15 August 2014

National Treasury

By email: nombasa.nkumanda@treasury.gov.za

CC: Adele Collins, South African Revenue Service
acollins@sars.gov.za

Dear Nombasa

Representations on the (draft) Taxation Laws Amendment Bill, 2014 (TLAB2014)

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

Our submissions include a combination of representations, ranging from serious concerns about the impact or effect of certain provisions to simple clarification-suggestions for potentially ambiguous provisions. We have deliberately tried to keep the discussion of our submissions as concise as possible, which does mean that you might require further clarification. In this respect, you are more than welcome to contact us.

As always, we thank National Treasury for the ongoing opportunity to participate in the development of the SA tax law.

Yours sincerely,

Kyle Mandy
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Director
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Attached:
- Detailed submissions

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DETAILED SUBMISSIONS

[Note: "ITA" means the SA Income Tax Act (No 58 of 1962)]

DRAFT TAXATION LAWS AMENDMENT BILL 2014

1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

1.1 VALUATION OF FRINGE BENEFIT FOR DEFINED BENEFIT CONTRIBUTION

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 72	Clause 1.1	Para 12D, 7th Sch & Regulations

Legislation

Retirement funding income

1. The definition of retirement funding income is linked to the definition of remuneration in the Fourth Schedule. That definition include only 80% of the amount of any travel allowance or taxable benefit for the use of a motor vehicle and 50% of any allowance for public office bearers. The result is that, to the extent that the full amount of such benefits is taken into account in the determination of employer retirement contributions, the formula for determining the taxable benefit will under-value the benefit.

2. Submission: The definition of retirement funding income should include the full value of any travel allowances, company car benefits or public office bearer allowances taken into account in the determination of employer retirement contributions.

Effective date

3. The substitution of paragraph 12D of the 7th Schedule applies from 1 March 2015. However, numerous matters need to be attended to prior to that date, e.g. the issue of contribution certificates and the making of regulations. As it stands, none of this would be capable of being done prior to 1 March 2015.

4. Submission: The effective date for the substitution of paragraph 12D should be years of assessment commencing on or after 1 March 2015.

Definitions

5. Paragraph 12D contains definitions of 'fund member category' and 'valuator'. However, these terms are not used in the provision.

6.	Submission: The above definitions appear to be superfluous and should be deleted. If necessary, the definitions should be in the regulations.

Regulations

General comments

Fund rules

7. There are some pension funds that have more than one member category. Through cross-subsidisation of contributions, the valuator of the fund only calculates one employer contribution rate in respect of all these members.

8. If tax legislation requires the valuator to calculate a separate fund member category factor for each member category, then the employer or fund may also have to change the actual contribution requirements to be different for each member category, instead of one contribution rate across all member categories. This would lead to additional changes in the fund rules to allow for different contribution rates for different member categories and would lead to additional administration and changes in the operation of the funds.

Overstated fund member category factors

9. Consider the scenario where an active member (belonging to a DB pension fund) is taxed on contributions towards the fund, because the calculated contributions (for tax purposes) in respect of this member exceed the allowable tax deductible limits of 27.5% or R350,000.

10. However, due to poor investment performance while the member is in retirement, the actual pension increases received by this member are much lower than the pension increases assumed in the annuity factors prescribed in the tax calculation. The tax on the member's contributions are therefore not in line with the actual pension increases and benefit that the member receives during retirement. In fact, the contributions for tax purposes were overstated (in hindsight) compared to the benefit the member receives and one can argue that the member was therefore unnecessarily taxed or overpaid tax during his/her working lifetime.

11. What would happen in such a case? Would the member be refunded with the overpaid tax amount? Would these non-deductible fringe benefits qualify for relief from tax against annuity income in terms of section 10C? If the latter, a fund member may be prejudiced.

12. By the same token, if actual annuity increases exceed those used in the annuity factors for the tax calculation, the member of the fund will potentially benefit by not having paid tax based on a contribution factor that is representative of actual benefits received. Should there therefore not be adjustments made to correctly reflect actual benefits received?

Factor updates

13. There are many fixed factors in the draft regulation, as stated below:

- The annuity factors based on retirement age and pension increases as provided in the document titled *Income Tax Act, 1962: Publication of proposed factors for defined benefit funds as contemplated in draft regulations in terms of paragraph 12D(5)(a) of the seventh schedule*.

- The fixed 0.8 factor as per par. 4(1)(*e*) of the draft regulation.

- The fixed 0.1 factor as per par. 5(1)(*c*) of the draft regulation.

- The fixed 0.005 factor as per par. 6(2) of the draft regulation.

14. How often would these fixed factors be updated to account for changes in the markets?

<u>*Calculation date*</u>

15. Clarity needs to be provided regarding the date of the calculation, for example will the calculation be done as at the last statutory valuation or as at 31 December each year?

<u>*Defined benefit component factor*</u>

16. The factors to determine the taxation applicable to active members are fixed for all pension funds, irrespective of the past or expected future pension increases awarded by funds. There are various reasons why we believe using fixed annuity factors may not be appropriate. These reasons are listed below:

    - Some DB funds do not allow their active members to receive a pension in-fund, but rather to purchase it from an insurer. Details should be provided as to how the annuity factor will be determined for such funds, as the benefit would be significantly different to that estimated by the tax calculation.

    - In line with the section above, if there are two funds offering different pension increases in retirement, but the same service accrual, similar members (with respect to age, salary and past service) will have the same tax rate applied to their contributions. However, the benefits they will receive in retirement will be completely different. The one member will therefore receive lower benefits than the other, however the same tax was applied to both of them. This seems unfair to the member receiving the lower pension increases in retirement.

    - Our understanding is that the factors are based on the Government Employees Pension Fund. The experience and annuity factors for this fund may not be appropriate for all other funds.

17. As an alternative, the annuity factors may be based on the targeted pension increase as stated in the pension increase policy. All DB funds should have a pension increase policy, as this is a requirement by the Pension Funds Act. Furthermore, the targeted pension increase should be expressed as a percentage of inflation, as required by the following:

- Section 14B(3)(*a*) of the Pension Funds Act: *The board shall establish and implement a policy with regard to increases to be granted to pensioners and deferred pensioners, which policy must – (i) aim to award a percentage of the consumer price index, or some other measure of price inflation which is deemed suitable by the board.*

- The following paragraphs from Interpretation note 1 of 2010 (issued by the Financial Services Board):

8. The board of a registered fund must establish and implement a pension increase policy that aims to award pension increases in line with a percentage of the consumer price index or some other measure of price inflation which is deemed suitable by the board.

9. As a result, the pension increase policy must be linked to a measure of price inflation. The pension increase policy cannot be determined both in relation to such a linked rate and a fixed rate. A pension increase policy structured in terms of the combination of a linked rate and a fixed rate obviates the need for minimum pension increase test, which could not have been the intention of legislature.

10. The pension increase policy cannot claim that a fund aims to award pension increases of a percentage of price inflation but in reality the funding target is a lesser amount.

18.	Submission: The annuity factors should be based on the targeted pension increase as stated in the pension increase policy and not fixed annuity factors.

19. Although the targeted pension increase stated by the pension increase policy may provide a more accurate indication of future expected pension increases, the following issues should be considered when the targeted pension increase as per the pension increase policy is used to determine the annuity factors:

- Some funds' pension increase policy states a targeted pension increase range, for example 70% to 80% of inflation. Consideration should be made as to which part of this range will be used to determine the annuity factor.

- There is scope for the employer or trustees to manipulate the calculation by setting a low targeted pension increase in the pension increase policy, but allow for higher actual increases if affordable by the fund. The defined benefit component factor will therefore be low (as it is based on annuity factors based on a low targeted pension increase) and the probability of the contributions in respect of the member exceeding the 27.5% or R350,000 will also be low. However, actual pension increases granted may be significantly higher than the targeted pension increase. In summary, the member will then benefit on tax deductible contributions and from higher pension increases. The tax payable on the contributions will not be representative of the benefits received by the member in retirement.

20.	Submission: To counter potential abuse in this regard, an appropriate mechanism should be provided to allow the Commissioner to adjust contribution factors where deemed appropriate

and/or to impose a penalty regime where the board significantly understates targeted pension increases in relation to actual pension increases.

21. Annuity factors are provided for various ages. The annuity factor to be used for a member category should be based on a specific retirement age, calculated as the average age between 65 years and an earlier age at which no early-retirement penalties apply anymore. More clarity needs to be provided on the factors to be applied to in-service members that are older than 65. The tax applicable to their contributions would most likely be overstated. Furthermore, the factors may not be appropriate for funds where the normal retirement age is less than 65.

22. We do not have detail on how the DB component factors are calculated, but we understand that it allows for expected investment returns, mortality and spouse's benefits. Also, as the valuator will only adjust factor "A" based on accrual rate, the following should be noted:

- Funds have different mortality experiences with different mortality tables applied by different valuators. These bases are approved by the Financial Services Board. We would therefore expect an adjustment to factors to account for different rates of mortality between funds and the DB factors provided;

- Funds have different guarantee periods for which the pension will be paid. An adjustment for these are needed;

- Funds have different level of spouse's benefits in retirement. Adjustments for these are needed;

- The average increase in annuity benefits is determined for each individual member and then averaged over all members within the same fund member category. It is not clear if this average, if at all, should be weighted based on salary or liability.

    - If no weighting is applied then there will not be consistency with the accrual in overall fund benefits.

    - If a salary weighting is applied, it may result in members who do not receive good salary increases paying more tax due to other individuals receiving excessive salary increases.

    - If a liability weighting is applied, this could lead to complicated administration and calculations, as the valuator would be required to perform some form of valuation on the fund every time the contribution certificate should be issued. This could lead to significant time and costs for employers and funds.

23. Submission: Consideration is required as to how the average annuity accrual rate is to be determined and should be incorporated in the regulation. Furthermore, the definition of annuity accrual rate does not appear to contemplate averaging, although this is clearly the intention.

24. It is our understanding that a different fund member category would only be applicable if a different level of contribution is paid by the employer or employee in respect of a different

category of membership where the benefits are determined in the same way. We would like to note the following:

- Historically valuators would calculate different levels of required contribution for different categories of membership, but for simplicity the cost thereof is often quoted as one average rate of contribution.

- An adjustment to fund rules allowing for different rates of employer contribution for different category of membership where members within a category accrue the same level of benefit will therefore ensure that the definition for "fund member category" will hold in these instances and the fund member category factor is more in line with the actual contribution paid for each member.

25. Where different accrual rates apply to varying lengths of service the members of the fund will fall within a single fund member category if the contribution rates are the same. The use of an average annuity accrual rate will accordingly result in those with shorter service having a higher contribution factor and those with longer service a lower contribution factor than should be the case had the actual annuity accrual rate have been enjoyed. The result is that those with shorter periods of service subsidise the tax benefit of those with longer periods of service. This is inequitable and should not be allowed.

26. Submission: Although it will increase complexity slightly, different annuity accrual rates should result in different fund member categories for which separate contribution factors are determined.

27. The lump sum component forms part of the DB component factor and is calculated by multiplying the lump sum accrual rate by 0.8. No information is provided on how the factor of 0.8 was calculated.

28. Submission: The lump sum factor should be supported by an appropriate actuarial determination to support the contribution factor.

Underpin component factor

29. It is proposed that a factor of 0.1 is used when calculating the underpin component factor. However, it is unclear how the figure of 0.1 was determined and we recommend that more details are provided on this.

30. Submission: The underpin factor should be supported by an appropriate actuarial determination to support the contribution factor

31. The manner in which the underpin component factor is determined means that there will always be an "additional contribution" for the member in respect of the underpin, irrespective of whether or not the underpin will apply.

32. For example, in a scenario where a member's defined contribution ("DC") fund credit is much higher than the guaranteed DB underpin, the employer is most likely not required to pay

additional contributions for this underpin (in excess of the normal DC contributions), as chances are small that the DB guarantee will bite. However, the underpin component factor will "charge" an additional amount to the normal DC contributions due to the option, irrespective of the fact that the underpin is unlikely to apply.

33. Further, if the fund makes use of a guaranteed reserve account to fund the DB underpin, the same level of contributions could apply for DC members with or without the DB underpin guarantee. However, the tax deductible limit for these two groups of members may be different.

34. Some funds offer members the choice of using their actual DC fund credit at retirement to determine their pension or their DB guarantee, as the pension arrangements (e.g. a guaranteed period) are different between the two options. If a member chooses the DC fund credit option at retirement, will there be a refund on overpaid tax on contributions compared to other DC members who were not entitled to the DB underpin and who therefore had different tax deductible limits applicable to their contributions?

35. Submission: Further refinement is required on the underpin component to take into account the above comments and eliminate the anomalies that may arise.

Risk benefit component factor

36. It is proposed that a factor of 0.005 is used when calculating the risk benefit component factor. However, it is unclear how the figure of 0.005 was determined and we recommend that more details are provided on this.

37. Furthermore, it is our understanding that disability benefits are excluded from the risk benefit component factor calculation. However, the document does not provide enough details or an explanation on this. We recommend that more details are provided on the treatment of premiums on disability benefits.

38. Further, funds do not only provide lump sum death benefits. Funds may also provide a spouse's pension on death in service. The spouse's pension may already be accrued for if the actuarial reserve value of a member exceeds the death in service spouse's pension. If tax is then calculated on both the actuarial reserve value accrual and the death benefit, it may lead to double taxation of the same benefit.

39. Therefore, in the same way that any DC account values paid to member's dependents on their deaths should be excluded, one could argue that the spouse's pension to be received should also be excluded given that the actuarial reserve value exceeds this benefit. The average risk benefit may in these instances be zero, or even negative. Further clarity is needed in this regard.

40. If all death benefits (including a spouses' pension) should be expressed as a lump sum, then valuators would be required to perform a calculation to convert a spouses' pension on in-service death into a lump sum/capital amount. Details of how such a calculation should be done (including what valuation basis to be used) should be provided.

41. Submission: The risk benefit factor should be supported by an appropriate actuarial determination to support the contribution factor.

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1.2 EXEMPTION OF AMOUNTS RECEIVED OR ACCRUED IN RESPECT OF TAX FREE INVESTMENTS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 13(1)(e), 26, 44(1)(e), 65(1)(e)	Clause 1.2	Sections 12T, 10(i), 29A,64F(1)

Effective date

42. The effective date of the consequential amendment to section 29A is years of assessment commencing on or after 1 March 2015. While this date may work for individuals, it does not work for a life insurance company that may have a year of assessment ending other than on the last day of February. In order for such amounts to be tax-free in the hands of the insurance company during the period from 1 March 2015 to the commencement of the company's next year of assessment, it would be necessary for the provision to apply from 1 March 2015.

43. Submission: The effective date of the amendment to section 29A should be 1 March 2015 and years of assessment commencing on or after that date.

Tax free investment

44. A number of problems exist with regard to the definition of a tax free investment in section 12T.

45. A tax free investment is defined as any financial instrument issued by a bank, long-term insurer in the form of a policy, property unit trust, securities unit trust or the government. The result is that any of these financial instruments will qualify as tax free investments. For example, any bank account, any policy issued by a long term insurer, any unit in a unit trust and any government bund will be a tax free investment as defined. Our understanding was that a specific tax free investment account would have to be offered by these institutions and only investments in these tax free accounts would qualify.

46. The EM also refers to regulations that will govern these investments. However, section 12T makes no provision for the issue of regulations.

47. Submission: The definition of tax free investment requires clarification insofar as the qualifying institutions are concerned and the rules governing such investments.

48. There should be an 'or' between subparagraphs (i) and (ii) of the definition of tax free investment in section 12T.

49.	The reference in paragraph (b) to an insolvent estate of a person should be a reference to an insolvent estate of a natural person.
50.	The definition contains a circular reference to 'tax free investment' in paragraph (c) which should be remedied.

Capital gains

51. Section 12T(3) provides that in determining the aggregate capital gain or capital loss, any capital gain or capital loss must be disregarded. The wording is clumsy, particularly insofar as capital losses are concerned.

52.	Submission: The provision should provide that "In determining the aggregate capital gain or **aggregate** capital loss …".

Annual Contribution limit

53. The annual contribution limit of R30 000 proposed has remained unaltered since the tax-free savings account was first proposed in 2012. While we welcome the stated intention to increase the annual limit on a regular basis for inflation, the limit has already been eroded by inflation since then.

54. It is our view that, in any event, the annual limit is too low and should be increased further in order to promote the uptake of such products. In this regard, it should be borne in mind that the tax benefits associated with tax-free savings accounts should be more attractive than those associated with saving outside of the regime in order to encourage their uptake. By way of illustration, annual exemptions up to a limit are already available for interest (R23 800 or R34 500) and capital gains (R30 000). The relatively low limit therefore does little to make the proposed tax-free savings accounts attractive for savings yielding such returns.

55.	Submission: It is suggested that the annual limit should accordingly be increased to at least R50 000.

Treatment of withdrawals

56. The rationale behind the replacement of withdrawals being subject to the annual limit is understood. However, application of this same rationale to the lifetime limit is questioned.

57. Reasons for saving vary dramatically, ranging from saving for a rainy day (e.g. in the case of unemployment or unforeseen medical expenditure) to saving for future costs of education to saving for the purchase of large assets, such as homes, cars or furniture and these reasons and needs for saving change over the lifetime of an individual. All of these reasons for saving are perfectly acceptable and certainly preferable to funding such needs with debt. As such, they should be encouraged.

58. By not allowing such savings to be replenished towards the lifetime limit following withdrawal sends the wrong message. For example, a person may initially save to buy their

first car (or at least pay the deposit). After that they may save towards the deposit for a house and the furnishings thereof. Later in life once they have children, they may save towards the education of their children. The reasons for saving are endless.

59.	Submission: It is our submission that withdrawals from the tax-free savings account should not be penalised by counting towards the lifetime limit and that such withdrawals should accordingly be allowed to be replaced.

Contributions in excess of caps – penalties

60. We agree that penalties may be the only administratively viable option to address contributions in excess of the proposed caps. We are of the view, however, that a penalty based on 40% of the excess being deemed to be an amount of normal tax payable is excessive.

61. By levying a penalty of, say, 10% on an annual basis on the excess contributions, the incentive to over-contribute will be removed as the investment would need to return 10% just to recover the cost of the penalty.

62. To illustrate the effect of such a penalty, assume a taxpayer made excess contributions of R1 000 and the investment yielded a return of 20%. If that return were in the form of capital gains these would be taxed at an effective rate of 13.3%, yielding an after tax return of R187. If the return was in the form of interest it would have been taxable at rates of up to 40%, yielding an after tax return of R120. If a penalty of 10% of the over contribution were levied, the after tax return on the tax-free investment account would be reduced to R100, thereby making it unattractive to invest excess contributions in such an account.

63. It is therefore recommended that an annual penalty of 10% of any excess contributions be levied where the annual contribution in any year exceeds the annual limit to the extent that such excess contributions have not been reversed through withdrawals or contributions below the annual limit in subsequent years. A similar penalty should apply to contributions in excess of the lifetime limit to the extent that such excess contributions are not taken into account in determining excess contributions in relation to the annual limit.

64. Note that such a penalty would require an amendment to section 213 of the Tax Administration Act as percentage based penalties as contemplated in that section apply only to unpaid tax.

65.	Submission: It is our submission that the proposed penalty be reduced on the basis that that 40% of excess contributions be deemed to be an amount of normal tax payable.

Contributions in excess of caps – administrative issues

66. Individuals will be permitted to open various tax free savings accounts at different institutions, investing in different tax free investments.

67. However, provision is made for circumstances where a taxpayer contributes in excess of the prevailing annual and lifetime contribution limits in any year across all of their tax free

investments. In such a case, a penalty of 40 per cent on the amount of the excess contributions will be levied by SARS on the taxpayer.

68. Re-investment of amounts received or accrued to a taxpayer in respect of a tax free investment will be excluded when determining whether the annual and lifetime contribution limits have been exceeded.

69. It may become difficult for taxpayers to monitor the extent of compliance with the caps.

70. Based thereon that only specified institutions will be permitted to provide these tax free investments, consideration should be given to requiring these institutions to implement standardised monitoring and reporting to a taxpayer of actual contributions made by him to each of his tax free investments. Re-investment amounts and returns should be separately disclosed.

71.	Submission: Institutions permitted to offer tax free investments should implement standardised monitoring and reporting to a taxpayer of actual contributions made by him to each of his tax free investments.

Transfers from estates

72. Any transfer of tax free investments from one individual or his estate to another will be deemed to be a contribution and subject to the annual and lifetime contribution limits of the recipient.

73. However, to qualify as a contribution in respect of a tax free investment, the contribution must be an amount in cash.

74. The implication is that any transfer of a tax free investment from one individual or his estate to another will necessitate the liquidation of the investment to cash and the re-investment thereof in other financial instruments which qualify as tax free investments. This may result in the levying of unnecessary administration fees.

75.	Submission: Consideration should be given to broadening the requirements applicable to contributions to also include the transfer of other tax free investments.

1.3 VALUATION OF FRINGE BENEFIT FOR EMPLOYER PROVIDED RENTAL ACCOMMODATION

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 71	Clause 1.3	Para9, 7th Sch

76. No comments.

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1.4 VALUATION OF COMPANY CAR FRINGE BENEFITS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 70	Clause 1.4	Para 7, 7th Sch

77. No comments.

1.5 CLARIFICATION OF THE LOSS REQUIREMENT IN RESPECT OF KEY PERSON INSURANCE POLICIES

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 16	Clause 1.5	Section 11(w)(ii)(c)

Effective date

78. The Explanatory Memorandum states the effective date of the amendment to be 01 March 2014 and applicable in respect of years of assessment commencing on or after that date, while the Draft Amendment Bill states the effective date of the amendment to be 01 March 2015 and applicable in respect of years of assessment commencing on or after that date

79. Submission: The effective date of the amendment should be clarified.

1.6 THE RETIREMENT FUND ACCRUAL DATE

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 1(m), (n), 66	Clause 1.6	Section 1, Para 4of the 2nd Sch

80. No comments.

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1.7 RESTRAINT OF TRADE RECEIPTS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 1(j)	Clause 1.7	Para (cA) of the definition of gross income, section 11(cA)

Effective date

81. The Explanatory Memorandum states the effective date of the amendments to be 01 March 2015, while the Draft Amendment Bill states the effective date of the amendments to be the date of promulgation of thereof and applicable in respect of any restraint of trade imposed in respect of years of assessment ending on or after that date.

82. Submission: The effective date of the amendment should be clarified.

Amendments to section 11(cA)

83. Amendments to section 11(cA) seem to have been omitted from the Draft Amendment Bill.

84. Submission: Amendments to section 11(cA) should be considered to bring it in line with the amendments to paragraph (cA) of the gross income definition.

2. INCOME TAX: BUSINESS (GENERAL)

2.1 THIRD PARTY BACKED SHARES: PREFERENCE SHARE REFINEMENTS ON GUARANTEES

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 7	Clause 2.1	Section 8EA

Refinancing

85. While we welcome the proposal to correct the concerns regarding refinancing, it does not go far enough. While, the primary concern relates to the refinancing of preference shares issued for a qualifying purpose, there are other qualifying purposes aside from the acquisition of shares in the operating company and the refinancing of preference shares for the acquisition of shares in the operating company.

86. These other qualifying purposes relate to the refinancing of any debt and the payment of dividends. These are not covered by the proposed amendment.

87. Submission: Section 8EA(3)(b)(ii) should be amended to read "any issuer of a preference share if that preference share was issued for that qualifying purpose". This would result in all qualifying purposes being covered by the exclusion.

Asset-backed preference shares

88. The proposed section 8EA(3)(b)(vii)(aa) places too onerous a restriction on the on the use of the funds as the issuer is limited to a direct acquisition of equity shares in an operating company. Importantly, it does not allow for an indirect acquisition of shares in the operating company or any refinancing of debt or preference shares that were used by the issuer for a qualifying purpose. As such, the proposed provision gives rise to similar concerns as for refinancing above.

89. It is submitted that this requirement is unnecessary. Section 8EA(3)(a) already requires the funds derived from the issue of the preference shares to be used for a qualifying purpose. All that that is required is that section 8EA(3)(b)(vii)(aa) require that the funds be used for that qualifying purpose.

90. Submission: Section 8EA(3)(b)(vii)(aa) should require that the funds be used for "that qualifying purpose" and not for the acquisition of equity shares in an operating company in order to cover all qualifying purposes.

2.2 THIRD PARTY BACKED SHARES: REVISION OF THE DEFINITION OF OPERATING COMPANY

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 7	Clause 2.2	Section 8EA

91. No comments.

2.3 DEDUCTIBLE INTEREST LIMITATION IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 34	Clause 2.3	Section 23M

Adjusted taxable income

92. We welcome the proposed add back of assessed losses. However, we note that there is an "and" that needs to be moved as a result of the addition of this add-back.

93. Submission: The "and" needs to be moved as a consequence of the addition of assessed losses.

Formula

94. We welcome the proposal to allow for the formula to increase up to a maximum of 60% of adjusted taxable income.

Other matters

95. Notwithstanding the above proposed amendments, another concern that was raised in relation to section 23M has not been addressed. For ease of reference, we briefly set this out below.

96. The interaction between sections 23M, 23N and 31 is not clear. Although section 23N is made subject section 23M, all 3 sections could apply to the same debt.

97. Submission: Both section 23N and section 31 (thin capitalisation) should provide that they do not apply to any debt to which the provisions of section 23M apply.

98. The provisions apply where a creditor is in a controlling relationship with the debtor. In this regard, a controlling relationship is defined as a relationship between a company and a connected person in relation to the company. The threshold is extremely low and could now apply where the creditor holds as little as 20% of the equity shares or voting rights in the debtor.

99. The original intention was that the interest limitation should only apply where the debtor and creditor were in a group relationship. The rationale for this was that the creditor would have the choice as to whether to finance the debtor in the form of debt or equity and the purpose of the provision was to remove the tax bias towards debt funding. That rationale fails when the creditor is not in a position to determine the nature of the funding.

100. At the current threshold, the provision could result in unintended consequences and wholly commercial transactions being impacted. For example, a life insurance company that is a connected person in relation to a debtor could see a denial of deductions for interest paid by the debtor to the life company where the interest is included in the untaxed policyholder fund.

101.	Submission: The threshold for a controlling relationship should be increased to at least 50% and an exclusion should be introduced for interest paid to life companies.

102. Section 23M only applies where the debtor is a resident. As such, the provisions unfairly discriminate against SA resident companies, while foreign companies operating in SA are not subject to similar limitations on the deductibility of interest.

103.	Submission: The provisions should be extended to apply to non-resident debtors.

2.4 DEDUCTIBLE INTEREST LIMITATION IN RESPECT OF REORGANISATION AND ACQUISITION TRANSACTIONS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 35	Clause 2.4	Section 23N

Adjusted taxable income

104. We welcome the proposed add back of assessed losses. However, we note that there is an "and" that needs to be moved as a result of the addition of this add-back.

105.	Submission: The "and" needs to be moved as a consequence of the addition of assessed losses.

Formula

106. We welcome the proposal to allow for the formula to increase up to a maximum of 60% of adjusted taxable income.

Effective date

107. The effective date of the amendments is proposed be for years of assessment commencing on or after 1 January 2015. However, the provisions of section 23N essentially apply from 1 April 2014 for transactions or refinancings entered into on or after that date. As such, companies will remain exposed to, in particular, the inclusion of assessed losses in adjusted taxable income.

108.	Submission: It is submitted that the amendments should be backdated to the effective date of section 23N.

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Other matters

109. Notwithstanding the above proposed amendments, other concerns that were raised in relation to section 23N have not been addressed. For ease of reference, we briefly set these out below.

110. The definition of "**adjustable taxable income**" does not provide for a grossing up or other adjustment where the year in which the acquisition transaction or the reorganisation transaction takes place does not include trading for a 12 month period.

111.	Submission: In applying the two-pronged test in the five years succeeding the year in which the reorganisation transaction occurs, the "**adjustable taxable income**" for the first year should be adjusted so that it includes 12 months of trading. This could be achieved by a pro rata gross up.

112. No provisions are included to exclude facilities which are of a temporary nature such as bank overdrafts and which are subject to cyclical fluctuations depending upon working capital requirements. These facilities are not regarded as acquisition debt and are typically assumed by the borrower when the business is transferred.

113.	Submission: Interest incurred on overdraft facilities and other temporary working capital facilities should be excluded from the ambit of section 23N.

114. Section 23N applies, inter alia, to all debt "*assumed…for the purposes of procuring, facilitating or funding the acquisition by that acquiring company of any asset in terms of a reorganisation transaction*". Therefore, where one group company transfers assets to a fellow group company in terms of section 45 and the consideration is partly settled by the assumption of pre-existing debt, section 23N will apply to the interest incurred on such debt, even though there has been no introduction of new debt to the business.

115. The ambit of section 23N is significantly wider than section 23K and the framework contemplated in the media statement of 29 April 2013. It is therefore a material hindrance for groups of companies wanting to rationalise their legal structures and/or their business models.

116.	Submission: The assumption of debt should be excluded from the ambit of section 23N.

117. Section 23N applies to all debt "applied directly or indirectly *for the purposes of procuring…*", regardless of whether or not that debt is intra-group. This is contrary to the position under section 23K where there is an exemption for such funding.

118.	Submission: Intra-group debt should be excluded from the ambit of section 23N.

2.5 DIVIDENDS TAX: CONTRIBUTED TAX CAPITAL REFINEMENTS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 1	Clause 2.5	Section 1

119. The proposed wording in sections 1(c) and (d) of the draft Bill is clumsy and unnecessary. .

120. Submission: The proposed amendments should be deleted.

121. 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).

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

123. 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 is clumsy and leads to uncertainty.

124. Submission: The adjustments to CTC on conversion are more appropriately dealt with through a proviso rather than messing with 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.

125. 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.

126. Submission: 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.

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

128. Submission: The above references to paragraphs and subparagraphs should be corrected.

129. 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.

130.	Submission: It is suggested that the effective date should be the date on which the draft Bill was issued or the date of promulgation.

2.6 REVISION OF SHARIA COMPLIANT FINANCING ARRANGEMENTS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 39	Clause 2.6	Section 24JA

131. No comments.

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

3.1 LONG-TERM INSURER'S RISK INSURANCE BUSINESS TO BE TAXED IN CORPORATE FUND

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Clause 44	Clause 3.1	Section 29A

General

132. We previously submitted comments on this proposal in relation to batch 1. We have repeated those comments in this document, together with any further comments, for ease of reference.

Consultation process

133. We have researched Life Tax reform in other jurisdictions and consulted with our global network in this regard. Research was also performed by the SAM Tax Task Group of the FSB on the taxation of Life Insurers in other jurisdictions and the move to Solvency II.

134. The research showed that the only other jurisdiction that applies the "I-E" Tax system for Life Insurers is the United Kingdom ("UK"). The UK also implemented similar reform in their life tax system, together with a move to Solvency II.

135. Based on the above findings, we have in the last few months consulted with PwC UK regarding the Life Tax reform in the UK. Some of our PwC UK tax partners were tax directors in the industry during the introduction of the new corporate tax regime for life insurers and played a significant role in the discussions with HM Revenue and Customs ("HMRC") and HM Treasury which led up to the changes. PwC UK also commented on how the change has been dealt with by companies from an operational and financial perspective.

136. The reasons for Life Tax reform in the UK were very similar to that of SA, being mainly the move to Solvency II and the perception that the regime was outdated and required modernization. The changes in the UK Life Tax reform were mainly as a result of the change from a Solvency I basis for taxation of policyholders to that of IFRS, together with the change of taxation of risk business. These changes are therefore very similar to that of SA.

137. We want to highlight that the effective date for the UK changes was 1 January 2013, but the UK's consultation process started in 2009 and lasted until 2013. It was therefore a very thorough consultation process. This consultation process was open and regarded by most in the UK Life tax industry as a "model" consultation to be proud of. We want to highlight that as part of their consultation process, working groups were established to discuss and debate the main areas of change. HMRC, HM Treasury, advisors and industry players were all represented on these working groups.

138. We therefore propose that the process of Life Tax reform in SA should aim to leverage off the lessons already learnt from other jurisdictions and strive for a similar consultation process. The benefits of a thorough and open consultation process will be a better understanding by Treasury of the long-term insurance industry and products, the development a tax framework that will be equitable between industries and also different players within the same industry and ultimately legislation of a better quality with fewer anomalies and unintended consequences requiring correction at a later stage and greater certainty for taxpayers.

139. The current process of consultation before the publication of this draft legislation under comment was very short, with limited input from the majority of role players into this draft legislation. The timeframe in which to comment on this draft legislation (i.e. 14 days), is also wholly inadequate for what is required for such a major change.

140. It is noted that the proposed amendments are to come into effect for years of assessment commencing on or after 1 January 2016. There is therefore no urgency to rush through legislation in 2014. It is preferable that more time be invested in getting it right through a thorough consultation process over the next year with any legislation introduced in 2015. If necessary, the proposed effective date should be delayed by a year to accommodate this process, including allowing for time to make the inevitable systems changes that would be required by the insurers.

141. Submission: Our primary submission is that a comprehensive consultation process be introduced to consider the proposed changes to the taxation of life insurance. All role players should be included in the consultation process and the benefits, problems, impact and fairness of all changes should be debated.

142. We highlight below the concerns that have immediately come to mind with the proposals. However, we caution that these are likely to not be comprehensive and that other concerns are likely to arise on a thorough analysis of the implications.

Definition of risk policy

143. The definition of a risk policy is too wide and could be open to manipulation, especially insofar as the inclusion of any policy with an element of risk, no matter how small the risk element, is concerned.

144. By way of illustration, whole life policies would fall within the definition of a risk policy, notwithstanding that they include an investment component.

145. Submission: The definition of a risk policy requires further consideration.

Capital gains and dividends

146. One of the most concerning changes is the inequality created for long-term insurers through the introduction of a formula resulting in the taxation of a percentage of dividends and capital gains of the company at the normal tax rate. The reasons given in the explanatory memorandum for the introduction of this formula are unsupported and appear to be solely for the purpose of preventing a loss to the fiscus. As a result of this proposed formula, the Treasury is creating a disparity between long-term insurers and other industries upon the application of basic tax principles. Short-term insurers, for example, also earn dividend income and/or capital gains which can also be used to pay claims, but no such measures exist in their tax framework. Similar implications could apply for all other industries. There is no correlation, in principle, between the taxability of amounts and deductible expenditure funded from such amounts or vice versa. The sole issue at stake is whether the expenditure in question is incurred in the production of income. If so, it is deductible even if funded out of non-taxable income. Take for example a mining company that disposes of investments and realize a capital gain in respect thereof. If it decides to use the proceeds from the disposal of the investments to fund its operational expenses and these are deductible, such a capital gain remains subject to tax at CGT rates.

147. The proposed solution for the taxation of risk business should be fair and equitable when compared to other industries and corporates. As it stands, the proposal will discriminate against long-term insurers.

148. Submission: The proposal to tax long-term insurers on a portion of their dividends and capital gains should be withdrawn.

149. The proposed section 29A(11)(*b*)(ii) refers to the capital gain being 100% of the net capital gain. The correct reference should be to taxable capital gains.

150. Submission: In section 29A(11)(*b*)(ii) the reference to “net capital gain” should be a reference to “taxable capital gain”.

151. If net capital gains are essentially to be taxed as revenue, as is proposed, then assessed capital losses should be allowed as a deduction in order to achieve the requisite symmetry.

152.	Submission: Assessed capital losses should be allowed as a deduction.

IFRS to be used as a basis for policyholder liabilities

153. No mention is made of any transitional arrangements where significant differences might exist between the current regulatory basis and the IFRS basis. Although the legislation contemplates that this will be done on a policy by policy basis such that in theory liabilities in relation to policies issued on or after 1 January 2016, in practice it is unlikely that the liabilities will be determined on this basis.

154.	Submission: The application of IFRS for purposes of determining policy liabilities requires further consideration.

3.2 LONG TERM INSURERS: AVOIDANCE OF UNWARRANTED RELIEF FROM ONGOING TAXATION IN RESPECT OF FOREIGN REINSURANCE

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 44	Clause 3.2	Section 29A

155. No comments.

3.3 AMENDMENT OF DEFINITION OF INSTRUMENT

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 38	Clause 3.3	Section 24J

156. No comments.

pwc

3.4 REFINEMENTS OF REAL ESTATE INVESTMENT TRUST (REITS)

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 42	Clause 3.4	Section 25BB

Timing of deduction of qualifying distribution in the case of a Property Unit Trust ("PUT") or a REIT company versus in the case of a Property Loan Stock company ("PLS"):

157. The issues raised under this heading are not new or arising as a result of the proposed amendments to section 25BB in terms of the draft TLAB2014, but need to be addressed urgently.

158. The definition of "qualifying distribution" in section s25BB(1) currently reads as "a dividend paid or payable or interest incurred in respect of . . . . . "

159. That means that the deduction for the qualifying distribution will only be allowed in a PUT or REIT company when the dividend is paid or payable, but for a PLS when the interest is incurred.

160. Interest is incurred in terms of section 24J of the Act and will therefore always fall within the same year as the profits from which these distributions are made, even if the payment is only made in a subsequent year.

161. Dividends paid or payable from our reading of the Explanatory Memorandum to the Act can however only be deducted at the earliest on the date of declaration of the dividend, which refers to "payable". This could mean that in the case of PUT's or REIT companies there could be a substantial mismatch compared to PLS's, where the distribution/dividend is only declared after the year end of a company and the deduction only allowed in such subsequent year, although it relates to profits generated in a previous year of assessment.

162. This would defy the purpose of the introduction of REIT tax legislation, which was to align the tax treatment of PLS's and PUT's.

163. Submission: We propose that the dividends be allowed in the year to which the profits relate, even though the dividend is only declared after year end. This would align the treatment with PLS's.

Supplementary submissions

164. We may provide supplementary submissions in relation to REITS.

pwc

3.5 REVISION OF FAIR VALUE TAXATION IN RESPECT OF FINANCIAL ASSETS AND LIABILITIES

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 40	Clause 3.5	Section 24JB

165. No comments.

4. INCOME TAX: BUSINESS (INCENTIVES)

4.1 REFINEMENT OF ALLOWANCES IN RESPECT OF TELEPHONE LINES OR CABLES USED FOR THE TRANSMISSION OF ELECTRONIC COMMUNICATIONS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 18	Clause 4.1	Section 12D

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

Scrapping allowances

167. 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.

168. 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.

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

Lease premiums

170. 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.

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

Effective date

172. 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.

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

4.2 REVISION OF THE RESEARCH AND DEVELOPMENT INCENTIVE

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 17	Clause 4.2	Section 11D

Deduction for R&D

174. A significant concern related to the deduction of R&D expenditure has not been addressed.

175. Previously, section 11D provides 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.

176. 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.

177. Furthermore, due to inadvertent delays in the approval by the DST, taxpayers often only receive approvals in subsequent years. A taxpayer is then faced with the administrative burden and responsibility of reopening those years in order to claim the full deduction.

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

Amendments to section 23B

179. Although amendments are proposed to section 23B, the amendments do not address all the required issues. In addition to the activities contemplated in the proviso to the definition of research and development in section 11D(1), unapproved R&D expenditure should also be included.

180. Submission: In addition to the activities contemplated in the proviso to the definition of research and development in section 11D(1), unapproved R&D expenditure should also be included.

TLAB and DST guideline

181. We have also noted a disconnect between the TLAB and the draft DST guideline. For illustrative purposes, we include an example of this: 1) The draft guideline does not comment or deal with the proposed changes to the definition of functional design as addressed in the TLAB. The TLAB proposed significant changes to this specific definition and this definition needs to be clarified in the draft DST guideline. 2) The DST guideline indicates that a taxpayer may appeal against a decision taken of the DST to decline an R&D project through a court. Neither the DST guideline nor the TLAB deals with jurisdiction, relevant rules or the process a taxpayer will need to follow.

182. Submission: It is our recommendation that in order to ensure consistency between section 11D, the TLAB and the DST guidelines, it is imperative that National Treasury along with SARS and the DST align and consolidate the disclosures made both in the section 11D and the DST guideline. This will ensure a consistent application of section 11D read in conjunction with the DST guidelines.

Functional design definition

183. The TLAB proposes an extended definition for a functional design, in addition to the definition in terms of the Designs Act, to include innovation in respect of the functional characteristics or intended uses of the functional design.

184. Previously, we have raised the concern over the use of specific intellectual property terminology in the ITA legislation as this may lead to confusion and raise unnecessary issues

of ambiguity. We acknowledge the basis for this proposed amendment to preventing taxpayers from claiming the incentive without proving a scientific or technological advance.

185. Submission: We would recommend exercising caution in using very technical intellectual property terminology that may result in ambiguity, confusion or the incorrect application of the provisions of section 11D.

186. We would therefore further recommend that this amendment in relation to the creation of a functional design, be made in conjunction with a clear definition and explanation of the term "innovative" or innovation" in the DST guideline, without deviating from intellectual property principles.

Multisource (generic) pharmaceutical companies

187. We appreciate the inclusion of multisource (generic) pharmaceutical companies in this programme. It indicates the commitment of the government to encourage new product development and new technology in a wide spectrum of industries.

188. Submission: In order to prevent confusion and ambiguity, we recommend that proper rules are set in the regulations and the DST guideline, in relation to multisource pharmaceuticals.

189. We concur with the proposed amendment to Section 11D(5), as a point of clarification.

190. Submission: We recommend that in the interest of equity for taxpayers that all the proposed amendments become effective from 1 October 2012.

Control element

191. We express our support for the relaxation of the "control" element in the context of clinical research trials. We have always maintained the view that the ability to control the direction of research ought to be regarded as an indication of eligibility to claim the incentive. However, this view is in line with the approach adopted in the USA and the UK and cannot be the sole determinant of qualifying R&D.

192. We appreciate and support the draft regulations to be promulgated under section 11D. We also support the distinction between Phases I – III and Phases IV – V of clinical research trials, and the view that only the former ought to be regarded as qualifying R&D activities for the incentive.

193. Submission: We suggest more detail to the grounds for excluding epidemiological research and clinical interaction between pharmaceutical products and other medicine. The exclusion of these two categories appears to us to be arbitrary and without any clear basis. Certainly, no reason for this distinction is advanced in the draft explanatory memorandum.

pwc

4.3 TAX TREATMENT OF ALLOWANCES IN RESPECT OF PUBLIC PRIVATE PARTNERSHIP

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 13, 23	Clause 4.3	Sections 10(zI), 12NA

194. No comments.

4.4 REFINEMENT OF OIL AND GAS INCENTIVE

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 86	Clause 4.4	10th Schedule

195. No comments.

4.5 REFINEMENT OF ALLOWANCES IN RESPECT OF INDUSTRIAL POLICY PROJECT INCENTIVE

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 21	Clause 4.5	Section 12I

Anti-double dipping

196. While the objective of the proposed deemed ownership of leasehold improvements is understood for purposes of industrial policy projects, cognisance should be taken of the possibility of double dips as a result of the proposed amendment. To this end, consequential amendments should be made to section 11(g) in order to extend the anti-double dipping provision to section 13quat.

197.	Submission: Amendments should be made to section 11(g) in order to address double dipping.

4.6 REVISION OF ALLOWANCE FOR ENVIRONMENTAL CONSERVATION IN RESPECT OF NATURE RESERVES OR NATIONAL PARKS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 48, 49	Clause 4.6	Sections 37C, 37D

Endorsement

198. 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.

199.	Submission: It is submitted that this requirement should be retained.

Allowance

200. Section 37D(2)(b) reads "an amount equal to four percent of ... an amount equal to four percent ...".

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

202. The limitation on aggregate deductions is poorly 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! What it should be limited to is the cost or "A' in the formula as the case may be.

203.	Submission: The drafting of the allowance needs to be corrected.

Effective date

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

205.	Submission: The two amendments should have the same effective date.

pwc

4.7 REVISION OF SMALL BUSINESS CORPORATION TAX RELIEF

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 19	Clause 4.7	Section 12E

Tax rate

206. We are in support of the proposed repeal of the reduced tax rate regime for small business corporations. This is in line with OECD[1] and IMF studies which suggest that such incentives are ineffective.

207. In this regard, we agree that the focus should be on reducing the compliance burden. "A simplified tax regime for small taxpayers may be desirable if these firms face relatively higher costs in complying with complex tax rules."[2]

208. However, we have a number of concerns with the proposals contained in the draft Bill.

Refundable compliance rebate

209. We are opposed to this proposal in principle for the reasons set out below.

210. Firstly, we are concerned with the precedent that is being set. Taxpayers should not be rewarded for complying with their legal obligations.

211. Secondly, the proposal is fundamentally at odds with the principles of neutrality and fairness. Why should SBCs be rewarded for being tax compliant or receive a contribution to their compliance costs in preference to other taxpayers? More to the point, is why should 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 not be able to benefit from the compliance rebate.

212. In our view, greater efforts should instead 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.

213. Submission: The proposed refundable compliance rebate is not supported.

[1] OECD (2010), *Tax Policy Reform and Economic Growth*, OECD Publishing.
[2] IMF, Fiscal Policy and Employment in Advanced and Emerging Economies, page 20

Alignment with Davis Committee proposals

214. The compliance rebate was part of a package of reforms proposed by the Davis Committee, which included a number of proposed reforms to the SBC provisions. However, the only substantial amendment proposed to the definition of a small business company is to introduce a de minimis turnover level of R1 million.

215. The result is that the SBC regime will be substantially narrowed without the concurrent benefits:

- The Davis Committee suggested that the turnover limit should be increased to R50 million. However, this has been left unchanged.
- The exclusion for shareholdings in other companies was proposed to be limited to shareholdings in any other SBC.
- Relaxations were proposed for the shareholders in a SBC.

216. As it stands, the introduction of the R1 million threshold will penalise those companies with low net margins. They will not qualify for the accelerated asset allowances (which are retained) and will be forced into a position where they have to choose between paying tax at a 28% rate or the turnover tax (which may result in higher tax).

217. While the rationale for the R1 million threshold is understood, it is submitted that it is not appropriate in the absence of further reforms.

218. Submission: 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 SBC regime.

4.8 TAX INCENTIVES FOR PROVISION OF FUNDING TO SMME'S

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 13, 46, 65	Clause 4.8	Sections 10, 30C, 64F

Small, medium or micro-sized enterprise

219. The definition excludes sole proprietorships or partnerships with a turnover in excess of R1 million. It also excludes professional services businesses, where there is a distinction between a micro business and a SBC from a definitional perspective.

220.	Submission: The definition should be broadened to capture all types and forms of business.

4.9 EXEMPTION OF GRATUITOUS FUNDING IN THE HANDS OF SMME's

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 13, 36	Clause 4.9	Sections 10, 23O

Small, medium or micro-sized enterprise

221. The definition excludes sole proprietorships or partnerships with a turnover in excess of R1 million. It also excludes professional services businesses, where there is a distinction between a micro business and a SBC from a definitional perspective.

222.	Submission: The definition should be broadened to capture all types and forms of business.

Allowance assets

223. 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 in a CGT concept only and requires definition for purposes of this section.

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

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

4.10 BROADENING THE SCOPE OF THE VENTURE CAPITAL REGIME

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 22	Clause 4.10	Section 12J

Efficacy of the venture capital regime

226. At the outset, we must emphasise that we fully support the objectives of the venture capital regime insofar as the provision of finance to small businesses and junior miners is concerned. However, we have concerns that a tax policy instrument is not the appropriate instrument to address the externality in relation to the financing of small business.

227. Insofar as junior miners are concerned, we generally support the VCC regime. In this regard, it has many similarities to the much acclaimed Canadian flow-through shares regime, although it is more generous in some respects and more onerous in others, particularly insofar as investment directly in the junior miner is concerned.[3]

228. From a small business perspective, the regime has been unsuccessful in addressing the externality in question, notwithstanding the incentive being made more attractive. In our view, it is doubtful that making further concessions in the tax incentive is going to make a significant difference to its attractiveness. This is because, notwithstanding that government shares some of the risk in the investment, the investor will remain exposed to between 60% and 72% of the risk associated with the investment.

229. An IMF study agrees that policies that ensure access to financing for small businesses are likely to be effective in levelling the playing field[4]. However, the study warns against special tax advantages for small business and has the following to say with regard to funding of small businesses:[5]

> "Small firms may find it more difficult to access debt and equity markets to finance investments than large firms, especially during a financial crisis. The best policy response to such financing constraints is to act directly on these market imperfections, for instance by offering subsidized loans, grants, or guarantees."

230. We are in agreement with the IMF recommendations.

231. Submission: The regime should be withdrawn for small business and replaced with a targeted on-budget expenditure programme for small business. The regime should be simplified for junior minors and the best features of the VCC regime and Canadian FTS regime incorporated into a regime that allows for direct investment in junior mining companies.

Recoupment

232. Outcome 2 of the example in the draft EM indicates that where an investment with a cost of R100 000 is disposed of after 5 years for a consideration of R250 000, there would be no

[3] See http://miningtaxcanada.com/flow-through-shares/
[4] IMF, Fiscal Policy and Employment in Advanced and Emerging Economies
[5] At page 20

recoupment and a capital gain of R150 000 would arise. In the absence of an amendment to the 8th Schedule, this is incorrect.

233. In terms of paragraph 20(3), the base cost of an asset is reduced by any amount that is allowed as a deduction. as such, the base of the venture capital share is nil. Furthermore, paragraph 35 provides that the proceeds is the amount received in respect of the disposal. This is only reduced by an amount that is included in gross income, i.e. the recoupment. As there is no recoupment the proceeds are not reduced and, in the example, the capital gain would be R250 000 and not R150 000.

234. Submission: If the intention is that a share in a VCC held for 5 years should only give rise to a capital gain equal to the proceeds less the cost of the share (before considering any deduction), a consequential amendment should be made to paragraph 20(3) in this regard.

4.11 CLARIFICATIONS ON THE VENTURE CAPITAL REGIME

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 22	Clause 4.11	Section 12J

235. No comments.

4.12 PUBLIC BENEFIT ORGANISATIONS: LOWERING OF THE DISTRIBUTION REQUIREMENT

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 27	Clause 4.12	Section 18A

236. The proposed section 18A(2D)(a)(iii) contains a textual error. It should refer to "the government".

237. 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.

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

239. Secondly, the provision does not cater for any PBO established on 1 January 2015.

240. 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. The provision should therefore require that income be distributed within 5 years of having been earned.

4.13 REFINEMENTS TO THE EMPLOYMENT TAX INCENTIVE

Draft Amendment Bill	Explanatory Memorandum	Employment Tax Incentive Act
Sections 103 – 109	Clause 4.13	Sections 1, 4, 5, 6, 7, 9

241. Submission: The reference in section 6(g) to remuneration should be a reference to monthly remuneration.

242. Submission: The effective date of the amendment to section 7(5) is 1 March 2015 while all the other amendments to the grossing up are 1 January 2015.

4.14 REFINEMENTS OF SPECIAL ECONOMIC ZONE TAX INCENTIVE PROVISIONS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Sections 24, 25	Clause 4.14	Sections 12R, 12S

243. No comments.

pwc

5 INCOME TAX: INTERNATIONAL

5.1 SIMPLIFIED FOREIGN BUSINESS ESTABLISHMENT EXEMPTION FOR CONTROLLED FOREIGN COMPANIES

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 11	Clause 5.1	Section 9D

Imputation of capital gains

244. It is proposed that section 9D(2A)(f) be deleted. The explanation provided in the EM is at odds with the implications of the deletion. Contrary to it having the effect that CGT will be calculated at the rates of the resident, it will result in CGT being calculated at the rate for companies, i.e. two thirds of the net capital gain will be taxed in the hands of the shareholders as opposed to one third. Furthermore, the proposed deletion will be effective from the date of promulgation and will therefore impact any imputation computations having to be done after that date.

245. Submission: The proposed deletion of section 9D(2A)(f) should be abandoned.

5.2 TRANSFER PRICING: SECONDARY ADJUSTMENTS

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 47	Clause 5.2	Section 31

Secondary adjustment

246. The proposed amendment drastically over simplifies the issue. As it stands, the provision deems the transfer pricing adjustment to be a dividend paid by that resident for purposes of section 31(2). A number of problems arise in this regard:

- Firstly, it is not always appropriate to deem the adjustment to be a dividend. The most obvious circumstance is where the taxpayer in question is not a company. However, even where the taxpayer is a company, it is not always appropriate to deem the adjustment to be a dividend. For example, where the taxpayer is a

resident company and the non-arm's length terms benefit a non-resident subsidiary, the benefit is more appropriately regarded as a capital contribution to the subsidiary. In such circumstances, from a purist point of view, the benefit should be viewed as an increase in the cost of the equity shares of the subsidiary. However, at a minimum there should be no secondary adjustment in such circumstances. A deemed dividend should accordingly only arise to the extent that the company granting the benefit is a resident and has been impoverished as a result.

- The dividend is deemed to be paid by the company granting the benefit. However, the provision is silent as to whom the dividend is deemed to have been declared, although example 2 in the draft EM implies that it would be to the person receiving the benefit. The dividend should be deemed to be for the benefit of a shareholder or shareholders who are connected persons in relation to the taxpayer in proportion to their effective interests in the equity shares. For example, where a company that is wholly owned by a SA resident company gives a transfer pricing benefit to a fellow wholly owned non-resident subsidiary, the dividend should be deemed to be declared to shareholder. As the shareholder is a resident company, no liability for dividends tax will arise as it qualifies for exemption. This is the right outcome as the SA dividends tax base is not eroded by the transfer pricing in such circumstances. Where the shareholder is a non-resident, a liability for dividends tax would arise, subject to treaty relief.

- The provision refers to *that resident*. However, transfer pricing adjustments do not only arise for residents. For example, a transfer pricing adjustment may apply to a PE of a non-resident or a CFC. In such circumstances, it is not appropriate that a deemed dividend should arise. Even if it did, it would not be subject to dividends tax. However, to the extent that the transfer pricing erodes the SA dividends tax base, a deemed dividend should arise, not for the non-resident, but for any resident company that is a direct or indirect shareholder in the non-resident.

- The provision provides that the adjustment is a deemed dividend for purposes of section 31(2). That provision requires a tax liability to be determined as if that transaction was entered into on an arm's length terms and conditions. Arguably, the result would be that the deemed dividend would not give rise to any tax liability as this is the transaction that must be tested in terms of section 31(2) and, by default, an equity dividend is always at arm's length. The deeming provision should not be for purposes of section 31(2), but for purposes of the dividends tax in part VIII of chapter II.

- A deemed dividend payment date is required as a liability for dividends tax is only triggered on payment. It is submitted that the appropriate deemed dividend date is the last day of the year of assessment.

247. Submission: In light of the serious shortcomings, it is suggested that this issue be workshopped in depth in order to formulate an appropriate secondary adjustment having regard to the various situations that could arise in practice. Alternatively, the secondary

adjustment should provide for a discretion on the part of SARS to deem a dividend to have been paid by a resident company having regard to the circumstances and the extent to which the SA dividends tax base is eroded.

248. The secondary adjustment up to 1 January 2015 will continue to be the deemed loan. This creates a problem as these deemed loans will remain in place indefinitely and continue to give rise to transfer pricing adjustments. The deemed loans should accordingly be eliminated as part of the switch to a deemed dividend. One way to deal with these would to be to deem them to have been settled on the effective date and for a deemed dividend to have arisen for an equivalent amount in appropriate circumstances.

249. Submission: The deemed loans that arose under the existing secondary adjustment should be eliminated.

Effective date

250. The effective date of the amendment to the secondary adjustment is proposed to be 1 January 2015. Firstly, this effective date is difficult to interpret in the context of section 31 because any adjustments to taxable income are done in respect of a year of assessment. Accordingly, the effective date should be linked to a year of assessment. Secondly, it would result in secondary adjustments prior to that date being the deemed loan. Given that the secondary adjustment only came into effect for years of assessment commencing on or after 1 April 2012 and, it is considered reasonable that the amendment be backdated to that date as the first tax returns for such years would only likely have been submitted in 2014. A transitional rule could be included in relation to the date of the deemed dividend in order to alleviate any interest and penalties that would arise, e.g. the dividend should be deemed to have been declared on the date of promulgation in relation to any year of assessment ending prior to the date of promulgation.

251. Submission: The effective date should be amended to years of assessment commencing on or after 1 April 2012.

252. No specific effective date for the amendments to section 31(7) is included. The result is that the effective date will be the date of promulgation. For similar reasons to those noted above, this is not workable.

253. Submission: The effective date of the amendments to section 31(7) should be linked to a year of assessment. In this regard, it is suggested that years of assessment commencing on or after 1 January 2015 would be appropriate.

5.3 CURRENCY OF REACQUISITION OF ASSETS OF PERSONS CEASING TO BE RESIDENT

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act

Sections 12, 82	Clause 5.3	Section 9H, para 43 8th Sch.

254. No comments.

255.	Submission: content.

6. VALUE ADDED TAX

6.1 SECOND HAND GOODS – PRECIOUS METALS

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section 87	Clause 6.1	Section 1

Second hand goods made from precious metals

256. We understand the aim of the proposed amendment and acknowledge the risk of fraud associated with these types of goods.

257. However, we submit that VAT fraud and associated tax losses cannot be ascribed to the definition of 'second hand goods' in the Value-Added Tax Act No. 89 of 1991 ('the VAT Act'). Rather, VAT fraud is a global phenomenon in which unscrupulous vendors will attempt to take advantage of the open VAT system. Therefore, in order to reduce and discourage fraud, emphasis should rather be placed VAT compliance and monitoring measures rather than the amendment as proposed.

258. Furthermore, the removal of the notional input tax credit currently available to the purchasers of gold will have a detrimental impact negatively impact the supply chain and result in a cascading VAT effect.

259.	Submission: We submit that the proposed amendment be excluded from the Act.

6.2 DOCUMENTATION

Draft Amendment Bill	Explanatory Memorandum	VAT Act

Section 90	Clause 6.2	Section 16.2

260. We agree with the proposed amendment.

6.3 TAX INVOICES, DEBIT AND CREDIT NOTES

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section 94(1)	Clause 6.3	Section 54(1)

261. No comments.

6.4 AGENTS

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section 94(1)(b)	Clause 6.4	Section 54(3)

262. We agree with the proposed amendment.

6.5 CONTRACT PRICES

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section 96	Clause 6.5	Section 67

263. The inclusion of the phrase "imposed for the first time in terms of this Act" does not clarify the intention of the legislature. Specifically, this phrase could be construed as referring to the date of commencement of the Act.

264. The Explanatory Memorandum distinguishes between vendors who are registered as such and those who are required to register. The Explanatory Memorandum further states that the purpose of the proposed amendment is to exclude vendors falling within this latter category (i.e. those who are required to be registered) from relying on the provisions of section 67.

265. Submission: We submit that the wording of the proposed amendment be reconsidered to prevent uncertainty.

6.6 BARGAINING COUNCILS

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section 89	Clause 6.6	Section 12(l)

266. While the principle of the proposed amendment is welcomed, the wording of the amended section 12(l) should be refined so as to ensure that the scope of the exemption is clear.

267. The Explanatory Memorandum states that the purpose of the proposed amendment is to broaden the scope of section 12(l) in order to include the supply of administration services for which the bargaining councils receive separate fees derived from interest resulting from investment in various Funds on behalf of members.

268. However, the wording of the proposed amendment in its current format seems to create a blanket exemption for the entity rather than merely extending the current exemption to include the supply of administration services as set out in the Explanatory Memorandum.

269. In its current format, the proposed amendment represents a departure from other exemptions in terms of the Act. Specifically, the proposed amendment will exempt entities (i.e. bargaining council's) rather than specific supplies.

270. Submission: We submit that the wording of the proposed amendment be reconsidered.

6.7 ZERO RATING OF GOODS FOR AGRICULTURAL, PASTORAL OR OTHER FARMING PURPOSES

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Sections 88(1)(a), 99(1)(a) and 100	Clause 6.7	Section 11(1)(g), Schedule 1 and Schedule 2, Part A

271. SARS has stated that the proposed amendment is required in order to eliminate the VAT losses incurred by the fiscus due to the high prevalence of fraud, which has resulted from the zero-rating of agricultural products.

272. However, we submit that VAT fraud and tax losses cannot, as such, be ascribed to the section 11(1)(g) zero-rating. Instead, VAT fraud is a global phenomenon. The risk of VAT fraud has been foreseen since the introduction of VAT - hence the emphasis on VAT compliance monitoring, in particular the VAT audit trail and VAT registration procedures.

273. Therefore, the fact that unscrupulous vendors abuse measures which have been designed to lessen the compliance cost of VAT for farmers, does not mean that the section 11(1)(g) zero-rating was incorrect or has caused VAT losses. Fraudsters have in countless instances submitted false input tax claims, based on fraudulent or inflated tax invoices for fictitious sales or exports. These cases have forced SARS to increase its compliance monitoring efforts. The fraud has not resulted in a general denial of vendors' entitlement to input tax claims or refund payments. Accordingly, just as all VAT vendors have not been punished (by the removal of the right to input tax claims or refunds), all farmers should not be punished by a sudden change to the VAT status quo.

274. We urge SARS not to punish the agricultural industry, but to rather implement alternative control measures to monitor compliance and eliminate fraudulent behaviour. The removal of the section 11(1)(g) zero-rating would not eliminate VAT fraud, as fraudsters can use any section of the VAT Act to commit financial crime by abusing the VAT mechanism. But the removal of the zero-rating would most likely have devastating consequences for the agricultural sector.

275. Submission: We submit that section 11(1)(g) should not be repealed or, at least, delayed until such time as further consideration can be given to the broader implications of this proposed amendment. We will make detailed supplementary submissions in this regard.

6.8 VAT TREATMENT OF LEGAL TENDER OR MONEY

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section	Clause 6.8	Sections 1 & 12 and Sch 1

276. No comments.

7. CLAUSE-BY-CLAUSE

7.1 CLAUSE 3

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 3		Section 6*quin*

277. 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.

278. 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.

279. 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.

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

7.2 CLAUSE 9

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 9		Section 9

281. The proposed amendment does not achieve its objective as a lump sum benefit as defined in section 1 only relates to SA retirement funds and not foreign funds.

282.	Submission: The provision should refer to a lump sum benefit or any lump sum from a foreign superannuation scheme.

7.3 CLAUSE 13

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 13		Section 10

283. The proposed amendment to section 10(1)(gC) does not achieve its objective as a lump sum benefit as defined in section 1 only relates to SA retirement funds and not foreign funds.

284.	Submission: The provision should refer to a lump sum benefit or any lump sum from a foreign superannuation scheme.

285. 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.

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

7.4 CLAUSE 14

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 14		Section 10B

287. 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.

288. 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.

289. 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".

290. 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 on-declared it could be subject to the dividend withholding tax.

291. 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.

7.5 CLAUSE 30

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 30	Clause	Section 22

292. 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.

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

7.6 CLAUSE 37

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 37		Section 24I

294. 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 $100, $90 is reflected as long term and $10 as current, the proposal would mean that $10 of the debt would not qualify for deferral and the balance of $90 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.

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

296. S24I(10A)(a)(ii) contains an 'or' between items (aa) and (bb). This has the result that only one of these requirements would need to be met for deferral to apply, whereas the intention is seemingly that both requirements would need to be met. The intention was that deferral should apply only to related party debt and third party debt and then only to long term debt. The effect of the "or" is that the exclusion for current debt will not apply where the debt was not indirectly funded by a third party.

297.	Submission: The 'or' in S24I(10A)(a)(ii) should be substituted with an 'and'.

7.7 CLAUSE 42

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 42	Clause	Section 25BB

298. Section 42(1)(d) deems any interest received by a REIT that is a resident to be a dividend or foreign dividend. However, the provision fails to address in what circumstances interest will be deemed to be a dividend and in what circumstances interest will be deemed to be a foreign dividend. The implication is that the taxpayer is free to choose, although it seems clear that is not the intention.

299.	Submission: Interest should be deemed to be a dividend if received from a resident and a foreign dividend if received from a non-resident property company.

7.8 CLAUSE 50

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 50	Clause	Section 41

300. 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.

301.	Submission: The definition of shareholder should not be deleted.

pwc

7.9 CLAUSE 53

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 53		Section 44

302. The proposed amendments are riddled with errors and result in absurdities relating to the extent to which all the assets must be disposed of as more than one provision will now deal with the assets to be disposed of. There are also incorrect references to the various paragraphs.

303. Furthermore, no effective date is specified.

304. Submission: The amendments need to be reformulated to combine the proposals with the existing requirements relating to the disposal of all assets.

7.10 CLAUSE 55

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 55		Section 47

305. The proposed amendment results in a new type of liquidation distribution rather than amending the existing type. In addition, the amendments do not address the situation of CFC liquidation distributions.

306. Furthermore, no effective date is specified.

307. Submission: The amendments need to be reformulated to combine the proposals with the existing requirements relating to the disposal of all assets.

7.11 CLAUSE 56

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 56		Section 49D

308. The effective date of the amendment is 1 July 2013 in respect of which an exemption under section 49D has not been granted. Firstly, 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 is unconstitutional.

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

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

7.12 CLAUSE 61

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 61		Section 51A

311. When the withholding tax on service fees was proposed in 2013, it was agreed that it would be delayed to 2016 for further consideration. Since then, there have been no further consultations held. However, in addition to the withholding tax, non-residents are now required to submit returns for all SA sourced service fees and it is proposed that such service fees be subject to the reportable arrangement provisions.

312. This calls into question the need for the withholding tax given that its primary purpose was to identify SA sourced service fees that should be subject to income tax.

313. For the sake of brevity, we have not repeated our comments made in 2013, save to say that they are even more valid in light of the subsequent developments.

314. Submission: The withholding tax on service fees should be repealed.

7.13 CLAUSE 65

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 65		Section 64F

315.	Submission: Consequential amendments to sections 64G and 64H are required for the new *de minimis* exemption. It is not feasible for the beneficial owner to provide the declaration envisaged and the company or regulated intermediary is in a position to determine this.

7.14 CLAUSE 87

Draft Amendment Bill	Explanatory Memorandum	VAT Act
Section 87		Sections 1 &11(2)

Electronic services

316. We welcome the inclusion of these provisions.

317. However, as suppliers of electronic services are foreign entities, and given the nature of the supplies concerned, most suppliers will issue electronic invoices to recipients of their electronic services.

318. In light of the above, and from a reading of the proposed amendments, it is unclear whether an 'address' will be limited to a physical address or whether this will include an electronic address (e.g. an IP address).

319.	Submission: We submit that the wording proposed under section 87(1)(a) be reconsider to prevent uncertainty.

7.15 CLAUSE 110

Draft Amendment Bill	Explanatory Memorandum	Income Tax Act
Section 110		Section 11D

320. As a matter of good practise, amendments to amendment acts should be avoided, particularly where such previous amendments have already come into effect. Accordingly, the amendments to section 11D should preferably be made through an amendment of the Income Tax Act and not an amendment of the Taxation Laws Amendment Act, 2013.

321.	Submission: Section 11D should be amended and not the amendment Act.

8. MATTERS NOT ADDRESSED IN DRAFT BILL

322. Numerous anomalies and technical corrections that were required to be addressed were brought to the attention of National Treasury as part of the Annexure C submission process. Unfortunately, many of these have not been attended to.

323. This is unfortunate as some of the issues have been around for a number of years and require urgent intervention in order to address the uncertainties that arise as a result. We would request that these are attended to as part of the 2014 legislative process.

324. For ease of reference, we have repeated the relevant Annexure C submissions below. Some of these matters are, however, also addressed in the comments made above on proposals forming part of the draft Bill.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
S8F	There is seemingly a mismatch insofar as the timing of the deemed dividend in the hands of the issuer and holder of the hybrid debt instrument is concerned.	Under s8F(2)(a) interest incurred by the company during the year of assessment (of the company) is deemed to be a dividend declared and paid on the last day of the year of the company. Therefore if a company with a June year end incurs interest of 100 during the year, it will be deemed to have declared and paid that amount as a dividend on 30 June and it will not be deductible. S8F(2)(b) seems to give rise to	

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Problem	Legal nature of problem	Detailed factual description	Proposed solution
		an anomaly or mismatch. It says that any amount of interest that accrues to a person during a year of assessment (presumably the year of assessment of the recipient of the interest) is deemed to be a dividend accrued to the person on the last day of the year of assessment of the company. If the recipient has a December year end and the company a June year end, if the words are applied literally, the interest accruing to the person from January to December will be deemed to have accrued to the person as a dividend on 30 June (but of which year?). Clearly this cannot have been the intention. Presumably what is intended is that there will be a matching between	

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		paras (a) and (b) such that any amount that is deemed to be a dividend declared and paid by the company on the last day of the year of assessment under para (a) will be deemed to be a dividend that accrued to the recipient of the interest on the same date. Alternatively, any interest accruing to the person should be deemed to be a dividend accruing on the last day of that persons year of assessment rather than that of the company. This is seemingly the case insofar as s8FA is concerned.	
S9	S9(2)(b) refers to deemed interest contemplated in s8E. However, s8E no longer deems dividends to be interest, but		S9(2)(b) should be amended to refer to interest deemed to be income by s8E.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	income.		
S23K	s23K(10)(c) is introduced with effect from 1 April 2014. This provision effectively says that the denial of the deduction under s23K(2) does not apply if a directive has been issued under s23K(3). The precise purpose of this provision is not clear and it can be interpreted in 2 ways. Firstly, it could be superfluous in the sense that it allows a deduction for interest in respect of which a directive has been issued. However, s23K(3) already allows for this. Secondly, it could be interpreted as meaning that any limitation imposed in the directive is no longer applicable and all interest will be allowable as a deduction with		The provision should be clarified.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	no restrictions. Clarity is required on the purpose of this provision		
S23M/s23N/s31	The interaction between these sections is not clear. Although s23N is made subject s23M, all 3 sections could apply to the same debt.	Assume Company A borrows an amount of R1000 at 10% from Company B, a connected non-resident in a treaty country that provides for a nil withholding tax on interest, in order to fund a reorganisation transaction. Company A has adjusted taxable income of R200 and no interest received. Applying s23M, Company A's interest deduction will be limited to R80 and the balance of R20 will be carried forward to the next year. An identical result arises in	Both s23N and s31 (thin capitalisation) should provide that they do not apply to any debt to which the provisions of s23M apply.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		terms of s23N, with the exception that the excess is entirely disallowed for the first 6 tax years. S31 could also apply if Company A is considered to be thinly capitalised.	
S24B repeal	S24B is repealed in relation to shares acquired, issued or disposed on or after 1 April 2013. However, s40CA which provides for deemed expenditure in relation to the issue of shares as consideration for the acquisition of an asset was only effective for acquisitions on or after 1 January 2013. The result is that the repeal		Rather than repeal the entire section, s24B(2) should be amended to provide that it does not apply from 1 April 2013.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	arguably has the effect that where a share was acquired prior to 1 January 2013 in exchange for the issue of shares and is disposed of on or after 1 April 2013, such share will have no cost for tax purposes as the Labat principle will apply to the acquisition of such share.		
S12N	In terms of the draft TLAB, 2013, voluntary improvements to land or buildings by a lessee would be deemed to be owned by the lessee, regardless of the nature of the owner (private or government/quasi government). However, in the final TLAB, 2013, only voluntary improvements to government/quasi government	Some taxpayers have already embarked on projects to effect improvements to privately owned land and buildings on the basis that s12N would apply to such improvements.	S12N should be amended retrospectively to the effect that voluntary improvements to privately owned land will qualify under the section.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	owned land qualify for s12N, as with compulsory improvements. This is contradicted by the EM which implies that voluntary improvements to any property would qualify. No explanation was provided for this deviation in the response document and we presume that it was unintentional.		
S19(6)	The amendment to s19(6) in the TLAB, 2013 will result in numerous anomalies with regard to recoupments on allowance assets. The intention was that any reduction amount relating to the financing of an allowance asset would first reduce any remaining tax basis in the asset (i.e. reduce base cost and future	Assume Company A borrows an amount of R1000 from Company B, a company in the same s41 group of companies to acquire an allowance asset in the form of manufacturing plant for R1000. Company A has claimed allowances on the asset amounting to R400. Company A runs into cash flow difficulties and Company B	S19 and para 12A require to be revisited insofar as they apply to allowance assets.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	allowances) with any excess being subject to recoupment.	waives the entire R1000 owing by Company A. Para 12A does not apply as the companies form part of the same s41 group of companies. As such, the base cost of the asset remains at R600. In terms of s19(6), a recoupment of R400 will arise and in terms of s19(7) no further allowances will be available. The problem with this scenario is that the base cost of the asset should be increased to R1000 because of the recoupment. In this scenario where the companies were not part of the same group, para 12A would apply to reduce the base cost of the asset to nil, no recoupment will arise under s19(6) and in	

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		terms of s19(7) no further allowances will be available. The problem with this scenario is that the allowances previously claimed should be recouped. If the facts as set out above were the same, save that only R500 of the debt was waived, the following would be the outcome. Para 12A does not apply as the companies form part of the same s41 group of companies. As such, the base cost of the asset remains at R600. In terms of s19(6), a recoupment of R400 will arise and in terms of s19(7) future allowances will be limited to R100. There is now a mismatch between s19(6) and s19(7) which will result in net	

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		allowances of only R100 whereas the aggregate allowances should be R500. Where the companies were not part of the same group, para 12A would apply to reduce the base cost of the asset to R100, a recoupment of R400 will arise under s19(6) and in terms of s19(7) future allowances will be limited to R100.	
S42/44	S42 and s44 only apply rollover relief to the extent that consideration for the assets is given in the form of shares or the assumption of qualifying debts.	Frequently, going concerns are disposed of wholly or partly for consideration in the form of the assumption of liabilities, including contingent liabilities. These contingent liabilities frequently take the form of leave pay, bonuses, warranties,	Debt should be extended to include contingent debt for purposes of the disposal of a going concern.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		post retirement medical, etc. As these contingent liabilities seemingly technically not debt as contemplated in those sections (supported by the used of the word incurred), the assumption of contingent liabilities would seemingly technically not constitute qualifying consideration.	
S46	In the TLAA, 2013 para (a)(i) of the definition of an unbundling transaction was amended to make it clear that all the shares held in an unbundled company have to be distributed. To this end, the words "but only to the extent to which those equity shares are so distributed" were deleted.	Unfortunately, this has the effect of creating some uncertainties with respect to unbundlings within a group of companies where a minority shareholder is present. Previously, it was clear that where shares in an unlisted unbundled company were distributed to a group company and a minority	The legislation should be clarified to make it clear that an unbundling of unlisted shares qualifies to the extent that the distribution is to a group company.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		shareholder in accordance with their effective interests, the distribution would qualify as an unbundling transaction to the extent that the distribution was to a group company, while the distribution to the minority would not qualify. With the removal of the words in question, the distribution of unlisted shares will only qualify if *that shareholder* to which the distribution is made forms part of the same group of companies. The implication is that such unbundlings can only be done within a wholly owned group of companies.	
S64FA(1)(a) read with	S64FA(1)(a), read with s64F(m), provides for an	Uncertainty potentially arises in circumstances where an	It is submitted that the purpose of the relief granted

Problem	Legal nature of problem	Detailed factual description	Proposed solution
s64F(1)(m)	exemption from dividends tax for a dividend *in-specie* if the dividend would have qualified for exemption had it not been a dividend *in-specie* and the beneficial owner is "*any person to the extent that the dividend was subject to the secondary tax on companies"* ("STC").	interest free loan was treated as a deemed dividend in terms of s64C(2)(g) for the purposes of STC, with the STC being duly paid. Furthermore, the interest free loans were not repaid before 1 April 2012, therefore not giving rise to an available STC credit. In subsequent years (under the dividends tax regime), the same loan is declared by the same company (who was subject to and paid the STC on a deemed dividend on the loan) as a dividend *in specie* to its shareholders. The Explanatory Memorandum explains the	in s64F(1)(m) envisages that the "deemed dividend paid" (after 1 April 2012), which was subject to the STC, would not also be subject to dividends tax, and that the wording in s64F(1)(m) should simply be expanded to specifically cater for such scenarios.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		purpose of s64F(1)(m) as follows: "Dividends … previously subject to the Secondary Tax on Companies will be relieved from the Dividends Tax". Clarity is sought to confirm that the relief in s64F(1)(m) would apply to such loans (to the extent they were subject to STC) if now distributed by means of a declaration of a dividend *in specie*. As the legislation stands, arguably the *in-specie* distribution of the loan would not qualify for exemption as, technically, it is a different dividend to the deemed dividend that arose for STC purposes (which is itself not a	

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		dividend for dividends tax purposes).	

Problem	Legal nature of problem	Detailed factual description	Proposed solution
Shares issued for foreign shares	There is inconsistency in the effective dates for the amendments made to paragraphs 11(2)(b) (1 April 2014) and 35(1A) (1 January 2014) in the TLAB, 2013.		The effective date for the amendment to paragraph 35 should be amended to 1 April 2014.
S24I(10)	All exchange items qualifying are deemed to be realised on the last day of the year of assessment ending prior to years of assessment commencing on or after 1 January 2014. Where the item is an FEC, the ruling exchange rate would therefore be the spot rate as opposed to the market related forward rate usually used to translate an open FEC at the end of a year		Where an FEC is deemed to be realised under s24I(10), the ruling exchange rate should be deemed to be the market-related forward rate as for any other translation of an FEC.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	of assessment. The result will be further differences between the tax and accounting treatment.		
S24I(11A)	It is noted that this provision has been deleted with effect from years of assessment commencing on or after 1 January 2014 (together with para 20(4) 8th Sch. from years of assessment commencing on or after 1 April 2014) on the basis that it is obsolete. As noted in our submissions on the draft TLAB, 2013, this provision is not obsolete and the deletion thereof is misplaced and will result in further differences between the accounting and tax treatment	The purpose of the provision was to align the accounting and tax treatment of foreign currency hedges of the acquisition price of equity shares. For example, where a company enters into an agreement to acquire the shares in another company for $1 million and takes out a FEC to hedge the purchase price between the date that the agreement is concluded and the date that the shares are acquired, any exchange gains or losses on the FEC between those dates is accounted for against the cost of the shares	The deletions of s24I(11A) and para 20(4) should be reversed.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	of exchange differences.	for IFRS purposes. The purpose of s24I(11A) is to align the tax treatment with the accounting treatment by disregarding the exchange gain or loss for tax purposes and increasing or decreasing the base cost of the shares by the same amount.	
S41-47	The corporate rollover provisions do not adequately address the situation where exchange items are transferred between parties. While these provisions provide relief for CGT purposes, the extent of the relief and implications for purposes of s24I are not clear.	Company A has a USD loan owing by a group company which qualifies for relief in terms of s24I(10A) until such time as it is realised. Company A disposes of the loan claim to Company B in terms of s45. There is seemingly no relief provided for any exchange gain or loss on realisation of the	The corporate rollover provisions should be extended to apply to the realisation of exchange items, including liabilities.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
		loan by Company A.	
S10B(4)	This provision continues to result in numerous unintended consequences for legitimate commercial transactions. The main reasons for this are that: • the provision applies regardless of any causal relationship between the deductible payment and the receipt of a foreign dividend; • the provision does not require any relationship between the person claiming the deduction and the person receiving the	Company B pays an amount of 100 to Foreign Company A (a CFC), a wholly owned subsidiary of Company A (a resident). Company B Company A are not related in any way. Company B obtains a deduction for the payment to Foreign Company A which is not taxed on the amount and which is not included in net income for CFC purposes. Foreign Company A pays a dividend to Company A of 1000, including out of the amount received from Company B. The dividend of 1000 received by Company A does not qualify for the participation exemption	The section requires narrowing and refinement to more closely target those objectionable arrangements and avoid the unintended application to legitimate commercial transactions.

Problem	Legal nature of problem	Detailed factual description	Proposed solution
	dividend; and • where any portion of the dividend arises directly or indirectly from the deductible payment the entire dividend is disqualified from exemption and not only that portion arising from the deductible payment.	by virtue of s10B(4).	