TAXATION LAWS AMENDMENT BILL & TAX ADMINISTRATION LAWS AMENDMENT BILL

Standing and Select Committees on Finance

Presenters: National Treasury and SARS | 24 August 2016

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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Overview of tax process

- The Minister of Finance announced in his 2016 Budget Speech and in the 2016 Budget Review proposed changes to tax rates and the tax base.
- The Draft Rates and Monetary Amounts and Admin Bills, published on Budget Day, contains most of the proposed changes to tax rates and monetary amounts, as well as the proposed changes for Special VDP.
- The Draft Revenue Laws Amendment Bill also published on Budget Day, and enacted into law in 20 May 2016, to postpone annuitisation of provident funds.
- The Taxation Laws Amendment Bill (TLAB) and the Tax Administration Laws Amendment bills (TALAB) published later on 8 July 2016, contains more complex and technical tax proposals which normally require more legal drafting
  - Contains changes to the tax base, the closing of tax loopholes, changes to tax administrative procedures and other technical and procedural changes to tax laws.
- Some of the proposed tax changes in Budget are not included in the draft bills but effected through changes to the Schedules to the Customs and Excise Act and/or subordinate legislation (e.g. the tax on sugary beverages)

Overview of tax process AFTER publication of Bills

- Bills are normally in sets of two, as tax bills have to be split between money bills in terms of section 77 of the Constitution to levy the tax, and related administrative changes bills in terms of section 75 of the Constitution
- Bills are published as DRAFT bills, and we take public comment, given the Money Bills Procedure Act
- Department and SCOF both take public comments, but times are not always aligned given tight deadlines (e.g. recess local govt elections)
  - This year, two consultative processes run in parallel, one for set of Rates bills, and one for set of TLAB/TALAB bills, due to recess
- Rates and Special VDP bill public hearings at SCOF on 30 August, and for TLAB/TALAB on 14 September
- NT and SARS will present a RESPONSE document in Sept/Oct after which the above bills will be revised

Officials present

- Ismail Momoniat, NT
- Cecil Morden, NT
- Yanga Mputa, NT
- Franz Tomasek, SARS
- Johan de la Rey, SARS
- Catinka Smit, SARS

GENERAL

Aligning tax charging provisions that enable the Minister of Finance to change the tax rates in all the tax acts

- The 2016 Draft TLAB contains a proposed amendment that seeks to align the tax charging provisions that will enable the Minister of Finance to change (whether it is for purposes of an increase or decrease) the tax rates in all the tax acts administered by SARS.

- It makes provision for the rates announced by the Minister of Finance in the annual Budget to apply from the effective date announced by the Minister subject to Parliament passing the legislation giving effect to that announcement within 12 months of that announcement.

- The proposed amendment is similar to the provisions available in paragraph 9 of the Fourth Schedule to the Income Tax Act as well as the Customs and Excise Act.

PERSONAL INCOME TAX

Introducing measures to prevent tax avoidance through the use of trusts
(Clause 12 of the Draft Bill: Section 7C of the Act)

- The proposed amendment is an anti-avoidance measure aimed at limiting the avoidance of Estate Duty and Donations Tax through the use of interest free loans to a trust.
- It has been a long standing practice of some taxpayers to use interest-free loans as a mechanism to transfer growth assets such as shares and fixed property to trusts in exchange for interest-free loans that are subsequently waived.
- This effectively allows these taxpayers to transfer wealth without paying Donations Tax on the transfer of assets to the trust or alternatively avoiding Estate Duty on the growth of the assets in the trust.
- The proposal addresses this avoidance by deeming the difference between the official rate of interest and the interest on the loan to a connected person trust as deemed income in the hands of the person who made the interest free loan to a trust.
- The deemed income will be subject to tax at the marginal rate applicable to that person.
- Secondly, the amount included in the income of the natural person under this proposal will not qualify for the current annual interest exemption.
- Thirdly, no deduction or loss may be claimed in respect of any waiver or write-off of loans captured under this proposal.
- Fourthly, the annual exemption from Donations Tax of R100 000 may not be used to decrease loans captured under this proposal.

Addressing the circumvention of rules dealing with employee based share incentive schemes
(Clauses 13 & 14 of the Draft Bill: Sections 8C & 8CA of the Act)

- The proposed amendment is to prevent taxpayers from disguising high salaries through the use of restricted shares or share-based incentive schemes, which gives rise to dividends instead of salaries.
- The amendment is intended to stop abuse. Some schemes are created to avoid normal income tax by passing income to employees as dividends. This effectively allows employees to pay tax at a lower dividend tax rate of 15% instead of the marginal tax rates, e.g. 41%.
- The proposed amendment upholds the underlying principle that income earned from the employer is for services rendered as an employee and should not be treated as dividends.
- As a result, such income will be regarded as remuneration in the hands of the employee and subject to PAYE at marginal tax rates.
- In turn, the actual historic costs incurred in providing employees with restricted shares will be tax deductible in the hands of the employer. However, the deduction will be spread over the period of restriction, until the restricted shares vests in the hands of the employee.

Removing the exemption for pension benefits paid from local retirement funds in respect of services rendered outside South Africa (Clause 24 of the Draft Bill: Section 10(1)(gC))

- Section 10(1)(gC) of the Act makes provision for exemption on South African residents receiving foreign pensions from employment outside South Africa.
- There is uncertainty regarding the interpretation of the current provisions of section 10(1)(gC). The consequence is that South African tax residents who work outside of South Africa receive those retirement benefits that they earned while outside South Africa free from tax, even if those payments are made from South African retirement fund (local retirement fund).
- This provision unintentionally allows South African tax residents to contribute to a local retirement fund and receive a tax deduction while also receiving those retirements fund benefits tax free.
- To ensure a fair tax treatment of retirement benefits received by South African residents, it is proposed that the exemption provided in section 10(1)(gC)(ii) only applies to retirement benefits from foreign retirement funds.

Increasing the cap for exemption regarding employer provided bursaries
(Clause 24 of the Draft Bill: Section 10(1)(q) of the Act)

- The monetary limits set out in the Income Tax Act for bursaries or scholarships granted by the employer to qualifying employees and relatives of the qualifying employees under this exemption regime were last revised in 2013.
- In order to support skills development and to encourage the private sector (employers) in the provision of education and training, the following is proposed:
  - The monetary limit in respect of remuneration for qualifying employees be increased from R250 000 to R400 000.
  - The monetary limits in respect of the exempt bursary or scholarship be increased from R10 000 to R15 000 for studies from Grade R to 12 including qualifications in NQF level 1 to 4 and from R30 000 to R40 000 for qualification in NQF levels 5 to 10.

GENERAL BUSINESS TAXES

Addressing double non-taxation arising from cross border hybrid debt instruments (Clauses 17 & 18 of the Draft Bill: Sections 8F& 8FA) - 1

- In 2013, specific legislation dealing with hybrid-debt instruments and interest charged under these instruments was introduced in the Income Tax Act which predate but are in line with the G20/OECD BEPS project.

- These anti-avoidance measures operate to reclassify interest as dividends with the aim to prevent the artificial generation of interest deductions by a borrower of a debt instrument (referred to as the issuer) if the debt instrument exhibits equity features or the dividend is not determined with reference to an interest rate or the time value of money.

- However, parties to transactions involving non-resident issuers of debt instruments are intentionally including equity features in their debt instruments as a mechanism of taking advantage of the re-classification feature of these anti-avoidance rules knowing very well that the interest denial will not apply to the non-resident issuer.

Addressing double non-taxation arising from cross-border hybrid debt instruments (Clauses 17 & 18 of the Draft Bill: Sections 8F& 8FA) - 2

- To stop this arbitrage, it is proposed that the scope of the current anti-avoidance measures should be limited to instances where the South African rules can deny an interest deduction for the issuer of a hybrid-debt instrument. The anti-avoidance rules should only apply to the following:
  - in instances where the issuer is a resident company; and
  - in instances where the issuer is a non-resident company in respect of the debt instrument that is attributable to a permanent establishment in South Africa or a controlled foreign company whose profits are attributed to a South African resident.
- This means that where the issuer is not within the South African tax net, the hybrid-debt instrument anti-avoidance measures will not apply and interest paid by that non-resident issuer will not get dividend treatment.
- As announced in the 2016 Budget Review, this proposal came into operation from 24 February 2016 and applies in respect of amounts incurred in respect of an instrument on or after that date.

Relaxing rules for hybrid debt instruments subject to subordination agreements to assist companies in financial distress (Clause 17 of the Draft Bill: Section 8F of the Act)

- The specific anti-avoidance measures dealing with hybrid-debt instruments treat interest incurred in respect of a hybrid debt instrument as a dividend if that debt instrument contains equity-like features.
- One of these features, is that the anti-avoidance measures will be triggered by any arrangement where the obligation to repay any amount owing in respect of the debt instrument (i.e. the principal amount or interest) is subject to the debtor retaining solvency.
- In the current economic climate, it is not uncommon for companies to enter into subordinate agreements at the insistence of their auditor with the aim of subordinating their shareholder loans in favour of third party lenders to maintain solvency so that they may continue to trade with the hope of making a financial recovery.
- The re-classification of the interest as a result of the subordination agreement, gives rise to added pressures for the company.
- In order to assist companies in financial distress, it is proposed that interest paid in respect of a hybrid-debt instrument will not be reclassified if –
  - the debt is between companies that form part of the same group of companies (i.e. there is at least a 70% shareholding); and
  - following the interest payment, the borrower company would not be solvent or liquid.

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Refinement of tax implications on outright transfer of collateral (Clauses 5, 40, 69, 89 of the Draft Bill: Sections 1, 22 and para 11 of the 8th Schedule to the Act)

- In 2015, changes were made in the Income Tax Act to provide relief in respect of an outright transfer in beneficial ownership of collateral in the form of shares.
- As a result, there are no capital gains tax and securities transfer tax implications is a listed share is transferred as collateral in a lending arrangement, provided that the identical shares are returned to the borrower by the lender within a limited period of 12 months from the date in which the collateral arrangement was entered into.
- The above mentioned tax relief in collateral arrangements was welcomed by taxpayers, however, concerns have been raised about certain restrictions and potential shortcomings in this regard.
- Due to the fact that collateral arrangement support financial stability objectives and because of the role they play in mitigating credit risk, the following is proposed:
  - To extend the allowable period with which the identical shares are returned to the borrower by the lender from 12 months to 24 months.
  - To cater for corporate actions in relation to situations outside the control of the parties, that could result in an identical share being unable to be returned in terms of this arrangement.
  - To extend the tax dispensation to include listed Government bonds that are transferred in terms of this arrangement.

Refinement of third party backed shares rules to assist legitimate transactions entered into before 2012 (Clause 16 of the Draft Bill: Section 8EA)

- In 2012, third-party backed shares anti avoidance rules were introduced in the Income Tax Act to deal with share instruments with debt like features, e.g. preference shares.
- These rules targets share issues where the dividends in respect of those shares are guaranteed by unrelated third parties.
- It has come to Government attention that these rules have the unintended consequences of impeding certain historic legitimate arrangements and transactions that were entered into before 2012, i.e., before the introduction of these rules.
- In order to provide relief in respect of these legitimate transactions that were entered into before 2012, it is proposed that:
  - Parties that entered into any transaction before 2012 that fall foul of these rules be allowed to cancel these transactions.
  - The cancellation should be effected within a window period of 12 months starting from 1 January 2017 to 31 December 2017.

Addressing circumvention of anti-avoidance rules dealing with third party backed shares
(Clauses 16 & 16 of the Draft Bill: Sections 8E & 8EA of the Act)

- Several schemes have been identified where taxpayers structure transactions to circumvent the anti-avoidance rules dealing with third-party backed shares.

- These schemes include, for example, the formation of a trust holding mechanism, whereby investors acquire participation rights in trusts and the underlying investments of those trusts are preference shares.

- The formation of a trust effectively breaks the anti-avoidance link by interposing a trust between the investor and the tainted preference shares to avoid activating any of the anti-avoidance measures.

- In order to curb the circumvention of these anti-avoidance rules, it is proposed that:
  - Amendments be made in the definitions of "*hybrid equity instrument*" and *"preference share"* to include any right or interest where the value of that right or interest is directly or indirectly determined by the underlying share that is either an equity share or a share other than an equity share.

Extending the small business corporation regime to personal liability companies
(Clause 30 of the Draft Bill: Section 12E of the Act)

- The small business corporation regime provides for small business corporations to be subject to tax at progressive tax rates which are more favourable than the normal flat rate of 28 per cent.
- In order to qualify for the special dispensation, the entity must meet the definition of a “small business corporation” in the Income Tax Act.
- When the regime was introduced, a small business corporation had to either be a close corporation or a company registered as a private company in terms of the then applicable Companies Act, 1973.
- When the new Companies Act came into effect in 2011, the definition of a private company in the new Companies Act expressly excluded a personal liability company.
- This means that personal liability companies cannot benefit from the small business regime.
- In order to correct this, it is proposed that personal liability companies should be expressly included in the definition of a “small business corporation” contained in the Income Tax Act.

TAXATION OF FINANCIAL INSTITUTIONS AND PRODUCTS

Tax treatment of long term insurers due to the introduction of SAM
(Clause 48 of the Draft Bill : Section 29A of the Act)

- In 2015, an announcement was made in the Budget Review to cater for the tax treatment of the long term insurance industry as a result of the planned introduction of the SAM framework and the new Insurance Act. This will replace the current regulatory regime for the long term insurance industry.
- As a result, changes were proposed in the 2015 Draft TLAB submitted to Parliament to cater for the above. Parliament recommended that due to the fact that the Insurance Bill enabling SAM still requires to be considered by Parliament and envisaged that it will be introduced in 2017, proposals relating to tax treatment of long term insurers de to the introduction of SAM be removed from the 2015 Draft TLAB and be considered in 2016 and to allow further consultation with the industry.
- In view of the above, the following amendments are proposed:
  - The definition of "*value of liabilities*" in the Income Tax Act be standardised and be the same for both the risk policy fund and the policy holder funds. This amendment will be deemed to have come into operation on 1 January 2016 (i.e. the date in which the risk policy fund was introduced in the Act).
  - The new definition of *"Adjusted IFRS*" be applied to both the risk policy fund and the policy holder funds. This amendment will come into effect when the new Insurance Act and SAM come into effect.
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Tax treatment of long term insurers due to the introduction of SAM (Clause 48 of the Draft Bill : Section 29A of the Act)

Continued

- In order to stabilise revenue collection by SARS and to minimize the financial impact on long term insurers as a result of changes to the tax treatment of long term insurers due to the introduction of SAM, it is proposed that transitional rules and a phasing in period be introduced.
  - These rules are intended to cater for the differences in treatment of negative liabilities under the new regime (coming into effect when SAM comes into effect), and the previous rules that applied for tax purposes.
  - As a result, a 6 year phasing in period is proposed.

TAX INCENTIVES

Accelerated capital allowances for expenditure supporting renewable energy

(Clause 36 of the Draft Bill: Section 12U of the Act)

- Currently, assets used to generate electricity by way of renewable resources and the supporting structures of such assets are eligible for an accelerated capital allowance.

- However, capital expenditure that indirectly support renewable electricity production, such as the construction of roads and fences do not qualify for tax deduction.

- It is proposed that the provisions of the Act be broadened to allow for tax deduction of capital expenditure incurred for supporting capital infrastructure for large scale renewable energy projects.

- Only large scale renewable energy projects that generate electricity exceeding 5 megawatt will qualify.

Allowing additional municipalities to apply for the UDZ tax incentive
(Clause 38 of the Draft Bill: Section 13*quat* of the Act)

- The UDZ tax incentive was designed to encourage property investment in derelict CBDs and promote investment in urban renewal.
- It provides for an accelerated depreciation allowance on the value of new buildings and improvements to existing buildings.
- The incentive only allows 16 municipalities to designate UDZ areas, 15 of which now have demarcated UDZs within its boundaries.
- In 2015, changes were made in the Act to allow municipalities with a population of 1 million to demarcate an additional UDZ area, based on the requirements set out in the Act.
- Municipalities outside of the 16 currently designated have approached the Minister of Finance to broaden the scope of UDZ incentive to cover additional municipalities.
- It is proposed that the UDZ tax incentive be amended to provide a framework for the Minister of Finance to consider applications from municipalities currently not allowed to designate a UDZ area.

Refining the enabling venture capital regime for start up venture capital companies
(Clause 32 of the Draft Bill: Section 12J of the Act)

- In 2008, the VCC regime was introduced in the Income Tax Act in order to encourage equity funders to invest in small businesses. There are currently 37 registered VCCs and R600 million invested at VCC level.
- Taxpayers investing in a VCC generate an upfront deduction for the investment.
- As anti avoidance measures, the Act makes provision for a recoupment of tax deduction upon withdrawal, if the investment is not held for a minimum period of 5 years. In addition, connected persons do not qualify for the VCC tax deduction to ensure that taxpayers cannot obtain a deduction merely by recycling funds among closely connected parties.
- It has come to Government attention that at the initial stages of finding investors for a VCC, it may transpire that only a limited number of investors are able to provide seed funding. This may have the unintended consequence of breaching the anti-avoidance measure of connected person test.
- In order to create a more enabling environment for VCCs, it is proposed that the connected person test be performed 36 months after the first shares are issued by the VCC, as opposed to being performed at the end of every year of assessment.

Providing relief for mining companies spending on infrastructure for the benefit of mining communities
(Clause 50 of the Draft Bill: Section 36 of the Act)

- To be eligible for the granting of mining or production rights, the MPRDA makes it compulsory for mining companies to submit a Social and Labour Plans ("SLP").
- SLPs are aimed at assisting with the development of mining communities, which typically involves a company agreeing to build infrastructure, for example, roads, creches, schools, clinics, housing, recreational buildings, etc.
- The current tax provisions allows mining companies to deduct certain capital expenditure in equal amounts over a period of ten years, only if that capital expenditure relates directly to its employees, not the wider community.
- To further assist mining companies to meaningfully contribute toward community development it is proposed that the current incentive on capital expenditure on infrastructure development for employees be extended to cover infrastructure expenditure incurred for community development.
- To be eligible for tax deduction, the infrastructure should reflect what was agreed to between the mining company and the Department of Mineral Resources. In turn, similar to allowable capital expenditure for employees, it is proposed that the tax deduction for infrastructure expenditure be spread over a 10 year period or remaining life of the mine, whichever is the shortest.

Facilitating tax neutral consolidation of Department of Human Settlements Development Finance Institutions (Clauses 24 & 49: Sections 10(1)(t) & 30 of the Act)

- The Department of Human Settlements is currently consolidating all its Human Settlement Development Finance Institutions, under one entity, namely, the NHFC, which is wholly owned by Government.
- The NHFC is a taxable entity, whereas the other entities, namely, the RHLF and NURCHA are regarded as public benefit organisations, thereby exempt from normal tax.
- Given that the activities of these entities qualify as public benefit activities and were tax exempt before consolidation, consolidation should not deter public benefit activities that qualify for tax exemption.
- It is proposed that the receipts and accruals of NHFC should be exempt from tax in terms of section 10(1)(t) of the Income Tax Act.
- In order to allow for tax neutral transfer of assets and liabilities from NURCHA and RHLF to NHFC, (which are currently exempt PBOs), it is proposed that a further amendment be made to section 30(3)(b) of the Income Tax Act.

Exempting from tax property transfers envisaged under the land reform initiatives stipulated in the National Development Plan

(Clauses 60, 75 & 76 of t6he Draft Bill: Section 56,paragraphs 64A &64D of the Eighth Schedule to Act)

- The Income Tax Act makes provision for tax relief in respect of land donated under certain land reform programmes. For example, land granted in terms of the Land Reform Programme as contemplated in the White Paper on South African Land Policy, 1997 is exempt from donations tax.
- In addition, awards or compensations in terms of Restitution of Land Rights Act, 1994 are exempt from capital gains tax.
- Subsequent to this, Government has since introduced other land reform initiatives as stipulated in Chapter 6 of the National Development Plan (NDP).<u>These land reforms include commercial agricultural and farming as part of empowerment</u>.
- As the existing tax relief in the Income Tax Act was introduced prior to the publishing of the NDP, the relief does not extend to land reform initiatives aligned to Chapter 6 of the NDP.
- In order to provide relief to other land reform initiatives as stipulated in Chapter 6 of the NDP, it is proposed that such land reform initiatives should be exempt from donations tax and capital gains tax.

Extending the list of exempt education and training public benefit activities to benefit industry based training organisations
(Clause 79 of the Draft Bill: Part 1 of the Ninth Schedule to the Act)

- The public benefit organisation provisions in the Income Tax Act makes provision for tax exemption of educational and training activities provided that the training is provided to unemployed persons with the purpose of enabling them to obtain employment or if the training is provided to persons employed by Government.

- It has come to Government attention that certain industry based associations provide education and training activities to persons employed in that industry for purposes of upgrading their skills and they issue them with certificates on the completion of the training programme.

- These certificates are recognised by the industry as well as Department of Labour.

- In order to encourage skills development, it is proposed that the list of exempt public benefit education and training activities be extended to cater for a tax exemption of industry based training organisation.

Provision for exception to the R&D incentive prescription rules
(Clause 28 of the Draft Bill: Section 11D of the Act)

- The R&D tax incentive is aimed at promoting R&D related job opportunities and economic growth.
- This tax incentive is in the form of a 150 per cent deduction for non-capital R&D expenditure.
- Taxpayers who seek to benefit from the R&D allowance are required to obtain pre-approval from the Minister of Science and Technology, who in turn makes a decision on such approval based on the findings of the committee set up for this purpose.
- The Minister of Science and Technology appointed a Task Team to make recommendations on how the R&D tax incentive could be improved.
- One of the issues identified by the Task Team is the fact that delays in processing approvals could possibly result in tax assessments prescribing before approval decision is communicated to the taxpayer.
- In order to avoid possible SARS interest & penalties, taxpayers choose not to include the full 150% deduction on their tax returns until approval has been granted by DST.
- It is proposed that legislation be amended to allow SARS to re-open and re-assess a previous year tax return in order to grant an R&D deduction that would've been deducted if approval was granted timeously.

INTERNATIONAL TAXATION

Repeal of the withholding tax on services regime
(Clause 59 of the Draft Bill: Part IVC of Chapter II of the Act)

- In the 2013 Budget , the Minister of Finance announced the introduction of withholding tax on cross border service fees at 15%. However, the effective date for this new regime was postponed to 1 January 2017.
- This is a final withholding tax in respect of fees payable by a South African resident to a non-resident for technical, management and consulting services rendered by that non-resident to a South African resident aimed at identifying and collecting revenue from non-residents.
- On 3 February 2016, SARS issued in Notice 140 of the Government Gazette no 39650 a revised list of reportable arrangements. According to this Notice, an arrangement between a South African resident and a non-resident where the non-resident rendered certain listed services and the South African resident will incur expenditure that exceeds or is anticipated to exceed R10 million, is a reportable arrangement provided that it does not qualify as remuneration as defined.
- Both the withholding tax on services regime and the above-mentioned reportable arrangement regime are aimed at achieving the same objective.
- If the reportable arrangement regime were to be applied concurrently with the withholding tax on services regime, it would result in additional administrative and compliance burden.
- It is therefore proposed that the withholding tax on services regime be repealed.

Exemption of Collective Investment Schemes from controlled foreign company rules
(Clause 21 of the Draft Bill: Section 9D of the Act)

- The South African tax system has anti-avoidance CFC rules aimed at preventing South African residents from shifting income offshore by investing through CFCs.
- There is uncertainty regarding the application of CFC rules where South African collective investment schemes invests in global fund, which is a foreign fund.
- There is a view that South African collective investment schemes should be considered to be the direct holders of the participation rights in that global fund. On the other hand, there is another view that as South Africa collective investment schemes are established as vesting trusts, the units in the global fund are beneficially owned by the investors in the South African collective investment schemes in proportion to their effective interests in such global fund.
- In order to eliminate this uncertainty and potential double taxation and to recognise the widely held nature of South African collective investment schemes, it is proposed that:
  - South African collective investment schemes investing in a global fund should be excluded from applying the CFC rules.
  - The conduit principle will apply and tax will ultimately fall in the hands of the unit holders.

Adjusting the calculation for comparable tax exemption in respect of controlled foreign companies
(Clause 21 of the Draft Bill: Section 9D(2A) of the Act)

- In 2009, a CFC comparable tax exemption was introduced.
- The purpose of this exemption is to disregard tainted CFC income, if little or no South African tax was at stake after taking into account the South African tax rebates.
- The CFC will qualify for the high tax exemption if it's net income in aggregate is subject to foreign tax of at least 75% of the amount of normal tax that would have been imposed had the CFC been fully taxed in South Africa.
- The comparable tax exemption is based on a calculation of a hypothetical amount of the global level foreign taxes imposed by all foreign spheres of government. The global foreign tax is calculated after disregarding foreign tax carry forward and carry back losses as well as group losses.
- Generally, the income tax does not allow foreign tax rebates for notional foreign taxes. However, in the calculation of the hypothetical amount of foreign taxes, some CFCs within a group of companies that are in a loss making position benefit from comparable tax exemption.
- This creates anomaly because in these circumstances, no foreign tax is actually paid or payable.
- In order to close this anomaly, in the determination of foreign tax for comparable tax exemption, it is proposed that the adjustment for foreign group losses and carry forward foreign losses of the CFC be withdrawn.

Value added tax (VAT)

Revision of the 2014 amendment relating to notional input tax on goods containing gold
(Clause 82 of the Draft Bill: Section 1 of the VAT Act)

- In 2014, changes were made in the VAT Act to amend the definition of "*second hand goods*" to specifically exclude "gold" and "goods containing gold" from the definition, thereby denying the notional input tax credit on all gold and goods containing gold.
- The policy rationale for these amendments was to curb fraudulent input tax deductions as a result of deduction of notional input tax especially in the case of illegal gold sales and smuggling.
- It has come to Government attention that the 2014 amendments have led to unintended consequences of denying the notional input tax credit on all goods containing gold, especially with regard to second hand goods where the gold content is minimal or inconsequential and the legitimate trade in second hand jewellery.
- In order to remove the unintended consequences, it is proposed that:
  - the 2014 amendments be revised;
  - the definition of "*second hand goods*" in the VAT Act be amended to allow the deduction of notional input tax on goods containing gold that will be resold in the same manner or substantially the same state as they were purchased in.

Allowing municipal entities to account for VAT on payment basis where the supply is R100 000
(Clause 84 of the Draft Bill: Section 15 of the VAT Act)

- The VAT Act makes provision for certain entities including public authorities and municipalities to register and pay VAT on a payment basis.

- The VAT Act further requires that vendors who are registered on the payment basis to account for VAT payable on the invoice basis in respect of any one supply exceeding a value of R100 000. However, public authorities and municipalities are not required to meet this requirement.

- The current exclusion from the requirement to account for VAT payable on the invoice basis in respect of any one supply that exceeds R100 000, available to public authorities and municipalities is not extended to municipal entities.

- It is proposed that the VAT Act should be amended so that the current exclusion is made available only to municipal entities that supply electricity, gas, water services, etc.

VAT exemption in respect of goods that are lost, destroyed or damaged through natural disasters (Clause 86 of the Draft Bill: Schedule 1 to the VAT Act)

- The Customs and Excise Act makes special exemption from paying customs duties on the importation of goods if those goods are subsequently lost, destroyed or damaged through natural disasters and provided that they meet specified requirements.

- On the other hand, no similar exemption is available in the VAT Act for goods proved to be lost , destroyed or damaged through natural disasters.

- It is proposed the VAT Act should be aligned with the Customs and Excise Act and amendments be made in the VAT Act to exempt the above-mentioned goods.

Tax Administration Laws Amendment Bill (TALAB)

Contents: Main amendments

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  - General anti-avoidance rule understatement penalties
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Withholding tax on interest relief if interest is irrecoverable

[Clause 58 of TLAB; section 50G of ITA]

- Tax must be withheld from interest paid to a foreign person & interest deemed paid on date on which the interest becomes due and payable

- If withholding tax on interest (WTI) is paid but the actual interest is never paid and becomes irrecoverable, there is currently no mechanism for a refund of the WTI

- Mechanism for refund inserted as section 50G(2)
  - Person who paid the tax will be able to claim refund where WTI paid on irrecoverable interest
  - Equitable alignment of WTI scheme with SA taxpayer's right to deduction of irrecoverable interest under section 11(i) of ITA

Provisional tax

[Clauses 7, 10, 11 and 12 of TALAB; paragraphs 9, 11C, 19, and 20 of 4th Schedule to ITA]

- Directives to be sought for lump sum withdrawals from and reinvestments in retirement funds as tax treatments of retirement funds differ
- Calculation of deemed remuneration to directors of private companies for employees' tax purposes repealed, amounts taxable in directors' hands and companies permitted deduction when payments are made
- Failure to submit a second provisional tax estimate deemed to be a nil estimate four months after end of year of assessment, instead of six months, to align with opening of filing season for individuals
- Removal of specific exclusions from penalty calculation
  - Once-off amounts such as lump-sum and severance payments are taxed separately in terms of special tables and tax owed is withheld before payment
  - Other similar amounts currently excluded from penalty calculation
  - Taxpayers thus not penalised if they fail to pay the provisional tax due at normal rates in respect of the similar amounts

Customs & Excise Act

[Clause 20 of TALAB, clause 80 of TLAB; sections 113 and 119B of C&E Act]

- Maximum weight of cigarettes that may be imported or manufactured
  - Maximum allowed weight of cigarettes that may be imported or manufactured updated to more accurately reflect volumes of tobacco inputs currently used in cigarette production
  - This will assist anti-illicit tobacco enforcement interventions that match tobacco inputs against declared cigarette outputs
- General anti-avoidance rule
  - General anti-avoidance rule (GAAR) added to the customs and excise legislative framework in order to enhance enforcement and compliance efforts for customs duties and excise taxation
  - Design of the GAAR is in line with similar provisions in other indirect tax legislation

Value-added Tax Act

[Clauses 24 and 26 of TALAB; sections 16 and 44 of VAT Act]

- Alternative documentary proof
  - Vendors (suppliers) obliged to issue documents in a defined form and manner which are generally aligned with commercial & accounting practice
  - Purchasers sometimes issued with defective documents or are unable to obtain documents from suppliers
  - Purchasers cannot claim input tax deductions without proper documents
  - Amendment clarifies criteria for alternative documentary proof that may be used as a last resort
- Alignment of prescription periods for refunds
  - A person may deduct an amount from output tax attributable to a later tax period if period falls within five years from the date of certain events, e.g. the date a tax invoice should have been issued.
  - Clarification of time limit for the payment of refunds – a refund claim must be received by SARS within five years after date upon which the payment of the amount claimed as refund was made

Mineral and Petroleum Resources Royalties (Administration) Act

[Clauses 30 – 44 of TALAB; sections 1, 5, 5A, 6, 6A, 8, 14-16, 18A, 19 and Part III, IV and Part 4 of Act]

- The payment of mineral and petroleum resources royalties under the Act largely follows the provisional tax system in the Fourth Schedule to the Income Tax Act
- To improve payment automation, greater alignment with the Fourth Schedule is required, particularly with regard to interest and penalties
- Proposed amendments aim to effect such alignment:
  - Amended wording of section 5 & new section 5A more clearly reflects the steps in the process of estimate, return and payment of royalty
  - Proposed wording change to section 6 clarifies fact that there may be more than two payments if an estimate is adjusted under section 5A
  - Insertion of new section 6A for refunds in case of overpayments by taxpayer
  - Clarification of when penalty on underpayment based on underestimation will be imposed & calculation thereof
  - Interest system linked to Tax Administration Act interest system

Independence of Tax Ombud

[Clauses 47 – 50 of TALAB; sections 14, 15, 16 and 20 of TAA]

- Two international models considered when Tax Ombud (TO) introduced
  - Independent ombud drawing resources from revenue administration
  - Tax function in government ombud's office (i.e. Public Protector)
- First model selected – Not UK example originally recommended by Katz Commission, closer to Canadian example adapted for South African legal and constitutional dispensation
- Following discussions with TO & Office of the Tax Ombud (OTO) CEO, several amendments to enhance TO's independence are proposed
  - Tenure of TO: Extended from three to five years
  - Staff: TO will appoint staff directly in terms of SARS Act, without secondment or consultation with Commissioner
  - OTO expenditure: Although paid from funds allocated to SARS, payments will be made in terms of budget for OTO approved by Minister
  - Mandate: In addition to reviewing systemic issues identified through taxpayer complaints, TO will review such issues at request of Minister
  - TO recommendations not accepted: Taxpayers and SARS to indicate reasons

Legal costs and objection time periods
[Clauses 46, 55 of TALAB; sections 11, and 104 of TAA]

- Legal costs
  - SARS legal costs recovered by state attorney currently paid directly to SARS as original costs were expended from its budget
  - Such costs will be paid into National Revenue Fund in future to align SARS with other organs of state
- Extension of periods for objection and condonation of late objections
  - Current period for lodging objections (30 business days) has been shown to be too short in practice resulting in large number of condonation applications
  - Period is set in rules issued by Minister of Finance after consultation with Minister of Justice and Constitutional Development and to be adjusted there
  - Further period for late objections on “reasonable grounds” extended from 21 business days to 30 business days

General anti-avoidance rule understatement penalties and voluntary disclosure programme

[Clauses 59 – 61 of TALAB; sections 221, 223, 225 and 226 of TAA]

- General anti-avoidance rule (GAAR) understatement penalties
  - Case law under the additional tax penalty system, the predecessor to the understatement penalty system, supports imposition of such penalties in GAAR matters
  - Amendments clarify that this continues to be the case in respect of understatement penalties, which is also in line with international practice
  - In addition, to provide clarity as to what the appropriate penalty would be in GAAR matters, it is proposed that a new behavioural category be inserted in the understatement penalty table between “no reasonable grounds for ‘tax position’ taken” and “gross negligence”
- Voluntary disclosure programme
  - If a person is aware of audit or investigation related to default to be disclosed, application for voluntary disclosure programme is restricted
  - Amendments clarify the meaning of audit or investigation by defining and substituting terms “pending audit” and “criminal investigation”

Other – not in these Bills

Accelerated depreciation for investment in cleaner fuels

- The 2016 Budget Review notes that: *Compliance with new fuel specifications will require an estimated R40 billion in capital expenditure by South African oil refineries. To facilitate the necessary upgrades, government proposes to provide an accelerated depreciation allowance for a limited time. This would allow qualifying capital expenditure to be deducted over a three-year period.*
- Initial consultations followed by written comments from all the fuel companies indicated that the proposed amendment will not have any impact on companies decisions to proceed with clean fuel investments.
- All the companies are of the view that nothing less than full cost recovery will be required to encourage them to consider upgrading their refineries to produce cleaner fuels.
- It is now up to the Department of Energy to re-initiate a process to consider if the request / demand by the industry are reasonable and if and how such a request should be considered.

Clarifying the tax treatment of non-executive director's fees (1)

- The 2016 Budget Review notes that : *Under the Income Tax Act (1962) and the Value-Added Tax Act (1991), non-executive director's fees may be subject to both employees' tax (PAYE) and VAT. Views differ on whether to deduct PAYE from these fees and if the director should register as a VAT vendor. It is proposed that these issues be investigated to provide clarity.*

- Upon further investigation and after consultation with stakeholders it was agreed that this difference of opinion can be resolved if we can agree on fundamental tax principles. These are:

  - Directors fees is subject to Income Tax – it is a payment / income for services rendered.
  - Directors fees is also subject to VAT at 14% as such services are taxable supplies – it is neither zero-rated nor is it exempt supplies. So where the total taxable supplies (in this case director fees payable is in excess of R1.0 million over a 12 month period) such supplies are subject to VAT at 14%.

Clarifying the tax treatment of non-executive director's fees (2)

- The question is now if the Directors fees should be subject to PAYE.
- Its should be noted that PAYE is not an additional tax it is merely a withholding mechanism to recover Income Tax on a monthly basis from employees or deemed employees (or more legally more correct - remuneration or deemed remuneration).
- The conclusion is that director fees might also be subject to PAYE – if the facts and circumstance suggest that there is the likely of deemed remuneration.
- Again it is important to note the deduction of PAYE does not amount to double taxation, it merely assist with the collection of Income Tax revenue

- In the end it was agreed that no legislative amendments are require and that SARS will clarify this by way of Interpretation Notes.

Employment tax incentive (ETI) and Learnership allowance (tax incentive)

- ***From 2016 Budget Review:***

- *"The learnership tax incentive, introduced in 2002, aims to encourage education and work-based training. The **employment tax incentive**, introduced in 2014, was designed to promote the employment of young workers. Both incentives will expire towards the end of 2016. SARS has made data on the employment tax incentive available and a review is under way. It is envisaged that **results from the review of both incentives will be published and presented to Parliament by the third quarter of 2016**. If there are delays in completing these reviews, government may consider extending the incentives by one year."*

Review of the Employment Tax Incentive (ETI) and the Learnership tax allowance / incentive

- The ETI is aimed at drawing young, inexperienced workers into the labour market
- The Learnership tax allowance / incentive is meant to support work-based training & skill development
- Both programmes are approaching their sunset dates:
  - ETI expires 31 December 2016
  - Learnerships entered into after 1 October 2016 will not qualify for the learnership tax incentive.
- NT is reviewing the performance of both these programmes
  - There is a lag of approximately 18 months to two years before good data becomes available
  - NT is engaged in consultations with Nedlac partners on the ETI
  - We releasing ETI descriptive report to enable SCoF to assess Treasury review
  - Treasury ready to provide a more detailed presentation to SCoF
- Will propose any amendments – if required - through supplementary draft legislation in Sept / Oct 2016 for comment and then incorporate into final TLAB in late Oct

ETI claims

- Take up of the ETI was much larger than initially anticipated
  - Close to R6bn compared to an estimated R2bn – over a period of two years

- Exact number of workers comes out with a lag
  - **Initially we estimated the number for the first year of claims using the maximum value,** which is constant for the first year, not thereafter.

	Tax years			
	2013/14*	2014/15	2015/16	2016/17
Total ETI claimed (using EMP201s)	R 198 mn	R2 648 mn	R3 615 mn	
Number of ETI supported jobs (using IRP5 data)	134 923	686 402	*Available 2016 q4*	*Available 2017 q4*

** Note that results for the 2014 tax year only cover two months of ETI data (the scheme began in January 2014 and the tax year ends in February 2014).*

Firms who are claiming the ETI

- **The number of firms claiming the incentive has been relatively high.** In the two months in the 2013/14 tax year, 13 399 firms lodged at least one claim for the incentive.
- In the following tax year, 2014/2015, 32 368 firms lodged at least one claim.
- This represents 15% of firms with eligible employees claim the incentive.

Industry	Number of ETI claiming Firms	% of firms in database claiming ETI	Average ETI claim per firm
Agriculture	3 041	18%	85 209
Mining	392	18%	47 320
Manufacturing	7 448	16%	40 077
Utilities	317	11%	31 235
Construction	1 728	13%	34 872
Trade	5 532	18%	128 703
Transport	1 014	13%	38 350
Tourism	2 246	26%	65 804
Financial Services	7 111	11%	113 450
Non Govt Community Services	3 201	10%	31 401
Unknown	318	3%	10 243
Total	32 368	13%	75 879
Of which labour brokers	257	40%	819 446

- **Interestingly, there are more manufacturing firms claiming the ETI than any other grouping,** although total claims per firm are smaller. Also notable is how many firms in financial services and trade are claiming the ETI.

Firms who are claiming the ETI (ii)

- ETI claims broadly mirror the proportion of ETI-eligible workers across sectors.

Industry	% of workforce eligible for ETI	ETI claim amount (R millions)	Number of jobs ETI claimed for	% of ETI eligible workforce claimed for ETI
Financial Services	24%	807	244 503	26%
Trade	38%	712	157 600	28%
Manufacturing	19%	298	83 852	21%
Agriculture	35%	259	96 667	26%
Tourism	39%	148	38 549	28%
Non Gov Community Services	20%	101	25 525	13%
Construction	23%	60	19 297	19%
Transport	13%	39	11 589	18%
Mining	6%	19	5 491	19%
Utilities	9%	10	2 534	21%
Unknown or errors	16%	3	625	7%
Total	**22%**	**2 460**	**686 418**	**23%**
*of which labour brokers**	43%	211	74 583	28%

- Take up has been dominated by industries that typically employ lower waged young workers
  - Financial services, Retail, Manufacturing, Agriculture.