WORKSHOP ON THE DRAFT TAXATION LAWS AMENDMENT BILL & TAX ADMINISTRATION LAWS AMENDMENT BILL

Standing Committee on Finance

Presenters: National Treasury and SARS | 19 August 2015

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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PERSONAL INCOME TAX

Closing a loophole to ensure a consistent tax treatment on all retirement funds
(Section 1 of the definition of 'pension fund')

- Retirement reform amendments were included in the Taxation Laws Amendment Act, 2013.
- These reforms created a consistent tax treatment for contributions to all retirement funds (including pension funds, provident funds and retirement annuity funds).
- The amendments also harmonised the requirement to purchase an annuity upon retirement.
  - For example, provident fund members who are under the age of 55 at 1 March 2016 would be required to purchase an annuity in the same manner as pension funds and retirement annuity funds.
  - Full vested rights for amounts already in provident funds at 1 March 2016 and no requirement to purchase an annuity for those over the age of 55.
- The amendments inadvertently excluded paragraph (a) and paragraph (b) pension funds from the requirement to purchase an annuity.
- This proposal seeks to harmonise the treatment of all retirement funds by including paragraph (a) and paragraph (b) funds in the requirement to purchase an annuity.

Objectives of retirement reforms

- The primary aim of the proposals is to **encourage household savings** and ensure that individuals are not vulnerable to poverty while working and in retirement.
- Key policy proposals:
  - **Simplify the taxation** of retirement contributions
  - **Encourage annuitising** at retirement
  - **Encouraging non-retirement saving** through tax free savings accounts
  - **Encourage good value retirement products and services** by reviewing costs
  - **Encourage preservation and portability**, especially during job changes
  - **Enhance governance** of funds
- The above retirement reform proposals were initiated by the policy document: ***"A Safer Financial Sector to Serve South Africa Better"***, released and endorsed by Cabinet in 2011.
- These are urgent proposals to address major challenges in the current retirement system, especially member protection.

The rationale for the tax changes in TLAA 2013

- SARS publishes information on the deductions allowed for employee contributions to pension funds and retirement annuity funds.

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 <u>three different tax treatments</u> for allowable deductions for pension funds, provident funds and retirement annuity funds.
  - Excessively <u>complicated</u>: creates confusion on how to save for retirement most effectively from a tax perspective.
  - <u>Inequitable</u>: 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.

Retirement tax regime for contributions 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 deductions in TLAA 2013

- National Treasury published a discussion document in October 2012 titled **'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**

TLAA 2013 enacted simplified and harmonised tax treatment of retirement contributions

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 Rollover of non-deductible contributions & any amount that remains are not taxable upon exit Contributions include amounts paid towards risk benefits & administration costs	27.5%	Maximum of R350 000	All retirement funds

Provident fund members who contribute will see increase in net pay

	Current	Proposals	Current	Proposals	Current	Proposals
Employee basic salary	**70,000**	70,000	**140,000**	140,000	**250,000**	250,000
Employer contribution	7,000	7,000	14,000	14,000	25,000	25,000
Employee contribution	3,500	3,500	7,000	7,000	12,500	12,500
Fringe benefit	-	7,000	-	14,000	-	25,000
Employees remuneration	70,000	77,000	140,000	154,000	250,000	275,000
Tax deductible contribution	-	10,500	-	21,000	-	37,500
Taxable remuneration	70,000	66,500	140,000	133,000	250,000	237,500
Tax liability	-	-	11,943	10,683	37,191	33,941
Net pay	66,500	66,500	121,057	122,317	200,309	203,559
Difference		-		**1,260**		**3,250**
Monthly difference		-		**105**		**271**

Amendments to annuitisation requirement in TLAA 2013

- National Treasury also published a discussion document in September 2012 titled '**Preservation, portability and governance for retirement funds'** which covered the annuitisation requirement of all retirement funds
- Employee contributions by provident fund members would now receive a deduction which was not previously available
- To ensure complete alignment/harmonisation, allowing for a deduction would also mean that benefits at retirement should also be treated the same across all retirement funds. Therefore, the annuitisation requirement for pension funds and retirement annuity funds would apply to provident funds
- However, full vested rights are protected
  - Anyone over the age of 55 (who stays in the same provident fund) will not be required to annuitise
  - Anyone below the age of 55:
    - can still take as a cash lump sum, accumulated provident fund savings as at 1 March 2016 (and the investment growth on that) at retirement
    - Only 2/3rds of new contributions from 1 March 2016 will be required to be annuitised
    - If these new contributions are below R150 000 (de-minimus) then don't need to annuitise

Impact on GEPF members

- The resignation problem is a public sector (GEPF) problem and not widespread
  - High indebtedness within country and public sector
- The GEPF is a defined benefit pension fund so the annuitisation requirement is already applicable to GEPF members
  - Members will continue to receive both a lump sum and annuity on retirement
  - Members will continue to be paid out their retirement interest if they resign
- The value of the employer contributions will be treated as fringe benefit in the hands of the employee from 1 March 2016
  - Given the unique circumstances of defined benefit funds it will be a notional value
- Increase in allowable deductions means GEPF members can contribute more to a retirement annuity fund and get a larger deduction
- No impact on take home pay (except for DG's earning above around R1.6m)
- There have been no legislative amendments to pre-retirement preservation:
  - If an individual were to resign from employment they can take the full amount of their pension in cash (but may face a high tax charge)
  - This will **not** change from 1 March 2016, so there is no reason for anyone to resign before that date to access their pension

Withdrawal from retirement funds by non residents

(Paragraph (b)(x)(dd) of the definition of "retirement annuity fund" in section 1)

- Many expatriates who move to South Africa for employment contribute to a retirement annuity fund (RA) to continue saving for retirement.

- After their employment contract expires they return to their home country and would like to withdraw the value of their retirement interest in the RA as a lump sum.

- Currently, South African residents who emigrate from South Africa (as recognised by the South African Reserve Bank) are able to take their RA as a lump sum (after paying tax), however expatriates are not able to take their RA as a lump sum (since it is not recognised as emigration by the South African Reserve Bank).

- The amendment would allow expatriates to take a lump sum from their RA when they leave South Africa and either cease to be a tax resident or at the end of their work visa, aligning the treatment with those of South African residents.

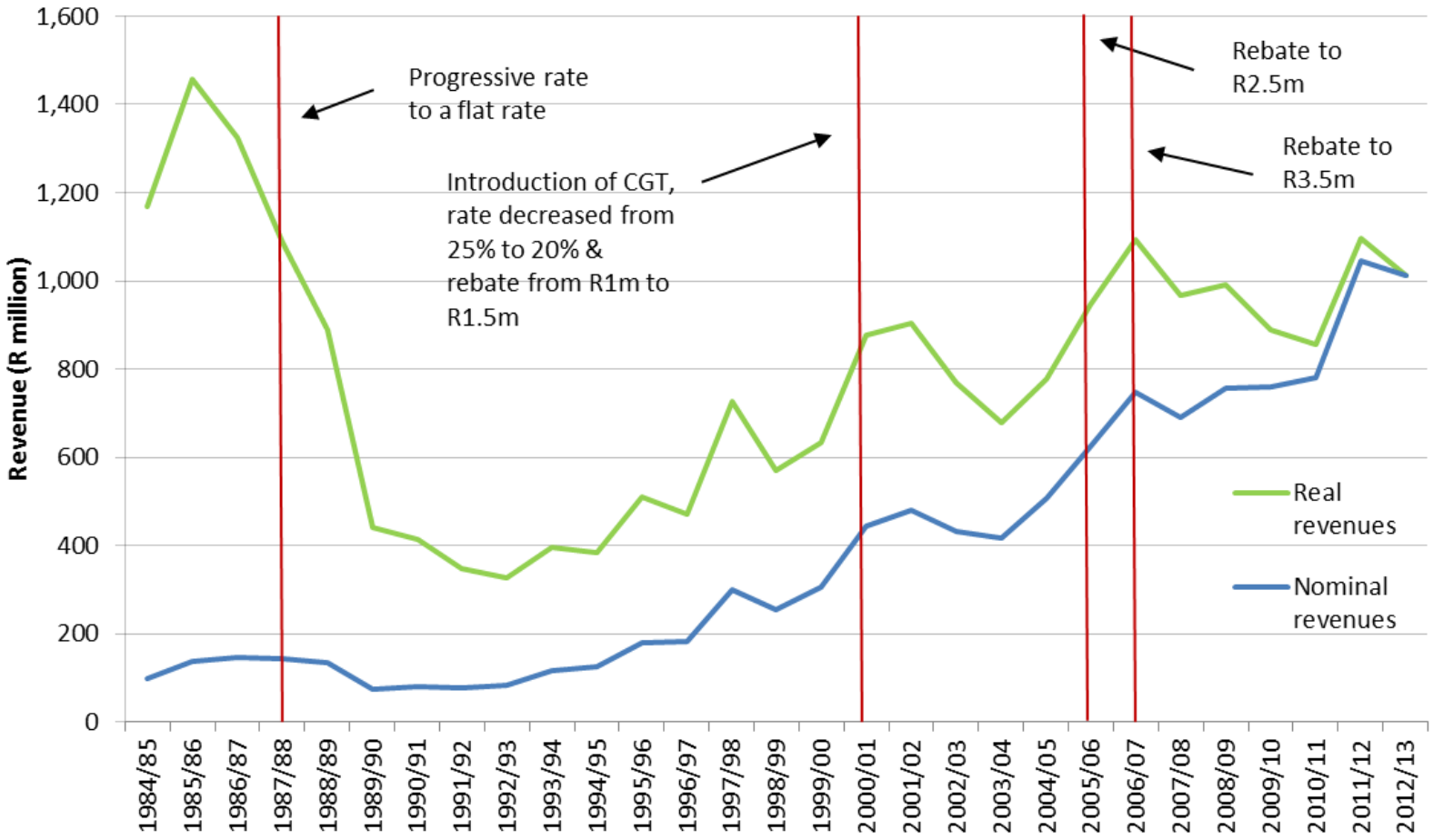
Closing a loophole to avoid estate duty through excessive contributions to retirement funds
(Section 3 of the Estate Duty Act)

- Taxation Laws Amendment Act, 2008 removed a the requirement to purchase an annuity by the age of 70 for retirement annuity funds
- In the same year, retirement funds were made exempt from estate duty

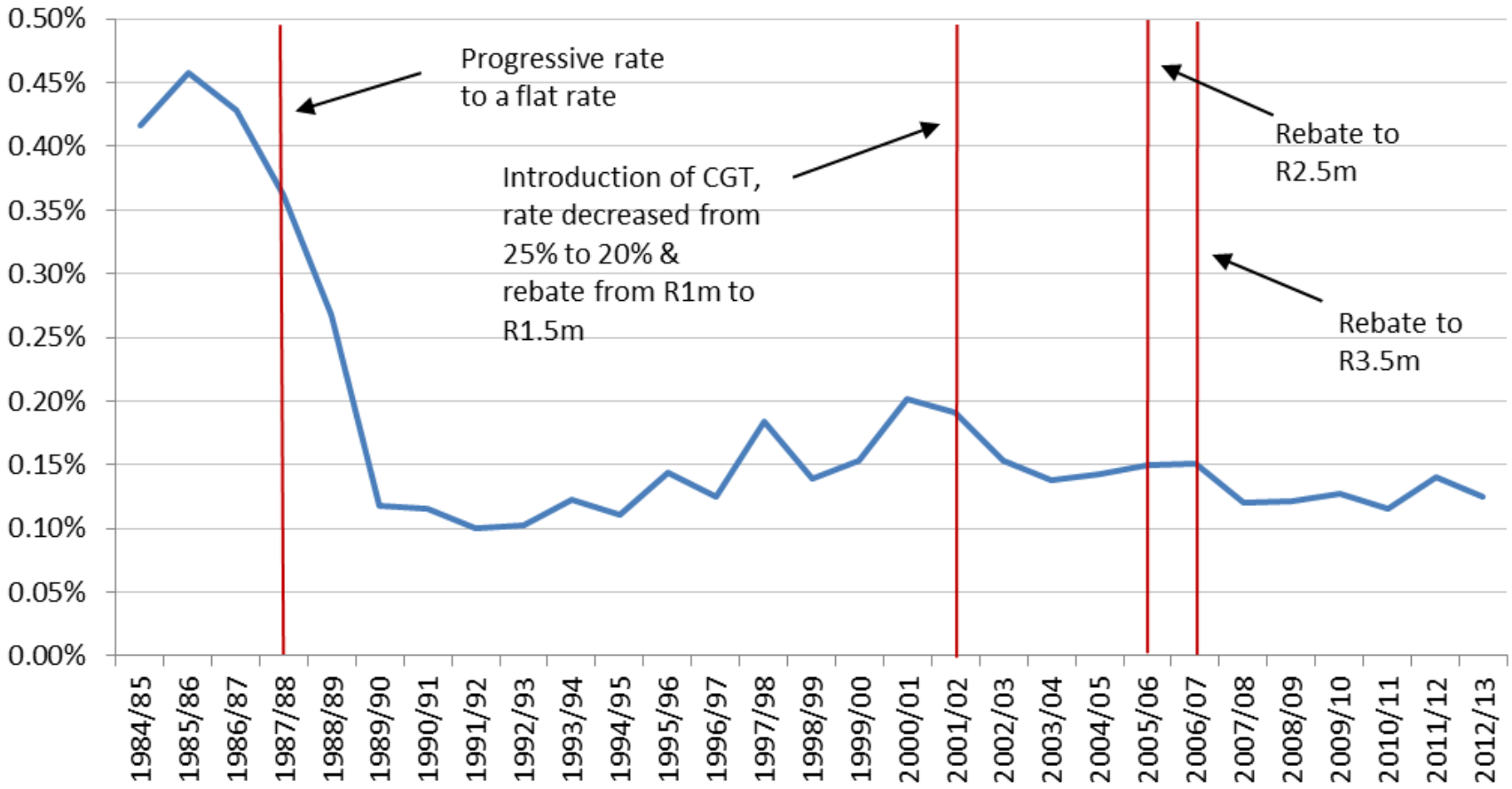
- These changes allowed some individuals to use retirement annuity (RA) contributions as a way to avoid estate duty
- Contributions to an RA that did not receive a deduction (were above the 15% of non-retirement funding income limit) do not pay tax according to the lump sum tax tables upon death and are not liable for estate duty

- To close down this avoidance of estate duty it is proposed that contributions to a retirement fund that did not receive a deduction are included in the dutiable part of the estate for estate duty purposes

Estate duty revenues are around R1bn



Although as a % of total revenues this is a small amount



Low revenues may be from trusts and other avoidance

- Estate duty assists in raising revenues by expanding the tax base
  - Brings in transfers of wealth (and capital gains on 'disposal' of assets at death)
- However, estate duty does bring in a small amount of revenue of just over R1bn (or 0.12% of total tax revenue) for 2012/12.
  - Donations tax is also minimal at R82m in 2012/13

- Policy changes are likely to have kept revenues subdued, with a decrease in the rate and increases in the rebate (abatement)
- Use of vehicles to avoid estate duty may be diminishing revenues further
  - such as trusts and marketing to use retirement annuities, such as in this example
  - Very wealthy may spend more effort in avoiding estate duty (art, foreign property, etc.)

- Estate duty acts a proxy wealth tax, and even with low revenues contributes to the progressive nature of the tax system

Estate duty report from the Davis Tax Committee

- The Davis Tax Committee published the draft of the Estate Duty Report on 13 July 2015
- The current proposal will assist with estate duty revenue collections and is directly in line with the initial recommendations of the DTC
  - "The DTC is of the opinion that it could never have been the intention of National Treasury to create an obvious loophole of this nature. Thus, the practice should be stopped by simply deeming all retirement fund contributions, made on or after 1 March 2015 and disallowed in the determination of taxable income, to be included in the estate duty computation." (page 61, First Interim Report on Estate Duty)
- Other proposals in the report include:
  - Reforming the taxation of trusts by repealing the "attribution" principle for local trusts (so that all income is taxed in the trust and not in the hands of the beneficiaries at a lower rate)
  - Distributions of foreign trusts be taxed as income
  - Withdraw or limit inter-spouse exemptions and roll-overs
  - An increase in the primary abatement from R3.5 million to R6 million

Removing anomalies for income and disposals to and from deceased estate

(New s9HA, s22(8)(b), 25, paragraphs 40, 41 and 67 of the 8th Schedule])

- Section 25 of the Income Tax Act makes provision for income received or accrued and expenses incurred by a deceased estate for the benefit of the beneficiaries (from 1961).
- The deceased estate is treated as a conduit, whereby the beneficiaries tax consequences are determined with reference to the income received or accrued by the estate (including allowable deductions).
- Paragraph 40 of the Eighth Schedule treats a deceased person as having disposed of all their assets on death and capital gains tax is recognised in the hands of the deceased.
- The deceased estate is then taxed as a separate legal entity on any income, accruals or disposals.
- Section 25 and paragraph 40 of the Eighth Schedule are at odds with one another and create anomalies and interpretational difficulties.
- Section 25 also goes against the principle that only expenses borne by the taxpayer can be deducted (since expenses in the estate can be deducted by the beneficiary).
- The proposals seek to align the rules so that all gains will be taxed in the hands of the deceased and income and accrual will be taxed in the hands of the estate (with roll-over relief to beneficiaries).

Bursary and scholarship exemption for basic education: Grade R to 12

(Section 10(1)(q)(bb))

- The bursary and scholarship exemption was amended from 1 March 2013 to allow a larger exemption for post school studies (by increasing the exemption from R10 000 to R30 000 for qualifications that are NQF 5 – 10).

- In creating the split between the types of bursaries, the R10 000 exemption was defined to apply for bursaries and scholarships for NWF levels 1 – 4.

- However, NQF levels 1 – 4 exclude grades R to 8, which meant that these qualifications were unintentionally excluded.

- The proposal seeks to align the eligible qualifications with those from before the amendment in 2013 by including grades R to 8.

GENERAL BUSINESS TAXES

STT & CGT implications on collateral arrangements
(Sections 1 & 8 of STT Act and sections 1, 9C, 22 and para 11 of the 8th Schedule)

- Collateral is the provision of asset(s) as security against the risk of default on any form of debt arrangement.
- The provision of collateral on debt arrangements can take two forms, namely, (i) pledge and (ii) outright transfer.

(i) Pledge	(ii) Outright transfer
No transfer of beneficial ownership	Transfer of beneficial ownership
Security temporarily held in trust account (cannot be sold / reused) and returned once debt is settled in full	Security can again be sold or re-used with similar asset being obtained in market and returned once debt settled in full
No STT and CGT triggered as there is no change beneficial ownership	STT and CGT triggered upon change in beneficial ownership

2015 Changes

- The use of outright transfer of collateral is not attractive due to its tax implications.
- In order to minimize the negative effects as a result of the above-mentioned tax implications, the following special tax dispensation is proposed for outright transfer of collateral:
  - No STT & CGT tax implications arise for collateral arrangements for a duration of up to 12 months. This implies that assets (listed securities) will not be allowed to be provided as collateral for longer than 12 months. If assets (listed securities) are provided as collateral for a period longer than 12 moths, they will attract STT & CGT.

Debt-financed acquisitions of controlling shares interests
(Section 24O)

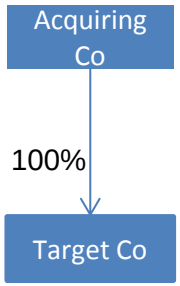
- In order to determine the tax liability of a taxpayer, one must first determine the taxable income of that taxpayer.
- Taxable income is the amount remaining after deducting all allowable deductions and allowances from the income of a taxpayer.
- The deduction follows the general deduction formula in section 11(a), which only allows expenditure incurred in the production of income to be deducted.
- For example, if a taxpayer uses debt to fund expenditure for business purposes, interest incurred on that debt will generally be allowed as a deduction.
- With regard to corporate reorganisations (mergers & acquisitions) taxpayers often use interest bearing debt to fund these acquisitions.
- These acquisitions can be done through either a share purchase of a target company or by purchasing the business assets of a target company as a going concern.
- Interest incurred on a debt used to fund a share purchase is not deductible because shares produce dividend income which is exempt from normal tax.
- On the other hand, interest incurred on a debt used to fund the purchase of business assets as a going concern is deductible because business assets produce taxable income.

Debt-financed acquisitions of controlling shares interests
(Section 24O)

- The fact that interest incurred on debt used to fund the purchase of shares is not deductible made taxpayers to enter into tax complicated structures in order to obtain an interest deduction.

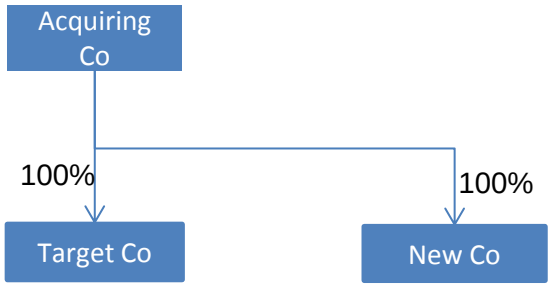
Example 1: Typical tax complicated structure

Step 1



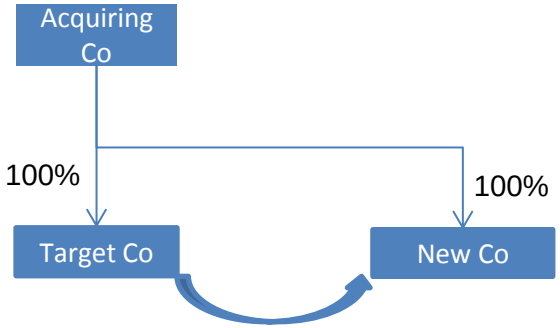
Acquiring Co uses debt to purchase the shares of Target Co.

Step 2



Acquiring Co establishes a subsidiary, New Co.

Step 3



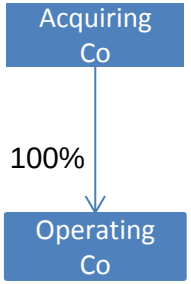
New Co raises interest bearing debt. New Co then acquires the business assets of Target Co using the interest bearing debt raised in a tax-deferred intra-group transaction.

New Co is able to claim an interest deduction on the interest bearing debt used to acquire the business assets of Target Co.

Debt-financed acquisitions of controlling shares interests
(Section 24O)

- In order to limit the use of these tax complicated structures, a special interest deduction was introduced in in 2012.
- This special interest deduction was intended only for debt used to fund this structure.

Example 2: Allowable special interest deduction structure

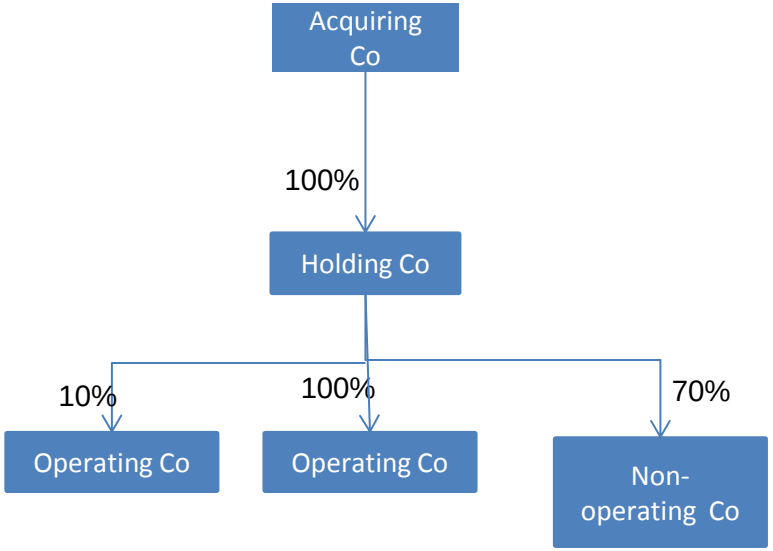


Direct acquisition of shares in an operating company.

Debt-financed acquisitions of controlling shares interests
(Section 24O)

- Taxpayers have used the 2012 special interest deduction for the following unintended structures.

Example 3: Unintended structure



Indirect acquisition of shares in an operating company.

2015 Changes

- The 2015 changes will stop the use of these unintended structures and ensure that a special interest deduction is only allowed for the allowable structures shown under Example 2.

Removing anomalies arising from cancellation of contracts
(Paragraphs 3,4,11,20 & 35 of 8th schedule)

- Taxpayers often enter into contracts, including but not limited to the purchase and sale of an asset(machinery).
- When such contract is cancelled the cancellation of a contract is regarded as disposal for CGT purposes and could have tax implications for both parties to the contract (buyer & seller).
- The cancellation of a contract, especially between connected persons (e.g., relative, trust, beneficiary of a trust, member of a partnership, group of companies) could give rise to certain anomalies which do not result in the intended tax neutral cancellation but rather taxpayers could benefit from an unintended step-up in the base cost of an asset and a capital loss.
  - The current adjustment rules relating to the cancelation of contracts are flawed in that they allow a reduction of the proceeds in the hands of the original owner to the value of the amount that has been repaid or has become repayable to the person to whom the asset was sold. This has a netting effect on the amount of proceeds, effectively reducing it to nil. However, the base cost of the asset in the hands of the original owner is unaffected resulting in a possible capital loss in the hands of the original owner.

2015 Changes

- The following 2015 changes will effectively close these anomalies:
  - When a contract is entered into and cancelled in the same year of assessment, cancellation of a contract will not be regarded as a disposal in the hands in the hands of the original owner of the asset. No capital gain/loss will be determined by the original owner and the base cost of the asset in the hands of the original owner remains the same as it was prior to entering into the contract.
  - When a contract is cancelled in a following year of assessment to which it was entered into:
    - Capital gain/loss will be included in the current year of assessment (year of cancellation) which is equal to the capital gain/loss realised in the year that the asset was sold in terms of the original contract (year of entering into a contract).
    - Base cost of the asset at the time of cancellation will be limited and equal to the base cost of the asset at the time of entering into a contract.

Addressing the issue of return of capital after a taxpayer has held a share for three years
(Section 9C)

- Generally, the sale of shares trigger either normal tax or CGT depending on the circumstances of the taxpayer.
- In 2007, section 9C was introduced to give certainty to taxpayers regarding tax implications on the disposal of shares. As a result, taxpayers are subject to CGT if they dispose of shares held for a period of at least 3 continuous years.
- This is attractive to taxpayers due to the lower effective tax rate the CGT regime offers (18.6% companies & 13.65 % individuals) as compared to full normal tax (28% companies & 41% individuals).
- However, section 9C does not address the issue of return of capital, other than cash, received on shares held for at least 3 years as well as the meaning of the term "disposal" as contemplated in this section.

2015 Changes

- The following 2015 changes clarify the policy intent:
  - Any return of capital, whether cash or otherwise, will be treated as capital.
  - Any expenditure incurred on shares held for at least 3 years will be deemed to be of a capital nature.
  - The term "disposal" for section 9C purposes means "disposal" as defined in the 8th schedule (dealing with CGT) as well disposal as contemplated in section 9H.

TAXATION OF FINANCIAL INSTITUTIONS AND PRODUCTS

Transitional tax issues resulting from the regulation of hedge funds (section 41(1), 42(1), 42(3A) and 44(14)(Bb))

- Hedge Funds are pools of private capital from individuals and some institution. The manager will manage the funds according to the funds strategy. Hedge funds are generally structured as a limited partnership with the objective of consistently achieving returns exceeding the market by investing in a variety of asset classes and by using non-traditional investment strategies, including short selling, leverage, derivatives and arbitrage.

Before 1 April 2015

- Hedge fund managers were not regulated by the Financial Services Board (FSB).

After 1 April 2015

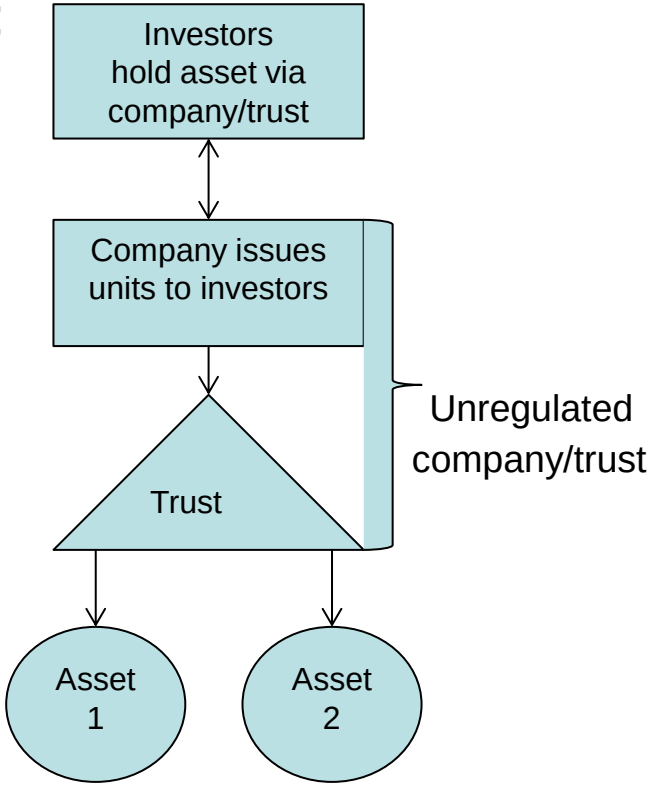
- With effect from 1 April 2015, the Minister declared the business of hedge funds to be regulated as Collective Investment Schemes. This implies that managers of all hedge funds must apply to the FSB to operate a hedge fund under a structure that is approved and regulated according to the Collective Investment Schemes Control Act.

Advantages

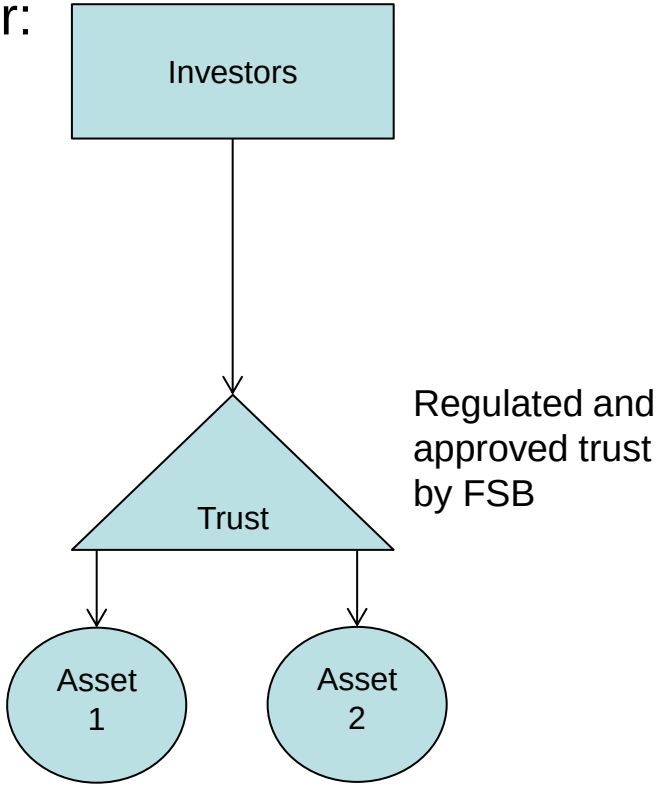
- To protect investors and assist with monitoring systemic risk, while promoting the integrity of the industry and encouraging financial market development.
- To provide tax certainty.

Hedge Funds: Examples

Before:



After:



It is proposed that when the structure changes from unregulated to regulated, tax should not be triggered

Extension of Murabaha and Sukuk to listed entities
(Section 24JA)

- In 2010, changes were made in the Act recognising diminishing musharaka, mudaraba and murabaha as forms of Islamic finance equivalent to traditional finance entailing interest offered by banks.
- Subsequently, in 2011, further changes were made to recognise sukuk as another form of Islamic finance, but limited only to Government. In 2015, sukuk was extended to public entities.
- Although Islamic financing arrangements have been introduced in stages, it has always been the Government's intention to ensure that these forms are accessible to other entities as well as an additional source to raise capital.

2015 Changes

- The proposed changes to the legislation extend murabaha and sukuk to listed entities.

TAX INCENTIVES

Accelerated capital allowances for manufacturing assets governed by supply agreements (Section 12C)

- Currently, an accelerated depreciation allowance is available for machinery used in the process of manufacture in cases where the taxpayer (i) owns the machinery and directly uses that machinery to manufacture goods and (ii) where the taxpayer leases the machinery to another person who then uses such machinery to manufacture goods.
- Manufacturers sometimes enter into agreements to outsource parts of their manufacturing operations together with the machinery for no consideration. This is to secure the supply of components used in the assembly process of manufactured products.
- Given that no rental is received by the manufacturer under these arrangements, the supplier cannot claim the depreciation allowance because the supplier is using the machinery for business requirements of the manufacturer. In addition, the manufacturer cannot claim the depreciation allowance because the manufacturer has outsourced both the machinery and the manufacturing operations to the supplier and does not directly used the machinery for process of manufacture.

2015 Changes

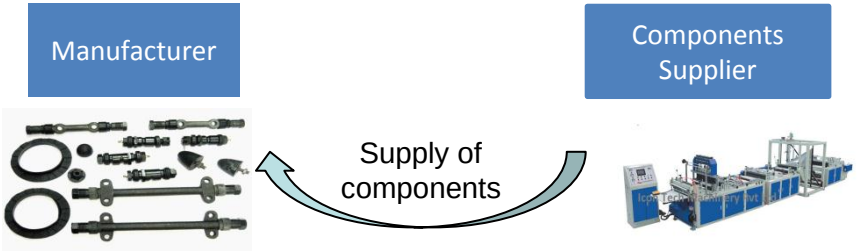
- In order to align the depreciation allowances with the new business models, changes have been made to allow a full depreciation allowance where machinery that is owned by a taxpayer is made available to a components supplier for no consideration for the benefit of the manufacturer's processes in terms of the supply agreement.

Accelerated capital allowances for manufacturing assets governed by supply agreements (Section 12C)

Facts:

The Manufacturer acquires a plant for R50 million, which is at all times owned by and remains in the fixed register of the Manufacturer. The plant is made available to the Components Supplier for no rental payable and is housed at the property of the Components Supplier.

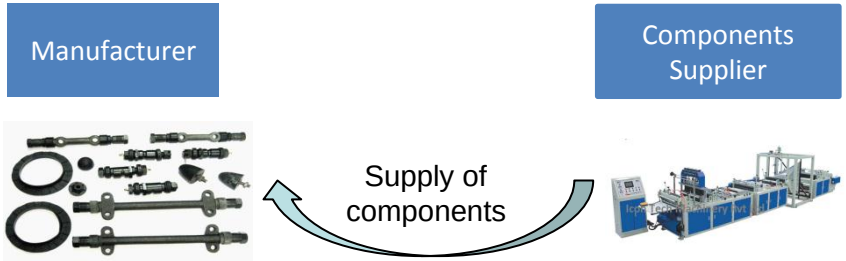
Current tax consequences



Tax consequence:

An accelerated allowance under section 12C will not be allowed for the Manufacturer that invested in the plant and neither will it be allowed for the Components Supplier.

Proposed tax consequences



Tax consequence:

An accelerated allowance under section 12C will as a result of the proposal be available to the Manufacturer that invested in the plant. The accelerated amount will be determined with reference to the cost of R50 million of the plant as follows:

Year 1	Year 2	Year 3	Year 4
40%	20%	20%	20%
R20 million	R10 million	R10 million	R10 million

SEZ: anti-profit shifting measure
(Section 12R)

- In 2013, a special tax incentive regime for the special economic zones (SEZ's) was introduced in the Act. As a result, a qualifying company benefits from an accelerated depreciation allowance on capital structures (buildings) and also qualifies for a reduced corporate tax rate of 15 per cent.
- There is a risk that profits may be artificially shifted from fully taxable connected persons to qualifying companies in the SEZ regime to take advantage of the lower tax 15% corporate tax rate.

2015 Changes

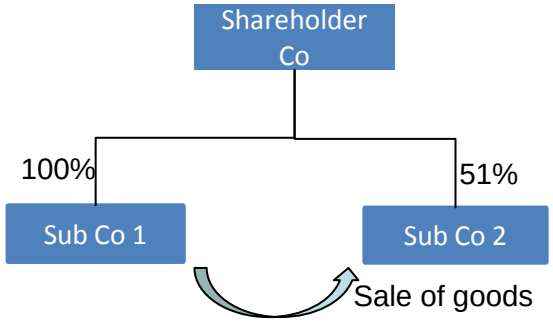
- In order to limit the risk of potential shift of profits, it is proposed that a company should be disqualified from benefitting from the 15 per cent tax rate in the SEZ regime if more than 20 per cent of that company's deductible expenditure incurred or gross income arises from transactions with connected persons.

SEZ: anti-profit shifting measure
(Section 12R)

Facts:

Shareholder Co and Sub Co 2 are companies operating outside of a designated SEZ, while its subsidiary Sub Co 1 operates within a designated SEZ. The total Gross Income of Sub Co 1 during one year of assessment is R5 million, R1.5 million of which arose from the on-selling of goods to its fellow subsidiary Sub Co 2. Its deductible expenses in that year amounted to R3.5 million, no expenses relate to transactions in the group.

Current tax consequences

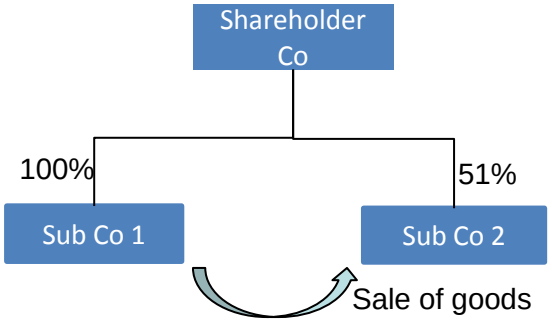


Tax consequences for Sub Co 1:

No exclusion from the favourable tax rate is applicable

Gross Income:	R5 million
Deductible Expenses:	(R3.5 million)
Taxable income:	R1.5 million
Applicable tax rate:	15%
Tax payable:	**R225 000**

Proposed tax consequences



Tax consequences for Sub Co 1:

Determination of the exclusion applying:

(R1.5 million/R5 million) x 100 = 30% (exceeds 20%)
Therefore a 28% tax rate will apply and not the favourable 15% tax rate.

Gross Income:	R5 million
Deductible Expenses:	(R3.5 million)
Taxable income:	R1.5 million
Applicable tax rate:	28%
Tax payable:	**R420 000**

Further alignment of the tax treatment of government grants
(Sections 10(1)(*zl*) & 12P)

- In 2013, a unified system for tax treatment of government grants was introduced.
- Under this unified system, an expanded list of government grants and any other government grants that are identified by the Minister of Finance by notice in the Gazette are exempt from normal tax.
- In turn, anti-double-dipping rules that deny a deduction of any expenditure that is funded by the government grant recipient using an exempt government grant were introduced. The policy rationale is that exempt government grants should not be used to fund expenditure in respect of which a deduction can be claimed against other income of the government grant recipient.
- The tax treatment of government grants provided for Public Private Partnerships (PPP) is not aligned with the above-mentioned system of government grants.

2015 Changes

- It is proposed that PPP grants should also be subject to the similar anti-double-dipping rules available in the unified system for tax treatment of government grants.

Demarcation of additional UDZs
(Section 13*quat*)

- In 2003 the Urban Development Zone (UDZ) tax incentive was introduced to encourage property investment in derelict CBDs and promote investment in urban renewal.
- The incentive provides for an accelerated depreciation allowance on the value of new buildings and improvements to existing buildings.
- Currently, legislation only allows municipalities with a population greater than 2 million people to demarcate two areas as UDZs.
- The amalgamation of various municipalities highlighted the need to extend the demarcation of more UDZ areas per municipality.

2015 Changes

- To make the incentive more accessible, changes have been made in the legislation to allow municipalities with a population of at least 1 million or more to be allowed to demarcate more than UDZ area.
- With regard to municipalities with less than 1 million population, the Finance Minister will have discretion by notice in the Government Gazette to approve a municipality to demarcate more than one UDZ area.

UDZ Tax Incentive

New / improvement	Use	Allowance
Erection / extension / addition	Commercial / residential	20% year 1 8% years 2 – 11
	Purchased from a developer	Deemed cost = 55% of purchase price (deductible over 11 years as above)
	Low-cost residential unit	25% year 1 13% years 2 – 6 10% year 7
Improvements	Commercial / residential	20% years 1 – 5
	Purchased from a developer	Deemed cost = 30% of purchase price (deductible over 5 years as above)
	Low-cost residential unit	25% years 1 – 4

UDZ- List of approved municipalities

- Buffalo City
- Cape Town
- Ekurhuleni
- Emalahleni
- Emfuleni
- eThekwini
- Johannesburg
- Mangaung
- Matjhabeng
- Mbombela
- Msunduzi
- Nelson Mandela
- Polokwane
- Sol Plaatjie
- Tshwane

UDZ- 2013 Study Results

- UDZs have ignited and accelerated urban renewal
- Moderate to highly effective in addressing its general objectives
- However, the mere presence of a UDZ does not in itself guarantee or accelerate urban renewal
- Most economic, labour and real estate value benefit when:
  - UDZ part of a larger package of interventions
  - Municipal programmes (and budget) clearly focused on the inner city
- UDZ incentive succeeded in accentuating market demand and sound planning practice
  - i.e. investments based on sound demand principles and planning policy, and made even more attractive by the incentive
  - Investments thus likely to be sustainable and continue to generate economic and fiscal benefits even after the incentive has ceased

Extending the window period and introducing a Compliance Period for the IPP tax incentive regime
(Section 12I)

- In 2008, the Industrial Policy Project (IPP) tax incentive was introduced to support investment in manufacturing assets to improve the productivity of the manufacturing sector. The IPP offers support for both capital investment and training.
- Compliance with the incentive is based on regulatory criteria reviewed by an adjudication committee. Approved IPPs must report annually to the adjudication committee regarding progress in meeting the qualifying criteria. They should also report on training expenditure as a share of its total wage bill over a 6-year period.
- It has come to our attention that there is uncertainty regarding timeframes with respect to compliance with all the qualifying criteria, the end date for annual progress report and additional training allowance benefit period.

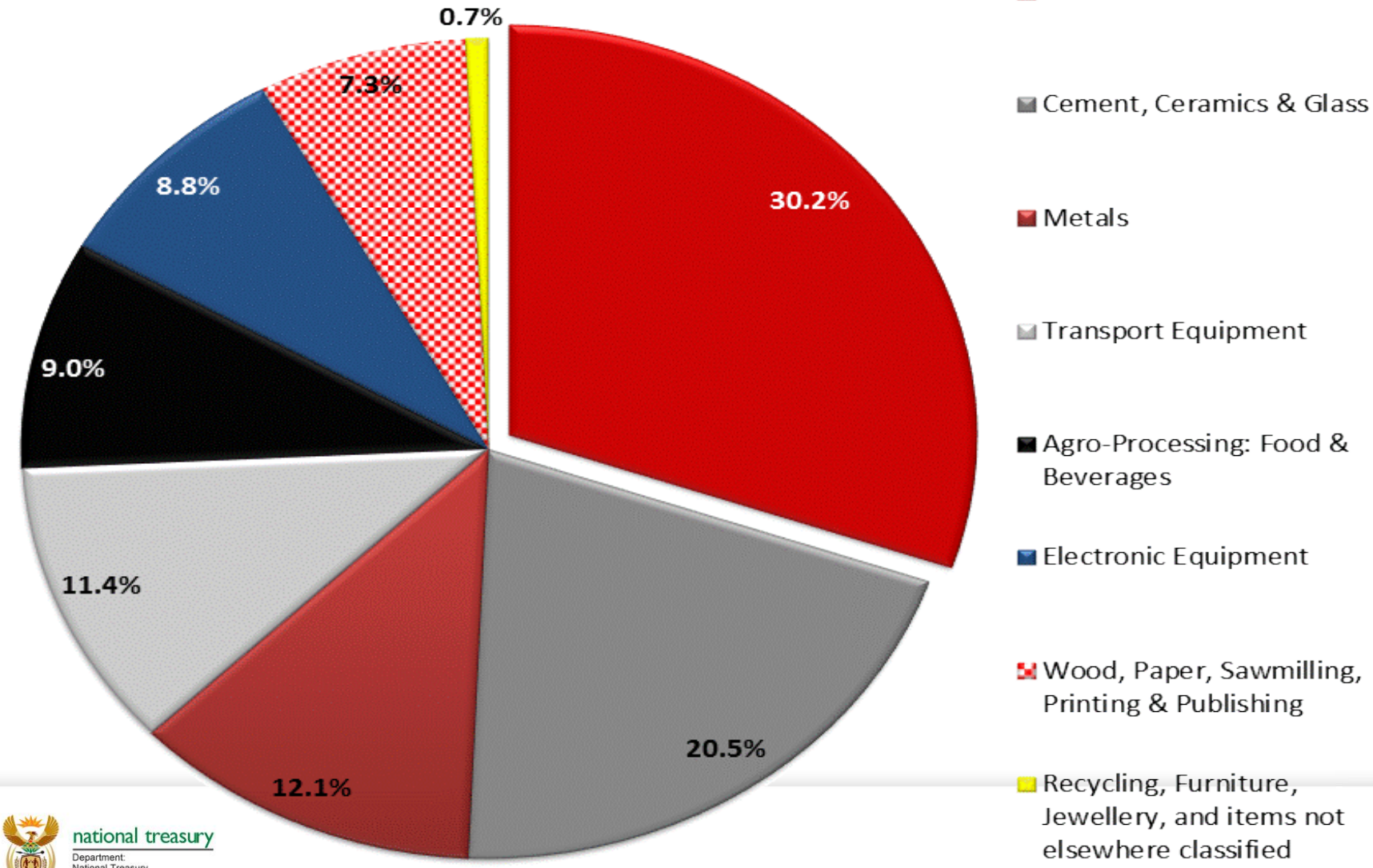
2015 Changes

- In order to address the above-mentioned issues, it is proposed that a "compliance period" be introduced to allow projects to easily comply with the requirements stipulated in section 12I.
- Given the impact of the incentive since its inception, it is proposed that the window period for IPP will be extended from 31 December 2015 to 31 December 2017.

IPP- Scoring criteria

Criteria	Max Points
1. Innovative processes	1
2. Improved energy efficiency	2
3. General business linkages	1
4. SMME procurement (Max: Green = 1; Brown = 2)	1(2)
5. Direct employment creation	*N/A*
6. Skills development	2
7. Located in an IDZ (Only Greenfields)	1
Total Points (9 as of 1 Jan 2015)	**10**
Qualifying status	5 out of 10
Preferred status	8 out of 10

IPP-Approved projects by Sector

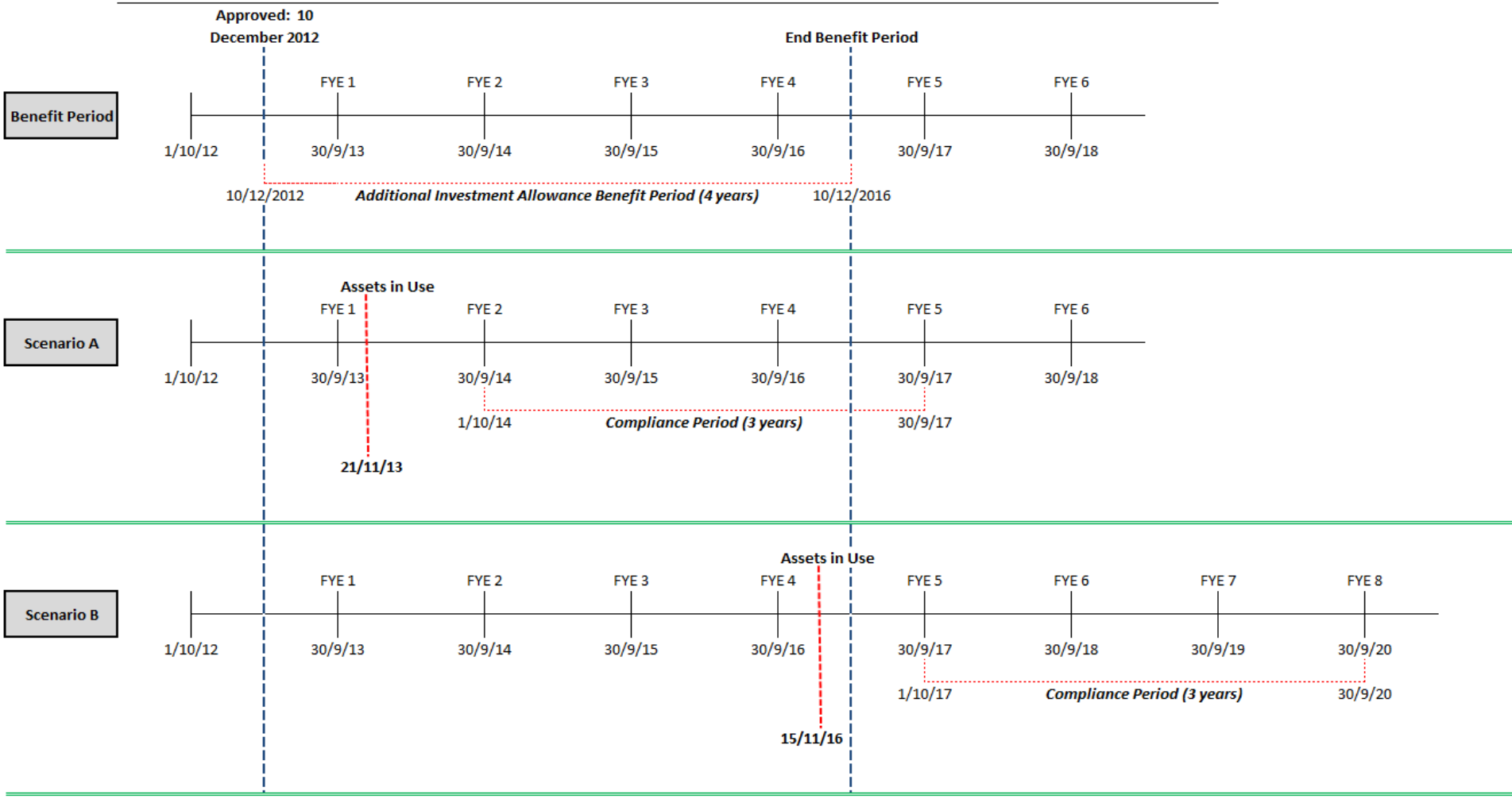


IPP-Compliance Period

Assumptions:
1. Date of Approval: 10 Dec 2012
2. Benefit Period: 10 Dec 2012 - 10 Dec 2016 (4 years)
3. Company Financial Year End: 30/9 (30 Sep)

Scenario A:
1. Assets in Use: 21/11/2013
2. CP: 1/10/14 - 30/9/17 (3 years)

Scenario B:
1. Assets in Use: 15/11/2016
2. CP: 1/10/17 - 30/9/20 (3 years)



Depreciation allowance in respect of transmission lines or cables used for electronic communications outside South Africa (section 11(f))

- In 2009, changes were made in the Act following international standards of how international submarine telecommunication cables are treated for tax depreciation purposes.
- These cable systems are often prohibitively expensive for single buyers, hence owners may grant 3rd parties the right of use to this system through an 'Indefeasible Right of Use' (IRU).The IRU provides the grantee the right to use the capacity of the submarine cable without ownership.
- Improvement in technology and shorter economic life of the assets have necessitated a review of the period over which the right of use of submarine lines or cables are depreciated.
- International industry practice indicates a shorter period of 15 years as compared to 20 years regarding the write–off period of submarine lines or cables.

2015 Changes

- In order to align the tax treatment of depreciating IRUs for submarine lines or cables with international practice it is proposed that the write-off period should be reduced from 20 years to 15 years.

Accelerated depreciation allowance Solar PV - Rooftops (Section 12B (1)(h)(ii))

- An additional initiative to encourage investment in cleaner energy, reduce GHGs, broaden energy sources and ease the pressure on the national electricity grid.
- Current legislation does allow for accelerated depreciation allowances for renewable energy in the forms of solar, wind, biomass and hydro of less than 30 MW.
- Solar is however classified as a single concept without delineating it into its different forms e.g. solar photovoltaic (solar PV) or concentrated solar power (solar CSP).

2015 Changes

- It is proposed to further enhance the depreciation allowance for embedded solar PV (with a generation capacity of up to 1 000 kW or 1MW or less).
- Solar PV is favoured due to its low environmental and water consumption impact, economies of scale, efficiencies of learning and speed of implementation.
- It is proposed to enhance the accelerated depreciation incentive for embedded solar PV for self-consumption from current 3 year 50:30:20 to a 1 year 100% allowance.

Adjustment of energy savings tax incentive
(Section 12L)

- The energy efficiency savings tax incentive implemented in November 2013 to encourage the uptake of energy efficiency measures that result in improvements in energy use and contributes towards reductions in GHGs.
- The monetary value of the allowance (a tax deduction) is currently set at 45 cents per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.
- The current rate of 45 c / kWh was set in 2009 (when the proposal was originally mooted) is deemed to insufficient to incentivise a sufficient large number of energy efficiency savings projects.

2015 Changes

- It is proposed that the amount of the allowance to be claimed by taxpayers in respect of energy efficiency savings be increased from 45 cents per kilowatt hour to 95 cents per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.
- In addition the regulations were amended to extended this incentive to cogeneration projects.

Energy Efficiency Savings Tax Incentive
(Section 12L)

- Regulations giving effect to the Energy Efficiency Savings (EES) incentive were published in December 2013.
- The EES incentive will run until January 2020.
- Taxpayers that can prove EES from implementing an energy efficiency measures can claim the allowance.
- The implementation of the EES incentives requires adequate measuring, monitoring and verification of energy use and commensurate efficiencies.
- Only accredited measurement and verification professional can verify the EES.
- The taxpayer baseline is adjusted annually with the amount of EES claimed.
- Over time some of the carbon tax revenues to be “recycled” to fund this tax incentive

Energy Efficiency Savings Tax Incentive: Progress to date

Key Performance Indicator	Value
No of Users Registered on the System	92
No of Projects Registered on the System – Section 12 L	74
Potential kWh Savings from Registered Projects	+- 3 826 MWh
No of Projects Activated and Evaluated by SANEDI	11
No of SANAS Accredited M&V Bodies	6

Energy Efficiency Savings Tax Incentive: Applications per sector to date

Sector	No of Applications	Comments
Mining	28	Mainly large projects awaiting baseline submissions
Agriculture	3	Awaiting baseline submissions
Industrial	20	Large projects, awaiting baseline submissions
Commercial	21	Mainly lighting & air-conditioning retrofits in commercial buildings, including hotels and two possible cogeneration projects
Transport	2	One logistics fleet and one mining/ haulage project
Total	74	

Film incentives
(Section 12O & section 23f)

- In 2012, a film incentive was introduced to encourage the development of film industry in South Africa.
- The incentive entails the exemption from tax of income derived from exploitation rights of a film and a deduction in respect of acquisition of those exploitation rights.
- The application of both exemption and deduction provided under the film incentive created anomalies as generally for income tax purposes, a deduction is not allowed in respect of expenditure that gives rise to exempt income.

2015 Changes

- Changes have been made to allow both an exemption and a deduction with respect to film incentive.

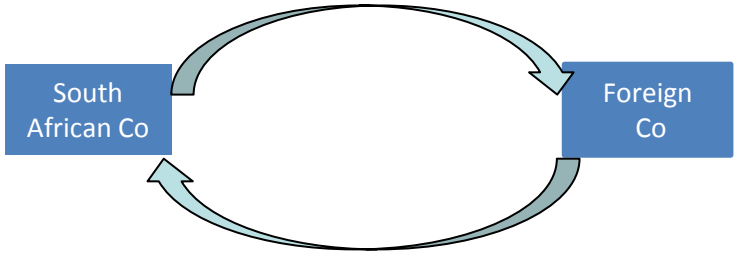
INTERNATIONAL TAXATION

Relaxing CGT rules on cross issue of shares and introducing measures to counter tax-free corporate migrations

(Section 9H, paragraphs 11(2)(*b*) and 64B of the 8th Schedule)

- A cross issue of shares occurs generally occurs during cross border company formations.
- When acquiring the shares of a foreign target company, a South African company will issue its own shares to that foreign target company instead of paying for the shares in a foreign company in cash. The end result is that the foreign target company will own shares in a South African company and a South African company will own shares in a foreign target company.
- Prior to 2013, the above-mentioned cross issue of shares were not subject to tax and the policy rationale was to allow for a suitable environment for cross border company formations.

Example 1: Cross-issue of shares



South African Co issues shares in itself to Foreign Co as consideration for the shares issued by Foreign Co in itself to South African Co.

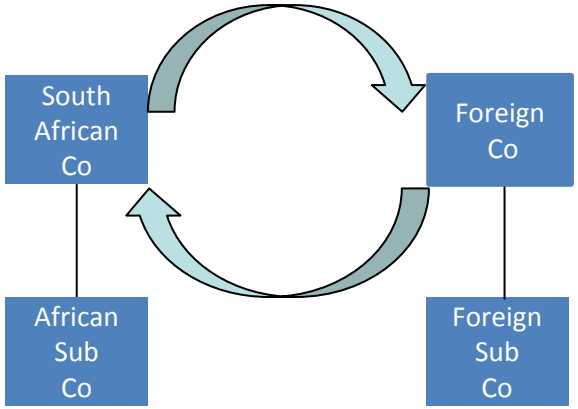
Relaxing CGT rules on cross issue of shares and introducing measures to counter tax-free corporate migrations

(Section 9H, paragraphs 11(2)(*b*) and 64B of the 8th Schedule)

- As these cross issues of shares were exempt, taxpayers took advantage and used the cross issue transactions to facilitate tax free company migrations through profit shifting structures.
- These profit shifting structures abused the participation exemption. Participation exemption was intended to allow for tax free sale of foreign shares and subsidiaries to encourage the repatriation of capital back to South Africa.

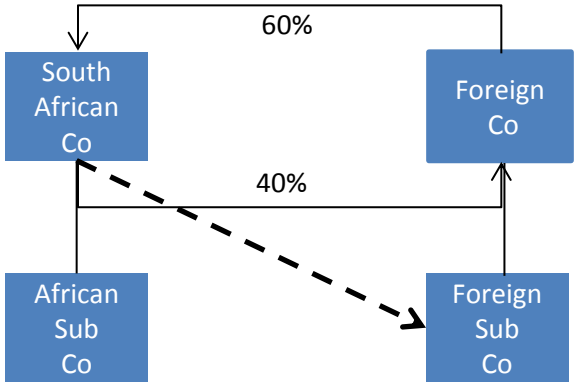
Example 2: Tax free company migrations

Step 1



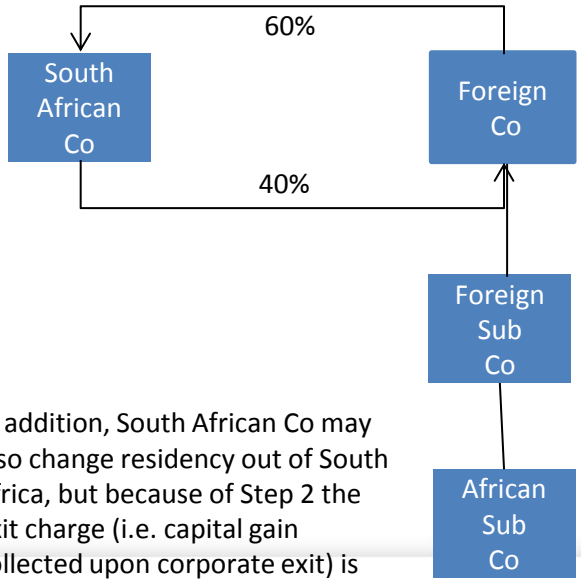
Cross issue between South African Co and Foreign Co transferring a controlling stake to Foreign Co.

Step 2



South African Co disposes of its shares in African Sub Co to Foreign Sub Co free of tax using the participation exemption. Effectively tripping South African Co of its investment operations tax free.

Step 3



In addition, South African Co may also change residency out of South Africa, but because of Step 2 the exit charge (i.e. capital gain collected upon corporate exit) is decreased due to the previous tax free migration of African Sub Co.

Relaxing CGT rules on cross issue of shares and introducing measures to counter tax-free corporate migrations

(Section 9H, paragraphs 11(2)(*b*) and 64B of the 8th Schedule)

- In 2013, changes were made in the Act to prevent erosion of the South African tax base through tax free company migration shown under example 2 in the previous slide. As a result, if a South African resident issues shares as a consideration for its acquisition of shares in a foreign company, a capital gain is triggered for the South African resident company.
- However the 2013 changes affected bona fide company formations that do not result in tax free company migration and profit shifting.

2015 Changes

- Changes made in 2013 will be reversed so that bona fide company formations are not hampered.
- In order to counter tax free corporate migrations and profit shifting, a two pronged approach is now proposed to prevent the identified base erosion schemes shown under example 2 in the previous slide. This two pronged approach comprise:
  - A denial of the participation exemption where a South African resident disposes of its shares in a foreign company to a foreign related party in relation to a South African resident, and
  - A claw back of the participation exemption that a South African resident company may have had 3 years before the South African company migrates out of the South Africa tax net.

Withdrawal of the special foreign tax credit
(Section 6 *quin)*

- In 2011, a special foreign tax credit was introduced to deal with foreign withholding taxes imposed in respect of fees from a South African source.
- The special foreign tax credit was intended to operate as some form of a relief from double taxation on cross-boarder services for South African Multinational companies that renders services to their foreign subsidiaries.
- The concern was that some treaty country partners that have withholding tax on services fees in their domestic law ignored treaty provisions and charged withholding tax on services fees paid to South African residents.
- The special tax credit regime is a departure from international tax rules and tax treaty principles and indirectly subsidies countries that do not comply with tax treaties. Also, it has resulted in significant compliance burden for SARS.

2015 Changes

- It is proposed that the special foreign tax credit for services be withdrawn and tax treaty disputes should be resolved by competent authorities of the respective countries through mutual agreement procedures.

Reinstatement of the CFC diversionary income rules (Section 9D)

- Prior to 2011, Controlled Foreign Company (CFC) provisions contained three sets of diversionary rules, namely, (i) CFC inbound sales; (ii) CFC outbound sales; and (iii) CFC connected services rules.
- In 2011, the diversionary rules in respect of CFC outbound sales were completely abolished . In addition, the 2011 amendments narrowed the diversionary rules in respect of CFC inbound sales of goods. However, the diversionary rules in respect of CFC connected services rules were retained.
- The removal of the diversionary rules in respect of outbound sales of goods resulted in the CFC rules being less effective in addressing profit shifting by South African resident companies. In addition, the narrowing of the CFC inbound sale of goods rules limited the scope of effective application of this rules.

2015 Changes

- In order to address these anomalies, it is proposed that the diversionary rules in respect of CFC outbound sale of goods and CFC inbound sale of goods be reinstated in their pre 2011 form.

VALUE ADDED TAX

VAT Accounting method
(Section 15(2)(a))

- In terms of the Broadcasting Act No. 4 of 1999, anyone who acquires a TV set or possesses or uses a TV set must have a valid TV licence and pay their annual TV licence fee. SABC issues notices of renewal 2 months prior to the expiry of the TV licence, however, there is a high level of non-payment of TV licence fees by TV owners.

- The invoice basis requirement to account for output tax on revenue SABC might not be able to collect from TV licence places a significant financial constraint on SABC.

- Changes have been made in the legislation to allow SABC an option to request the Commissioner to account for VAT output on a payment basis. However, in exercising this option, SABC will have to operate its entire business on a payment basis, not only on TV licence fees.

REPEALING THE ZERO RATING FOR THE NATIONAL HOUSING PROGRAMME

(Sections 8(23) and 11(2)(s))

- VAT Act makes provision for the zero-rating of services supplied to a public authority or municipality in terms of a national housing programme.

- It has been administratively difficult to implement the VAT provision effectively on some of the schemes provided through the national housing programme due to the variations in the programmes and the legislative interpretation by various role-players involved in the implementation of the housing programme.

- Due to administrative difficulties as well as the past decisions on related court cases, it is proposed that the zero-rating provisions for the national housing programme be abolished with effect from 1 April 2017 and concession be funded through on-budget allocations.

ENTERPRISE SUPPLYING COMMERCIAL ACCOMMODATION: MONETARY THRESHOLD ADJUSTMENTS (Section 1)

- Currently, the monetary threshold for enterprises supplying commercial accommodation is R60 000.

- This monetary threshold was last adjusted in 2003 from R48 000 to R60 0000.

- It is proposed that the monetary threshold for enterprises supplying commercial accommodation be adjusted from R60 000 to R120 000.

ZERO RATING OF SERVICES: VOCATIONAL TRAINING
(Section 11(2)(r))

- VAT makes provision for zero rating of vocational training of employees in South Africa if for example, the training is provided to an employee of a non-resident employer.
- The words *"for an employer who is not resident"* implies that for zero rating to apply, a contractual relationship must exist between the person supplying the vocational training services and the employer.
- As a result, this section does not cater for a situation where the vocational training is subcontracted by a non-resident supplier to a third party vendor in South Africa.
- It is proposed that the section be amended to ensure that vocational training is zero rated to include instances where the training is provided through a third party vendor *for the benefit* of an employer who is not resident in South Africa.