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Dear Nombasa and Adele,

**RE: CALL FOR COMMENTS ON DRAFT TAXATION LAWS AMENDMENT BILL 2014.**

We refer to the call for comments on the above-mentioned document. Set out below please find the SAICA National Tax Committee's submission. Our comments are arranged such that they follow the sequence of the draft Bill. In our comments we will use "DTLAB" when we refer to the draft Taxation Laws Amendment Bill, 2014.

**PROPOSED AMENDMENTS TO THE INCOME TAX ACT, NO. 58 OF 1962 (THE ITA)**

**Clause 1: Amending Section 1 definition of 'contributed tax capital' (CTC)**

**General comments**

The area of convertible shares and the swapping of different shares in a single company has become a great source of confusion. While the SARS Capital Gains Tax Guide has provided some helpful interpretations on the point, this Guide is far from authoritative. The deletion of paragraph 78 and the unannounced narrowing of section 43 have added to the confusion.



To date, a number of taxpayers have taken the position that the conversion of shares (due to an embedded convertible or otherwise) creates CTC in the new shares because the old shares are being surrendered. It is uncertain whether this position is correct or incorrect, amongst many other issues involving share swaps. Despite the pro-taxpayer nature of the amendment, we would suggest that this amendment be deferred. SARS should instead issue an interpretation note on the various forms of share swaps to obtain overall clarity first. If not deferred, we have the following suggestions.

**Problem statement – Clause 1(1)(d)**

Wording is not consistent with the rest of the paragraphs.

**Submission 1**

The words ‘in the case of any other company’ should precede the words ‘in relation to a class of shares issued by the company’ as a matter of style consistency.

**Problem statement 2 – Clause 1(1)(f)**

Wording is inappropriate.

**Submission 2**

The words ‘an amount equal to the sum of’ in subparagraph (iii)(aa) should occur immediately after the word ‘contingency’ i.e. the amount in question should be determined as the sum of items (aa) and (bb).

**Problem statement 3**

The provisions should only apply to conversions that took place on or after 1 January 2011. Prior to that, any CTC would be determined in accordance with subparagraph (i) of paragraph (b).

Furthermore, the addition to CTC only applies to paragraph (b) shares, whereas it should apply to both paragraph (a) and (b) shares.

The drafting insofar as the reduction is concerned is problematic. It is implied through the use of the word “and” that all three provisions must be complied with, i.e. a transfer of CTC, election by the directors and conversion. As such, this provision leads to uncertainty.



### **Submission 3**

The adjustments to CTC on conversion are more appropriately dealt with through a proviso rather than amending the core provisions of the definition. For example, a proviso could simply provide that if shares of one class are convertible to shares of another class, on conversion a proportional amount of the CTC of the class of shares converted will be deemed to relate to the class of shares into which they are converted.

### **Problem statement 4**

The provisions appear to operate only where conversion takes place on the occurrence of a “specified contingency”. This would rule out shares that convert automatically after a given time period or shares that are converted by agreement.

### **Submission 4**

There appears to be no reason why all conversions of shares from one class to another should not qualify for rollover of the CTC, regardless of whether it is in accordance with a time clause or by agreement.

### **Problem statement 5**

The drafting convention in the definition is incorrect – (b) is a paragraph, (i) is a subparagraph, (aa) is an item and (C) is a sub-item. Accordingly, the references to paragraph (C) and subparagraphs (aa) and (bb) are incorrect.

### **Submission 5**

The above references to paragraphs and subparagraphs should be corrected.

### **Problem Statement 6**

The effective date is proposed to be 1 January 2015. The result is that any reductions in CTC prior to that date will not be able to take advantage of the proposal.

### **Submission 6**

It is suggested that the effective date should be the date on which the DTLAB was issued or the date of promulgation.



### **Clause 3: Amending Section 6*quin***

#### **Problem statement**

The requirement to submit a return in relation to foreign tax withheld within 60 days of the date it was withheld is already impractical and the extension of this requirement to non-treaty countries will result in further administrative difficulties for taxpayers. The purpose of the reporting requirement was to enable SARS to engage with a treaty country in the circumstances where the treaty country was imposing withholding tax in contravention of the treaty. As such, the reporting requirement is irrelevant for non-treaty countries.

While it is acknowledged that SARS is entitled to returns in this regard, the requirement to submit the return within 60 days of withholding should be revisited. As it stands, it imposes a significant compliance burden on taxpayers who have to render such returns on a frequent basis, for each individual service and at a point in time when all the information required may not be available.

#### **Submission**

The reporting requirement should be aligned with the submission of the annual tax return and should not be required within 60 days of withholding.

As a further point, it is noted that the amendment is more appropriate if dealt with in the Tax Administration Laws Amendment Bill.

### **Clause 7: Amending Section 8EA**

#### **Problem statement 1**

The proposed relief for third-party backed shares in respect of limited share and loan pledges/guarantees is welcome. However, we note that the relief (both in respect of refinancing and asset-backed preference shares) applies only on the initial, direct acquisition of equity shares in an operating company.

#### **Submission 1**

We request that the relief apply to third-party backed shares issued for all permissible “qualifying purposes” and not just for the initial, direct acquisition of equity shares in an operating company. This broader view would be more consistent with section 8EA as a whole.



## **Problem statement 2**

Many third-party backed arrangements are trapped under section 8EA due to impermissible guarantees. The funders of these agreements are often willing to permanently waive these impermissible guarantees in order to eliminate the impact of ordinary revenue under section 8EA (which indirectly assists the issuers because of the funder gross-up clauses in most agreements). However, this unilateral waiver is most likely a violation of the General Anti Avoidance Rules (GAAR) even if the waiver is permanent, because the waiver will be performed solely for tax reasons.

## **Submission 2**

We suggest that a special legislative or interpretative exemption from GAAR be made to allow for the permanent waiver of third-party rights and obligations.

## **Clause 11(1)(b): Amending Section 9D**

### **Problem statement**

It is unclear how the deletion in subsection (2A) of paragraph (f) will have the effect, as stated in the Draft Explanatory Memorandum to the Taxation Laws Amendment Bill (the EM), that the capital gains tax (CGT) of the controlled foreign company (CFC) will be included in the taxable income of a natural person, special trust or insurer at the rates of the resident and not at the rate of the CFC. It would seem that the effect of the deletion of paragraph (f) will be that the inclusion rate for a company i.e. 66.6% will apply to the capital gain in the calculation of the net income of the CFC in terms of section 9D(2A) for inclusion in the hands of an individual or special trust.

### **Submission**

Paragraph (f) is needed to ensure that the capital gain is included in the hands of the natural person, special trust or insure at the correct inclusion rate and we therefore suggest that this paragraph should remain.

## **Clause 12(1)(b): Amending Section 9H**

### **Problem statement**

Whilst the amendment addresses the scenario where the asset was acquired in one currency only, it does not address that situation where the taxpayer must determine the market value in cases in which there are multiple currencies of expenditure.



## **Submission**

The issue of an asset/s acquired in multiple currencies should be addressed to clarify treatment in this regard.

### **Clause 13(1)(a): Insertion of paragraph (1)(cQ) in subsection (1) of Section 10**

#### **Problem statement**

The proposed relief does not match the relief applicable in respect of other non-profits even though these entities are essentially funding entities – much like a funding public benefit organisation. More specifically, the relief for passive income (as well as capital gains) is noticeably absent. It is unclear why business profits are favoured when this type of profit raises competitive concerns vis-à-vis domestic taxable entities. The rules also limit recurring fundraising so an internal need exists to grow the limited fundraising via reinvestment (all of which should be completely exempt).

## **Submission**

We recommend that this section be reconsidered in light of the relief provided in respect of other similar non-profit organisations in order that these may be aligned.

### **Clause 13(1)(c): Amending Section 10(1)(gC)**

#### **Problem statement**

Section 10(1)(gC) provides for the exemption of foreign sourced pension. The amendment to clarify that the provisions apply to lump sum payments as well as annuity type payments is welcomed as it has been a contentious issue for a number of years.

The use of the words “lump sum benefit” is, however, problematic when referring to foreign sourced pensions. “Lump sum benefit” is a defined term in both the Act and the Second Schedule to the Act, as set out below.

#### **Section 1 of the Act**

“Lump sum benefit” – means a retirement fund lump sum benefit or retirement fund lump sum withdrawal benefit.

“Retirement fund lump sum benefit” – means an amount determined in terms of paragraph 2 (1) (a) of the Second Schedule.



## Second Schedule

Paragraph 2(1) of the Second Schedule determines when a lump sum benefit is derived, that is, either on death or retirement or during retrenchments under specific conditions. This provision also uses the term “lump sum benefit”, however, for the purposes of the Second Schedule the definition of a “lump sum benefit” includes references to pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund all of which are again defined in the ITA and in the Second Schedule and in all cases refer to approved funds.

The circular references to “lump sum benefit” in the ITA, the Second Schedule and now in the proposed amendments to section 10(1)(gC) create much confusion as it seems to require that to be a lump sum benefit it must originate from an approved fund. This interpretation would then render section 10(1)(gC) completely ineffective as regards foreign funds as these would not be approved funds in South Africa.

### **Submission**

It is suggested that the word “lump sum” be used instead of “lump sum benefit” in order to avoid the cross reference to the Second Schedule definition and approved funds.

### **Clause 13(1)(g): Amending Section 10(1)(k)(i)**

#### **Problem statement 1 – proviso (gg) to section 10(1)(k)(i)**

The treatment of dividends in respect of borrowed shares seems to overlap (because dividends in respect of borrowed shares are always offset by matching manufactured payments).

#### **Submission 1**

Proviso (ff) should be removed and the rule should be completely integrated with proviso (gg).

#### **Problem statement 2 – proviso (hh) to section 10(1)(k)(i)**

The initial language (as well as the adjustment) leaves many questions unanswered. The vagueness of the language appears to be creating unintended problems for commercial transactions while creating unintended loopholes for others.

#### **Submission 2**

We suggest that this area stand over for further detailed discussion and inquiry.



### **Problem statement 3**

The amendment to section 10(1)(k)(i)(gg) is effective from years of assessment commencing on or after 1 April 2014. However, the provision was applicable to dividends received or accrued on or after 25 October 2012. As it is a technical correction, it should be backdated.

### **Submission**

The amendment to section 10(1)(k)(i)(gg) should apply to dividends received or accrued on or after 25 October 2012.

### **Clause 14: Amending Section 10B**

#### **Problem statement**

This proposed amendment unfortunately does not correctly address the issue. As a result of the Reserve Bank rules now allowing natural persons to invest offshore (but also as a result of historical structures) we are aware of various structures where typically individual family members and/ or trusts hold shares in foreign companies, which are CFCs. Even though an individual person or trust may hold less than 10% of the equity shares in the CFC he/ she/ it will not be exempted from CFC imputation because of the fact that the investors are connected parties. The exclusion from imputation in section 9D only applies where a resident **together with connected persons** holds less than 10 percent of the interest in the CFC.

Should the suggested amendment above go through in its current format the result is that such persons will be subject to tax when imputed in terms of section 9D and again when a dividend is declared. The reason for this is the fact that the participation exemption in section 10B only applies where that person **together with any other company forming part of the same group of companies** as that person holds at least 10 percent of the shares in the CFC. Natural persons and trusts cannot be part of a group of companies.

In summary, this discrepancy and double tax is a result of the fact that the "penalising" (section 9D) and exemption (section 10B) sections in the Act do not use the same wording. What is needed in our opinion is for section 10B to also use the "connected person" wording as opposed to "group of companies".

We further point out that depending on the structure concerned it could in fact result in triple taxation - should the dividend be received by a company in South Africa and then when on-declared it could be subject to the dividend withholding tax.



## **Submission**

We propose the amendment of the wording of the participation exemption in section 10B (and other places in the Act, such as paragraph 64B of the Eighth Schedule) by replacing the "group of companies" wording with the "connected persons" wording.

### **Clause 17: Amending Section 11D**

#### **Problem statement 1**

The DTLAB proposes that, with effect from 1 January 2014, the tax incentive for Research and Development (R&D) expenditure in section 11D should be restricted to companies only – in terms of the proposed changes to section 11D(2)(a). Thus, individuals and trusts would be excluded from benefitting from the incentive.

No explanation for this amendment is provided in the EM and it is not clear why the incentive should be restricted to corporate taxpayers.

We note that excluding individuals and trusts from claiming the incentive is contrary to the following objectives of the R&D incentive, as set out on page 37 of the EM:

- Knowledge transfer;
- Skills upliftmentThe encouragement of R&D activities that would not have occurred in the absence of the incentive.

We understand that it has been previously argued that non-corporate taxpayers would not be fully committed to R&D (that is, that they would perform the R&D in their spare time) or that it would be more difficult to monitor deductible costs of R&D in the hands of non-corporate taxpayers. However, these arguments fail to take account of the substantial and arduous application and monitoring procedures that must be undertaken to qualify for the R&D incentive (sections 11D(9) and 11D(13)) which have been introduced in recent legislation. It is submitted that any taxpayer, corporate or otherwise, that complies with these procedures would be fully committed and capable of being monitored by the South African Revenue Service (SARS).

For these reasons we consider the exclusion of non-corporate taxpayers from the incentive as unjustifiable.

## **Submission 1**

The proposed amendment restricting the incentive to corporates should be retracted.



## **Problem statement 2**

Clause 17(1)(c) of the TLAB proposes the insertion, in subsection (1) in the definition of “research and development” after paragraph (c), of the following paragraphs:

- “(d) creating or developing a multisource pharmaceutical product, as defined in the World Health Organisation Technical Report Series, No. 937, 2006 Annex 7 Multisource (generic) pharmaceutical products: guidelines on registration requirements to establish interchangeability issued by the World Health Organisation, conforming to such requirements as must be prescribed by regulations made by the Minister after consultation with the Minister for Science and Technology; or
- “(e) conducting a clinical trial as defined in Appendix F of the Guidelines for good practice in the conduct of clinical trials with human participants in South Africa issued by the Department of Health (2006), conforming to such requirements as must be prescribed by regulations made by the Minister after consultation with the Minister for Science and Technology:”;

It is proposed that these paragraphs will be deemed to have come into operation on 1 October 2012 and is to apply in respect of expenditure incurred in respect of R&D on or after that date.

Although the retrospectivity of this amendment is to be welcomed, it may have little force or effect. This is because section 11D(2)(a)(iv) only allows a deduction of expenditure incurred on or after receipt of an application by the Department of Science and Technology (the DST) for approval of the R&D. If taxpayers made no application for this expenditure in the past, because it was excluded from the ambit of the incentive at that time, then even if it is now allowed, claiming a deduction for such expenditure will be frustrated because the requirements of section 11D(2)(a)(iv) would not have been met.

## **Submission 2**

A provision should be inserted that amends the requirements under section 11D(2)(a)(iv) for taxpayers that, on or after 1 October 2012, undertook R&D in the forms set out in clause 17(1)(c) of the DTLAB but failed to submit an application to the DST for approval of the R&D, so that these taxpayers may also benefit from this retrospective amendment.



### **Problem statement 3**

While the widening of the definition of R&D to include clinical trials and multisource pharmaceutical products is to be welcomed, the change to the definition would not have been necessary if the requirement (in section 11D(6)(a)) that a person carries on R&D if that person may determine or alter the methodology of research was moved to section 11D(2). Section 11D(2) of the Act governs the requirements for qualifying for the tax incentive. It would be more logical and more consistent with the Oslo Manual if the R&D definition in the ITA acknowledges that R&D could be carried on, even if a taxpayer did not determine or alter the methodology of the research.

It could be specified from a South African perspective, however, that a person must be able to determine or alter the methodology of the research and, thereafter, to specifically exempt clinical trials or multisource pharmaceutical products from this requirement.

This would be clearer from a drafting perspective and make the legislation easier to read.

### **Submission 3**

It is proposed that the requirement under section 11D(6)(a) be moved to section 11D(2) and that the exemptions from this requirement for clinical trials and multisource pharmaceutical products be moved from the R&D definition to another subsection within section 11D(2).

### **Problem statement 4**

Previously, section 11D provided for a deduction of 100% of the cost associated with R&D expenditure and a 50% uplift where approval was obtained from the DST. However, following the amendments made in 2013, only a deduction of 150% applies if approval is obtained from the DST, i.e. the 100% deduction for unapproved R&D expenditure was deleted from section 11D. This results in any unapproved R&D expenditure arguably not being deductible as it won't qualify for deduction under section 11(a). This is because section 23B(3) provides that no deduction is allowed under section 11(a) for expenditure of a type for which a deduction may be granted under any other section as a prerequisite for deduction under such section.

### **Submission 4**

The 100% deduction for unapproved R&D under section 11D should be reinstated.



## **Clause 18: Amending Section 12D**

While the proposals are welcomed, there are a number of related issues which, we believe, should also be addressed.

### **Problem statement 1 – Scrapping allowances**

To the extent that an asset contemplated in section 12D is disposed of, no deduction is allowed for the remaining tax base in the asset after any consideration has been taken into account. This is because section 11(o) does not apply to assets contemplated in section 12D and, in addition, only applies to assets with an expected useful life for tax purposes of up to 10 years. Given the issues affecting the useful life of such cables, it is considered that a scrapping allowance should be allowed on the disposal of telecommunication cables. The same concerns also apply to electricity cables.

#### **Submission 1**

A scrapping allowance should be allowed in respect of telecommunication and electricity cables.

### **Problem statement 2 – Lease premiums**

Section 11(f) provides for the deduction of lease premiums in relation to certain submarine cables (IRUs) where the right of use is for a period of at least 20 years and was meant to align the provision with owned cables contemplated in section 12D. In order to bring this provision in line with section 12D, the required contractual period should be reduced to 15 years.

#### **Submission 2**

The required contractual period for submarine cables in section 11(f) should be reduced to 15 years.

### **Problem statement 3 – Effective date**

The effective date is proposed to be 1 April 2015. This creates uncertainty as to how the changes are to be applied. For example, does this mean that all telecommunication lines are depreciable over 15 years, regardless of whether or not they were acquired in previous years and how the catch up of allowances is to be made (as a lump-sum or over the remaining allowance period). More concerningly, is that the provision arguably brings existing second hand cables into section 12D and will enable allowances to be claimed from 1 April 2015 on such cables.



### **Submission 3**

It is recommended that the amendments should only apply to cables acquired on or after the effective date.

### **Clause 19(1)(a): Amending Section 12E**

#### **Problem statement 1**

The proposed amendment would have the effect that small businesses with a gross income of under R1 million per annum may not avail themselves of the relief provided by section 12E (that is, the accelerated asset allowances), but would have to register for the turnover tax regime to obtain any benefits. This is a counterproductive step as such businesses may benefit more from the section 12E relief than from the turnover tax regime. A choice for such businesses should therefore remain or the *de minimis* threshold should be reduced to a more reasonable amount

### **Submission 1**

If the compliance rebate proposal is to be retained, it is suggested that the *de minimis* threshold be reduced to, say, R50 000 in order to allow companies with a turnover above that amount to stay within the small business corporation (SBC) regime.

#### **Problem statement 2**

The new regime whereby the graduated tax table for purposes of section 12E would be replaced with an annual refundable tax compliance rebate (RCR) of R15 000 does not sufficiently cater for the annual compliance costs experienced by such businesses. Whereas under the graduated income tax rate system such businesses could have benefitted by up to R94 549 per annum (for the 2015 year of assessment), such businesses would only benefit by R15 000 on an annual basis.

Such a fixed incentive would also have the unintended effect of encouraging small businesses to remain small. This is because the fixed amount of R15 000 is a constant and would amount to a much higher relative percentage of tax payable for a smaller business than for a larger one. This has been illustrated in the examples below.

#### **Example 1:**

Small business corporation A has a taxable income of R600 000

Under Proposed RCR regime

Under current regime (Tax tables for SBC's)



Taxation at 28%	R 168 000	Taxation according to tables =R 59 451 + ((R 600 000 – R 550 001) *28%)
Small business Credit (R 15 000)		
Taxation for the year:	R 153 000	Taxation for the year: R 73 451
Increase in taxation for the year:	R 79 549	

### Example 2

Small business corporation A has a taxable income of R365 000	
Under Proposed RCR regime	Under current regime (Tax tables for SBC's)
Taxation at 28% R 102 200	Taxation according to tables =R 0 + ((R 365 000-R 70 701)*7%)
Small business Credit (R 15 000)	
Taxation for the year: R 87 200	Taxation for the year: R 20 601
Increase in taxation for the year:	R 66 599

### Example 3

Small business corporation A has a taxable income of R400 000	
Under Proposes RCR regime	Under current regime (Tax tables for SBC's)
Taxation at 28% R 112 000	Taxation according to tables =R 20 601 + ((R 400 000 – R 365 001) * 21%)
Small business Credit (R 15 000)	
Taxation for the year: R 97 000	Taxation for the year: R 27 951
Increase in taxation for the year:	R 69 049

From the above three examples it can be seen that small businesses making a taxable profit, will be worse off than what they currently are on the current regime. This will place an additional burden on small businesses in an already stressful economic climate, which will not contribute to creating more jobs etc.

### Submission 2

In our view, the current graduated rate system should be retained or, alternatively, a graduated compliance rebate system which increases to say R100 000 at the highest levels of taxable income (incorporating measures to prevent abuse) should be implemented.



### **Problem statement 3**

In our view, the proposal (in general) is fundamentally at odds with the principles of neutrality and fairness. It is unclear as to why taxpayers carrying on a business in the form of a sole proprietorship or partnership, an individual earning remuneration income or a company carrying on personal services are not be able to benefit from the compliance rebate.

### **Submission 3**

Greater efforts should be made to simplify and reduce the compliance burden for small businesses, regardless of the nature of their business or the form in which they are conducted.

### **Clause 21(1): Amending Section 12I**

#### **Problem statement 1**

Whereas the EM makes reference to immovable “manufacturing assets”, the scope of the proposed amendment only refers to “buildings”. If the amendment does indeed relate only to buildings, in our view lessee created “plant” under section 12C is a major omission to the relief intended. Unlike machinery, “plant” constructed on a lessor’s property is no longer “owned” by the lessee if constructed on lessor land (like the underlying structure of section 13 and 13*quat*). The cost of “plant” is substantial and the real “value-addition” for industrial projects.

#### **Submission 1**

In our view the amendment should be extended to immovable plant and machinery – for example, section 12C should be brought within the relief for plant constructed on leased property to the same extent as sections 13 and 13*quat*.

#### **Problem statement 2**

The need for the deeming in section 12I in respect of section 13 and 13*quat* is not entirely clear given the existence of section 12N. One can only presume that the intention is to cover leased property owned by lessors outside the list of lessors contained in section 12N. If so, this deeming is insufficient because the additional allowance will only be available in respect of section 12I but not in respect of the basic allowance under section 13 and 13*quat* (because section 12N does not apply). It makes no sense to provide the additional incentive without the basic allowance.



## **Submission 2**

If the intention is that manufacturing and UDZ buildings that are part of an industrial project are to be treated as owned for all purposes of the ITA (thereby covering both additional and basic additional depreciation), we suggest that this provision be redrafted.

### **Clause 23: Amending Section 12NA**

On the whole, the proposed introduction of S12NA is a positive amendment for Public Private Partnerships (PPPs). The following matters, however, need consideration:

#### **Problem statement 1**

The proposed Section 12NA will only apply if the government of South Africa in the national or provincial spheres holds the right of use or occupation of the relevant land or building. The exclusion of municipalities (that is, local government) is not explained in the EM. This introduces an unnecessary bias between PPPs conducted with different spheres of government.

Under the Municipal Finance Management Act, municipalities substantially have the same powers of procurement (that is, they are allowed to procure under a PPP structure) as other spheres of government have under the Public Finance Management Act, and it is unclear why municipalities would not be afforded the same benefits of affordability as granted to national or provincial government entities entering into PPP arrangements. This will have a negative impact on the overall affordability of the project, and will most likely deter municipalities from entering into PPPs, which ultimately negatively impacts the development of public infrastructure.

## **Submission 1**

PPPs conducted with all spheres of government (that is, including municipalities/local government) should be included in the ambit of section 12NA of the ITA, and this should be explicitly stated.

#### **Problem statement 2**

There are currently no provisions in the ITA to provide relief to private parties (who do not own the assets subject to the PPP agreements) to claim capital allowances on assets other than land and buildings.



## **Submission 2**

In light of the fact that there may be PPP projects/agreements involving assets other than land and buildings, for example, trains and busses, consideration should be given to the introduction of a concession for these types of assets in a PPP arrangement, similar to the proposed section 12NA.

## **Problem statement 3**

The proposed introduction of section 12NA stems from the fact that certain types of PPP agreements do not meet the requirements of section 12N, which is currently applicable in respect of a right of use or occupation granted to a private party in terms of a PPP on or after 2 November 2010. The main stumbling block in section 12N is that the “right of use or occupation” is not actually granted to the private party in all PPPs.

The deductibility of project expenditure has been a contentious and debated issue for a number of years with much uncertainty, and the ITA should acknowledge this. As such, the section 12NA should be retrospective to the extent that the PPP had already factored such deductions into the PPP financial model. If not retrospective, this will either render some existing PPPs unaffordable, or put certain concessionaires at financial risk (depending on the wording of the PPP contracts).

For example, if a project has expenditure which may have been incurred both before and after 1 April 2015, the proposed effective date suggests that only a part of the project expenses would be deductible. This does not accord with the stated intention of the proposed legislation which is to remove the bias towards taxpayers who entered into PPPs that do not grant them the actual “right of use or occupation” of the relevant land or building.

## **Submission 3**

Since section 12N was introduced with effect from 2 November 2010, we recommend that section 12NA has the same effective date. This will remedy the unintentional shortcoming of section 12N, which is now being addressed by the proposed introduction of section 12NA.

## **Problem statement 4**

The EM states: “The proposed amendments will come into operation on 1 April 2015 and applies in respect of expenditure incurred to effect improvements during any year of assessment commencing on or after that date.” The DTLAB states that the effective date of the introduction of section 12NA is 1 January 2015.



## **Submission 4**

The effective date should be clarified.

## **Clause 26: Amending Section 12T**

### **Problem statement 1**

The proposed subsection 12T(2) provides that any amount received by or accrued to a person in respect of a tax free investment will be exempt from normal tax. The proposed subsection 12T(5) however, states that any amount contemplated in subsection (2) that is reinvested must not be taken into account in determining whether a person contributed in excess in respect of the limitation amounts for contributions i.e. the R30 000 annual and R500 000 aggregate amounts.

There appear to be differing interpretations on how subsection 12T(5) and subsection 12T(2) should be read together. The issue relates to the fact that the accruals in subsection 12T(2) can either mean accruals within the tax free investment itself (that is, investment growth) or actual withdrawals taken from the tax free investment. What is envisaged in section 12T(2) will determine the value of what can be reinvested in the tax free investment without falling foul of the limitation amounts for contributions.

### **Submission 1**

Comprehensive examples should be provided in the EM in order to clarify the basis on which investors will be able to reinvest withdrawals taken during and across tax years.

### **Problem statement 2**

Whilst the limit on the annual and lifetime saving amount is necessary, the amount may not be sufficient to encourage saving in these instruments.

### **Submission 2**

The annual and lifetime limit should be increased.

### **Problem statement 3**

Since there is a limit proposed, it appears punitive to also include such a substantial penalty for extra savings which is the underlying encouragement. There may be instances where a



taxpayer is not informed regarding how the limitations work and this person will be unduly prejudiced by the proposed penalty on the capital investment.

### **Submission 3**

The penalty should be removed or reconsidered, for example, a provision could be added to ensure that any interest earned on the excessive investment should be subject to normal tax as opposed to imposing a penalty on the excessive investment itself.

### **Problem statement 4**

The legislation covers property unit trusts but not real estate investment funds (proposed paragraph (a)(i)(cc) of the “tax free investment” definition under section 12T(1)). Real estate investment trusts are now the dominant form of listed property investment with property unit trusts being phased-out.

### **Submission 4**

Both forms of property investment should equally be covered as a matter of savings neutrality.

## **Clause 27(1)(b): Amending Section 18A**

### **Problem statement 1**

In terms of the proposed subsection (2D)(b), the obligation to distribute amounts every 5 years applies to all amounts received or accrued ‘in respect of financial interests held by [the public benefit organisation]’, including amounts that did not originate from donations for which section 18A receipts had been issued. For example, an amount may accrue to a public benefit organisation in respect of trading income on which it was taxed.

### **Submission 1**

In our view, the obligation to distribute should not apply to such income.

### **Problem statement 2**

Section 18A(2D)(b) requires that income from the approved investments (e.g. dividends and interest) must be distributed every 5 years from registration, if incorporated after 1 January 2015, and every 5 years from date of promulgation if incorporated prior to 1 January 2015.

Firstly, many PBOs are trusts and are therefore not incorporated. They are formed or established.



Secondly, the provision does not cater for any PBO established on 1 January 2015. Thirdly, the provision is impractical in some respects. For example, a PBO established in 2015 will have to distribute all income within 5 years of its approval as a PBO. This would include income that is earned shortly before this 5 year anniversary.

### **Submission 2**

We recommend that the provision should require that income be distributed within 5 years of having been earned.

### **Clause 30: Amending Section 22**

#### **Problem statement**

The provisions of section 22 apply to all taxpayers, regardless of the form in which they operate. However, IFRS only applies to certain companies and not to all taxpayers. The concern with the existing provision was the requirement that the approval of the Commissioner is required and not that it did not refer to IFRS.

#### **Submission**

The provision should continue to refer to generally accepted accounting practice and not IFRS.

### **Clause 32(1): Amending Section 23B**

#### **Problem statement**

This proposed amendment appears to be superfluous for two reasons: firstly, R&D activities are of a capital nature and therefore would not qualify for deduction in terms of section 11(a). Secondly, even if the expenditure in question was not of a capital nature, section 23B(3) would not be an obstacle to the deductibility of expenditure that did not meet the requirement for deductibility in terms of section 11D, since no deduction or allowance ‘may be granted’ in terms of section 11D where such expenditure did not meet the requirement for deductibility in terms of that section. In our view the fact that such expenditure does not fall into the definition of ‘R&D’ should not be construed as a ‘limitation on the amount of such deduction or allowance’.

#### **Submission**

We recommend that this proposal be deleted.



## **Clause 34(1)(c): Amending Section 23M**

SAICA has previously made submissions requesting that section 23M be deleted in its entirety. This submission has been attached for ease of reference. We have not yet received a response to this submission and if the decision is made to retain section 23M, we recommend the following amendments, in addition to those suggested in our previous submission.

### **Problem statement 1**

The proposal that the debtor's interest deduction in times of high interest rates be capped at 60% of the adjusted taxable income of the debtor in order to 'protect the fiscus' has no sound conceptual basis. In the case of high interest rates, businesses that are not subject to section 23M are entitled to a full deduction for the interest expenses that otherwise qualify for deduction. There is no provision to 'protect the fiscus' in these circumstances. The same principle should apply in the case of interest limited in terms of section 23M. High interest rates cause debtors to suffer economically and debtors that happen to fall into section 23M should not be made to suffer further by denying such debtors the deduction of part of the interest they incur.

### **Problem statement 2**

The proposed section 23M(1) refers to interest incurred in respect of a debt owed to a creditor, subject to certain criteria, "and the amount of interest so incurred is not during that year of assessment-

(aa) subject to tax in the hands of the person to which interest accrues; or..."

The reference to interest not subject to tax is unclear and open to interpretation.

The words "subject to tax" cause confusion. For example, it is unclear whether a non-resident taxpayer, who receives South African sourced income (that is, "gross income", as defined in section 1 of the ITA), 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.



## **Submission 2**

The reference to “not subject to tax” should be clarified 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.

## **Problem statement 3**

With regard to the proposed amendment to the formula (that is, the now adjustable formula), based on the most recent annual average repo rate (for the last 12 months to 31 July 2014) results in the percentage applied against the ‘adjusted taxable income’ to be less than the 40% previously legislated:

$$A = B \times C/D$$

$$A = 40\% \times (5.26\% + 4\%)/10$$

$$A = 37\%$$

This rate could well change with possible increases in the repo rate over the near future, but should all else remain the same; the interest deduction limitation will be more restrictive than expected.

Further, the current legislation provides that a taxpayer will never be limited to an interest deduction lower than 40% of the adjusted taxable income. The proposed amendments, however, allows for an interest deduction limitation of 16% of the adjusted taxable income (in the scenario that the repo rate is nil).

## **Submission 3**

As with the 60% ‘cap’, a 40% ‘floor’ should be provided to the adjustable formula. This aligns with prior submissions regarding the economic considerations to balance the disincentivisation of tax base erosion in contract with not disincentivising foreign direct investment into South Africa.

## **Problem statement 4**

The rules relating to guarantees by controlling (i.e. connected) persons are creating a variety of anomalies. Many shareholders with significant share interests in companies provide commercial guarantees unrelated to (taxable and exempt) lenders without any tax avoidance motive. In fact, commercially driven guarantees are the norm. None of these commercially driven guarantees operate as disguised lending from the controlling (i.e. connected) person.



Example (parent versus subsidiary): South African parent company owns all the shares of South African subsidiary. Further assume that the group is seeking debt finance from various unrelated lenders – some of which are foreign persons and pension funds. Under this scenario, section 23M will never apply if the borrowing is directly incurred by the South African parent company. However, if the South African subsidiary borrows the same funds from the same creditors, section 23M potentially applies if the South African parent company guarantees the debt. In our view, the potential for avoidance is not greater in the latter circumstance.

We note that the guarantee rule of the United States (i.e. section 163(j)) applies only to guarantees made by “exempt persons” – not by all persons. We also note that the U.S. rule has similarly caused unintended difficulties despite the even narrower scope.

The impact of the section 23M rules against guarantees creates real problems because of the frequent use of guarantees as security by various (taxable and tax-exempt) lenders within the domestic market. Guarantees by themselves do not equate to indirect funding from the guarantor unless there is ring-fenced (indirectly pledged) passive funds backing the guarantee. This form of special purpose guarantee is very rare.

#### **Submission 4**

We suggest that section 23M(2)(b)(ii) be removed from the final TLAB (or at least delayed for further consideration). We note that this request is not “technically” outside the DTLAB because wording is fully within clause 34(1)(b) of the TLAB.

#### **Clause 35(1)(b): Amending Section 23N**

##### **Problem statement 1**

In the proposed subsection (3)(b) it is not clear which year of assessment should be elected by the debtor in terms of (i), (ii) and (iii). Presumably the intention is that the debtor should be able to elect the year of assessment with the highest ‘adjusted taxable income’, but this is not clear from the wording.

##### **Submission 1**

In the proposed subsection (3)(b)(iii) the word ‘immediately’ should be inserted immediately preceding the word ‘prior’, so that the sentence reads ‘immediately prior to the year of assessment...’



### **Problem statement 2**

The proposal that the debtor's interest deduction in times of high interest rates be capped at 60% of the adjusted taxable income of the debtor in order to 'protect the fiscus' has no sound conceptual basis. In the case of high interest rates businesses that are not subject to section 23N are entitled to a full deduction for the interest expenses that otherwise qualify for deduction. There is no provision to 'protect the fiscus' in these circumstances. The same principle should apply in the case of interest limited in terms of section 23N. High interest rates cause debtors to suffer economically and debtors that happen to fall into section 23N should not be made to suffer further by denying such debtors the deduction of part of the interest they incur.

### **Problem statement 3**

With regard to the proposed amendment to the formula (i.e. the now adjustable formula), based on the most recent annual average repo rate (for the last 12 months to 31 July 2014) results in the percentage applied against the 'adjusted taxable income' to be less than the 40% previously legislated:

$$A = B \times C/D$$

$$A = 40\% \times (5.26\% + 4\%)/10$$

$$A = 37\%$$

This rate could well change with possible increases in the repo rate over the near future, but should all else remain the same, the interest deduction limitation will be more restrictive than expected.

Further, the current legislation provides that a taxpayer will never be limited to an interest deduction lower than 40% of the adjusted taxable income. The proposed amendments, however, allows for an interest deduction limitation of 16% of the adjusted taxable income (in the scenario that the repo rate is nil).

### **Submission 3**

As with the 60% 'cap', a 40% 'floor' should be provided to the adjustable formula. This aligns with prior submissions regarding the economic considerations to balance the disincentivisation of tax base erosion in contract with not disincentivising foreign direct investment into South Africa.



## Clause 36: Insertion of Section 23O

### Problem statement

Section 23O(3) and (5) provide that the base cost of an asset must be reduced to the extent of grants. There is no definition of base cost, this being a CGT concept only and requires definition for purposes of this section.

Furthermore, trading stock is also an asset for CGT purposes. Accordingly, the base cost of trading stock should also be reduced.

### Submission

Base cost should be defined and a reduction should also apply in the case of trading stock.

## Clause 37: Amending Section 24I(10A)

### Problem statement 1

The proposed amendment fails to change a fundamental drafting error in the current legislation.

Section 24I(10A) of the ITA provides for circumstances under which exchange differences on unrealised exchange items between connected persons or members of the same group of companies may be deferred for income tax purposes (that is, deferment relief). Only upon the sooner of realisation or when the group/connected person nexus is lost, will a currency gain or loss be triggered as ordinary revenue.

According to the Explanatory Memorandum dated 10 December 2012 to the Taxation Laws Amendment Bill, 2012 which introduced section 24I(10A) into the ITA (paragraph 5.12, page 127), this deferment relief was not to apply to:

- Short-term loans that constitute current assets and liabilities; and
- Loans funded by third-party loans.

Notwithstanding the intention to exclude these loans from the deferment relief provided under section 24I(10A), the legislation may currently be interpreted so that the deferment relief unintentionally covers:

- Short-term connected party loans that constitute current assets and liabilities provided they are not also funded by third parties; or



- Connected party loans funded by third parties provided they are not also short-term loans that constitute current assets and liabilities.

The basis for this interpretation lies in the use of the preposition “or” at the end of subsection (a)(ii)(aa) of section 24I(10A).

Subsections (i), (ii) and (iii) below section 24I(10A) set out the conditions that an exchange item would need to fulfil in order to be subject to the deferment of resultant foreign exchange differences. However, subsection (ii) is split into two further subsections: (aa) and (bb). As the preposition “or” is used to separate (aa) and (bb), the legislation can be read to mean that only one of these subsections (that is, (aa) or (bb)) needs to apply in order to meet the requirements for the deferment relief while the other subsection can be disregarded.

As (aa) prescribes that the exchange item must not be a current asset or current liability and (bb) prescribes that the exchange item must not be funded by a third party, subsection (ii) can be read to mean that only one of these requirements need to be met for the taxpayer to apply the deferment of foreign exchange differences.

This would mean, for example, that an exchange item that arose from a connected party current asset or liability (thus in breach of subsection (aa)) would nevertheless qualify for the deferment provided it was not also funded by a third party (in terms of subsection (bb)).

Assuming this interpretation was not intended, then it is submitted that the placing of the preposition “or” at end of section 24I(10A)(i)(aa) represents erroneous drafting.

## **Submission 1**

The proposed amendment should be amended to substitute the preposition “or” at the end of section 24I(10A)(a)(ii)(aa) with the preposition “and”.

## **Problem statement 2**

A problem arises with the proposal that an exchange item only qualifies for deferral to the extent that the exchange item does not represent a current asset or liability. By way of illustration, where the total debt in question is \$1 000, \$900 is reflected as long term and \$100 as current, the proposal would mean that \$100 of the debt would not qualify for deferral and the balance of \$900 would. However, section 24I does not contemplate such a scenario as it requires that the full amount of an exchange item be taken into account in determining an



exchange difference and does not provide for only a portion of a debt to be so taken into account.

### **Submission 2**

It is submitted that deferral should not apply only where the full amount of the exchange item is reflected as current.

### **Clause 42: Amending Section 25BB**

#### **Problem statement 1**

Currently, the ITA requires that a company that wishes to qualify for the South African Real Estate Investment Trust (REIT) dispensation must be listed on an exchange and the shares must be listed on the JSE as shares in a REIT. In addition, there are specific requirements, in terms of the JSE listing requirements, which have to be met before a company can obtain such listing.

Whilst the listing requirement is in line with other international regimes and can be seen to serve as a mechanism to ensure that appropriate measures have been taken to comply with legal requirements (to provide investor protection), this “listing” requirement appears to be very narrow and administratively burdensome. Additionally, under the current legislation, unlisted REITs are not able to benefit from the favourable REIT dispensation. Furthermore, international recognition from foreign investors is not given to unlisted REITs.

#### **Submission 1**

The South African REIT dispensation requires that the relevant entity must be listed on the JSE as a REIT. However, the United States (US) REIT regime applies to listed and unlisted companies. The Finance Minister proposed in the 2013 Budget Speech that the REIT regime be extended to unlisted entities as well. This proposal included that the regime be extended to wholly-owned entities of private and government pension funds, as well as long-term insurers. However, to date, National Treasury has not yet released draft legislation that would provide for an extension of the South African REIT regime to unlisted companies.

In addition, consideration needs to be given to, eventually, extending the REIT legislation further to entities such as wholly-owned entities of private and government pension funds, and long-term insurers, and to private companies with significant sized property portfolios.



It is submitted that there may be difficulty associated with regulating the unlisted REITs and ensuring that all requirements for an unlisted company to qualify as a REIT are met on an annual basis. This would be important to ensure compliance, so that only qualifying companies benefit from the REIT dispensation. Currently, listed REITs are governed by the strict JSE listing requirements, which need to be complied with on an ongoing basis. Therefore, more certainty exists where a body such as the JSE reviews whether a company complies with the regulating requirements imposed, and enforces the requirements, if required.

National Treasury has also stated in the 2013 National Budget Review Chapter 4 that consideration must be given to legislation dealing specifically with property syndication, in an attempt to “protect investors from Ponzi schemes”. It is clear that, if there are no proper regulations in place (for example not an actual investment in property to generate rental income), the REIT regime may be “abused” by the unlisted REIT sector, which may leave investors vulnerable.

### **Submission 1**

At this stage it is not clear what body would be most suitable to be used for governing or regulating unlisted REIT companies. However, the US permits listed and unlisted REITs to participate in the REIT regimes. Unlisted US REITs are required, as are listed REITs, to be registered with the Securities and Exchange Commission and comply with disclosure requirements, including providing the Securities and Exchange Commission with quarterly and annual reports and filing a prospectus and these documents are available to the public on the Securities and Exchange Commission’s database.

Therefore, National Treasury may wish to follow such a route and require unlisted REITs to be registered with the JSE, from a compliance point of view, in an attempt to regulate unlisted REITs in the same manner as listed REITs and to protect investors from fraudulent schemes.

### **Problem statement 2**

Currently, it appears that the income from a property company may effectively be subject to economic double taxation. This is because a property company does not qualify for the “qualifying distribution” deduction (which is only available to a REIT or a controlled company in terms of section 25BB(2) of the ITA). Therefore, the property company is taxed on its taxable income at the corporate tax rate of 28% (that is, normal corporation tax rules apply). However, in addition, any dividend paid by such company to a REIT or controlled



company (from post-tax profits) may be re-characterised as a taxable dividend in the hands of the property unit holder in the REIT in terms of section 25BB(6) of the Act.

This, in effect reduces the return on investment for the investor in the REIT (which earns income from the property company). Accordingly, this would not be a very desirable investment from an investor's perspective.

## **Submission 2**

It is proposed that section 10(1)(k)(i)(aa) of the ITA be amended to exempt from income tax any dividend distributed by a property company. This should ensure that returns for investors are not unfairly reduced and remain commercially and economically viable.

## **Problem statement 3**

Where a controlled company of a REIT is in the process of being wound up, it may not be possible to wind up this company within the same year that it ceases to operate as a controlled company and to declare a liquidation dividend in the same year. A delay, which could result in a scenario where the liquidation dividend can only be paid out in a subsequent year after the company has, for example, ceased trading more than three years ago, could often occur due to the lengthy process involved for property companies to be wound up. This delay would often be the result of industry specific, practical problems, for example, resolving municipal accounts.

Therefore, the REIT may receive income in the form of a liquidation dividend from the company, which was previously a controlled company, and, therefore, the dividend received will not constitute "rental income" in the hands of the REIT, as it does not constitute a qualifying distribution received from a controlled company at the time of that distribution (that is, in this example, the controlled company ceased trading more than three years ago and it can therefore not meet the requirement that more than 75% of its gross income consists of rental income in the preceding year of assessment).

If this dividend is significant in relation to the total income of the REIT, this may result in the REIT not meeting the 75% rental income threshold criteria in the following year, as stipulated to be eligible for the qualifying distribution deduction, which may result in an additional layer of tax in the hands of the REIT and ultimately reducing the return (that is, dividend) received by the investor on their investment.



### **Submission 3**

Consideration must be given to provide for such once off occurrences, which property companies are experiencing as a result of practical problems (for example, resolving municipal accounts) and which could ultimately disadvantage a REIT, which receives such a dividend from a controlled company, by it not qualifying for the qualifying distribution.

### **Problem statement 4**

The capital gain or capital loss resulting from the disposal of a share or a linked unit in a company that is a controlled company at the time of that disposal has been omitted from section 25BB(5) of the ITA.

### **Submission 4**

Section 25BB(5) of the ITA should be amended so that any capital gain or capital loss determined in respect of the disposal of a share or a linked unit in a company that is a controlled company at the time of that disposal, be disregarded when determining the aggregate capital gain or capital loss of a company that is a REIT or a controlled company on the last day of the year of assessment.

## **Clause 44: Amending Section 29A**

### **General**

We refer to the SAICA submission dated 24 June 2014 in respect of the First Draft of the Taxation Laws Amendment Bill, 2014 (attached for ease of reference), and state that the issues raised in that submission are still of concern and have not yet been addressed.

### **Problem statement**

In our view, the definition of risk policy is too broad and outside the stated objective. Risk policies with profits economically favouring the insurer (as opposed to the insured) in the case of long-term insurance can only involve death, disability and severe illness. The definition instead covers “any amount payable [that] is dependent on any future event of which the occurrence is uncertain”. As a result, the definition seemingly includes all of the various forms of “smooth bonus” and other complex investment plans and this should not be the case.



## **Submission**

'Pure' investment products were the core reason for the four fund policy system and should accordingly remain within the policyholder funds unless a decision is made to abandon the four fund system altogether.

### **Clause 46(1): Insertion of Section 30C**

#### **Problem statement 1**

The requirement in subsection (1)(b)(ii)(aa) that the funding must be 'provided by that small business funding entity for the benefit of, or is widely accessible to all small, medium and micro-sized enterprises', is overly restrictive. A small business funding entity may specialise in providing funding to small businesses operating in a particular industry, for example.

#### **Submission 1**

The requirement in subsection 1(b)(ii)(aa) should take into account those small business funding entity's which have been set up to provide funding to small businesses operating in particular industries on the basis that the funding is available to all small, medium and micro-sized entities within that particular industry.

#### **Problem statement 2**

The requirement in subsection (1)(d)(ix) that the small business funding entity not have a share or other interest in any business, profession or occupation which is carried on by the persons contemplated in subparagraph (i), does not prevent a connected person holding the share or interest. For example, the requirement can be circumvented by having the spouse of such a person hold the share or other interest.

#### **Submission 2**

The requirement should be extended to 'any person contemplated in subparagraph (i) or any person who is a connected person in relation to such person'.

#### **Problem statement 3**

Section 30C contains no equivalent to section 30(8), whereby a small business funding entity may reapply for approval.

#### **Submission 3**

An equivalent to section 30(8) should be inserted in the new section 30C.



## Clause 47(1) and (2): Amending Section 31

### Problem statement 1

The proposed treatment whereby secondary adjustments be treated as dividends *in specie* is generally welcomed. However, it would seem as if the deemed dividend treatment applies even if the beneficial owner of the dividend *in specie* is not the holder of any shares in the company deemed to be declaring the dividend or is not a connected person in relation to a holder of shares in the company. In these circumstances the dividend *in specie* treatment is not appropriate and it should not apply. Furthermore, it is not clear at which rate the dividends tax should be withheld in such a case.

### Submission 1

Consideration should be given to excluding non-shareholders from the deemed dividend treatment.

### Problem statement 2

The dividend *in specie* treatment would appear to apply even in circumstances in which the person deriving the tax benefit is not a company, for example an individual or a trust. Such treatment is inappropriate in these circumstances.

### Submission 2

The legislation should be clarified to ensure that it applies only to companies and will not apply to individuals and trusts.

### Problem statement 3

It is not clear when the dividend *in specie* is regarded as having been paid. If the deemed dividend arises as and when interest payments are made, this would increase the administrative burden of South African entities as a dividends tax return may be required on a monthly basis.

### Submission 3

The dividend should be deemed to be paid on the last day of the year of assessment of the company deemed to be declaring the dividend *in specie* as this is the date on which the shortfall in taxable income of such company can be determined.



#### **Problem statement 4**

The dividend *in specie* treatment also leads to a multiple taxation problem in that there is potentially three levels of taxation:

- disallowance of excessive interest (primary adjustment)
- 15% dividends tax is levied on the amount of interest that has already then been denied as a deduction in terms of the primary adjustment (secondary adjustment)
- withholding taxes on interest is also effective as of 1 January 2015 (15% of amount of interest paid), which results in further taxation

#### **Submission 4**

A credit against the dividends tax should be given for any withholding tax on interest that is suffered. Alternatively, the legislation must provide that the non-arm's-length portion of the interest is not subject to the dividends withholding tax.

#### **Problem statement 5**

It is not clear why the requirement in subsection (7) should be that no interest accrued in respect of the debt during the year of assessment. In our view 'equity' loans should enjoy relief from section 31 even if interest is charged but at a lower rate than an arm's length rate.

#### **Submission 5**

Consider rewording of the provision to take into account relief from section 31 in respect of 'equity' loans, even if interest is charged, but at a lower rate than an arm's length rate.

#### **Problem statement 6**

The effective date of the amendments is January 2015, however, taxable income is determined with reference to a year of assessment.

#### **Submission 6**

The effective date should be determined with reference to a year of assessment commencing on or after a certain date.

#### **Problem statement 7**

The commencement date for the new rule is 1 January 2015. However, in the interim period, that is, since the introduction of the "deemed loan" secondary adjustment (years of assessment commencing on or after 1 April 2012) the existing administrative burden regarding deemed loans continues to exist and puts an unjust burden on companies.



## **Submission 7**

Paragraph (a) of subsection (1) should be implemented retrospectively to have the effect that all secondary adjustments that were previously treated as a loan now be replaced by a dividend *in specie*. This will remove all the deemed loans between multinationals which would never be repaid. Alternatively, companies should at least be afforded the option to deem such loans to be dividends *in specie*.

## **Other**

Clarity is required as to whether this deemed dividend would be subject to relief provided by double taxation agreements.

## **Clause 49(1): Insertion of Section 37D**

### **Problem statement 1**

For purposes of subsection 3(b) it is not clear on which date the relative market values should be determined.

## **Submission 1**

The determination of market value of the declared land and the market value of the declared land had the land not been subject to the right of use should be made in the year in which the land becomes ‘declared land’.

### **Problem statement 2**

It is noted that it is no longer a requirement that the declaration of the property as a national park or nature reserve be endorsed for a period of 99 years.

## **Submission 2**

It is submitted that this requirement should be retained.

### **Problem statement 3**

Section 37D(2)(b) reads “an amount equal to four percent of ... if the market value of the declared land ...”.

If the market value and municipal value are equal to cost, there is no allowance available.

In our view, the limitation on aggregate deductions is inappropriately drafted. It states that aggregate deductions must not exceed the amount determined as contemplated in subsection



(2). However, the amount determined as contemplated in subsection (2) is the annual allowance. We believe that it should be limited to is the cost or ‘A’ in the formula as the case may be.

### **Submission 3**

The drafting of the allowance needs to be reconsidered and amended.

### **Problem statement 4**

The effective dates for the amendments to section 37C and the insertion of section 37D do not coincide.

### **Submission 4**

The two amendments should have the same effective date.

### **Clause 50: Amending section 41**

#### **Problem statement**

It is proposed to delete the definition of shareholder. However, this definition is necessary for the definition of “hold” which in turn is crucial to the application of many of the provisions in this part.

#### **Submission**

The definition of shareholder should not be deleted.

### **Clause 53(a): Amending Section 44**

#### **Problem statement 1**

The requirement in the proposed subparagraph (iii) to paragraphs (a) and (b) of the definition of ‘amalgamated company’ that the amalgamated company dispose of all assets is a duplication of the requirement in subparagraph (i) and is therefore not necessary.

#### **Submission 1**

This requirement should be excluded.

#### **Problem statement 2**

The requirement in the proposed subparagraph (iii) to paragraphs (a) and (b) of the definition of ‘amalgamated company’ that the amalgamated company has to settle all liabilities is of



concern, as, in terms of current legislation, the resultant company may assume the liabilities of the amalgamated company by delegation, thereby removing the necessity of the amalgamated company having to settle its liabilities.

### **Submission 2**

This requirement should be excluded.

### **Problem statement 3**

No effective date has been specified for the proposed amendment to take effect.

### **Submission 3**

An effective date should be specified.

## **Clause 54: Amending Section 46**

### **Problem statement**

The removal of tax-free unbundlings in the case of REITs and their controlled subsidiaries is not supported. This change was never announced in the Budget Review (either in the main chapter or in Annexure C) and, in our opinion, cannot be viewed as a technical correction. REIT unbundlings have the same policy purpose as any other unbundling.

### **Submission**

We recommend that this amendment be excluded from the final legislation.

We do acknowledge that should the amendment be excluded, one issue does exist and we recommend that this form of unbundling should not be treated as a “qualifying (deductible) distribution” under section 25BB. Otherwise, a deduction results on the one end and potentially exempt receipts and accruals occur on the other.

## **Clause 55: Amending Section 47**

### **Problem statement 1**

Subparagraphs (a)(i) and (ii) of the definition of ‘liquidation transaction’ are set in the alternative. The implication is that there would be no need for the liquidating company to be a resident in terms of paragraph (a) of the definition, provided that it comply with (ii) of the definition, in order for the relief to apply.



## **Submission 1**

The ‘or’ separating (i) and (ii) should be changed to an ‘and’.

If the proposed correction is implemented, the words in the brackets in subparagraph (a)(i) should be amended so as to read: ‘(other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and assets required to satisfy any reasonably anticipated liabilities…).

## **Problem statement 2**

No effective date has been specified for the proposed amendment to take effect.

## **Submission 2**

An effective date should be specified.

## **Clause 56(2): Amending Section 49D**

### **Problem statement**

The effective date of the amendment is 1 July 2013 in respect of which an exemption under section 49D has not been granted. Firstly, with respect, the effective date is meaningless as it is effectively circular. Secondly, if it is intended to be retrospective in application, it will impact on vested rights of taxpayers and impose additional obligations. As such, it is not in accordance with the rule of law and may be unconstitutional.

Furthermore, the exemption requires alignment with the corresponding exemption in section 10(1)(l).

### **Submission**

The effective date should be aligned with that of the complementary exemption in section 10, that is, 1 January 2015. This would also necessitate a change to the effective date of the amendments to section 49E.

## **Clause 57(2): Amending Section 49E**

### **Problem statement**

The provision relating to the effective date contains a circular reference.



## **Submission**

The effective date of the proposed amendment should be amended by the insertion of the words ‘up to the date of promulgation of the Taxation Laws Amendment Act of 2014’ immediately after the word ‘49E’.

## **Clause 65(1)(e) and (f): Amending Section 64F**

### **Problem statement**

The insertion of two new exemptions to dividends tax is welcomed to the extent that it provides clarity and certainty in law regarding these two specific situations.

The administration of dividends tax is, however, complicated by these exemptions. Under current provisions, exemption forms are required in order to substantiate situations where either no dividends tax is being withheld or where a lower rate is applicable. The new provisions relate to the situation where no dividends tax being withheld and are potentially applicable to large volumes of taxpayers.

Should exemption certificates be required for every natural person that opts for a section 12T investment and every natural person receiving less than R100 in dividends, the industry would be crippled by the administration of collating those exemption forms as well as the refund process should the taxpayer be dilatory in returning the forms and by default dividends tax is then incorrectly withheld.

## **Submission**

No exemption forms should be required under the new exemptions and the industry should be empowered to apply these automatically based on their own information and identification of the taxpayer as a natural person.

## **Clause 66: Paragraph 4 of the Second Schedule to the ITA, read with section 1**

### **Problem statement**

Whilst we support the alignment of tax directive applications with the value of a lump sum benefit at the accrual date, we note that the current proposal of deferring retirement by allowing members to elect has far-reaching consequences for members, retirement funds and their Boards of Management, as set out below.



## **Problem statement 1**

### *Transfer to alternate retirement vehicles*

It is unclear as to whether an option to transfer funds will be available on retirement. Some Boards of Management may welcome the option to transfer whereas others may see the transfer as an onerous obligation. We recommend that there should be an option for Boards of Management to approve the transfer benefits if they so choose.

## **Submission 1**

Confirmation is required as to whether the proposed changes will give the Boards of Management of retirement funds the option to transfer retirement members to alternate retirement vehicles such as preservation funds.

## **Problem statement 2**

### *Additional contributions*

Occupational funds currently collect contributions from employers and it will be administratively burdensome to collect additional contributions from retired members. Most administration systems are not geared up for receiving contributions directly from members.

Whether retired members should be allowed to make additional contributions to retirement funds should be dependent on the rules of the fund and whether the Board of Management of such funds will be prepared to amend the rules accordingly. Implementing business systems and processes to facilitate the direct collection of member contributions adds to the cost of the administration of the funds in question.

## **Submission 2**

Confirmation is required as to whether the proposed changes will allow members to continue to make additional contributions to occupational retirement funds after retirement, as any proposal to do so will require fund rules to be amended.

## **Clause 70: Paragraph 7 of the Seventh Schedule to the ITA**

### **Problem statement 1**

As currently worded, the proposal relating to subparagraph (a) does not indicate when the retail market value has to be determined.



### **Submission 1**

The words ‘at the time when the employer acquired the vehicle’ should be inserted immediately after the bracket.

### **Problem statement 2**

While the alignment of the fringe benefit across employers is welcomed, there are some areas that require clarity. The new determined value is based on the retail market value, however, it is not clear whether the same treatment regarding Value Added Tax (VAT) remains in effect.

No guidance has been provided on how one can determine the retail market value of a vehicle. For example, the retail market value of a vehicle in Pofadder can be markedly different to the retail market price of the same vehicle in Pretoria and can differ from month to month, that is, when a facelift or new model is due. This could still create disparity between employees driving the same vehicle.

As the fringe benefit is run through a payroll system, currently an invoice reflecting the cost of the vehicle is used to calculate the fringe benefit. A consideration of whether that value equates to retail market value will need to be undertaken, however, this is not merely a case of inputting a value and will require additional evidence to determine retail market value.

### **Submission 2**

Guidance on the VAT treatment in retail market value as well as what objective factors will be considered in determining the retail market value will be welcomed.

### **Problem statement 3**

There are numerous instances when an employee is obliged to use a particular vehicle due to business reasons and to promote the brand. For example, allowing an employee to use a competitor’s brand will not encourage the employee loyalty that all employers strive for. The current legislation provides for a maximum cap, however, it would be prudent to allow for a minimum cap as well or Commissioner discretion to ensure that lower paid employees are not disadvantaged.

### **Submission 3**

The words ‘or such other amount as the Commissioner may determine’ should be added at the end of subparagraph 1(c), that is, immediately after “in any other case, the retail market value... or manufactured the vehicle’.



### **Problem statement 4**

The insertion of the words “or business” into sub paragraph 4 is far too prescriptive. It may occur that a taxpayer carries on business at premises other than his residence or place of employment. Travel from residence to that place of business or client premises would be regarded as business travel if it is different to his place of employment. For example, internal auditors are based at Head Office, however, the nature of their roles require that they are often on-site at various other business premises. Travel to those places of business is not personal travel but required as part of their employment and therefore business in nature.

### **Submission 4**

If the purpose of the amendment is to clarify that a sole proprietor’s travel between home and his place of business is personal, then it is suggested that the use of the words “or business” is inappropriate and perhaps reference should be made to “the place at which he usually carries on his trade.”

### **Clause 71(1) (a): Paragraph 9 of the Seventh Schedule to the Act**

#### **Problem statement 1**

As the proposal is currently worded, there appears to be an overlap between subparagraph (3A)(a), that is, where full ownership vests in the employer or associated institution and (3C), as the word ‘obtained’ as used in (3C) could refer, *inter alia*, to property leased by the employer or owned by the employer.

#### **Submission 1**

It should be clarified that (3C) only applies to situations in which the employer or associated institution leases the property.

#### **Problem statement 2**

The proposed changes, although welcome, only address situations where the actual rental is not artificially inflated. This is particularly a problem in some of the mining areas and outer-lying areas where the Landlord is unreasonable and due to business reasons the employer is forced to lease the accommodation on a temporary basis.

This is particularly an issue if the rental needs to be paid up front.



## **Submission 2**

The inclusion in paragraph 9 of the words, 3(C)(c) – “or the monthly market value as determined by a registered valuator, subject to the Commissioner’s discretion” will allow the flexibility required to subject to employees’ tax a realistic value without hampering the business growth of the employer.

## **Problem statement 3**

We note that paragraph 9 does not provide for apportionment where two or more employees jointly inhabit employer-provided accommodation. This issue applies to many taxpayers and needs to be addressed.

## **Submission 3**

Given that changes are being proposed to this paragraph, we recommend that this issue of apportionment should also be considered. We suggest an amendment that provides for a simple division of the rent based on the number of employees sharing the employer-provided accommodation.

## **Clause 72: Paragraph 12D of the Seventh Schedule to the ITA**

### **General comment**

We note the enhancements to the proposed valuation for the fringe benefit value of defined benefit fund contributions which have been made since the First Batch of the DTLAB and we submit the following issues and related recommendations.

## **Problem statement 1**

With reference to the Draft Regulations to paragraph 12D(5)(a) of the Seventh Schedule - ‘Fund member category factor’, we note that the rate of discount methodology proposed is not aligned with the statutory valuations of defined benefit funds.

## **Submission 1**

We suggest amendments that provide for assumptions underlying the previous statutory actuarial valuation of the defined benefit fund so that the fringe benefit value is aligned with contribution rates and fund benefits.



### **Problem statement 2**

With reference to the Draft Regulations to paragraph 12D(5)(a) of the Seventh Schedule – ‘Fund member category factor’, specifically, paragraph 4(1)(c), we note that ‘B’ of the formula is based on the average age of members at retirement where no reductions in the benefits are applied. The table of annuity factors, however, does not allow for deviations, which may be detrimental to members.

### **Submission 2**

We suggest that the statutory valuation exercise conducted for the defined benefit fund in question should be used to determine the defined benefit component factor.

### **Problem statement 3**

The proposed contribution certificate requirements (refer to subparagraph 4 of paragraph 12D of the DTLAB) do not align with the anticipated experience of the fund.

### **Submission 3**

We suggest that a measure of discretion should be afforded to fund valuers when setting the assumptions of the contribution certificate.

## **Clause 86: Paragraph 8 of the Tenth Schedule to the ITA**

### **Problem statement**

The proposed addition of item (c) would only apply to the extent that an oil and gas company holds an exploration right jointly with another oil and gas company. The reference to an exploration right excludes holders of a production right from enjoying the same relief.

### **Submission**

It is proposed that the intended relief be extended to all oil and gas companies holding an oil and gas right granted pursuant to the Mineral and Petroleum Resources Development Act.

## **Proposed amendments to the Value-Added Tax Act, No. 89 of 1991 (the VAT Act)**

### **Clause 87: Amending Section 1 definition of ‘enterprise’**

#### **General comment**

The proposed changes have an impact on the registration liability of e-commerce companies that have already registered under the current definition. In terms of the first set of



amendments, there was a requirement that the electronic services (e-services) should be made either to a recipient being a South African resident OR where any payment for those services originate from a South African bank account. Now the suggested changes requires at least two circumstances to be present, which would imply that some of the original companies who were liable to register under the initial amendments would not have been required to register under these new requirements. It is unclear as to whether these companies who have already registered are now required to deregister for VAT.

### **Problem statement 1**

Based on the current wording, a person will not be carrying on an “enterprise” if that person supplies e-services from an export country to a non-resident in South Africa and payment originates from a South African Bank, but that non-resident elects that the tax invoice is delivered outside of the Republic. We don’t believe that this was the intention of this proposed amendment.

### **Submission 1**

This paragraph should be amended by the deletion of the words “where a tax invoice will be delivered” in order to avoid the situation highlighted above.

### **Problem statement 2**

Specifically with regards to the paragraph (cc) requirement, taking into account that e-services are a service rendered via the internet, it is highly unlikely that any recipient of these services would receive a tax invoice delivered at an address in the Republic. They would more likely receive these invoices via email with an email address as the address on the invoice. It is unclear as to whether a physical (manual) invoice will be required or whether tax invoices emailed to an email address which is accessed in South Africa will be sufficient.

### **Submission 2**

Clarification is required to ensure that an electronic tax invoice emailed to the recipient of the services will be considered sufficient for the purposes of this definition.

## **Clause 88: Amending Section 11**

### **Problem statement**

The proposed exclusion of e-services from section 11(2) implies that no vendor will be able to supply e-services to non-residents at the zero rate. This means that where a vendor supplies e-services to a non-resident, who is not registered or not required to be registered, the non-



resident will effectively pay VAT twice (that is, the VAT charged by the vendor and reverse charge VAT in the foreign country). Since the EM does not provide any concrete reasons for this proposed amendment, it is unclear why an amendment, which can have a double tax effect with the result that local suppliers of e-services will be prejudiced compared to their international competitors, is proposed.

Further, as far as non-resident suppliers of e-services are concerned, they will be able to claim back the VAT charged on the supply to them of e-services by a local vendor. However, non-resident suppliers of e-services are not required to open a bank account in South Africa. At the time when VAT was imposed on such services, National Treasury and SARS were apparently satisfied that the said non-resident suppliers of e-services will not have any refunds, hence no requirement for the non-resident supplier to have a South African bank account. If the above scenario finds application, the non-resident will still be liable to account for VAT on the e-services supplied inwards, but will be entitled to claim the 14% VAT on the supply to it of the e-services by the local supplier. If the timing does not coincide fully, the non-resident can be in a refund situation. From a practical point of view, there is uncertainty as to whether SARS will pay the refund into an offshore account.

### **Submission**

It proposed that the wording should read “other than electronic services supplied in terms of section 11(2)(k)”.

## **Clause 90: Amending Section 16**

### **Problem statement**

Last year’s amendment to section 16(3)(a)(iii) of the VAT Act, which has the effect that VAT on imports can only be claimed in the tax period in which the VAT was paid to SARS, causes tremendous financial hardship for many clients. Since section 16(2)(d) requires that the vendor claiming the input tax must be in possession of proof of payment to SARS when the vendor submits its return, the amendment merely creates a cash flow advantage to SARS at the expense of vendors.

### **Submission**

It is thus recommended that section 16(3)(a)(iii) be amended again to the effect that input tax on imports can be claimed in the tax period in which the goods are entered for home consumption.



## Clause 94: Amending Section 54

### Problem statement

The substitution in subsection (3) for the words following paragraph (b) refers. Specifically, the wording:

(ii) goods imported by the agent on behalf of the principal, the agent shall notify the principal in writing within 21 days of the end of the calendar month during which the goods were imported of the full and proper description of the goods, the quantity or volume of the goods, the value of the goods imported and the amount of tax paid on importation of the goods, together with the receipt number of the payment of such tax." (our emphasis)

Some agents have a deferred payment arrangement with SARS and so will not be in a position to issue the receipt number of the payment within 21 days of the end of the calendar month during which the goods were imported.

### Submission

The legislation should take into account those circumstances where a deferred payment arrangement applies and timing of providing the relevant documentation should be adjusted accordingly.

## Clause 96: Amending Section 67

### Problem statement

Bearing in mind the difficulties and delays in registering for VAT, a vendor may not be VAT registered because of delays out of his control and as a result of the proposed amendment that vendor will be unfairly prejudiced by not having the relief in terms of section 67 available to him.

### Submission

Provision should be made for the Commissioner to exercise his discretion and allow the relief to be granted to those vendors who can display that they have followed the correct process in terms of registering for VAT and any delay in registration was not within the vendor's control – that is, provision should be made for affected vendors to make an application to SARS to obtain the section 67 relief.



## **Clause 100: Repeal of Schedule 2 to the VAT Act**

### **Problem statement**

It is proposed that the zero rating of goods listed in Schedule 1 and supplied to farmers be deleted. The EM provides a very sketchy scenario of where the farmer effectively acquires goods at the zero rate and on-supplies the goods at standard rate (presumably) to a trader in such commodities. According to the scenario provided, it appears that there is a concern that of a risk that, since the farmer is on a six monthly tax period and the trader presumably on a monthly period, the trader shares the VAT refund with the farmer, and hence both gain a cash flow benefit and the repeal of Schedule 2 is to address this.

If this is indeed a practice of some farmers, it follows that the farmers in question did not qualify to acquire the goods at the zero rate in the first instance, since the goods were not used or consumed for farming purposes, as envisaged in section 11(1)(g) of the VAT Act and the proposed repeal of Schedule 2 unfairly prejudices those compliant farmers who do not indulge in this fraudulent practice.

### **Submission**

Instead of removing the zero rate provision, which will undoubtedly cause severe cash flow disadvantages for all compliant farmers, it is suggested that those farmers who abuse the system be brought to book. In our view, to amend the VAT Act to the detriment of the majority, so as to clamp down on vendors who embark on tax schemes, is simply counterproductive.

## **Proposed amendments to the Employment Tax Incentive Act, No. 26 of 2013 (the ETI Act)**

### **Clause 106(1)(f): Amending Section 6**

### **Problem statement**

With reference to the addition after subparagraph (f) of subparagraph (g), as presently worded, it is unclear for which period the remuneration of R6 000 or less should be received.

### **Submission**

It should be clarified that the R6 000 limit applies for the month in respect of which the Employment Tax Incentive is claimed.



## **Clause 107(1): Amending Section 7**

### **Problem statement**

In terms of the proposal, section 7(5) will deal with the ‘gross down’ in respect of the 160 hour standard, but there does not appear to be a provision determining how the ‘gross up’ of monthly remuneration should be calculated with reference to the 160 hour standard.

### **Submission**

Subsections 7(2) and 7(3) should be amended to account for the ‘gross up’ of monthly remuneration with reference to the 160 hour standard.

## **Clause 109(1): Amending Section 10**

### **Problem statement**

The effect of the proposed wording of subsection (3)(c) is that if there was an excess in respect of the reconciliation period to 28 February 2014 and the employer did not claim payment of such excess by the end of the reconciliation period to 31 August 2014, the amount of the excess is deemed to be nil at 31 August 2014. However, at 31 August 2014, there was no refund mechanism in place and no provisions dealing with credits prior to the introduction of the refund mechanism.

### **Submission**

The proposal accordingly needs to be amended so as to appropriately cater for credits prior to the introduction by SARS of the refund mechanism.

## **Clause 114**

### **Short title and commencement**

There is no commencement date and one should be inserted.

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

Yours faithfully

Piet Nel CA(SA)

**PROJECT DIRECTOR: TAX**

**The South African Institute of Chartered Accountants (SAICA)**