# RATES AND MONETARY AMOUNTS BILL, TAXATION LAWS AMENDMENT BILL (TLAB) & TAX ADMINISTRATION LAWS AMENDMENT BILL (TALAB)

*NCOP – Select Committee on Finance*

Presenters: National Treasury and SARS | 19 November 2014

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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<u>Additional slides</u>

1. Fuel taxes - done by amending the Schedules to the Customs & Excise Act.

# Tax revenue as a % of National Budget Revenue

Tax revenue by instrument as a % of National Budget Revenue

| | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|---|---|---|---|---|---|---|---|
| Individuals | 30.1% | 32.0% | 35.4% | 33.9% | 33.8% | 34.5% | 34.9% |
| VAT | 26.9% | 25.3% | 25.5% | 27.4% | 25.8% | 27.0% | 26.8% |
| Companies | 25.0% | 27.2% | 23.3% | 19.8% | 20.5% | 20.0% | 20.0% |
| Fuel levy | 4.2% | 4.1% | 5.0% | 5.1% | 4.9% | 5.0% | 4.9% |
| Specific excise | 3.3% | 3.3% | 3.7% | 3.4% | 3.4% | 3.6% | 3.3% |
| Customs duties | 4.7% | 3.7% | 3.4% | 4.0% | 4.6% | 4.8% | 5.0% |
| STC / Dividends | 3.7% | 3.3% | 2.7% | 2.6% | 3.0% | 2.5% | 2.0% |
| **Sub Total** | **97.9%** | **98.9%** | **98.9%** | **96.3%** | **96.1%** | **97.4%** | **96.9%** |
| **Three (PIT, VAT, CIT)** | **82.0%** | **84.6%** | **84.2%** | **81.1%** | **80.1%** | **81.5%** | **81.7%** |



# The Rates and Monetary Amounts Bill

# Taxable income brackets were increased

**Table 4.1 Personal income tax rate and bracket adjustments, 2013/14 – 2014/15**

| 2013/14 Taxable income (R) | 2013/14 Rates of tax | 2014/15 Taxable income (R) | 2014/15 Rates of tax |
|---|---|---|---|
| R0 - R165 600 | 18% of each R1 | R0 - R174 550 | 18% of each R1 |
| R165 601 - R258 750 | R29 808 + 25% of the amount above R165 600 | R174 551 - R272 700 | R31 419 + 25% of the amount above R174 550 |
| R258 751 - R358 110 | R53 096 + 30% of the amount above R258 750 | R272 701 - R377 450 | R55 957 + 30% of the amount above R272 700 |
| R358 111 - R500 940 | R82 904 + 35% of the amount above R358 110 | R377 451 - R528 000 | R87 382 + 35% of the amount above R377 450 |
| R500 941 - R638 600 | R132 894 + 38% of the amount above R500 940 | R528 001 - R673 100 | R140 074 + 38% of the amount above R528 000 |
| R638 601 | R185 205 + 40% of the amount above R638 600 | R673 101 | R195 212 + 40% of the amount above R673 100 |
| **Rebates** | | **Rebates** | |
| Primary | R12 080 | Primary | R12 726 |
| Secondary | R6 750 | Secondary | R7 110 |
| Tertiary | R2 250 | Tertiary | R2 367 |
| **Tax threshold** | | **Tax threshold** | |
| Below age 65 | R67 111 | Below age 65 | R70 700 |
| Age 65 and over | R104 611 | Age 65 and over | R110 200 |
| Age 75 and over | R117 111 | Age 75 and over | R123 350 |



# The adjustment provided tax relief of R9.25 billion

- The adjustment increases the tax free threshold from R67 111 to R70 700
- Around 40% of the total relief will go to those with taxable incomes that are less than R250 000

**Table 4.2 Estimates of individual taxpayers and taxable income, 2014/15**

| | Registered individuals | | Taxable income | | Income tax payable before relief | | Personal income tax relief | | Income tax payable after relief | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Taxable bracket** | **Number** | **%** | **R million** | **%** | **R million** | **%** | **R million** | **%** | **R million** | **%** |
| 0 - R70 000[1] | 8 835 791 | | 194 445 | 11.5 | 25 | – | 25 | | – | – |
| R70 001 - R150 000 | 2 758 078 | 43.0 | 288 161 | 17.0 | 18 092 | 5.2 | 1 740 | 18.9 | 16 351 | 4.9 |
| R150 001 - R250 000 | 1 644 142 | 25.6 | 321 624 | 19.0 | 41 491 | 12.0 | 1 843 | 20.0 | 39 648 | 11.8 |
| R250 001 - R350 000 | 852 656 | 13.3 | 250 125 | 14.8 | 43 789 | 12.7 | 1 557 | 16.9 | 42 232 | 12.6 |
| R350 001 - R500 000 | 531 173 | 8.3 | 220 166 | 13.0 | 48 072 | 13.9 | 1 475 | 16.0 | 46 597 | 13.9 |
| R500 001 - R750 000 | 346 123 | 5.4 | 208 636 | 12.3 | 55 303 | 16.0 | 1 335 | 14.5 | 53 969 | 16.1 |
| R750 001 - R1 000 000 | 132 917 | 2.1 | 114 037 | 6.7 | 34 663 | 10.0 | 591 | 6.4 | 34 072 | 10.1 |
| R1 000 001 + | 154 111 | 2.4 | 291 160 | 17.2 | 103 760 | 30.1 | 685 | 7.4 | 103 075 | 30.7 |
| **Total** | **6 419 200** | **100.0** | **1 693 908** | **100.0** | **345 169** | **100.0** | **9 225** | **100.0** | **335 944** | **100.0** |
| **Grand total** | **15 254 991** | | **1 888 353** | | **345 194** | | **9 250** | | **335 944** | |

*1. Registered individuals with taxable income below the income tax threshold*

## PIT reforms since between 1998

- Between 1998/99 and 2002/03 the marginal rates decreased by between 1 and 9 percentage points :
  - 1 (bottom) by 1 percentage points from 19% to 18%
  - 2 by 5 percentage points from 30% to 25%
  - 3 by 9 percentage points from 39% to 30%
  - 4 by 8 percentage points from 43% to 35%
  - 5 by 6 percentage points from 44% to 38%, and
  - 6 (top) by 5 percentage points from 45% to 40%

- Between 2002/03 and 2014/15 the bottom threshold was increased by 13.1 per cent per annum and that of the top income bracket by 9.0 per cent per annum.
- The marginal tax rates have remained unchanged during this period.
- The tax free threshold for taxpayers below 65 years was increase by 8.4 per cent per annum since 2002/03 and for those 65 years and above by 8.2 per cent per annum.



## The retirement lump sum tables were also adjusted upwards

- There are two different retirement benefit lump sum tax tables:
  - One taxes the amounts you receive as a lump sum at retirement or as part of their severance package
  - The other taxes amounts you withdraw from your pension before retirement (usually when an individual resigns from employment) - This is more punitive to discourage withdrawals before retirement
- The pre-retirement lump sum table has not been adjusted since 2007 and the retirement lump sum table was adjusted only once, in 2011

- The brackets in the tables have thus been increased by around 10%, but there has been a larger increase in the first bracket of retirement lump sum table from R315 000 to R500 000

- The larger increase was to avoid situations where individuals (especially in provident funds) who did not receive a deduction on their contributions over their working lives would be forced to now pay tax on their retirement benefits

# The amended values of the retirement lump sum tables

**Table 4.3 Pre-retirement lump-sum taxation, 2013/14 – 2014/15**

| 2013/14 | | 2014/15 | |
|---|---|---|---|
| Taxable income (R) | Rates of tax | Taxable income (R) | Rates of tax |
| R0 - R22 500 | 0% of taxable income | R0 - R25 000 | 0% of taxable income |
| R22 501 - R600 000 | 18% of taxable income above R22 500 | R25 001 - R660 000 | 18% of taxable income above R25 000 |
| R600 001 - R900 000 | R103 950 + 27% of taxable income above R600 000 | R660 001 - R990 000 | R114 300 + 27% of taxable income above R660 000 |
| R900 001 + | R184 950 + 36% of taxable income above R900 000 | R990 001 + | R203 400 + 36% of taxable income above R990 000 |

**Table 4.4 Retirement lump-sum taxation, 2013/14 – 2014/15**

| 2013/14 | | 2014/15 | |
|---|---|---|---|
| Taxable income (R) | Rates of tax | Taxable income (R) | Rates of tax |
| R0 - R315 000 | 0% of taxable income | R0 - R500 000 | 0% of taxable income |
| R315 001 - R630 000 | 18% of taxable income above R315 000 | R500 001 - R700 000 | 18% of taxable income above R500 000 |
| R630 001 - R945 000 | R56 700 + 27% of taxable income above R630 000 | R700 001 - R1 050 000 | R36 000 + 27% of taxable income above R700 000 |
| R945 001 + | R141 750 + 36% of taxable income above R945 000 | R1 050 001 + | R130 500 + 36% of taxable income above R1 050 000 |



# Inflationary adjustments were made to medical tax credits, car allowances and the taxable income threshold for small businesses

- Medical tax credits were increased by 6.2%
  - From R242 per month for the first two beneficiaries to R257 per month
  - And from R162 to R172 per month for each additional beneficiary
- The maximum value of the cost of a vehicle that an employer can use and claim a travel allowance increases from R480 000 to R560 000
  - The value was last adjusted in 2011 and has been increased for inflation
- The taxable income threshold for small business increases from R67 111 to R70 700
  - The new rate will be in line with the new income tax table for individuals to avoid any potential tax arbitrage

## Excise duties on alcohol

- The value of excise duties on alcohol is based on a targeted tax burden, which is expressed as a percentage of the weighted average retail selling price
- The 2012 Budget Review increased the targeted tax burden for beers and spirits to 35 and 48 per cent respectively (from 33 and 45)
- Excise tax rates have been increasing at above inflation levels since 2012 to achieve this target
- The largest increase in excise duties for regular alcoholic beverages was for sparkling wine and spirits, which each experienced a 10 per cent and 12 per cent increase in their excise duties, respectively
- There were no increases in excise duties for Traditional African beer and close to inflationary increases for unfortified and fortified wine, malt beer and ciders and alcoholic fruit beverages



## Tobacco excise duties increased

- The targeted total consumption tax burden is 52 per cent of the retail selling price of the most popular brand within each tobacco product category
- Adjustments to the tobacco excise duties are around the levels of inflation since the tax burden is relatively close to its target
- The largest increase is 9 per cent for cigars, while cigarettes and cigarette tobacco increased by 6.2% per cent and 7.2 per cent respectively
- There was a smaller than inflation increase of 2.5 per cent for pipe tobacco since the amendment from the previous year pushed the tax burden above the targeted level

# The amended excise duties for alcohol and tobacco

**Table 4.5 Changes in specific excise duties, 2014/15**

| Product | Current excise duty rate | Proposed excise duty rate | Percentage change | |
|---|---|---|---|---|
| | | | Nominal | Real |
| Malt beer | R63.81 / litre of absolute alcohol (108.48c / average 340ml can) | R68.92 / litre of absolute alcohol (117c / average 340ml can) | 8.0% | 1.8% |
| Traditional African beer | 7.82c / litre | 7.82c / litre | 0.0% | -6.2% |
| Traditional African beer powder | 34.70c / kg | 34.70c / kg | 0.0% | -6.2% |
| Unfortified wine | R2.70 / litre | R2.87 / litre | 6.2% | -0.0% |
| Fortified wine | R4.85 / litre | R5.21 / litre | 7.5% | 1.2% |
| Sparkling wine | R8.28 / litre | R9.11 / litre | 10.0% | 3.8% |
| Ciders and alcoholic fruit beverages | R3.19 / litre (108.48c / average 340ml can) | R3.45 / litre (117c / average 340ml can) | 8.1% | 1.9% |
| Spirits | R122.80 / litre of absolute alcohol (R39.60 / 750ml bottle) | R137.54 / litre of absolute alcohol (R44.36 / 750ml bottle) | 12.0% | 5.8% |
| Cigarettes | R10.92 / 20 cigarettes | R11.60 / 20 cigarettes | 6.2% | -0.0% |
| Cigarette tobacco | R12.16 / 50g | R13.03 / 50g | 7.2% | 0.9% |
| Pipe tobacco | R3.54 / 25g | R3.63 / 25g | 2.5% | -3.7% |
| Cigars | R56.76 / 23g | R61.87 / 23g | 9.0% | 2.8% |



# Taxation Laws Amendment Bill (TLAB) & Tax Administration Laws Amendment Bill (TALAB)

## 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.
- Tabling of all tax bills in Parliament on 22 October 2014
- Adoption of Bills by the SCoF 05 November 2014
- Debate in the House of Assembly 12 November 2014
- Briefing to the Select Committee on Finance 19 November 2014



## 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).

# Key tax legislative amendments TLAB & TALAB, 2014 (1)

1. Personal income taxes and saving
   a. Contributions towards retirement savings
   b. Tax free savings accounts
   c. Valuation of company car fringe benefits
2. General business taxes
   a. Limitation of interest deductions (23M & 23N)
3. Taxation of financial institutions and products
   a. The risk business of long-term insurers
   b. Foreign reinsurance
4. Tax incentives
   a. Research and development
   b. Biodiversity – Environmental conservation - nature reserves and national parks
   c. Employment tax incentive
   d. PBOs --- funding entities
   e. Small Business Funding Entities
   f. Venture Capital Company incentive



# Key tax legislative amendments TLAB & TALAB, 2014 (2)

5. International taxation
   a. Transfer pricing - secondary adjustment
6. Value added tax
   a. VAT zero-rating of agricultural inputs
   b. Withdrawal of the ability to claim a notional input VAT in the case of "second hand" gold
7. Tax Administration Laws Amendment Bill
   a. Relevant material and information gathering by SARS
   b. Amendments to provisional tax system
   c. Compulsory tariff determinations for alcoholic beverages
   d. Exchange of information for Customs and Excise duty purposes
   e. Preventing the unlawful use of SARS intellectual property
   f. Automatic exchange of information
   g. Disclosure obligations for reportable arrangements
   h. Tax clearance – modernisation

## Contributions to Retirement Savings
## The rationale for the tax changes in 2013

- SARS & the National Treasury publishes information on the deductions allowed for employee contributions to pension funds and retirement annuity funds – for 2012 the available information is as follow:

| Employee contributions | Number of people | Amount deducted (Rm) |
|---|---|---|
| Pension funds | 2,101,978 | 27,880 |
| Retirement annuities | 1,377,746 | 13,679 |

  - But there is no information on employer contributions or EE contributions to provident funds (which don't receive a deduction)
- There are currently three different tax treatments for allowable deductions for pension funds, provident funds and retirement annuities
  - Excessively complicated: creates confusion on how to save for retirement most effectively from a tax perspective
  - Inequitable: Individuals may get a varying allowable deduction that is dependent on which type of retirement fund they belong to and taxpayers with the highest levels of income receive the greatest benefit through a deduction

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## The current tax regime for contributions to retirement savings is complicated

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

## Amendments to tax treatment of contributions / deductions to Retirement Savings in 2013

- National Treasury published a discussion document in October 2012 entitled **'Improving tax incentives for retirement savings'** to detail the proposed tax amendments

- The 2013 TLAA legislated these proposals and sought to harmonise the tax treatment of contributions across different retirement funds to ensure equity and to simplify the calculation of the allowable deduction
  - Employer contributions to retirement funds would be treated as a fringe benefit in the hands of the employee
  - Total contributions (including employer and employee contributions) to all retirement funds would be given the same level of allowable deduction of 27.5% of taxable income or remuneration
  - Limit the benefit to higher earners by placing a cap of R350 000

- The allowable deduction would be higher for all taxpayers who are below the cap, increasing the tax incentives available for retirement savings



## Simplification and harmonisation of tax treatment of retirement contributions in 2013

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

## Amendments to annuitisation requirements in 2013

- National Treasury also published a discussion document in September 2012 entitled **Preservation, portability and governance for retirement funds'** which covered the annuitisation requirements of all retirement funds

- Employee contributions to provident fund members would now receive a deduction which was not previously available
  - In return for the allowable deductions and to ensure harmonisation across all different retirement funds, the annuitisation requirements for pension funds and retirement annuities would apply to provident funds

- However, full vested rights were put in place:
  - Anyone over the age of 55 (who stays in the same provident fund) will not be affected in any way from the annuitisation requirement
  - Anyone below the age of 55 can still take out the full value that was in their pension as at 1 March 2015 (and the investment growth on that) at retirement
  - Only 2/3rds of new contributions from 1 March 2015 will be required to be annuitised
  - But if new contributions are below R150 000 (de-minimis) then don't need to annuitise



## 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 fund deductions

- This is a new issue that arose following consultations with NEDLAC (so not in original July 2014 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 one year, from 1 March 2015 to 1 March 2016

## Implications of delay

- 2014 Update on Retirement Reform noted need for new proposals to be discussed at NEDLAC, as we do want to encourage members to preserve their retirement savings

- 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 March 2016
  - Contributions to provident funds will continue not to benefit from the tax deduction enjoyed for contributions to pension funds until March 2016
  - Annuitisation will not apply to provident funds for any contributions & growth in the fund before 1 March 2016, and will still be cashed out in one lump sum forever. Only new contributions after March 2016 above R150 000 and enjoying the tax deduction will annuitise thereafter for those below 55 years



## Tax free savings accounts (1)

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

FT6 revenue gains,
Franz Tomasek, 2014/11/18

## Tax free savings accounts (2)

- To ensure these limits are adhered to a penalty 40 per cent of contributions above these limits is proposed.

- 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.

- Regulations provide for a more definitive separation between qualifying and non-qualifying service providers and qualifying and non-qualifying products.

- Draft Regulations was published for public comment on 14 November 2014 and will be administered / enforced by the FSB, as it deals with savings and investment product descriptions.

## Fringe benefits of company cars (1)

- 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 commentators were of the 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. The list prices for new vehicles will be used as reference prices.

## 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)

- The 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.

## Tax treatment of the risk business of long term insurers (1)

### Background

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



## Tax treatment of the risk business of long term insurers (2)

### Reasons for change

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

## Tax treatment of the risk business of long term insurers (2)

- Business in respect of risk policies will be taxed in a fifth fund, namely the risk policy fund. The taxable income of the risk policy fund will be taxed at a rate of 28%.

*Risk policy*

- A risk policy is defined as a policy issued by an insurer during the insurer's year of assessment commencing on or after 1 January 2016 under which the benefits payable cannot exceed the amount of premiums receivable, except where the policy benefits are solely payable due to death, disablement, illness or unemployment and excludes a contract of insurance in terms of which annuities are being paid.
- Assets to cover liabilities of risk policies are to be allocated to the risk policy fund. The liabilities of a risk policy fund shall be:
  - an amount equal to the liabilities of the insurer in respect of risk policies determined in accordance with adjusted IFRS; and
  - any expenses allocated to the risk policy fund that has not been paid at the end of the year of assessment.
- Adjusted IFRS is defined to mean valuation of liabilities as per IFRS but without taking into account negative liabilities on a policy per policy basis. A negative liability shall be accounted for at nil.



## Long term insurers: Foreign reinsurance (1)

**Background**

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

**Reasons for change**

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

## Long term insurers: Foreign reinsurance (2)

**Amendment**

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



## 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.

# Venture Capital Company regime

- The Venture Capital Company (VCC) regime was introduced to encourage equity investment in small enterprises. Investments in qualifying small businesses through an approved VCC can be deducted from the investor's taxable income.

- The VCC regime has seen limited take off since its introduction in 2008, and it is believed that it needs to be made more attractive

- The following amendments are included in TLAB 2014:
  - Making the normal tax deductions permanent if the investments are held for a period exceeding 5 years
  - Increasing the asset limits for qualifying investee companies
    - From R 30 to 50 million for qualifying companies
    - From R 300 to R 500 million for junior miners



# Venture Capital Company Regime (2)

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

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

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

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

## Supporting Small Businesses - Grant funding

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

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

- Allowing tax relief for entities which provide grant funding for small business development. A new section 30C (along the lines of sections 30A and 30B) is proposed to define the terms and requirements for such entities.
- Making grants in the hands of small businesses tax exempt. For this purpose an additional exemption in section 10(1) is proposed.



## Reducing the distribution requirement for Funding PBO's

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

## Allowance for land conservation in respect of nature reserves or national parks

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



## Refinements to the employment tax incentive (1)

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

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

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

## Refinements to the employment tax incentive (2)

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

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

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



## Transfer pricing secondary adjustment (1)

**Background**

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

**Reasons for change**

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

## Transfer pricing secondary adjustment (2)

**Amendment**

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



## 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)

- The implementation date has been 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 include a provision that allows 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.



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

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

## TALAB
## 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
- A clarification of the application of the concept of relevant material is now proposed, so that SARS has access to all the information it requires as part of a tax audit or review
- Information gathering powers in line with international practice



## Proposed amendments to provisional tax system

- **Paragraph 18**: Align exemptions from payment of provisional tax for people older and younger than 65 & increase threshold to R30 000 for taxable income derived from interest, rent etc. proposed for all persons
- **Paragraph 19**: Ensure that certain amounts included under "gross income" are excluded from "basic amount" due to the irregular and once-off nature of these amounts
- **Paragraph 20**: Resolve problem that rebates are not taken into account when underestimate penalty is calculated & clarify that if no estimate is submitted this is equivalent to a nil estimate
- **Paragraph 20A**: Repeal of penalty for not submitting a provisional tax estimate in time as a late underestimation of provisional tax, with consequent late payments, may result in penalties under paragraphs 20 (underestimation), 20A (late estimate) and 27 (late payment)

## Compulsory tariff determinations – alcoholic beverages

- It is proposed that liquor manufacturers be compelled to apply to SARS for tariff determinations on their alcoholic beverages to obtain certainty on the appropriate tariff classification and excise duty rate applicable to their products
- Compulsory tariff determinations will ensure that all alcoholic beverages are accurately and consistently classified, the correct taxes are collected and that the beverages comply with the requirements of the Liquor Products Act, 1989
- A phased approach to the introduction of compulsory tariff determinations will be followed, beginning with the highest risk products
- Beverages that change their production processes, recipes, alcoholic strength or brand name will require a new tariff determination
- Existing tariff determinations for existing beverages will continue to apply until their ultimate re-determination or confirmation
- Determinations will only change if product was altered (in which case existing determination is no longer relevant) or existing determination is incorrect



## Exchange of information for customs and excise purposes

- It is proposed that the exchange of information provisions of section 50 specifically deal with the automatic exchange of information and the uses to which such information may be put
- Section 101B provides for the protection of advance passenger information and the proposed amendments extend the protection to the exchange and automatic exchange of personal information in terms of international agreements and thus also protect trader information
- The proposed amendments include amendments that the Commissioner may now obtain and use personal information for the administration of the Customs and Excise Act and international customs cooperation agreements
- The Commissioner must be satisfied that the recipient of information is subject to a law with similar protection of information principles
- The proposed amendments empower the Commissioner to specify conditions under which information will be exchanged

## Preventing the unlawful use of SARS intellectual property Automatic exchange of information

Preventing unlawful use of SARS's intellectual property

- Fraudulent or misleading use of SARS's names and logos has become prevalent and is aggravated by their improper and unauthorised use in domain names, the internet and social media
- Amendments are proposed to:
  - broaden SARS's protection against unlawful use of its intellectual property
  - protect the public from fraudulent schemes and misrepresentations of SARS's names and logos on the internet, in media as false advertising and on goods

Automatic exchange of information

- The new international standard for the exchange of information for tax purposes is automatic exchange of information
- Amendments are proposed to improve the framework for automatic exchange of information and related due diligence obligations on third parties



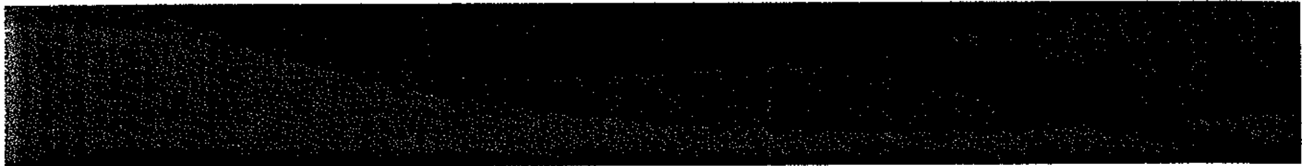
## Reportable arrangements Tax clearance modernisation

Reportable arrangements

- Proposal to include tax evasion under the term "tax benefit" to provide greater certainty as to what is meant by a "tax benefit" for purposes of the reportable arrangement scheme
- Other proposed amendments seek to clarify:
  - Reporting obligations of the promoter of an arrangement and all of the participants
  - When the reporting obligations arise

Tax clearance modernisation

- Current legislation is largely built around the model of a tax clearance certificate
- Proposed amendments cater for a full transition to a real time confirmation of a taxpayer's tax compliance status



Additional slides



## Fuel taxes

- The increase in the general fuel levy was in line with inflation. The proposed increase of 12c/litre is less than the increase applied in 2013/14.
- The increase for the Road Accident Fund levy of 8c/litre was equal to the adjustment in 2013/14.
- The effective date for both levies was 2 April 2014.

# Fuel taxes - regulations

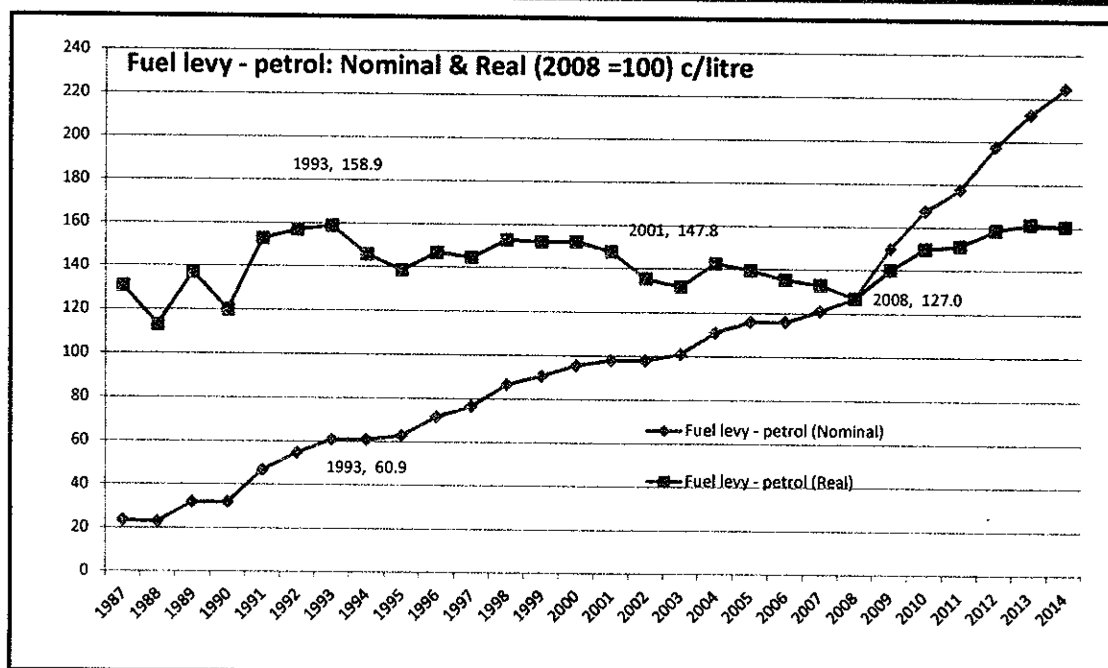
**Table 4.6 Total combined fuel taxes on petrol and diesel, 2012/13 – 2014/15**

| c / litre | 2012/13 93 Octane petrol | 2012/13 Diesel | 2013/14 93 Octane petrol | 2013/14 Diesel | 2014/15 93 Octane petrol | 2014/15 Diesel |
|---|---|---|---|---|---|---|
| General fuel levy | 197.50 | 182.50 | 212.50 | 197.50 | 224.50 | 209.50 |
| Road Accident Fund levy | 88.00 | 88.00 | 96.00 | 96.00 | 104.00 | 104.00 |
| Customs and excise levy | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| Illuminating paraffin marker | 0.00 | 0.01 | 0.00 | 0.01 | 0.00 | 0.01 |
| **Total** | **289.50** | **274.51** | **312.50** | **297.51** | **332.50** | **317.51** |
| Pump price: Gauteng (as in February)[1] | 1 077.00 | 1 026.69 | 1 206.00 | 1 129.17 | 1 375.00 | 1 311.35 |
| *Taxes as percentage of pump price* | *26.9%* | *26.7%* | *25.9%* | *26.3%* | *24.2%* | *24.2%* |

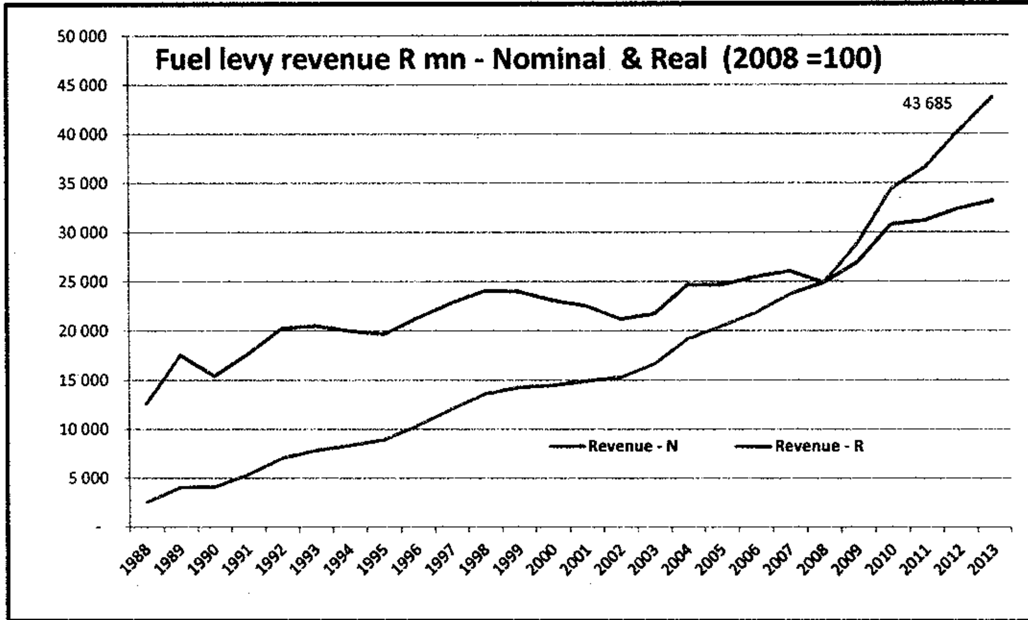
*1. Diesel (0.05% sulphur) wholesale price (retail price not regulated)*



# General Fuel Levy – Petrol 93 Octane



## Net Fuel Levy Revenue






## Fuel Levy Revenue : NRF (excluding RAF)