

Hearings on Fiscal Framework and Revenue Proposals (2015): Standing and Select Committees on Finance

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Tax Increase Reluctantly Accepted

- The Minister's tax increase is widely accepted as the least "worst" alternative
 - Given the situation with the international credit agencies, the books need some form of balancing to show long-term credibility
 - All parts of society will share in the cost – middle and upper incomes will bear the most of the personal income tax increase while the lower incomes will proportionately bear most of the fuel levy increases
 - Note: Some of the wealthier community would have preferred an increased VAT rate
- Big Issue – Expenditure!
 - The need for redistribution is accepted
 - Corruption and wasteful expenditure are not (the study by Institute of Internal auditors held that SA lost R700bn due to corruption over the last 20 years)
 - Can we really manage an ever growing State (e.g. State-Owned Enterprises) and an ever increasing amount of regulatory red tape?

“Elusive” Growth

- It is widely recognised (even by the National Treasury) that the only long-term answer to the SA economy is real economic growth
 - While post-2008 global growth has been lower than expected, SA has underperformed
 - Many foreign investors view SA as an increasingly low growth/high risk environment and are voting with their feet not to invest
- Over the last 15+ years, it is clear that
 - Fiscal policy cannot achieve growth by itself
 - Regulations can weigh down investment just as much as taxation
 - Uncertainty of property rights can equally deter investment (with new investors shying away and old investors de-risking their positions)

Small Business: We Love Them/Why Can't We Help Them?

- Tax – A Tool of Limited Effectiveness
 - Recent History of Incentives – Small Business Company Regime, Turnover Tax, Small Business Funding Entities, 4-Monthly VAT etc...
 - Note: Small Business is often a big contributor to the “Tax Gap” (e.g. service companies, 2-sets of books, VAT fraud)
- Real Problem
 - Income Tax has an impact only if a small business makes a profit and most small businesses fail this threshold (VAT should only have a temporary impact but delayed VAT refunds can be costly)
 - Government efforts should be on the expenditure side (30-day Government payment rule is a good start)
 - One-size fits all regulation has a disproportionate burden on smaller businesses – SARS and other help desks could be

Foreign Base Erosion: Where is It?

- South African Response
 - Davis Tax Committee studies OECD proposals
 - Davis Tax Committee effort mentioned as a Treasury priority
- OECD Reports
 - Intangibles/royalties (probably not)
 - Management Fees (possibly for some but other cross-border fees growing because global service centres are focused on low-labour cost locations – these locations are increasingly having skill)
 - Documentation – should be useful but can be oppressive and expensive
 - Tax treaties – some overly generous but how can SA quickly reverse?

The Rise of Environmental Taxes & Incentives

- List
 - Pending Carbon Tax
 - Electricity Levy, Diesel Refund review, Tyre Levy, etc.
 - Incentives: Energy efficiency, land conservation
- Thoughts to Consider
 - How effective are environmental taxes versus environmental regulation?
 - Is South Africa a motivator of environmental ideas or merely a taker of these ideas? Even if not a motivator, will adjustments occur over time?
 - Like all excise charges, the cost applies before profits, which can have a bigger impact than income taxes (applying solely after profits are determined)
 - What is SA's responsibility versus the global responsibility (SA is small but produces disproportionately)?

Notable Micro Issues

Retirement Savings and Estate Planning

- Proposal
 - Forced retirement withdrawals at a specified age will prevent avoidance
 - Retirement funds will be re-added to the taxpayer's estate
 - Likely criticisms: Why should the tax system force the reduction of savings? While the re-inclusion of retirement funds represents sound policy, what about the effective date of pre-2015 transactions
- Larger Policy Issue – Tightening Estate Duty
 - The Estate Duty redistributes wealth (equity)
 - However, the richest are the most likely to emigrate, and the Estate Duty is complex to enforce
 - Is the CGT instrument on death a better instrument?

Employee Share Schemes

- The Good – BEE schemes
- The Bad – Executive schemes designed to avoid the 40% rate
- The Ugly – 20+ years of disputes and legislative changes
- Longstanding issues
 - Taxation issues when vesting shares of a scheme trust to employees
 - Tax-free dividend schemes or low tax/no tax capital distribution schemes
 - Appropriate vesting points
 - Valuation

Removal of the 6quin Credit/International

- Foreign tax credits are mainly directed at foreign source activities, but this credit applies to foreign taxes (e.g. African taxes) on SA source activities even if the foreign country wrongly applies the law
- This relief is theoretically questionable
- However,
 - This credit is important tool to eliminate double tax for South Africa service providers operating in the region
 - A more widely used tool for gateway status than the Headquarter Company regime

Narrowing the SA Company “Share Issue” Anti-Avoidance Rule (Preserving Gateway Status)

- SA is seeking to be a regional gateway
 - Special tax and Exchange control relief for Headquarter companies
 - Exchange control relief for SA Treasury operations
- Misuse of tax-free share issues
 - SA allows SA companies to issue shares tax-free in accordance with international principles
 - However, concerns existed the share issue rule was being misused to allow for tax-free corporate migrations from SA
- Proposal
 - In 2013, share issues became taxable to prevent migrations
 - In 2015, it is now proposed that the anti-avoidance rule should be narrowed because the anti-avoidance prevents the creation of most headquarter and gateway companies

Withholding Taxes on Cross-Border Payments

- Cross-Border Withholding Taxes
 - Royalties (revised)
 - Dividends (also domestic withholding) (2012)
 - Interest (new)
 - Local SA services by foreign persons (pending)
- Refinements
 - System changes?
 - Can the local SA services withholding system be applied to reduce offshore leakages in terms of foreign technical fees without being unduly burdensome administratively?

VAT Cash Method of Smaller Companies

- Proposal:
 - Introduction of a cash method of accounting for smaller companies?
 - Davis Committee report
- Issues
 - Can the rules be devised to prevent prior avoidance schemes involving cash and invoice mismatches?
 - Increase the R2.5 million threshold?

VAT Electronic Cross-Border Services

- Foreign VAT vendors of electronic services to SA customers are now within the VAT net
 - Law passed
 - First round of regulations issued
- Issues
 - Categories of services within and outside the net
 - Taxpayers continue to resist business-to-business entry into the VAT net

Financial Service Industry

- Real Estate Investment
 - Refinement of REITs
 - Purpose: Regulation of unlisted property vehicles for regulation (i.e. to prevent another Sharemax Ponzi scheme) and to bring these vehicles into the tax REIT regime
- Hedge Funds – New form of collective investment scheme
- Long-term insurers: Risk products and the Four funds
 - Alignment with new SAM regulations and prevention of avoidance
 - Background issue: Long-term insurer competitiveness with collective investment schemes
- Islamic-compliant finance products (Sukuk etc.) added to private listed companies

Refinement of Tax Incentives

- Overall
 - Do these incentives add local economic activity as intended?
 - Which is better, cash grants or tax incentives?
 - Are we going back to a narrow base with a high rate?
- Revisions
 - Narrowing SEZ for connected person transactions*
 - Speeding the R&D process
 - Hydropower size threshold increased
 - UDZ area expansion
 - Film incentive clean-up
 - Increased tax-free grant list

Self-Assessment

- Proposal
 - Self-assessment system for Income Tax
 - Similar to Value-Added Tax
- Issues
 - SARS will have five years (currently three) to reopen assessments where there is no fraud, misrepresentation or non-disclosure of material facts
 - In theory, self-assessment should increase the speed of the tax process. However, SARS must have a strong risk engine to properly identify targets

Questions?

Thank you