

**RESPONSE DOCUMENT – COMMENTS ON DRAFT TAXATION
LAWS AMENDMENT BILL and TAX ADMINISTRATION LAWS
AMENDMENT BILL, 2014**
Standing Committee on Finance

Presenters: National Treasury and SARS | 15 October 2014



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Public consultation & SCoF process (1)

- The Draft Rates and Monetary Amounts Bill, 2014 published in July 2014
- The Draft Taxation Laws Amendment Bill (TLAB), 2014 and Tax Administration Laws Amendment Bill (TALAB), 2014 were released for public comment on 17 July 2014.
- National Treasury and SARS briefed the Standing Committee on Finance (SCoF) on 30 July 2014
- The SCoF heard comment from the public at hearings that were held on 26 and 27 August 2014.
- SCoF hosted a closed workshop on 19 September 2014
- Report back by NT & SARS to the SCoF on 15 October 2014, draft Response Document.

Public consultation process (2)

- The deadline for public comments on TLAB & TALAB was 17 August 2014.
- National Treasury and SARS received written responses from 90 organisations and individuals.
- There were 12 organisations who presented their responses orally during the public hearings hosted by the SCoF.
- Workshops with stakeholders to discuss and review their comments were held on 1 September 2014 for business and international taxes, on 2 September 2014 for personal incomes taxes and value added tax and on 12 September 2014 for tax administration.
- More focused meetings / workshops were also held to discuss specific issues (e.g. the tax free savings accounts; valuation of defined benefit fund contributions; proposed amendments to the small business corporation tax regime; valuation of fringe benefits in the case of company cars, and the zero rating of certain agricultural intermediate inputs / products).

Status of the Draft Response Statement

- Covers comments made to TLAB, TALAB and the Rates Bills, all published in July 2014.
 - Note no comments made on the rates bill, so no need to deal with any new points in this response document
- The document summarises or states the key points made in the hearings, submissions and workshops (put under “Comment”)
- Response of the Dept of National Treasury and SARS is put forward, taking into account the key points made
 - Response is not the final response, as put forward as a recommendation to the SCOF
 - Min will approve final response after taking into account any further recommendations of SCOF arising today
- Final response of the Minister will be incorporated into the revised Bill to be tabled in Parliament, expected to be next week

Contents of draft Response Document: TLAB & TALAB, 2014 (1)

1. Personal income taxes and saving

- a. Contributions towards retirement savings (pages 5 to 8)
- b. Tax free savings accounts , (pages 8 & 9)
- c. Valuation of company car fringe benefits (pages 10 & 11)

2. General business taxes

- a. Limitation of interest deductions (23M & 23N) (pages 13 to 17)

3. Taxation of financial institutions and products

- a. The risk business of long-term insurers (pages 17 & 18)
- b. Foreign reinsurance (pages 18 & 19)

4. Tax incentives

- a. Research and development (pages 20 to 21)
- b. Biodiversity – Environmental conservation - nature reserves and national parks (page 25)
- c. Employment tax incentive (page 25)
- d. PBOs --- funding entities (page 26)
- e. Small Business Corporation (SBC) regime (page 27)
- f. Small Business Funding Entities (page 27)
- g. Venture Capital Company incentive (pages 27 & 28)

Contents of draft Response Document: TLAB & TALAB, 2014 (2)

5. International taxation
 - a. Transfer pricing - secondary adjustment (pages 28 & 29)
6. Value added tax
 - a. VAT zero-rating of agricultural inputs (pages 30 & 31)
7. Tax Administration Laws Amendment Bill
 - a. ITA - Determination of basic amount for provisional tax (page 35)
 - b. Customs & Excise Act – Amend provision for tariff determinations for alcoholic beverages (page 36)
 - c. VAT Act - Relaxation of interest suspension (page 36)
 - d. TAA – Definitions of ‘international tax agreement’, ‘relevant material’ and ‘return’ (pages 37 to 39)
 - e. TAA - Disclosure obligations for reportable arrangements (page 40)
 - f. TAA - Tax compliance status (pages 43 to 45)

Valuation of fringe benefit for defined benefit contributions (1)

- The methodology to value the fringe benefit has been simplified to ease the administrative burden on payrolls and pension funds, but this comes at the expense of less accuracy in the calculation.
- Some commentators felt that the simplification was not appropriate and that the actuaries should be allowed more discretion in determining the fringe benefit. However, other commentators felt that less discretion should be provided to actuaries, to decrease the time it will take to complete the calculation and avoid any conflicts of interest.
- Given the varying views on this issue it is not intended to change the level of discretion available that was indicated in the draft TLAB.

Valuation of fringe benefit for defined benefit contributions (2)

- There were a number of more technical amendments that were requested, either to streamline the proposal or to provide further clarity. The majority of these requests have been accepted.
- The final draft of the legislation explicitly separates out members who only have a defined contribution component in their retirement fund (even if the fund offers a defined benefit plan to other members); additional voluntary contributions are explicitly excluded from the calculation of the fringe benefit value; and the information as contained in the contribution certificate pension fund actuaries are required to complete has been reduced.

POSTPONEMENT OF TAX HARMONISATION AND CAP ON RETIREMENT FUNDS

- This is a new issue that arose following consultations with NEDLAC (so not in original July bill)
- Labour and community constituencies have requested the need for more clarity on social security reform, in order to identify the road map
- Concern also about false retirement rumours on nationalisation and preservation, and pre-mature resignations to cash in retirement funds
- Though the above laws bring more equity and extend the tax benefit, and do not change preservation, Government proposes to delay implementation for two more years, from 1 March 2015 to 1 March 2017

Implications of delay in Retirement Laws

- 2014 Update on Retirement Reform noted need for new proposals to be discussed at NEDLAC, as we do want to incentivise members to preserve their retirement savings
- Some delay in default regulations and on Retail Distribution review, but we will continue to publish these and other draft regulations for consultation, including via NEDLAC
- Implication of delay is restricted to the law passed in 2013 and hence means
 - the higher 27.5% cap and limit of R350 000 will be delayed until 2017
 - Contributions to provident funds will continue not to benefit from the tax deduction enjoyed for contributions to pension funds till 2017
 - Annuitisation will not apply to provident funds for any contributions before 1 March 2017, and will still be cashed out in one lump sum forever. Only new contributions after 2017 above R150 000 and enjoying the tax deduction will annuitise thereafter for those below 55 years

Tax free savings accounts (1)

- A number of comments indicated that they thought the annual (R30 000) and lifetime (R500 000) limits for the tax free savings accounts were too low and that the penalty for excessive contributions (40 per cent) was too high.
- It is proposed that the annual and lifetime limits and the levels of the penalty remain at the same level as was published in the draft TLAB.
- A higher annual contribution limit for taxpayers 65 years and older could be considered in future, once the legislation and administration have been bedded down.
- A simple penalty was chosen to avoid additional administrative burdens, and it needs to be high to avoid individuals trying to game the system by contributing more than the limits.

Tax free savings accounts (2)

- The comments also stated that the legislation to enact the tax free savings accounts did not line up with the policy intent and that there was too much room for interpretation.
- The main concern was that the legislation included all financial products and was too restrictive on the requirements of service providers to offer different products.
- These comments have been accepted and the draft legislation and accompanying regulations was reworded to provide a more definitive separation between qualifying and non-qualifying service providers and qualifying and non-qualifying products.
- These regulations will be published in terms of the Income Tax Act but will be administered / enforced by the FSB, as it deals with savings and investment product descriptions.

Fringe benefits of company cars (1)

- The 2014 Budget announced that all company cars purchased or acquired on or after 1 March 2015 would have a fringe benefit value that is equal to the retail market value of the vehicle to ensure equity amongst individuals at different employers.
- Some comments welcomed the amendment to align the tax treatment of company cars. However organisations who currently enjoy a lower fringe benefit value (such as vehicle manufacturers and rental agencies) have opposed the amendment.
- Their view is that retail market value is a subjective measure which will be difficult to obtain and that the benefits to their employees is lower since they do not have a choice over whether to use a company car or not and the type of car they can use. They are of the view that using retail market value went against the principle of using cost to calculate fringe benefits. However, the tax policy approach is to achieve equal treatment amongst employees in different industries and to determine the fringe benefit value from the perspective of the employee.

Fringe benefits of company cars (2)

- Individuals should be taxed on the benefits they receive, irrespective of the form of that benefit. It is recommended that the list price, in the case of new vehicles, and the used car price list that is used in the insurance industry, for second hand cars, is the basis for retail market value.
- The legislation will allow the Minister of Finance to issue regulations to prescribe how the retail value of motor vehicles should be determined. Under consideration is the use of the list prices for new vehicles as reference prices. Some form of discounts could be considered for employees of motor manufactures, motor dealers and motor vehicle rental companies. Such additional discounts could be considered based on arguments by the motor industry that their employees use the specific vehicles of the employers as a marketing tool.
- The motor industry (coordinated by NAAMSA) is opposed to this amendment. Further consultations will be held to try and accommodate some of their concerns in the proposed regulations.

Excessive interest limitation rules (1)

- Sections 23M and 23N were introduced in the 2013 Taxation Laws Amendment Act as measures to limit the amount of interest that a company can deduct to a more reasonable level (since debt finance can be used to create opportunities for base erosion).
- These measures are in line with international practice and the South African interest limitation rules measure up well in light of current discussions on best practice at the OECD.
- Section 23N replaces the temporary section 23K (2011) measure that required companies to obtain SARS approval for interest deductions in respect of reorganisation and acquisition transactions.
- The new section has an objective set of rules that disallow the deduction of interest exceeding a percentage of the tax equivalent of EBITDA according to a formula that adjusts with changes to the repo rate. Section 23M follows the same approach to determine the deferral of interest deductions and applies in respect of debt between persons in a controlling relationship, where the interest income is not taxable in the hands of the creditor.

Excessive interest limitation rules (2)

- Comments with respect to the formula were mainly positive, with some requesting that there should be a minimum percentage provided and no upper cap. The other main comments received were in relation to guarantees and the definition of controlling relationship.
- The controlling relationship definition will be amended to a concept of control through a requirement of 50 per cent of equity shares or voting rights.
- Guarantees are often provided by a parent company for debt financing and it is agreed that these types of transactions should not be caught by the rules.
- Addressing both these comments took care of most of the concerns raised and in particular those raised by institutional investors (including retirement funds and long-term insurers) that often provide capital for infrastructure projects.

Excessive interest limitation rules (3)

- Taxpayers also stated that the interaction between section 23M, section 23N and section 31 (transfer pricing) is not clear. This is partly accepted – the purpose of transfer pricing rules is to ensure that if cross-border transactions, such as debt financing, are entered into by connected persons, they must be treated (for tax purposes) as if the interest rate charged between the parties is equivalent to that between two independent parties, i.e. the arm's length principle. In essence, section 31 seeks to correct mispricing of the interest rate.
- The excessive interest limitation has a broader objective. By limiting the amount of interest deductible, it discourages companies from excessive leveraging / thin capitalisation, which is often done because the tax system inherently encourages debt over equity financing.
- Transfer pricing always applies first by determining the correct pricing, where after section 23N applies and then section 23M. The legislation was amended to ensure that interest expenses disallowed under section 23N are not covered by 23M as well.

Research and development incentive

- The changes to the research and development tax incentive are predominantly technical in nature to ensure certainty and clarity for taxpayers.
- Regulations were issued with the draft TLAB that specifically cover the pharmaceutical industry (clinical trials and generic medicines) and some technical comments were received hereon.
- National Treasury continues to work with DST to try and ensure that the administration of this incentive runs smoothly.
- The main outstanding issue is defining the term 'innovative', which has proved a challenge due to the variety of industries that submit R&D projects to the adjudication committee for approval. A broad definition, along with nuances for industry specific requirements, is being developed for the DST guidelines as a first step.

Small business corporations tax regime (1)

- The Davis Tax Committee (DTC) completed a report on SMME taxation during January 2014. The DTC concluded that the (lower) graduated tax rates for small business corporations (SBC) are not effective, do little to support the objective of small business growth and do not address tax compliance costs.
- It was proposed that the graduated SBC regime be replaced with an annual refundable tax compliance rebate (RCR). Small business corporations would be taxed at 28 per cent and not according to the graduated scale. Any enterprise (with a turnover between R1 million and R20 million) that is compliant in terms of its tax returns and liabilities would be entitled to receive a tax rebate of R15 000.
- The rebate would be refundable, meaning that enterprises in a tax loss position would also receive it.

Small business corporations tax regime (2)

- The proposal was included in the draft TLAB and the comments received were mixed in their support for the amendment.
- Some comments suggested that the proposed change would impact negatively on the cash flow of profitable small businesses and result in a significantly higher tax burden for most SBCs, while others felt that the tax rebate was not sufficiently high enough to cover the actual compliance costs for SBCs.
- The proposals have thus been removed from the TLAB to provide more time for consultation with the Davis Tax Committee and other stakeholders.

Zero rating of goods for agriculture, pastoral or other farming purposes (1)

- The current VAT legislation zero rate some supplies of goods used or consumed for agricultural, pastoral or other farming purposes.
- This concession was intended to provide cash-flow relief to the agricultural sector when VAT was introduced, but creates a systemic weakness and has been open to abuse.
- The amendment sought to repeal the provision, however the industry is of the view it will have negative cash flow implications, increase costs of financing and is likely to have negative impacts on food prices and food security.

Zero rating of goods for agriculture, pastoral or other farming purposes (2)

- It is recommended that the implementation date be delayed for at least 12 months to allow SARS and the National Treasury together with the Department of Agriculture to do further analysis on the impact and to undertake additional consultations.
- The TLAB will include a provision that will allow the Minister of Finance the discretion to determine the implementation date by way of a notice however such implementation date can only take place 12 months after the promulgation of the TLAB 2014.

Relevant material and information gathering by SARS

- SARS's information gathering powers were extended in TAA to prevent protracted disputes around entitlement to information & consequent waste of resources
- Concepts such as “relevant material” and “reasonable specificity” introduced to give guidance on requests for information
- Information gathering powers in line with international practice
- Taxpayer information is secret and may only be disclosed in narrow circumstances
- Promotion of Administrative Justice Act, 2000, not in issue, since request for information has no external, final & adverse effect according to Supreme Court of Appeal
- Remedies for an auditor's overbroad requests are engagement with SARS management, approach to Tax Ombud, etc.