extend prescription. It is also unclear whether such queries would extend prescription altogether or whether prescription only directly related to issues covered by the specific SARS queries would be impacted.

### ***Recommendation***

The proposed Clause 34(e) of the 2013 DTALAB is unnecessary and should be deleted.



## **CUSTOMS AND EXCISE ACT**

*Applicable provisions: proposed section 73(6)(a) of the Customs and Excise Act, No 91 of 1964 (the Customs and Excise Act)*

### ***Issue***

It is proposed that section 73(6)(a) of the Customs and Excise Act be amended to read as follows:

*“The applicable date for a currency conversion in respect of goods imported into or exported from the Republic is the date of entry of the goods for any purpose in terms of this Act.”*

### ***Legal nature***

The concept of “due entry”, as envisaged in section 38 read with section 39(1) of the Customs and Excise Act, is set out in a manner that suggests that it means delivery of an appropriately completed and signed bill of entry in the prescribed form.

Where the bill of entry, which was delivered at an earlier date, is withdrawn and a new bill of entry is later delivered as a substitute for the original bill of entry (e.g. as contemplated in section 40(3)(a)(i)(B) of the Customs and Excise Act), it is unclear which date of due entry will be used for currency conversion purposes.

### ***Example 1***

In week 1 Importer A receives the bill of lading and other documents for goods purchased from an overseas supplier. The shipment is sea-freight and its estimated date of arrival is in three months' time (i.e. 12 weeks). The importer, through his clearing agent, delivers a “duty paid” bill of entry as a pre-clearance in week 1. When the goods arrive in week 12, the importer cancels the earlier bill of entry and applies for a refund of the customs duties paid. Subsequently, during the seven day period within which the importer is required to make due entry after arrival of the goods, the importer delivers a fresh “WH” bill of entry. This begs the question: which date of due entry will be used for currency conversion purposes?



### *Example 2*

In week 1 Importer A receives the bill of lading and other documents for goods purchased from an overseas supplier. The shipment is sea-freight and its estimated date of arrival is in three months' time (i.e. 12 weeks). The importer, through his clearing agent, delivers a “duty paid” of entry as a pre-clearance in week 1. Prior to the arrival of the goods the importer cancels the earlier bill of entry and applies for a refund of the customs duties paid. Subsequently, during the seven day period within which the importer is required to make due entry after arrival of the goods, the importer delivers a fresh “duty paid” bill of entry. This begs the question: which date of due entry will be used for currency conversion purposes?

### ***Recommendation***

It is suggested that section 73(6)(a) be amended to read as follows:

*“The applicable date for a currency conversion in respect of goods imported into or exported from the Republic is the date of first entry of the goods for any purpose in terms of this Act.”*

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

Piet Nel CA(SA)

**PROJECT DIRECTOR: TAX**

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