South African
Institute of
Tax Practitioners

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Ms N. Mpotulo
The National Treasury
240 Vermuelen Street
PRETORIA
0001

Ms A. Collins
Legal & Policy
The South African Revenue Service
Lehae La SARS
PRETORIA
8000

BY E-MAIL: nomfanelo.mpotulo@treasury.gov.za / acollins@sars.gov.za

Dear Ms Mpotulo and Ms Collins

RE: CALL FOR COMMENT: DRAFT TAXATION LAWS AMENDMENT BILL, 2013

Thank you for the opportunity to contribute commentary on the draft Taxation Laws Amendment Bill, 2013.

Set out below, is the consolidated commentary on the **corporate tax issues only** developed from both an internal review of the provisions as well as from consultations with members, stakeholders and industry. The commentary reflects the collective view of members, stakeholders and industry role players consulted.

1 ANTI-HYBRID DEBT INSTRUMENT RE-CHARACTERISATION RULES (s8F & 8FA), (Clause 16 &18)

1.1 Scope of the sections

Problem statement:
The Companies Act provisions impose a solvency test on the payments under subordinated shareholders loans. It is unclear whether the conditionality of both section 8F and 8FA is limited to the terms of the agreement, or to the Companies Act provisions.

The need for both section 8F and s8FA is questionable based on the fact that the test in both sections is identical.

Proposed solution / recommendation:
Section 8F(1)(c) and section 8FA(1)(b) should be 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.

T: +27 86 177 7274
F: +27 86 626 0650
E: info@thesait.org.za
W: www.thesait.org.za

Riverwalk Office Park, Building A
C/O Garsfontein & Matroosberg Roads
Pretoria, South Africa
0081

P.O.Box 73
Featherbrooke
1746

Consideration could be given to inserting four tests under section 8F for recharacterising the interest on the loans rather than having a separate section dealing with these issues (section 8FA).

1.2 Meaning of "time value of money" section 8FA

Problem statement:
Included in the definition in section 8FA of "hybrid interest" is any interest in respect of a debt owed by any resident company if the amount of that interest is not determined with reference to a specified rate of interest or the *time value of money*. Clarification is needed as to whether a CPI linked bond/debt falls within this definition – that is whether the interest is regarded as being linked to the time value of money.

Proposed solution / recommendation:
A concise definition of the meaning of "time value of money" is required in order to clarify if, for instance, the treatment of CPI linked bonds/debts under s8FA.

1.3 Interaction with DTA

Problem statement:
Section 8F and 8FA recharacterise the nature of a payment made from interest to a dividend in the hands of the payer and the recipient, but it is uncertain how the DTA relief is impacted by this recharacterisation (that is, should the dividend or the interest clause of the DTA be used).

Proposed solution / recommendation:
Corbett JA held in SIR v Downing (1975) (4) (SA 518(A) (37 SATC 249) that in the event of any ambiguity or conflict between the DTA and the provisions of the domestic tax law, the DTA must take preference and its provisions be given effect. Thus although the local legislation is changing the nature of the interest on the loan (debt) to equity returns (dividends), legally this is still interest, but clarity on the interaction between the DTA and the deeming provisions is required confirming this viewpoint.

1.4 Exclusion of Small Business Corporations

Problem statement:
The exclusion of small business corporations ('SBC') from the ambit of section 8F and section 8FA is welcomed. The concern, however, is that not all small businesses qualify as a SBC as defined in section 12E(4)(a) (such as small investment and professional service provider entities), and thus would potentially be subject to the recharacterisation provisions.

Proposed solution / recommendation:
To prevent small property development companies, rental property owing companies, investment companies and personal service providers from being subject to the provisions as

sections 8F and 8FA, we suggest that the exclusion from section 8F and 8FA should not be linked to a SBC as defined in section 12E but should rather be linked to only certain requirements in section 12E that relate to the size of the business, not those that relate to the nature of the activities or income. Furthermore, instruments held between companies that form part of the same group of companies (as defined in section 41(1)) should be treated as exempt from section 8F and 8FA.

1.5 Exclusion for a group of companies

Problem statement:
The application of these sections with regard to typical treasury companies in the group context needs to be taken into consideration in the amendments especially when there is no disadvantage the fiscus.

Proposed solution / recommendation:
In order to prevent unnecessary tax adjustments where a tax deductible expense equals the taxable income of the companies in the same group we propose that relief from sections 8F and 8FA be provided to groups of companies as defined in section 41 of the Income Tax Act.

2 CGT IMPLICATIONS ON CROSS ISSUE OF SHARES (s24B, 40CA, par 11(2)(b) of the Eighth Sch), (Clause 176)

Problem statement:
Paragraph 11(2)(b) does not clearly indicate who will make the deemed disposal – the company or the company's shareholders. As paragraph 11(2)(b) is applicable not only in respect of schemes which tried to shift control offshore, bona fide cross issue of shares between resident and non-resident companies will negatively be affected by the proposed changes should the gain be made in the company's hands, as no base cost deduction will be permissible.

Paragraph 11(3) incorrectly refers to a disposal by a company that is not a resident. This should be changed to a resident. Prop

Proposed solution / recommendation:
Paragraph 11(2)(b) should clearly indicate that the disposal of the shares will be take place in the hands of the shareholders of the resident company and not in the hands of the company. This will permit a deduction of the base cost for the shareholders of the resident company against the proceeds that they will receive. 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.

3 DEDUCTIBLE INTEREST LIMITATION IN RESPECT OF ACQUISITION INDEBTEDNESS (s23K,s23N, 23O) (Clause 65, 67,70)

3.1 Effective date

Problem statement:
Sections 23N and 23O (as well as section 23K(10)) are deemed to come into effect on 1 July 2013 and make reference to arrangements entered into on or after that date. This is clearly a case of retrospective legislation which could result in a person having to suffer in law (criminal or civil) for an act which was not unlawful when he/she committed it. Retrospective legislation destroys the certainty of law and undermines many characteristics of the rule of law.

The effective dates of section 23K(10) and section 23N render rulings (and legal agreements) that taxpayers have obtained under section 23K in respect of transactions still to be implemented, obsolete. Furthermore, 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.

Proposed solution / recommendation:
The changes proposed should be made to become effective on a date that is after the consultation process has been finalized and the law has been promulgated. Retrospective legislation (unless to the benefit of the taxpayer) is unacceptable. Furthermore, the term "entered into" should be clarified or reworded in order to establish whether conditional agreements as mentioned above would fall within section 23K or section 23N.

With regard to 23K rulings, taxpayers who have already obtain such a ruling (despite the fact that the transaction might not yet have been implemented) should be permitted to claim interest deductions as per the original terms of the ruling.

3.2 Period of the limitation of the deduction

Problem statement:
The document issued by the National Treasury on 29 April 2013 (Proposed limitations against excessive interest deductions) requesting public comment proposed that interest limitations would apply for the term of the financing and that any excess interest could be carried forward for 5 years. In terms of the proposed amendment to section 23N(3) and (4), the limitation of the interest deduction is only applicable for the first 5 years of the transaction, thereafter the interest is fully deductible. No mention is made of the treatment of the excess interest deductions in the first 5 years (is it carried forward?). A clear divergence of original intentions has taken place with the release of the proposed amendments. and clarity of why these changes differ from those originally proposed are required.

Proposed solution / recommendation:
The explanatory memorandum on the draft legislation should clarify why the proposed changes in the draft legislation differ from those originally proposed in the document issued for public comment. Furthermore, to prevent possible loss of foreign direct investment into South Africa, the proposals could consider making the interest limitation rules only applicable if the recipient or ultimate recipient pays tax at lower than 75% of the South African rate. The proposed withholding tax on interest should also cater for this problem.

3.3 Intra-group interest denial (section 23O)

Problem statement:
The provisions of section 23O appear far too wide. Various commercial reasons exist for charging interest in an intra-group situation – such as the existence of minority shareholders. The denial of the interest deduction in the hands of the debtor for all intra-group acquisitions between historic group members in terms of section 23O is therefore problematic. In addition, no provisions have been put in place to exclude the accrual of interest in the hands of the creditor.

Proposed solution / recommendation:
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. 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.

3.4 Controlling relationship clarification (section 23O)

Problem statement:
The term "controlling relationship" is defined with reference to section 23M. 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. Thus section 23M deals with debtor/creditor relationships, 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.

Proposed solution / 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).

3.5 Scope of section 23O

Problem statement:
Despite the use of the term "directly or indirectly" in section 23O(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 or whether the provisions are intended to apply only to instances where the purchase consideration remains outstanding on interest bearing loan account.

Should the section be applicable to a situation where the purchaser obtains funding from a third party (connected or otherwise), then 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.

Proposed solution / recommendation:
The scope of the proposed section 23O should be clarified by stating that the application of the section is 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.

3.6 Technical corrections in section 23N and section 23O

Problem statement & proposed recommendation:
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. The definition of 'acquired company' should be amended to remove this inconsistency.

4 DEFERRAL OF EXPENDITURE INCURRED BETWEEN TAXABLE PAYORS AND EXEMPT PAYEES (s23M), (Clause 68)

4.1 Effective date

Problem statement:
Sections 23M is deemed to come into effect on 1 July 2013. The provision is thus backdated to apply to expenditure incurred on or after 1 July 2013. Retrospective legislation destroys the certainty of law and undermines many characteristics of the rule of law.

Proposed solution / recommendation:
The changes proposed should be made to become effective on a date that is after the consultation process has been finalized and the law has been promulgated.

4.2 Definition of 'creditor'

Problem statement:
Section 23M(1) (and section 23P) defines the term "creditor" to mean "*a creditor that is not subject to tax under Chapter II*". The reference to "not subject to tax" is unclear and open to interpretation. For instance, would a company that has gross income but is subject to an exemption, be 'not subject to tax'? Or would a company has income but the amount is excluded because of the application of a Double Taxation Agreement, be regarded as being 'not subject to tax'? Similarly, going forward, would 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, be regarded as being 'not subject to tax'.

Another concern is that 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. For example, if a creditor is subject to Dividends Tax during the year of assessment in respect of a dividend from the debtor company it can be argued that the creditor falls outside the reach of the provision as regards other amounts owed to the creditor. Thus section 23M (and 23P) can easily be manipulated by the payment of any other amount subject to tax in terms of Chapter II.

Proposed solution / recommendation:
The definition of 'creditor' should 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.

The definition of 'creditor' should also specify that the creditor must not be subject to tax in respect of the specific amount in question. Consideration should be given to providing relief where the income is taxed in a country which has a tax rate in line with South Africa.

4.3 Interaction with section 24J

Problem statement:
Section 24J's purpose is to determine the accrual and incurral of interest. This section deems interest to be incurred usually on a yield to maturity basis. However, section 23M(2) deems the interest to be incurred only when it is paid. This conflicts with section 24J in the case of interest owing. It is unclear if it is the intention that section 24J should not apply at all to the determination of interest paid in the circumstances contained in section 23M (that is if section 23M overrides section 24J – and potentially also section 23H). The common law position is that interest accrues to the creditor upfront. In the absence of section 24J it could be argued that the entire portion of the initial payments in respect of a loan represent deductible interest.

Proposed solution / recommendation:

Rather than deeming the amount to be incurred only upon payment section 23M should deem the amount to be deductible only upon payment.

5 DEDUCTIBLE INTEREST LIMITATION IRO LOANS BETWEEN EXEMPT PERSONS AND DOMESTIC COMPANIES (s23P) (Clause 71)

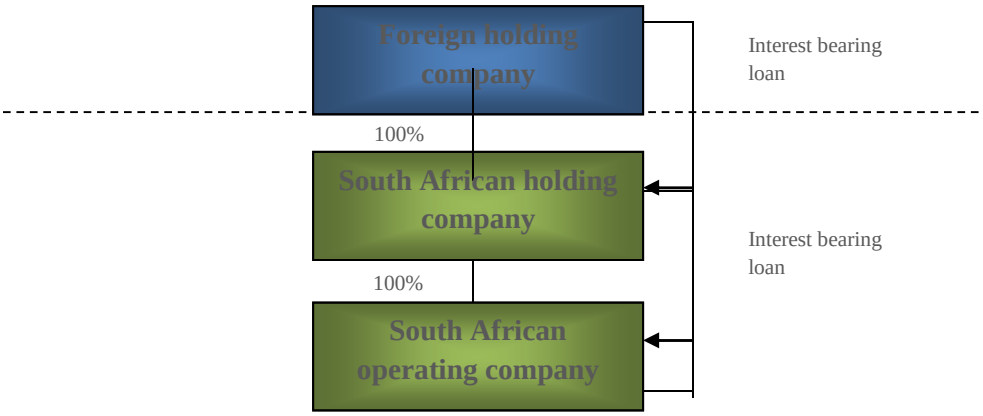
5.1 Effective date

Problem statement:
Sections 23P is deemed to come into effect on 1 July 2013. This is clearly a case of retrospective legislation which could result in a person having to suffer in law (criminal or civil) for an act which was not unlawful when he/she committed it. Retrospective legislation destroys the certainty of law and undermines many characteristics of the rule of law.

Proposed solution / recommendation:
The changes proposed should be made to become effective on a date that is after the consultation process has been finalized and the law has been promulgated.

5.2 Entities to which section 23P is applicable

Problem statement:



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.

Proposed solution / recommendation:
The ultimate user needs to be the entity which is subject to the adjusted taxable income calculation.

5.3 Interaction with section 23O

Problem statement:
There are instances in which both section 23P and 23N could 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. It is uncertain which of these sections would apply.

Proposed solution / recommendation:
Clarity is needed on how to treat these situations.

5.4 Calculation of interest limitation

Problem statement:
Taxable income (using income statement items) is used to calculate the limit at which the interest payment is deductible. Included in the calculation of taxable income are other items that have no bearing or relation to the debt funding. Furthermore, should the taxpayer experience a bad financial year, then it is possible that no interest deduction would be permissible.

Proposed solution / recommendation:
It is proposed that the debt limitation provision be based on balance sheet amounts.

6 TENANT CONSTRUCTION AND IMPROVEMENT ON LEASED LAND (s12N), (Clause 45)

6.1 Application of the section

Problem statement:
The Minister in his Budget Speech created an impression that these deductions would be of more general application than just being limited to public private partnerships (PPP) as in proposed in the amendments. The requirements of the section are quite specific with regard to PPP's set ups but not all PPP are set up in the manner required by the legislation.

Proposed solution / recommendation:
Further consultation on this issue, specifically with regard to the limitation and requirements of a qualifying PPP, should be considered.

6.2 Effective date of the section

Problem statement:
It is not clear why the application of this section has been delayed to 1 January 2014.

Proposed solution / recommendation:
The effective date for this section should be 1 July 2013 (as per so many other provisions in the draft legislation) so as to allow for the deduction of impending improvements.

7 ANNUAL FAIR VALUE TAXATION OF FINANCIAL INSTRUMENTS IRO BANKS AND BROKERS (s24JB) (Clause 78)

Problem statement:
It appears that there is an error with regard to the effective date as it states that the amendment is deemed to come into operation on 1 January 2014 and it applies in respect of years of assessment ending on or after that date.

A concern is raised that the definition of "covered person" is not broad enough as it does not include financial service groups that do not have banking licenses.

It also appears that there that there may be conflicting classifications between sections 8E, 8F and 8FA and the IFRS classification used in terms of section 24JB, in particular where IFRS classifies an instruments as a financial liability or a hybrid instrument, while the instrument is treated according to its equity form for tax purposes.

Proposed solution / recommendation:
The provision should take effect in respect of years of assessment commencing on or after 1 January 2014, not years of assessment ending on or after 1 January 2014.

The definition of 'covered person' should be broadened to include financial service groups that do not have banking licenses.

Although the effect of these conflicting classifications may be negated to some extent by the fact that only financial liabilities measured at fair value through profit or loss will be affected, we suggest that further consultations be held with the affected taxpayer to attempt to avoid these classification conflicts.

The effective date: the provision should take effect in respect of years of assessment commencing on or after 1 January 2014, not years of assessment ending on or after 1 January 2014.

8 DEEMED ORDINARY TREATMENT OF CERTAIN DISPOSALS OF PARTICIPATORY UNITS IN CIS ((section 9CA), (Clause 23))

Problem statement:
The proposed amendments could result in an investor in a hedge fund being taxed twice on the same speculative gain made. This arises in respect of disposals on or after 1 January 2014 as the value of the interest in the hedge fund disposed of will be based on the undistributed profits earned prior to that date when the entity was still taxed on its profits.

Proposed solution / recommendation:
Although the double taxation can be avoided (by realising the gains embedded in the interest in the hedge fund before 1 January 2014 and re-acquiring the interest at the same time), given the fluctuating nature of underlying investments of the hedge fund and the immediate capital gains tax implications, this may however not be feasible. Therefore we suggest that a transitional mechanism be implemented that would in a similar manner to the valuation date value when capital gains tax was implemented. This transitional provision would require the value of the interest in the hedge fund to be determined as at 31 December 2013. The proceeds on the disposal of interests acquired before 1 January 2014 where such disposal takes place on or after 1 January 2014, would need to be split into proceeds exceeding the market value at 31 December 2013, to which the provisions of section 9CA should apply and proceeds equal to the market value of the interest at 31 December, which should be taxed based on the principles that applied prior to 1 January 2014.

9 REFINEMENT TO R&D INCENTIVE ((s11D), (Clause 34)

One of the key objectives of the National Development Plan - 2030 ('the plan') is to expand science, technology and innovation outputs. The plan states that this objective will be achieved by increasing research and development (R&D) spending by government and by encouraging industry to also do so. The plan also appreciates that in order for South Africa to stay competitive and move up the value chain, R&D for innovation is essential. One of the areas identified in the plan as being essential to ensure that South Africa has a sharp innovative edge and continues to contribute to global scientific and technological advancement is that innovation and enhanced cooperation between public science and technology institutions and the private sector is required. It is against this backdrop that the proposed amendments are judged.

9.1 Effective date

Problem statement:
The changes to R&D are deemed to come into operation on 1 October 2012. This is clearly a case of retrospective legislation which could result in harsh implications for taxpayers who have already engaged in R&D since that date and have relied upon the existing requirements. In addition, this retrospective treatment appears to be contrary to the National Development Plan –

2030 that recognizes that while South Africa needs to spend more on R&D in general, the institutional setup also needs to improve the link between innovation and business requirements. The plan highlights that Government should partner with the private sector to raise the level of R&D, with resources targeted towards building the research infrastructure required by a modern economy. It appears that this partnering between Government and the private sector has not been achieved.

Proposed solution / recommendation:
Reliance on the previous legislation should not be to the detriment of the taxpayer and it is suggested that the changes proposed should be effective from 1 January 2014 to allow affected taxpayers to ensure that their R&D meets the new requirements laid down in the amendments.

9.2 Definition of R&D – requirement to be for use to the general public

Problem statement:
The National Development Plan – 2030 acknowledges that South Africa, as a middle-income country, has to compete on the basis of excellent products and brands, and effective entry into global distribution channels. This will require greater commitment to R&D and its commercialisation, an efficient logistics platform and effective economic diplomacy.

Taking cognizance of the above, it is submitted that the definition of 'research and development' is too restrictive in respect of the following:

- That the computer programs must be mainly intended for the purposes of the sale to, or for use by the general public [item (a)(i)(cc)];
- That it must be for the purposes of applied scientific knowledge mainly intended for the purposes of the sale to, or for use by the general public [item (a)(ii)];
- That significant and innovative improvements must be mainly intended for the purposes of the sale to, or for use by the general public [item (b)].

It is not clear why the requirement for the R&D to be globally novel has been introduced and why the above items (intended for sale or licensing to the respective business) do not qualify, if they meet the other requirements of the provision and do not pertain to one of the disqualified fields.

Proposed solution / recommendation:
With many small businesses trying to compete with global giants the R&D being done in South Africa to attempt to improve local developments to match or surpass global competition should be recognized. Particularly in light of the retrospective nature of the changes to this section and taking into account the reasons for section 11D (to incentivise South African companies to increase R&D), we suggest that reasons for the above amendments be provided in the explanatory memorandum as the changes appear to narrow the definitions of R&D and thus do not assist South African to become a world-leader in various sectors of the economy.

9.3 Definition of R&D – items not included any more

Problem statement:
The discovery of technological knowledge (previously included under section 11D(1)(a)(i)) is no longer catered for in the new definition of R&D. Neither is the "knowledge essential to the use of such invention, design or computer program" (previously included under section 11D(1)(a)(ii)(d)) catered for. This latter knowledge, such as drafting of operating manuals, enables the developer to sell or license the invention or computer program and is considered to be an integral part of the R&D process.

Proposed solution / recommendation:
Although sections 11D(1)(a)(ii) and 11D(1)(a)(iii) are intended to replace section 11D(1)(a)(i), we suggest that the discovery of technological knowledge be specifically included in the definition of R&D. Knowledge essential to the use of such invention, design or computer program should also be specifically included in the definition of R&D.

9.4 Definition of R&D – requirement to know if it is already utilized or known

Problem statement:
Proviso (f) of the definition of 'research and development' is unreasonable in that it requires a taxpayer to know whether or not the intellectual property is already utilized or known by other persons somewhere else in the world. This is not always possible due to the competitive and secretive nature of certain research.

Proposed solution / recommendation:
As definition of 'research and development' already requires the research to be innovative and will lead to the advancement of knowledge, this requirement is not considered necessary.

9.5 Definition of R&D – pharmaceutical inclusions

Problem statement:
It is submitted that the inclusion of certain categories of pharmaceutical research (such R&D in respect of certain clinical trial and generic medicine) is greatly welcomed, however, clarity is required as to the exactly what categories of pharmaceutical research is envisaged in this section. Extension of these R&D deductions to other industries of a similar nature has not been proposed but is considered relevant.

Proposed solution / recommendation:
Regulations or guidelines (issued preferably by the Department of Science and Technology) need to be issued as a matter of urgency in order for taxpayers to clearly understand what categories of pharmaceutical research would qualify for a R&D deduction.

The National Development Plan – 2030 indicates that successful countries have grown their ability to innovate and learn by doing, by investing public funding to help finance research and by promoting development in critical areas. The plan highlights many examples of this – the space programme, defence and aerospace in the United States; integrated value chains, just-in-time manufacturing and total quality management in Japan; high-tech manufacturing in Singapore; and almost everything in China today. Based on this information, we recommend that R&D deduction be extended to other similar industries.

9.6 Prototypes

Problem statement:
Section 11(2)(b) states that no deduction is allowed in respect of capital assets used in R&D. The incurral of costs in respect of prototypes is often a necessity before a product can be developed and sold and should therefore constitute R&D. As a result of this these expenses incurred should be excluded from the provisions of section 11(2)(b).

Proposed solution / recommendation:
The treatment of expenses incurred in respect of prototypes should be clarified and distinguished from other capital assets that are used in research and development as they tend not to be capital assets that are created as a result of research and development but rather they are a necessity before a product can be developed and sold.

10 TAX INCENTIVES FOR SEZ (s12R and s12s) (Clause 48, 49)

10.1 Definition of 'qualifying company'

Problem statement:
Larger entities might not qualify for the new incentive due to the requirement that not less than 90 per cent of the income of that company is derived from the carrying on of business or provision of services within that special economic zone (paragraph (d) of the definition of a qualifying company). Should these entities wish to qualify and move all their operations to the SEZs then this could negatively affect other sectors of the economy.

A further concern for larger entities is the requirement that 90 per cent of the income needs to be derived 'within that special economic zone'. This would pose a problem for entities planning a number of investments in more than one SEZ due to economic reasons or geographic spread of investment projects in South Africa as the amendment implies that the company will be limited to one specific SEZ should it wish to qualifying for the tax incentive.

Proposed solution / recommendation:
We do not believe that the above would have been the intention of the legislator and therefore suggest that the current wording be amended as follows:

…."services within any of the special economic zones;"
so that even though a company will have all its operations in SEZs that it will still be eligible for the incentives even if it does not derive its income from one SEZ only.

10.2 Consequences of fraud, misrepresentation or non-disclosure of material facts

Problem statement:
Section 12S(9) disallows all deductions under this section if a company is guilty of fraud, misrepresentation or non-disclosure of material facts with regard to any tax, duty or levy administered by the Commissioner. This disallowance is harsh as firstly it is uncertain as to what is meant by a company being 'guilty' of non-disclosure of material facts furthermore it is unclear whether the allowances would be disallowed retrospectively or only prospectively.

Proposed solution / recommendation:
Clarity on these issues should be provided.

10.3 Additional incentives under section 12I

Problem statement:
Section 12I (dealing with projects located within an industrial development zone ("IDZ")) currently offers additional incentives and additional point allocations to companies which are located in the initial demarcated IDZs than those contained in section 12R.
This results in none of the new SEZs being eligible for these additional incentive in terms of section 12I potentially leading to these companies opting to rather locate their investment in the current IDZs rather than within other SEZs as it will provide them with greater benefits.

Proposed solution / recommendation:
Should this be an oversight we suggest that the wording of sections 12I(2)(a)(ii), 12I(2)(b)(ii) and 12I(8)(f) be amended so that the additional incentive and additional point allocation be provided to industrial policy projects that are located within a SEZ as an IDZ be included in the definition of a SEZ as this would mean that both types of zones would receive similar benefits under section 12I.

11 SHARE SCHEME DEDUCTIONS (Section 11(t)) (Clause 32)

Problem statement:
Section 11(t) is amended 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). However, this proposed amendment does not cater for situations where shares are 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.
Neither does this amended cater for shares schemes that make use of trusts, especially in the light of the conduit principle of trusts being under scrutiny. The amendments also do not consider the costs (such as the IFRS 2 charges) of setting up a share scheme for employees. Thus there is a clear disconnect between the account and tax treatment of these schemes. The costs of unwinding these schemes are also not taken into consideration.

Proposed solution / recommendation:

A more holistic approach needs to be adopted when considering share schemes. Specific reference to should be made to the fact that the operating company must be allowed the deduction in respect of the dividends which are ultimately received by the employees. The deduction of other statutory costs of share schemes also needs to be addressed.

12 EXEMPTION OF INTEREST AND ROYALTIES (Section 10(1)(h), 10(1)(hB)), (Clause 28(1)(j) & (k))

Problem statement:
The requirement that a taxpayer reference number as defined in the Tax Administration Act (TAA) must have been allocated to a taxpayer before the exemption will be allowed may be to the detriment of the fiscus. This could arise when a taxpayer does not register for tax in terms of the TAA, resulting in the interest or royalty being exempt from income tax (payable at 28%) but subject to the withholding taxes (at 15%).

Proposed solution / recommendation:
Consideration should be given to rewording the sections as follows ".. and a tax reference number has or should have been allocated to that person"

13 AMOUNTS RECEIVED FROM A COLLECTIVE INVESTMENT SCHEME (s10(1)(iB) (Clause28)

Problem statement:
The meaning of the term 'subject to normal tax' is unclear as would a CIS in Securities that has an assessed loss be regarded as still being subject to normal tax.

Proposed solution / recommendation:
The term 'subject to normal tax' should be clarified in the Act.

14 TAXATION OF REITs (Section 25BB) (Clause 80)

Problem statement:
There is a mismatch between the front-end loaded rental payments received by REITs (regarded as fully taxable) and the 'qualifying distribution' in year 1 (that is a dividend declared in that year)

as the REIT is unable to pay a dividend due to it not having sufficient accounting profit to declare a dividend. Furthermore, the proviso to the definition of 'qualifying distribution' does not clarify if a dividend received from a non-REIT/non-controlled property company is to be disregarded.

Proposed solution / recommendation:
It is assumed that such dividend must not be taken into account in the determination of the 'rental income' for purposes of the determination of the qualifying distribution. The proviso to the definition is thus superfluous as the definition of 'rental income' specifically excludes such amounts.

15 DEBIT LOANS SUBJECTED TO STC (Section 64E(4)(e), 64F(m)) (Clause 110)

Problem statement:
Section 64E(4)(e) makes provision for the deemed dividend rules of section 64E(4) not to apply when a loan was deemed to be a dividend that was subject to STC.

Section 64F(m) exempts a dividend to a person to the extent that the dividend was subject to STC. Section 64FA(1)(a)(i) similarly makes reference to section 64F(m).

There is a perceived gap in this legislation as a company that advanced a debit loan that was subject to STC would not be able to declare a dividend to extinguish this loan or write off the loan without potentially being liable for dividends tax. The reason for this is that the second dividend (which would be declared on loan account and this loan account owing to the shareholder would then be set-off against the debit loan that was subject to STC) or the write off, is not the same dividend event that was previously subject to STC (this was only the advancing of the loan). In addition, section 64E(4)(e) only exempts such an existing debit loan from the deemed dividend provisions.

Extinguishing a debit loan that was subject to STC would therefore be subject to dividends tax, resulting in the same amount being subject to both dividends tax and STC.

A debit loan was advanced prior to 1 April 2012 and was subject to STC. Both the write off as well as the declaration of a dividend on loan account to extinguish this debit loan will be subject to STC.

Proposed solution / recommendation:
A specific exemption should be added in section 64F to cover events that extinguish debit loans that were subject to STC.

16 BASE COST OF LISTED SHARES (Paragraph 20) (Clause 141)

Problem statement:
The following costs applicable to assets used wholly or exclusively for business purposes (i.e. not only listed shares or a CIS) have been excluded from paragraph 20(1)(g) when determining the

base cost of these assets:

- one third of the finance costs to purchase the assets;
- the cost of maintaining, repairing, protecting or insuring that asset; and
- the rates or taxes in respect of the asset if the asset is immovable property;

The reason for the exclusion of these costs is unclear and considered unjust.

Proposed solution / recommendation:
The above mentioned costs need to be included in this amendment as there is no basis to exclude such costs from the base cost of an asset

Please do not hesitate to contact us if you have any queries in this regard.

Yours sincerely,

Prof Sharon Smulders
Head: Tax Technical Policy & Research

Cc: cecil.morden@treasury.gov.za
Cc: klouw@sars.gov.za
Cc: shenson@sars.gov.za
Cc: csmit@sars.gov.za