14/07/30 SC FINANCE

# DRAFT TAXATION LAWS AMENDMENT BILL

*Standing Committee on Finance*

Presenters: National Treasury and SARS | 30 July 2014

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Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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# 1. PERSONAL INCOME TAXES AND SAVINGS

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## Key retirement reforms policy proposals

- The primary aim of the proposals is to **encourage household savings** and ensure that individuals are not vulnerable to poverty while working and in retirement
- Key policy proposals
  - **Encourage preservation and portability**, especially during job changes
  - **Enhance governance** of funds
  - **Encourage annuitising** at retirement
  - **Simplify the taxation** of retirement contributions
  - **Encouraging non-retirement saving** through tax free saving plans
  - **Encourage good value retirement products and services** by reviewing costs
- The above retirement reform proposals were initiated by the policy document: ***"A Safer Financial Sector to Serve South Africa Better"***, released and endorsed by Cabinet in 2011
- These are urgent proposals to address major challenges in the current retirement system, especially member protection

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## Retirement tax regime for contributions was complicated

| Source | % cap on deduction | Contribution type – base | Retirement fund |
|---|---|---|---|
| **Employer** | Exempt entity - unlimited | "*approved remuneration*" (pensionable income) | Pension or provident fund |
| | Taxable entity - // 10% & 20% & SARS discretion | | Pension or provident fund |
| **Employee taxpayer** | 0% | No deduction, but amount not taxable upon exit | Provident fund |
| | 7.5% | "*retirement-funding employment*"- income (pensionable income). Non-deductible contributions are not taxable upon exit | Pension fund |
| **Other income** | 15% | 'non-retirement-funding employment income' (non-pensionable income). Non-deductible contributions are not taxable upon exit | Retirement annuity fund |

## TLAB 2013 enacted simplification of tax treatment of retirement contributions

| Source | Contribution type – base | % cap | Monetary cap | Retirement fund |
|---|---|---|---|---|
| **Employer taxpayer** | Employer contribution = fringe benefit = deemed employee contribution | Unlimited fringe benefit | Unlimited fringe benefit | All retirement funds |
| **All individual taxpayers** | The higher of employment or taxable income<br>Rollover of non-deductible contributions & any amount that remains are not taxable upon exit<br>Contributions include amounts paid towards risk benefits & administration costs | 27.5% | Maximum of R350 000 | All retirement funds |

## Tax free savings accounts
### (Section 10(1)(i), new section 12T, section 29A, section 64F(1)(o))

- Non-retirement savings are currently incentivised through interest income exemptions
- The interest income exemptions are not visible and are limited to one type of asset return
- Research shows that account based incentives can be more visible and design features can be more effective in encouraging household savings than an exclusively return based incentive
- Discussion papers were published in October 2012 and March 2014 to develop proposals to create a new mechanism to incentivise non-retirement savings
- After many positive comments, the proposal is to create tax free savings accounts
  - the draft legislation provides the framework in which to introduce these accounts

- The tax free savings accounts are intended to replace the current interest exemption
  - However, the interest exemption will not be abolished
  - Instead, there is no intention to increase the exemption in future years so that the value of the exemption will decrease over time due to inflation



## Tax free savings accounts
### (Section 10(1)(i), new section 12T, section 29A, section 64F(1)(o))

- The main features of the accounts are that:
  - All returns (interest, capital gains, dividends and other gains) in the account will be free from tax
  - Individuals can open multiple tax free savings accounts
  - But there is an annual limit of R30 000 in contributions across the multiple accounts
  - And a R500 000 lifetime limit (which would only be reached in many years time)
  - Individuals can access the amounts in the account at any time (unlike retirement funds)
  - But, withdrawals can only be replaced up to the value of the annual limit
- An annual limit puts a deadline on savings to encourage individuals to save today
- Individuals should think twice about withdrawing money as they can't replace it

- Options were put forward in the March 2014 discussion paper on how to deal with excessive contributions – many comments were against a 'reversal' system that would require more intensive communications between industry and SARS
  - To deter individuals from contributing excessively a penalty of 40 per cent on the excess contribution is proposed (over contributed amounts can still grow tax free)

## Valuation of fringe benefit for defined benefit contributions
### (Paragraphs 1 and 12D of the Seventh Schedule and specific regulations)

- Legislation was amended last year to make all employer contributions to a retirement fund a taxable fringe benefit in the hands of the employee
- For members of defined benefit funds this could lead to unfair tax charges since the employer contribution is not directly related to the benefits received
- To avoid this, it is proposed that a notional employer contribution is calculated to represent the increase in benefits that the individual would receive at retirement
- The notional employer contribution would then be added to all the other retirement fund contributions (e.g. employee contribution and retirement annuity contributions) to check whether the individual is within the 27.5% or R350 000 deductibility limits
- Due to the complexity of the amendment an initial version of the amendments was published in the First Batch of the TLAB on 10 June 2014
  - The amendments in the current draft TLAB take into account comments received on the previous draft



## Valuation of fringe benefit for defined benefit contributions
### (Paragraphs 1 and 12D of the Seventh Schedule and specific regulations)

- To calculate the notional employer contribution the pension fund will be required to split the employees that are members of the fund into different 'fund member categories' (where there are different benefits) and provide the 'fund member category factor' for each separate category (including death benefits or contributions to DC fund)
- The fund determines the factor according to a table that is supplied via regulation and is dependent on the earliest age at which members of that fund may retire with unreduced benefits
  - The factors in the table take into account expected: average salary growth rates; post-retirement mortality; pre- and post-retirement investment returns and spousal benefits
- The 'factor' (or notional employer contribution percentage) is then passed to the employer (along with other information on the details of the fund) in the form of a 'contribution certificate'
- The employer (or payroll company) will receive the contribution certificate and use a simple formula to calculate the value of the notional employer contribution

## Retirement fund accrual date
### (Section 1, paragraph 4 of Second Schedule)

- Retirement fund lump sum benefits are taxed differently from annuity benefits (according to the retirement benefit lump sum tax tables)
- In most cases where the individual is alive, the tax liability is calculated as at the 'retirement date'. 'Retirement date' is defined, in ITA, as the age when the retirement fund determines that the benefit falls due
- Retirement funds are obliged to withhold the lump sum tax liability of the individual immediately after the retirement date
- To determine how much tax to withhold the fund needs to:
  - find out from the individual how much of their total retirement benefit they would like to take as a lump sum at retirement (up to one third for pension funds and retirement annuity funds – known as an election)
  - Apply for a tax directive from SARS to determine the value of the tax liability (since the tax is based on cumulative lump sum amounts and comprises information that the fund may not have)



## Retirement fund accrual date
### (Section 1, paragraph 4 of Second Schedule)

- Sometimes, individuals delay in making the lump sum election, causing retirement funds to fall foul of their withholding obligation
- A further consideration is that the current process forces individuals to take their retirement assets at the retirement date of the fund
  - Individuals may well want to continue working past the fund determined retirement date and may want to keep their retirement assets in the retirement fund
- It is proposed that the retirement date, i.e. the date on which the retirement lump sum tax should be withheld, is determined by the date on which the individual makes the election that determines the lump sum amount
  - In this way there will be no timing complications around withholding taxes
  - And it provides greater discretion on the date of retirement for individuals, allowing them to preserve their retirement assets if they would like to do so

## Valuation of fringe benefit for employer provided accommodation
(Paragraph 9 of Seventh Schedule)

- "Rental value" is the value of use of accommodation for the fringe benefit calculation in the Income Tax Act
- Where an employer provides accommodation to an employee, the difference between "rental value" and all costs incurred by the employee in acquiring the use of the accommodation is equal to the fringe benefit
- The "rental value" that is determined is often higher than the true economic value to the employee. Employers are then compelled to apply for a tax directive from SARS to show that the actual cost is lower than the "rental value"
- It is proposed that where an employer sources accommodation from an unconnected third party on a rental basis, the total cost incurred by the employer, if lower than the calculated value, may be deemed to be the "rental value"



## Clarification of loss requirement for key person insurance policies
section 11(w)(ii)(c)

- Prior to 2011, no deduction was given for key person insurance policy contributions, but the benefit payouts would be tax free
- A 2011 amendment provided optionality to allow a deduction on contributions whereby the tax will be levied on the payout
- As the legislation is formulated, it is possible for companies to make use of the deduction option for policies that protect against non business costs, resulting from the death of a 'key person', i.e. for debt obligations rather than for business losses
- The legislative amendments clarify that the deduction for such policies is only permissible where the policy provides cover for losses in normal business continuity, not as security for the outstanding debts of the key person, in line with the original policy intent

## Restraint of trade receipts
(paragraph (cA) of the definition of "gross income", section 11(cA)

- Restraint of trade receipts for companies are treated as being of capital nature and subject to capital gains taxation
- Restraint of trade receipts for natural persons were historically treated the same way
- However, to prevent large salary payments disguised as restraint of trade payments, the definition of gross income was amended to include the receipt of restraint of trade payments for natural persons, labour brokers and personal services providers
- The amendment was to capture instances where a relationship of employment existed in whatever form

- However, the blanket inclusion of natural persons' restraint of trade receipts brought about unintended consequences whereby all natural persons were taxable on their restraint of payment receipts, even where no employment relationship exists
- The amendments align the treatment of restraint of trade payments for natural persons with those for trusts and companies, while clarifying that the inclusion of natural person restraint of trade receipts apply in situations where there is an employment link between the payor and the recipient



# 2. GENERAL BUSINESS TAXES

## Contributed Tax Capital (CTC)
### (Section 1 – Definition of 'contributed tax capital')

**Background**

- CTC is a notional amount derived from the value of contributions made to a company as consideration for the issue of a class of shares by that company
- If a company has issued several classes of shares, CTC must be maintained separately on a per class basis, e.g., CTC created by virtue of issue of ordinary shares cannot be allocated or reallocated to preference shares
- When a company implements a transaction using company re-organisation rules , the tax legislation allows for CTC rollover treatment

**Reasons for change**

- Currently, the tax legislation does not provide for a CTC roll-over treatment for deferred or convertible shares; e.g. shares that convert into a different class of shares on the occurrence of any specified contingency
- Based on this, CTC on the convertible shares will be lost because the class of shares to which it relates differs from class of shares after conversion

**Proposal**

- CTC roll-over treatment will be extended to include instances where deferred or convertible shares are converted to the other class of shares
- Any consideration received by a company in respect of the conversion of shares will be reflected as part of the CTC in relation to that other class of shares



## Third-party Backed Shares: Refinancing
### (Section 8EA)

**Background**

- The tax legislation has specific anti avoidance rules targeting transactions with preference shares having a dividend yield backed by a third party
- The dividend yield of third party backed shares is treated as ordinary revenue, unless the funds derived from the issue of third party backed shares falls under the exceptions described in the Act

**Reasons for change**

- Currently, the refinancing of third party backed shares, used to fund the acquisition of equity shares in an operating company is not covered under the exceptions

**Proposal**

- Legislation will be amended so that the refinancing of qualifying transactions be allowed as exemption

## Third-party Backed Shares: Asset-backed shares (Section 8EA)

**Background**

- The tax legislation has specific anti avoidance targeting asset backed shares
- Exceptions against these anti-avoidance provisions exist, that allow for a variety of third-party guarantees / obligations including the target operating company or the issuer of the preference shares

**Reasons for change**

- Funders of preference shares often require limited pledges of shares, especially when funding certain company transactions
- If during a company transaction, the shareholder of the acquiring company (i.e. the issuer of preference share) pledges its shares to the funder, the anti avoidance rules would not allow such a pledge, unless it holds at least 20% of the equity shares in the issuer of preference share
- This triggers the application of the rule (i.e. 28 per cent tax instead of an exemption) and therefore making the deal not financially viable for the parties involved

**Proposal**

- The scope of the exemption in respect of guarantees will be broadened to allow for the pledging of the equity shares and the associated debt claims in the issuer of preference shares



## Limitation of interest deductions (Sections 23M and 23N)

**Background**

- Internationally, the income tax system tends to favour debt financing over equity financing
- The G20 and the OECD countries have through BEPS, identified excessive interest deductions as one of the tax loopholes that should be addressed
- In 2013, measures were introduced in the tax legislation to provide for the limitation of deduction of excessive interest payments
- These rules specifically apply to the following:
  - Debts owed to connected persons not subject to tax
  - Debt used to fund reorganisation and acquisition transactions
- A formula determining the maximum amount of interest payments that may be deducted in a particular year was introduced

**Reasons for change**

- The following anomalies in the application and impact of these rules have been identified:
  - *Inclusion of assessed losses:* The interest limitation rule determines a percentage (currently 40 per cent) of adjusted taxable income to limit the interest deduction. Taxable income as determined at the end of the year may have been reduced by the set off of an assessed loss carried forward from the previous year.
  - *Formula:* The tax legislation provides for an adjustment of the 40 per cent limit through a formula. The 40 per cent factor is only adjusted in circumstances where a significant increase in the repo rate occurs, i.e, when it exceeds 10 per cent. This does not fully take into account changing market conditions and the resulting costs of servicing commercial debt

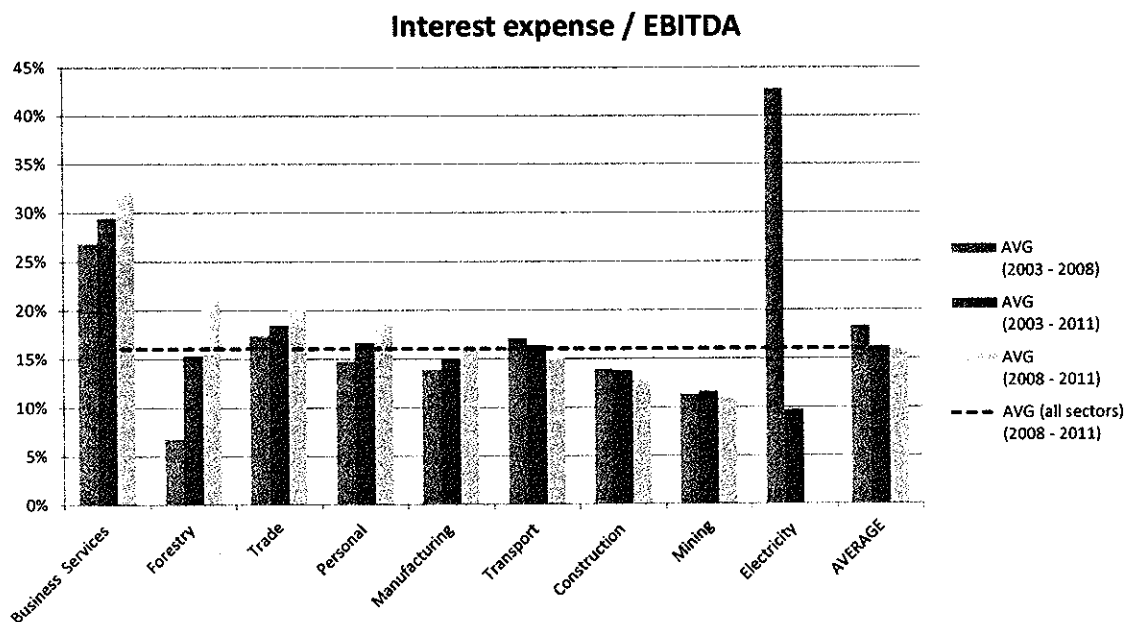
## Limitation of interest deductions (continued...)

**Proposal**

- Adjusted taxable income will be amended to exclude the previous years' assessed losses
- The formula will be amended to allow for the maximum percentage to fluctuate, recognising the change in interest rates and the cost of finance
- In order to protect the fiscus and tax base in periods of high interest rates, a cap on the interest deduction limitation of 60 per cent of adjusted taxable income is proposed



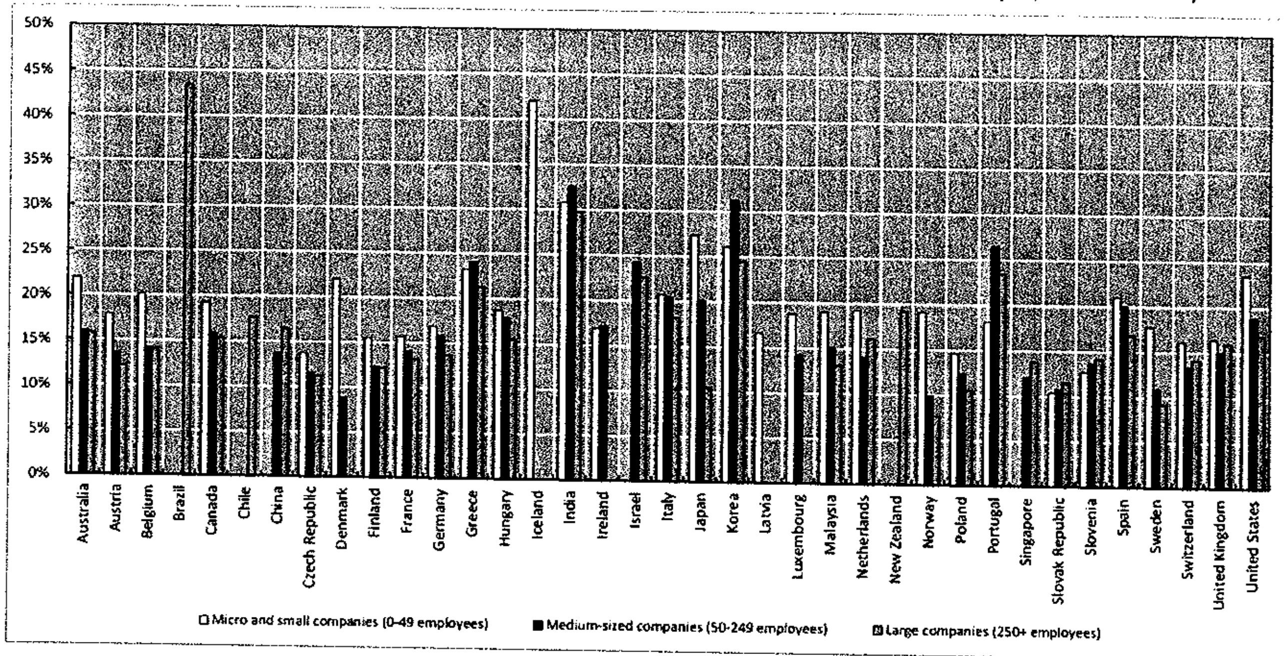
## Interest expense / EBITDA ratio across sectors (excluding banking and insurance)




*(Statistics South Africa)*

## How does this compare to other countries?

**Interest to EBITDA ratio – by company size and by country** (Average over total sample, 2001 – 2009)

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*(OECD, 2014 )*

# 3. TAXATION OF FINANCIAL INSTITUTIONS AND PRODUCTS

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## Tax treatment of the risk business of long term insurers (Section 29A)

### Background

- Currently South Africa taxes long term insurance business in accordance with the four funds approach
- In terms of the four funds approach, long-term insurance business written by a long term insurer must be allocated to three policyholder funds.
- These are as follows :
  - Individual Policyholder Fund for policies owned by individuals
  - The Company Policyholder Fund for policies owned by corporate entities
  - The Untaxed Policyholder Fund for policies owned by untaxed entities, exempt entities
  - The Corporate Fund. It consists of all the assets held by the insurer and all the liabilities owed by the insurer not falling in the above-mentioned policyholder funds



## Tax treatment of the risk business of long term insurers (Section 29A)

### Reasons for change

- There are concerns that the current taxation of long term insurers does not distinguish between investment and risk business
- In practice, a risk policy will pay out a specified cash amount on the happening of an event regardless of the amount of investment income earned during the term of the policy.
- This could result in a loss in respect of a specific policy which is contrary to the trustee principle applying to investment policies

## Tax treatment of the risk business of long term insurers (Section 29A)

### Proposal

- It is proposed that business in respect of risk policies be taxed in the corporate fund
- A risk policy will be defined as:
  - A policy issued by an insurer during the insurer's year of assessment commencing on or after 1 January 2016
    - in terms of which any benefits payable under a policy are dependent on any future event the happening of which is uncertain ; or
    - in terms of which any amount payable under the policy is only payable by reason of death; or
    - Any reinsurance policy in respect of a policy prescribed above
  - A policy with both investment and risk elements will be regarded as a risk policy if any of the policy benefits under the policy are risk benefits, even if it represents only a small portion of the total policy benefits



## Long term insurers: Foreign reinsurance (Section 29A(11)(g))

### Background

- Currently, long term insurers must disregard premiums paid and claims received in respect of reinsurance policies when calculating taxable income in accordance with the four fund approach.
- This creates a problem in the case of foreign reinsurance because this form of reinsurance enjoys unwarranted relief from South African tax

### Reasons for change

- A policyholder invests in a linked policy issued by a long term insurer (for example a policy linked to the growth of a share in a foreign company)
- The long term insurer reinsures the linked policy with a foreign reinsurer in a low tax jurisdiction or in a tax haven
- The foreign reinsurer utilises the premium it receives to purchase shares in the relevant foreign company
- On the maturity date of the policy, the long term insurer claims the full payout value of the linked policy from the reinsurer
- No tax is payable on the growth of the linked policy due to the fact that in terms of the current tax treatment, long term insurers must disregard premiums paid and claims received in respect of reinsurance policies when calculating taxable income

## Long term insurers: Foreign reinsurance
(Section 29A(11)(g)

**Proposal**

- In order to rectify the above, it is proposed that the net returns from foreign reinsurance be included in the calculation of the taxable income of the long term insurer



# 4. TAX INCENTIVES

## Depreciation allowance for transmitting electronic communications (Section 12D) (1)

- Currently, new lines or cables used for the transmission of electronic communications can be written off over a 20 year period.
- Developments have led to the write-off period being reviewed:
  - Improvements in technology
  - The move from copper wiring to fibre optics to maintain a suitable standard of telecommunication services has an impact on the expected useful life
  - Maintaining and adding new lines / cables to the network often results in multiple joins of copper wiring, sometimes of differing thickness that reduces speeds and impinges on the useful economic life.
- Fibre optic cabling is also not immune to wear and tear either.
  - Construction activities or road alterations can have a medium to long-term effect, increasing the fibre stress levels and / or bending radius, requiring additional fibre joints that further degrade the cable's transmission capabilities.
- Industry practice is to write off both copper and fibre optic lines / cables over 15 years for accounting purposes. International comparisons show that other countries allow a favourable tax depreciation allowance for these assets.



## Depreciation allowance for transmitting electronic communications (Section 12D (2))

- Purchases of used lines or cables used for the transmission of any signal for the purposes of telecommunication are becoming more common in the telecommunications industry.
  - Doing a fibre swap in existing infrastructure is cheaper than outlaying capital to build new infrastructure required to support the fibre

**Proposal**

- To move towards the most suitable expected economic life of such assets, given technological improvements and the environment that affect the useful life of the asset, and align with international practice, it is proposed that:
  - Telephone lines or cables used for the transmission of any signal for the purposes of telecommunication be eligible for a 15 year depreciation allowance; and
  - Used assets for the transmission of any signal for the purposes of telecommunication be eligible for a depreciation allowance in terms of section 12D.

## Research and Development tax incentive
(Section 11D(1))

**Background**

- The R&D tax regime provides tax incentives aimed at ensuring that local R&D is globally competitive
- This tax incentive is in the form of a 150 per cent deduction for non-capital R&D expenditure.

**Reason for change**

- 2013 amendments sought to deem the development of pharmaceutical products, including undertaking clinical trials, as R&D activities for the purposes of section 11D; however the desired outcome has not been achieved.
- A 2013 amendment led to an unintended consequence for entities funding R&D in a group of companies, by limiting the deduction to 50 per cent instead of the full 150 per cent.
- To ensure that only innovative functional designs qualify for the tax incentive



## Research and Development Tax incentive
(Section 11D(2))

Rationale for incentivizing pharmaceutical industry:

- Diseases place a heavy burden on South Africa's health system.
- Government support is essential for encouraging and strengthening local research and development
- To encourage innovative capabilities to produce and make available pharmaceutical products at a lower cost to consumers.

**Proposal**

1. Clinical Trials

- Amend the definition of R&D in section 11D(1) to include "clinical trials"
- For clinical trials to qualify for the 150 per cent deduction, the criteria provided by way of Regulations (draft published with the 2014 TLAB) must be met

## Research and Development Tax incentive
(Section 11D(3))

2. Multisource Pharmaceutical Products (Generics)

- Amend the definition of R&D in section 11D(1) to include "multisource pharmaceutical products"
- For multisource pharmaceutical products to qualify for the 150 per cent deduction, activities must meet the criteria provided by way of Regulations (draft published with the 2014 TLAB)

3. Adjustment of deduction in respect of R&D funding in a group of companies

- Amend s11D(5) to allow for a 150 per cent deduction, subject to R&D being approved by the Minister of Science and Technology.

4. Functional Design

- Amendment to include "innovation" in the definition of functional design



## Public Private Partnerships
(Section 12NA)

- Public private partnerships are an important element of South Africa's strategy to develop its public infrastructure.
- Currently, section 12N deems the private party (to a PPP agreement) to be the owner of improvements on government-owned land so that capital allowances can be claimed.
- Certain types of PPP agreements do not meet the criteria set out in section 12N and these limitations have an impact on the affordability for Government in respect of PPPs
  - E.g. a serviced office accommodation project, where the private party is responsible for financing; designing and constructing; and operating and maintaining a government-owned building (government is essentially buying a serviced working environment and the asset is only constructed to provide the service).
- **It is proposed** that taxpayers party to a PPP contract will be allowed to claim a capital allowance for expenditure incurred (of a capital nature) to effect improvements on government-owned land where government will use or occupy the land or building.

## Refinement of Oil & Gas incentive
(Tenth Schedule)

- Currently, an oil and gas company holding an exploration or production right can assign all of its fiscal stability rights to another oil and gas company.
- Oil and gas companies may wish to enter into a joint venture and partially assign the fiscal stability rights to the other party so that both parties are covered by the original fiscal stability agreement and equally enjoy the rights contained therein.
- However, there is uncertainty with respect to how to interpret the current wording in the legislation.
- To ensure clarity, **it is proposed** to amend the wording to achieve the following outcome:
  - where an oil and gas company has an existing FSA with Government and subsequently enters into a joint venture with another oil and gas company, both oil and gas companies that are party to a joint venture will be entitled to all the rights under the fiscal stability agreement entered into by the original oil and gas company.



## Refinement of allowances for industrial policy projects
(Section 12I)

- Section 12I allows taxpayers an additional investment and training allowance in respect of Industrial Policy Projects if they meet certain criteria prescribed by way of regulation.
- To be eligible for this incentive, a taxpayer must own the manufacturing asset
- Taxpayers investing in IPPs undertaken on leased land are currently precluded from claiming this incentive in respect of new and unused (immovable) manufacturing assets.
- Because this incentive is an additional investment allowance and not a deduction for the purposes of wear and tear, it seems reasonable to remove the ownership requirement.
- In addition, with some taxpayers conducting their manufacturing activities on leased land (99 year leases in some instances), the ownership requirement constrains investment activities government would like to promote.
- **It is proposed** that taxpayers undertaking an IPP in respect of immovable manufacturing assets be accommodated for purposes of this incentive.

## Refinement of Special Economic Zone tax incentive
### (Sections 12R and 12S)

- In the 2012 *Budget Review*, it was announced that tax incentives would be considered for the new special economic zones (SEZ) as proposed by the Department of Trade and Industry that would build on experience with the current industrial development zones (IDZs).
- This was achieved by introducing sections 12R and 12S into the Income Tax Act during 2013.
- Some of the provisions captured in section 12R are vague and potentially conflicting.
- **Proposed** amendments are purely aimed at clarifying these provisions.
- A decision tree has been included in the Explanatory Memorandum to assist taxpayers in determining which tax incentives they are eligible for.



## Venture Capital Company regime
### (Section 12J)

- The Venture Capital Company (VCC) regime was introduced to encourage equity investment in small enterprises. Investments in qualifying small businesses through an approved VCC can be deducted from the investor's taxable income.
- The VCC regime has seen limited take off since its introduction in 2008, and it is believed that it needs to be made more attractive
- The following amendments are included in TLAB 2014:
  - Making the normal tax deductions permanent if the investments are held for a period exceeding 5 years
  - Increasing the asset limits for qualifying investee companies
    - From R 30 to 50 million for qualifying companies
    - From R 300 to R 500 million for junior miners

## Venture Capital Company Regime II
(Section 12J)

- VCC's are required to utilise 80 per cent of their *investment expenditure* to acquire qualifying shares issued by qualifying companies. They are given a period of 36 months to meet this requirement.

- In addition VCC's are only allowed a maximum of 20 percent allocation to any one qualifying company. The methodology of the verification requirement (for the 20 per cent and 80 per cent requirements) has been identified as too inflexible and difficult to comply with. The following proposed amendments are in TLAB 2014:

  - The legislation dealing with this 36 month requirement is clarified to indicate that VCCs must comply with the 80 per cent allocation rule even after the 36 month period

  - The verification methodology is amended to use *"subscription monies received"* as a basis, rather than *"expenditure incurred"*. This will make it easier for VCCs to comply.



## Supporting Small Businesses - Grant funding
(Sections 30C and 10(1))

The Income Tax Act does not provide tax relief for grant funding aimed at supporting and developing small business.

During Budget 2014 it was indicated that such activities are beneficial to small business expansion and should be encouraged. Two measures towards this objective are contained in the draft TLAB of 2014 :

- Allowing tax relief for entities which provide grant funding for small business development. A new section 30C (along the lines of sections 30A and 30B) is proposed to define the terms and requirements for such entities.

- Making grants in the hands of small businesses tax exempt. For this purpose an additional exemption in section 10(1) is proposed.

## Small Business Taxation - Changes to the SBC Regime (Section 12E)

The Davis Tax Review Committee looked into the taxation of small business and found that the current SBC regime was not achieving its objectives. Only a relatively small number of businesses benefit from the provision, with those in a tax loss position excluded. The Davis Committee proposed that:

- The graduated rate structure currently available to SBC's be replaced, and that small businesses be taxed at 28 percent on their net profits.
- A refundable tax compliance rebate of R15 000 be given to SBCs which are fully tax compliant
- Only companies with a turnover of between R1 million and R20 million should qualify for the rebate.
- Micro businesses with an annual turnover of less than R1 million be accommodated in a revised Turnover Tax regime – their compliance costs will be low, hence no need to compensate them for tax compliance expenses.



## Businesses registered for VAT and SBC by turnover category

| Turnover group: 2010 | SBC - Number | % | VAT - Number | % | SBC / VAT % |
|---|---|---|---|---|---|
| 1 to 500 000 | 36 928 | 35% | 126 689 | 30% | 29% |
| 500 000 to 1 000 000 | 18 034 | 17% | 64 134 | 15% | 28% |
| 1 000 000 to 5 000 000 | 34 783 | 33% | 142 227 | 33% | 24% |
| 5 000 000 to 10 000 000 | 7 729 | 7% | 36 493 | 9% | 21% |
| 10 000 000 to 14 000 000 | 2 116 | 2% | 12 962 | 3% | 16% |
| 14 000 000 to + | 60 | 0% | | | |
| Turnover missing | 6 978 | 7% | | | |
| 14 000 001 to 20 000 000 | | | 10 560 | 2% | |
| 20 000 000 to 100 000 000 | | | 25 029 | 6% | |
| above R100 000 000 | | | 7 452 | 2% | |
| **Grand Total** | **106 628** | **100%** | **425 546** | **100%** | **25%** |

## Reducing the distribution requirement for Funding PBO's
(Section 18A (2A)(b))

- Funding conduit PBO's are currently required to distribute 75 per cent of their donations received during a particular year. The 75 per cent distributed must be used to fund public benefit activities as contemplated in the Ninth Schedule (Part 2) of the Income Tax Act. This requirement aims to ensure that PBOs utilise their funds as intended in the legislation.
- Several PBOs have indicated that the 75 per cent distribution requirement is too restrictive, and affects their sustainability adversely by preventing them from building up reserves.
- TLAB 2014 proposes that
  - Conduit PBOs distribution requirement be reduced to 50 per cent
  - Some conditions be placed on the use of undistributed funds



## Allowance for land conservation in respect of nature reserves or national parks
(Sections 18A, 37C(5) and new 37D)

- Government provides incentives to encourage private land owners to preserve biodiversity through conserving threatened or depleted ecosystems to support critical species habitats;
- Cost of land plus capital expenditure incurred in respect of the land being declared qualifies for a tax deductible section 18A donation with rollover of unused deductions in excess of 10 per cent;
- The reason for change is that basing tax deductions on taxable income instead of land values does not benefit low income landowners equitably;
- Propose to delink the current incentive for nature reserves/ national parks from treatment as a section 18A donation, instead allow a straight line deduction over 25 years based on cost of acquisition of land & improvements thereon unless the market value exceeds the cost in which case the deduction will be determined with reference to the lesser of municipal value or market value of the land.

## Refinements to the employment tax incentive
(Sections 7(5), 9(4) and 10(3) of the Employment Tax Incentive Act)

- To calculate the value of the incentive that an employer can claim for part-time employment the employer must:
  - Check what the employee would have earned if they were employed full time (gross up their part time remuneration to a full time remuneration)
  - Calculate the value of the incentive based on this amount
  - Gross down the value of the incentive in the same proportion

- Employers have asked for more clarity on this mechanism as it involves an element of discretion in terms of what constitutes full time employment
- Some industries may also have different hours for full time employment

- To remove the discretion, provide more certainty and ensure fair treatment, it is proposed that full time remuneration be determined with reference to 160 hours in a month
  - If an employee works less than this, the salary is grossed up to what it would be if they had worked 160 hours, the incentive value is calculated and then grossed down



## Refinements to the employment tax incentive
(Sections 7(5), 9(4) and 10(3) of the Employment Tax Incentive Act)

- A cap was placed on the amount of the incentive that could be rolled over (when there is insufficient PAYE liabilities to be offset against) for employers who were not tax compliant at the end of each bi-annual reporting period
  - The cap is set at R6 000 per qualifying employee as at the reporting date

- The cap was intended to only impact on non-tax compliant employers, however since the reimbursement mechanism is not yet in place the cap would have limited the value of the incentive that can be claimed for <u>all</u> employers in the first year
- If a small firm is not tax compliant at the reporting date they would face the cap and would also need to wait a further six months before they could potentially be reimbursed for the value of the rolled over incentive amount

- To avoid a cap on compliant firms and allow firms to receive the reimbursement when they become compliant (while retaining the limitation for non compliant firms) it is proposed that:
  - the rolled over amount is ring-fenced, and paid when the firm becomes compliant. If the firm is not compliant within six months the amount is lost

# 5. INTERNATIONAL TAXATION



## Transfer pricing secondary adjustment
[Section 31, clause 47(1)(a)]

**Background**

- In 2011, South African transfer pricing rules were aligned with the OECD transfer pricing rules
- The alignment also introduced secondary adjustment in the form of a deemed loan
- The deemed loan constitutes an affected transaction which implies that arm's length interest must be calculated on the deemed loan

**Reasons for change**

- Secondary adjustment in the form of a deemed loan creates an administrative burden both for the taxpayer and revenue administration
- It may be difficult for a foreign company to repay the loan and deemed interest because the loan is deemed for tax purposes. There are no pre-existing contractual legal obligations supporting the settlement
- It creates difficulties in relation to the accounting treatment of the deemed loan

## Transfer pricing secondary adjustment
[Section 31, clause 47(1)(a)]

**Proposal**

- It is proposed that the amount of the secondary adjustment be deemed to be a dividend
- In other words, where a South African subsidiary undercharges its foreign parent, the shortfall will be deemed to be a dividend paid by the South African subsidiary to its foreign parent
- That deemed dividend will be subject to Dividends Tax



## Currency of reacquisition of assets of persons ceasing to be a resident
[Clause 12(1)(b)]

**Background**

- Prior to 12 December 2013, immovable property of a taxpayer ceasing to be a resident and indirect interest therein were excluded from the exit charge
- The exit charge did not apply because it was assumed that these assets remain within SA taxing jurisdiction when a taxpayer ceases to be a resident
- However, new rules deeming the emigrating resident to have disposed of all assets including indirect interest in immovable property were introduced on 12 December 2013

**Reasons for change**

- The new rules introduced on 12 December 2013 do not state in which currency the reacquisition of the assets takes place

**Proposal**

- It is proposed that the currency in which the asset was actually acquired be deemed to be the currency of reacquisition

## Simplified foreign business establishment exemption for controlled foreign companies (CFCs) [Clause 11(1)(c)]

**Background**

- CFC attribution rules are subject to various exemptions
- These exemptions seek to strike a balance between protecting the tax base and the need for SA companies to be competitive
- Examples of exemptions available in the CFC rules include the high-tax exemption and the foreign business establishment exemption (FBE)

**Reasons for change:**

- The structure of section 9D requires a high-tax exemption to be tested before certain amounts can be excluded
- This involves a hypothetical SA tax calculation based on the transactions of a CFC as if it had been a resident
- In case of a South African multinational with many foreign subsidiaries this can be a cumbersome exercise



## Simplified foreign business establishment exemption for controlled foreign companies (CFCs) [Clause 11(1)(c)]

**Proposal**

- The net income of a CFC will be deemed to be nil if either the high-tax exemption or the foreign business establishment (FBE) exclusion is met
- The FBE exclusion will only be available if the CFC earned no passive or diversionary income

# 6. VALUE ADDED TAX



## Withdrawal of the VAT zero-rating of the supply of certain intermediate agricultural / farming supplies (Section 11(1)(g), Schedule 1 and Schedule 2, Part A)

- Purchases of animal feed, animal remedy, fertilizer, pesticide, plants & seed by authorised vendors for agricultural, pastoral & other farming purposes are zero-rated
- Concession was intended to reduce administrative burden and provide short-term cashflow relief to farmers
- SARS has detected that a significant number of VAT registered vendors are abusing the authorisation granted to acquire certain goods at the zero rate of VAT:
  - vendors misrepresent themselves to their suppliers to acquire goods at the zero rate
  - vendors who are carrying on farming activities collude with suppliers resulting in fabricated invoices
- SARS is of the view that the risks of the zero rating are ever increasing and impossible to manage adequately
- It is proposed that the zero rating of goods for agricultural, pastoral and other farming activities be withdrawn/repealed

## Withdrawal of the ability to claim a notional input VAT in the case of precious metals (gold)
### (Section 1(1) of the VAT Act)

- A VAT vendor who acquires second-hand goods, including goods made from precious metals, from a seller who is not a vendor, is entitled to claim a notional input tax deduction
- This allows for the unlocking of part of the VAT on goods previously paid by final consumers as those goods re-enter the formal supply chain
- SARS has detected that VAT vendors are abusing this provision to obtain fraudulent input tax deductions (i.e. jewellery is smelted along with gold coins and illegally acquired raw gold)
- In order to address this problem, it is proposed that second-hand goods made from precious metals be excluded from obtaining the notional input tax



## Providing for the VAT exemption of legal tender
### (Section 1, Section 12 and Schedule 1)

- The supply of legal tender by the SA Mint and the SA Notes Company (wholly owned subsidiaries of the SARB) to the South African Reserve Bank is currently subject to VAT at the standard rate
- Value added tax is calculated based on the production costs (plus mark-up) of the notes and coins and not the face value thereof
- This approach essentially treats supply of notes to the SARB as stationary and not money (legal tender)
- However, SARB argues that the notes and coins become legal tender as soon as it has been printed or coined and not only when it is issued by SARB
- Therefore, since legal tender is exempt in terms of the VAT Act, the supply of the notes and coins to the SARB should also be exempted
- It is proposed that the supply of legal tender or money to the SARB be exempted from VAT.