DRAFT

2017 DRAFT TAXATION LAWS AMENDMENT BILL & 2017 DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL

Standing Committee on Finance

Presenters: National Treasury and SARS | 15 August 2017

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Officials present

- Ismail Momoniat, NT
- Yanga Mputa, NT
- Chris Axelson, NT
- Franz Tomasek, SARS
- Catinka Smit, SARS
- Ronel Mosehane, SARS

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  7. Value Added Tax

- 2017 DRAFT TALAB
  1. Income Tax Act
  2. Customs and Excise Act
  3. Tax Administration Act
  4. Customs Duty Act and Customs Control Act

Overview of tax process

- The Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (Rates Bill), published on Budget Day (22 February 2017), the draft Taxation Laws Amendment Bill (TLAB) and the draft Tax Administration Laws Amendment Bill (TALAB) published on 19 July 2017, give effect to the tax proposals announced in the Budget.

- The 2017 Draft TLAB and 2017 Draft TALAB contain more complex, technical and administrative tax proposals.

- Some of the proposed tax changes in the Budget are not included in these draft tax bills but are effected through changes to the Schedules to the Customs and Excise Act and subordinate legislation.

Overview of tax process AFTER publication of draft Bills

- Due to constitutional requirements, the draft tax bills are split into two separate bills, i.e., money bills in terms of section 77 of the Constitution dealing with national taxes, levies, duties and surcharges (Draft Rates Bill, Draft TLAB) and an ordinary bill in terms of section 75 of the Constitution, dealing with tax administration issues (Draft TALAB).
- The draft tax bills are published for public comment and SCOF convene public hearings prior to their formal introduction in Parliament.
- NT and SARS will engage stakeholders submitting comments in more detail through workshops to be held in late August.
- NT and SARS will present a Response document around September/October after which the above draft bills will be revised taking into account public comments.

GENERAL

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

- In 2017, the Minister made an announcement in the Budget to increase the dividends tax rate from 15% to 20% with effect from the Budget Day, 22 February 2017, and these changes were made in the 2017 Draft Rates Bill that was published for public comment on Budget Day.
- Comments were submitted to the SCoF during public hearings on the 2017 Draft Rates Bill regarding the power to levy a higher dividends tax rate based on the Budget announcement, before the amending legislation (2017 Rates Bill) is promulgated.
- Even though in most countries, including South Africa, most rates and threshold changes take place on the day of the announcement and begin to be implemented before the tax laws are enacted (about ten months after the announcement), in order to address this issue, it is proposed that amendments be made in all the tax Acts administered by SARS, to align all the withholding tax rate provisions that will enable the Minister to change (whether it is for purposes of an increase or decrease) the withholding tax rates.
- It is proposed that the withholding tax rates announced by the Minister in the Budget should 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 amendments made in 2016, and is similar to the provisions available in the Customs and Excise Act.

PERSONAL INCOME TAX

Repeal of foreign employment income exemption
(Clause 14 of the Draft Bill: Section 10(1)(o)(ii) of the Act)

- SA moved to residence base of income tax in 2001. SA tax residents are taxed on their worldwide income.
- History of Section 10(1)(o)(ii): Started as a an exemption for foreign income earned by SA officers and crew who were outside SA for 183 days; was extended in 2001 to exempt all employment income of ANY residents who were outside SA for 183 days (60 days continuously) – though not public servants.
- Since 2001 SA has extended coverage of Double Tax Treaties – which assigns taxing rights to "source" and "residence" jurisdictions and eliminates double taxation.
  - SA's DTAs generally give source states a limited right to tax employment income received in the source state; residence states have exclusive right to tax resident individual's employment income for services rendered in a source state if outside resident state for < 183 days, working for resident employer who is not a permanent establishment in source state.
  - Source states have first right if these conditions are not met, but residence states are not precluded from taxing the same employment income.
  - However, if residence states impose tax on same income, it is required to provide relief from double taxation by way of a foreign tax credit or exemption.

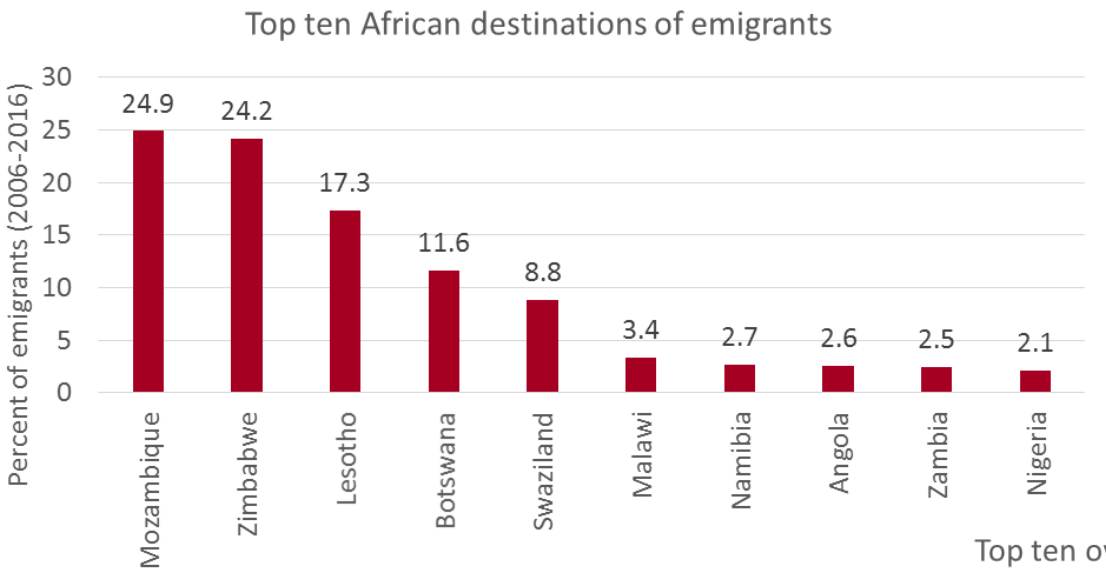
Repeal of foreign employment income exemption
(Clause 14 of the Draft Bill: Section 10(1)(o)(ii) of the Act)

- EM to Revenue Laws Amendment Act, 2000, anticipated the possibility of the abuse of this exemption. “The effect of this relief measure will be monitored to determine whether certain categories of employees abuse it to earn foreign employment income without foreign taxation.”
- The exemption creates circumstances of double non-taxation, where no (or very little) tax is applied in the foreign country and no tax is applied in South Africa and is a significant departure from the residence based principle of taxation
- Creates further inequities as exemption does not apply to SOE employees
- It is proposed that the current section 10(1)(o)(ii) exemption be repealed. As a result, all South African tax residents will be subject to tax on foreign employment income earned in respect of services rendered outside South Africa with relief from foreign taxes paid on the income under section 6quat of the Act.
- The existing architecture for foreign tax credits (section 6quat) to be utilized – with requirements for documentary proof for payment of foreign taxes to be developed further.
- SARS’s automatic exchange of information with other revenue authorities also strengthens enforcement

Repeal of foreign employment income exemption: Systems already in place and not based on citizenship

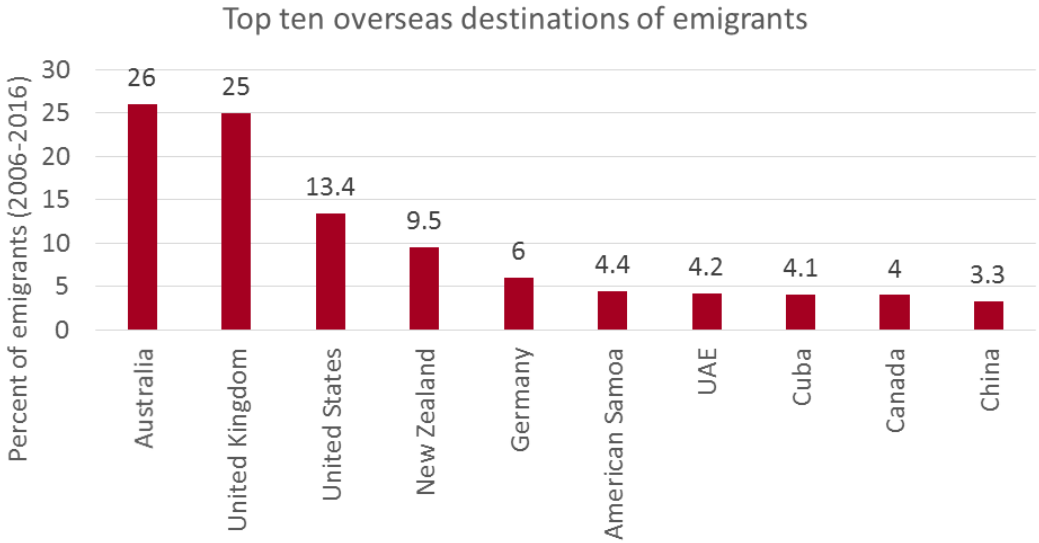
- Remuneration for services rendered out of South Africa is currently taxable if the 183/60 day criteria is not met or if income is not remuneration (contractor)
  - SARS already handles the administration of adding foreign remuneration to taxable income and crediting taxes paid in the foreign country when the exemption does not apply (this is not a new system)
- Individuals who are not SA tax resident (i.e. who have permanently left South Africa) will not be affected
  - However, if they did not previously tell SARS they are non-resident, they will need to notify SARS and capital gains tax would apply on their assets
- An individual is defined as a tax resident if
  - They are "ordinarily resident" (case law – do they have a home or family in SA? Do they intend to come back to South Africa?), or
  - They were physically present in South Africa for 91 days during the current year of assessment, and for 91 days during each of the five previous years of assessment and more than 915 days in total over the past five years of assessment
- The tax residency test is separate to citizenship
  - Emigration to stop being an SA tax resident does not require a change in citizenship

Repeal of foreign employment income exemption: Where do South Africans go when they leave the country?



- Data from the Community Survey 2016, which was compiled by Statistics South Africa, gives an indication of where South Africans went if they left the country between 2006 and 2016
- No indication of tax residency (i.e. whether exemption applies)

- The quantum of people leaving the country may be undercounted in the survey, but the data does give some insight into the relevant countries where South African go.
- What would be the tax treatment of foreign employment income in these countries?



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Repeal of foreign employment income exemption: Treatment in Australia

Australia: (https://www.ato.gov.au/Individuals/Income-and-deductions/Income-you-must-declare/Foreign-income/)

- "If you're an Australian resident for tax purposes, you are taxed on your worldwide income"
  - "including foreign employment income"
- The main determination of tax residency is the 'resides' test, which looks generally at whether the individual lives in Australia, but also looks at
  - The intention and behaviour of the person, family and business ties, location of assets (motor vehicles) and social and living arrangements (member of a local club)
- If not met, then look at "domicile test", the 183 day test (present in Australia for 183 days) and the superannuation test (government employees are residents)
- If a person works for 365 days of the year in another country and they are deemed to be an Australian tax resident, then the full amount of remuneration will be added to taxable income
  - Subject to DTAs and tax credits, but if no tax then full amount taxed in Australia
- 2017 Draft TLAB proposal matches the tax treatment of Australia

Repeal of foreign employment income exemption: Treatment in the United Kingdom

United Kingdom: (https://www.gov.uk/tax-foreign-income/residence)

- "Residents normally pay UK tax on all their income"
- Automatically resident if:
  - "you spent 183 or more days in the UK in the tax year
  - your only home was in the UK - you must have owned, rented or lived in it for at least 91 days in total - and you spent at least 30 days there in the tax year"
- Automatically non-resident if:
  - "you spent fewer than 16 days in the UK (or 46 days if you haven't been classed as UK resident for the 3 previous tax years)
  - you work abroad full-time (averaging at least 35 hours a week) and spent fewer than 91 days in the UK, of which no more than 30 were spent working"
- But if neither, then use a "Sufficient Ties Test"
  - Family members, usual accommodation, working days in UK, etc.
- If a UK tax resident (who isn't a non-domicile) renders services in another country for 348 days or less, that whole amount of remuneration will be taxable in the UK
- Non-domiciles (permanent home outside UK) pay tax on repatriated amounts

Repeal of foreign employment income exemption: Treatment in the United States

United States: (https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion)

- "If you are a U.S. citizen or a resident alien of the United States and you live abroad, you are taxed on your worldwide income."
- Note this is related to citizenship and not tax residency – these rules apply for as long as you are a citizen
- There is, however, a foreign earned income exclusion of $100,800 (in 2015) if the person meets the physical presence test
  - The physical presence test is met if the person is physically outside of the United States for at least 330 days over a 12 month period
  - Not dependent on where you are ordinarily resident or what your intentions are

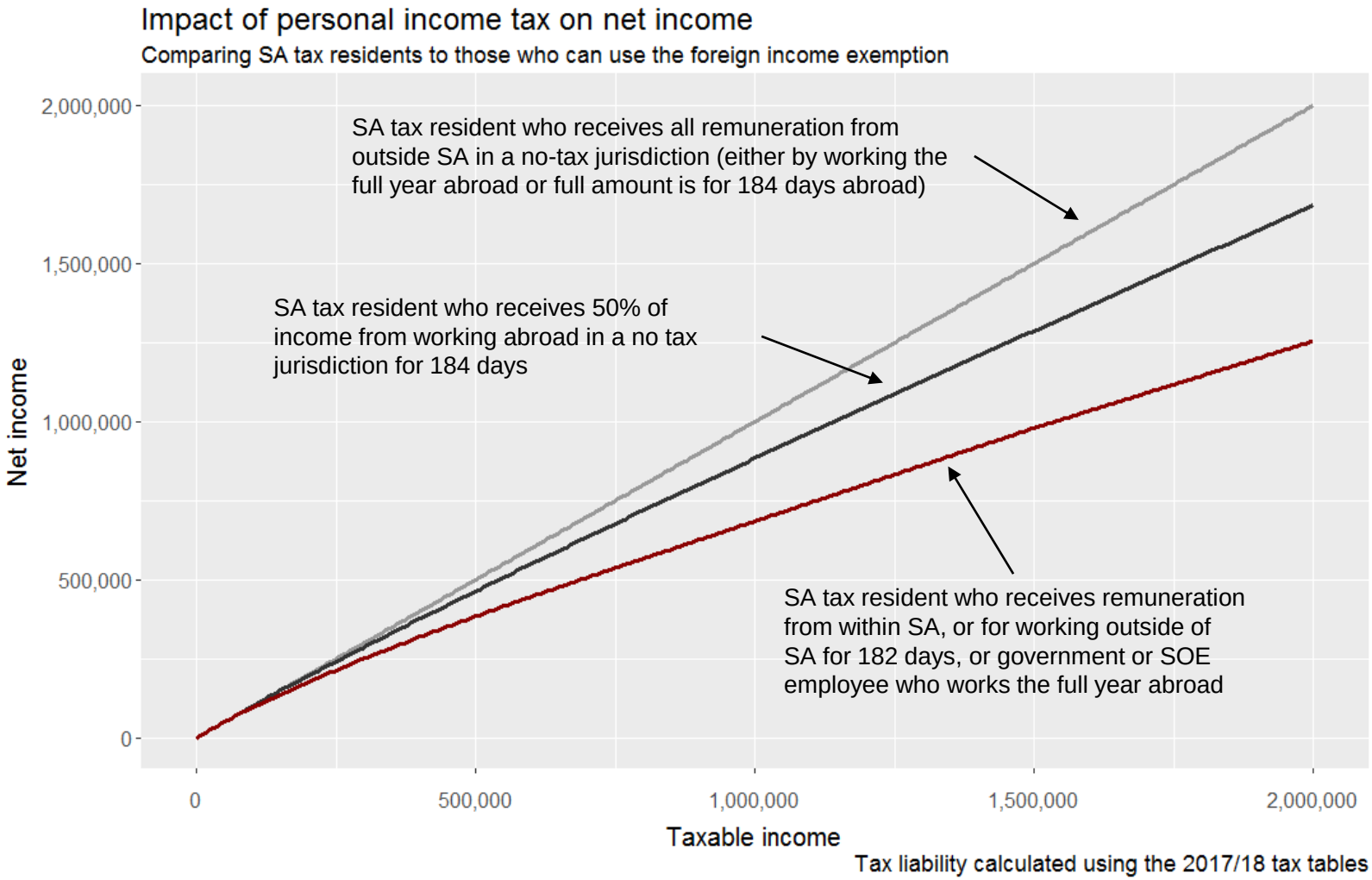
- If a US citizen renders services in another country for less than 330 days, they will be taxed in full in the US.
- If is longer than 330 days, will still be taxed on amounts above the foreign earned income exclusion

Repeal of foreign employment income exemption: Treatment in New Zealand

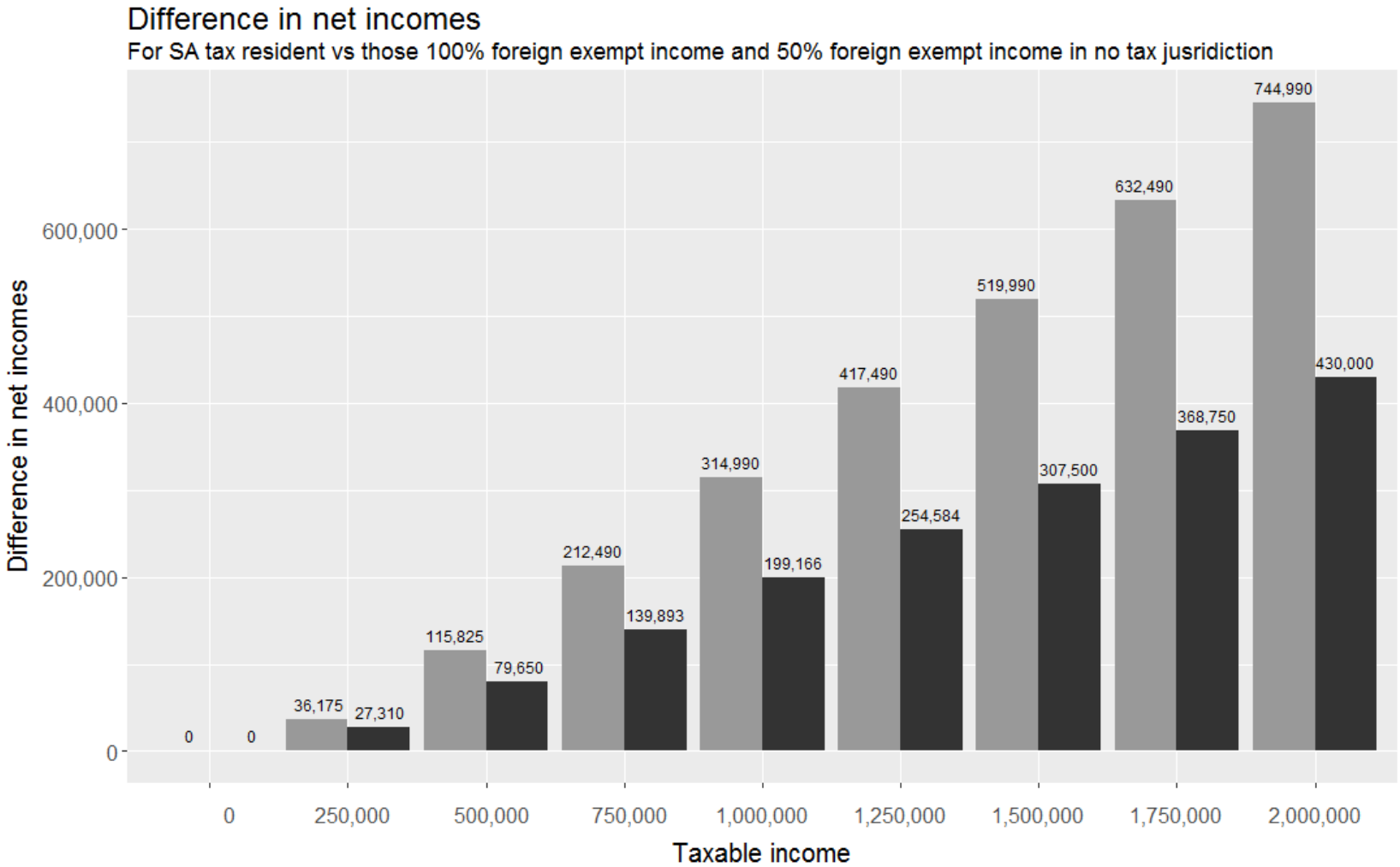
New Zealand: (https://www.ird.govt.nz/international/residency/personal/)

- "If you are a New Zealand tax resident, you are taxed on your worldwide income"
- A tax resident if you:
  - "are in New Zealand for more than 183 days in any 12-month period and haven't become a non-resident, or
  - Have a 'permanent place of abode' in New Zealand, or
  - Are away from New Zealand in the service of the New Zealand government"
- "If you've ever been a resident in New Zealand under the 183-day rule, you remain resident until you've been outside New Zealand for more 325 days in any 12-month period and don't have a permanent place of abode in NZ"
  - NB: the 'permanent place of abode' test overwrites any days-based rules – i.e. you'll always remain resident as long you have a permanent place of abode in New Zealand
- Some types of income earned abroad may be temporarily exempt from tax in New Zealand i.e. rental income, dividends, gains on the sale of property e.tc
  - However, this does not include employment income earned from rendering services abroad, whilst a resident of New Zealand

Repeal of foreign employment income exemption: Difference in net incomes after using exemption

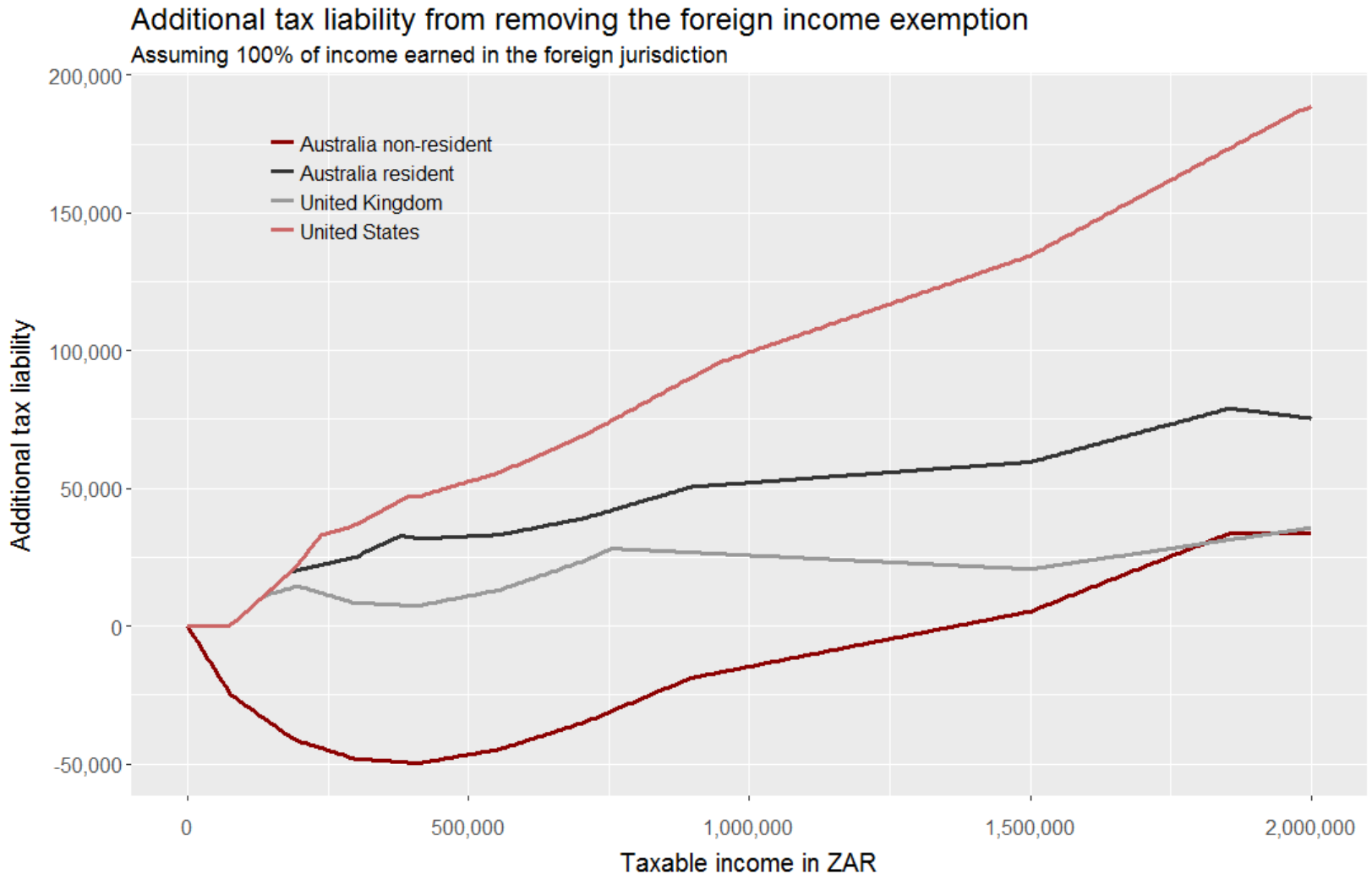


Repeal of foreign employment income exemption: Difference in net incomes after using exemption (2)



Tax liability calculated using the 2017/18 tax tables

Repeal of foreign employment income exemption: Potential additional tax liability



Repeal of foreign employment income exemption: Potential implications

- There were 5 109 individuals who declared non-taxable foreign remuneration in the tax year 2014/15
  - Clearly many SA tax residents who earn money abroad are not declaring that income to SARS, however since it has not been taxable they may have not seen the need to do so (although it is required)
  - There are many more SA tax residents abroad so impact will be far wider

- People formally emigrate or indicate to SARS they are not SA tax resident
  - Capital gains tax charge on their assets on emigration
  - Individuals move away from South Africa, potentially reducing the tax base
- Individuals on "net" contracts in foreign countries will have tax difference paid for by the employer
  - Little to no impact on these employees
  - Reduces competitiveness of SA employees abroad and increases costs for employers
  - Increase in tax revenues

Tax relief for Bargaining Councils regarding tax non-compliance
(Clauses 95-100 of the Draft Bill: Part II of the Act)

- Some Bargaining Councils have not deducted PAYE from a large number of members for holiday, sick leave and end of the year payments. Others have also not been paying income tax in respect of the growth/returns generated from the financial investments of the Bargaining Council.
- The Bargaining Councils' non-compliance with tax legislation potentially extends back a number of decades.
- Based on the consultation process with the Department of Labour, most of these Bargaining Councils would be at risk of closure or would suffer severe financial distress if high penalties and interest are imposed for non-compliance. Given the unique circumstances of this case, the 2017 Draft TLAB proposes the following degree of relief for Bargaining Councils:
  - Non-compliant Bargaining Councils will be required to pay a levy of 10% of the total PAYE that should have been deducted from all payments made to their members between 1 March 2012 and 28 February 2017;
  - Non-compliant Bargaining Councils will be required to pay a levy of 10% of the total untaxed investment income between 1 March 2012 and 28 February 2017;
  - The relief will apply in respect of the 5 year period, starting from 1 March 2012 to 28 February 2017. The 5 year period is linked to the period for record keeping requirements in terms of the TAA;
  - Non-compliant Bargaining Councils must submit a return and pay the levy to SARS on or before 1 September 2018 to benefit from the relief.
- Relief does not apply if the Bargaining Council complied with employees' tax withholding obligations, tax was assessed by SARS before 23 February 2017 or tax was paid for the period 1 March 2012 to 28 February 2017

Refinement of measures to prevent tax avoidance through the use of trusts
(Clause 4 of the Draft Bill: Section 7C of the Act)

- In 2016, an anti-avoidance measure aimed at curbing the transfer of assets to trusts through the use of low or interest free loans was introduced in the Act.
- This anti-avoidance measure deems the benefit received by a trust of paying interest in respect of low interest or interest free loans at a rate lower than the official rate of interest to be a donation that is subject to donations tax at a rate of 20 per cent.
- It has come to Government's attention that taxpayers have already devised schemes to attempt to circumvent this anti-avoidance measure by making low interest or interest free loans to a company that is held by a trust that is a connected person in relation to the company.
- In order to counter this abuse, the 2017 Draft TLAB makes provision for the scope of this anti-avoidance measure to be extended to cover interest free or low interest loans made to a company that is a connected person in relation to a trust.
- In view of the fact that this anti-avoidance measure intends to close a loophole created as a result of the 2016 tax amendments, it is proposed that this provision should come into operation at the date of the publication of the 2017 Draft TLAB for public comment, i.e. 19 July 2017.
- In addition, it is proposed that employee share scheme trusts be excluded from the application of this anti-avoidance measure as they are not set up for estate planning purposes.

Clarifying rules relating to the taxation of employee based share based schemes

(Clauses 72 & 73 of the Draft Bill: sections 8C and 8C(1A), paragraphs 64E, 80 and 80(2A) of the Eighth Schedule to the Act)

- In 2016, changes were made in the Act to introduce anti-avoidance measures preventing taxpayers from disguising high salaries through the use of restricted shares or share-based incentive schemes, which gives rise to dividends that are taxed at lower rates of 20% instead of a salary that is taxed at the then higher rate of 41%.
- The 2016 changes did not address with sufficient clarity the interaction between the anti-avoidance provisions of section 8C(1A), which includes in the employee's taxable income, amounts resulting from the value extracted from a restricted share and the provisions of the Eighth Schedule, which excludes from capital gains tax, gains arising from the vesting or disposal of a restricted share that is subject to tax in terms of section 8C(1A).
- The 2017 Draft TLAB proposes to clarify the interaction of the above-mentioned provisions by inserting a new paragraph 64E of the Eighth Schedule which makes provision for amounts that are included in the employee's taxable income in terms of the anti-avoidance provisions of section 8C(1A) to be disregarded for capital gains tax purposes.

Increase in thresholds for exemption of employer provided bursaries to learners with disabilities
(Clause 14 of the Draft Bill: Section 10(1)(q) of the Act)

- In the 2017 Budget Review, a proposal was made to increase the threshold of the exemption for employer provided bursaries to relatives of the employees.
- As a result, changes were made in the 2017 Draft Rates Bill to increase the remuneration eligibility threshold for employees from R400 000 to R600 000 and the monetary limits for bursaries from R15 000 to R20 000 for education below NQF level 5 and from R40 000 to R60 000 for qualifications at NQF level 5 and above.
- In addition, in order to cater for the limited resources in the majority of schools in South Africa for facilities to properly accommodate learners with disabilities, it is proposed that a new exemption threshold for employer provided bursaries in respect of learners with disabilities be introduced as follows:
  - The monetary limit in respect of exempt bursaries for learners with disabilities be set at R30 000 per annum in the case of Grade R to 12, including qualifications in NQF levels 1 to 4 (monetary limit set at R20 000 for learners without disabilities);
  - The monetary limit in respect of exempt bursaries for learners with disabilities be set at R90 000 per annum in the case of qualifications at NQF levels 5 to 10 (monetary limit set at R60 000 for learners without disabilities).

Preservation of retirement benefits after reaching normal retirement date (Clauses 1,61 and 64 of the Draft Bill: Section 1 and paragraphs 2 and 7 of the Second Schedule to the Act)

- From 2014 members of retirement funds were allowed to postpone 'retirement' by keeping their benefits within their funds past the 'normal retirement age' - subject to the rules and regulations of each individual fund. This helps members who are able to continue to work or support themselves alternatively to preserve their benefits as long as possible.
- While members may retain benefits within respective funds, they may no longer make contributions to those funds – or transfer the funds.
- There are many legitimate reasons why a member would prefer to sever links with the fund – and funds may prefer to cut down on administration of inactive members.
- It is proposed that employees be allowed to transfer their benefits into a retirement annuity fund for later consumption.
- Transfers to preservation funds are not currently included in the proposal , since it could result in withdrawal of all the benefits in a lump sum, rather than preservation, and a restricting that withdrawal would further add to complexity
- Effective date: 1 March 2018

Tax exempt status of pre-March 1998 build up in public sector funds
(Clauses 62 and 63 of the Draft Bill: Paragraphs 591)(e) and 6(1)(b)(v) of the Second Schedule to the Act)

- The Act currently allows the withdrawal of pre-March 1998 tax free benefits if those benefits are withdrawn from a fund, and those benefits were previously transferred from a public sector fund.
- These transfers were exempt for only one transfer.
- Member are now obliged to stay in those funds, when it may now make sense to transfer funds to a different fund (for consolidation for example)
- It is proposed that amendments be made to the Second Schedule to allow for the exemption, in respect of pre-March 1998 benefits, to apply in cases where **one** additional transfer to a different fund occurs of benefits originally coming out of a public sector fund
- Effective date: 1 March 2018

Removing the 12 month limitation on joining newly established pension or provident fund
(Clause 1 of the Draft Bill: Definition of pension and provident fund Section 1 of the Act)

- Currently, if an employer establishes a new pension or provident fund, employees have up to 12 months to make application to join that fund. An employee who fails to make application to join within the 12 month period is not permitted to join that fund.
- In order to encourage employees to contribute towards their retirement and remove practical difficulties, it is proposed that the current limit of 12 month period be removed so that employees are allowed to join a new established pension or provident fund at any time, subject to the rules of the fund.
- Effective date: 1 March 2018

Postponement of annuitisation requirement for provident funds to 1 March 2019 (Clauses 90-93 of the Draft Bill: Sections 3,150 and 159 of the Taxation Laws Amendment Act, 2015 and section 1 of the Revenue Laws Amendment Act, 2016

- As part of ongoing social security and retirement reform, National Treasury proposed amendments in 2015 regarding the tax treatment of provident funds in order to enhance preservation of retirement fund interests during retirement. In particular, provident funds will be treated like other pension and retirement annuity funds and be required to annuitise benefits (with vested rights for accumulated amounts and the growth on those amounts).
- These amendments were supposed to come into effect on 1 March 2016, however, in February 2016, Government postponed the annuitisation requirements for provident funds for two years until 1 March 2018.
- This was done to provide sufficient time for the Minister of Finance to consult interested parties, including the National Economic Development and Labour Council (NEDLAC), regarding the annuitisation requirements for provident funds after the publication of the comprehensive policy document on social security, and to report back to Parliament on the outcome of those consultations no later than 31 August 2017.
- Several changes have taken place since the postponement of these amendments and the discussions on the comprehensive paper on social security are still ongoing in NEDLAC.
- It is proposed that provisions relating to the annuitisation requirements for provident funds be postponed for 1 year from 1 March 2018 to 1 March 2019.
- Effective date: 1 March 2019

Deduction in respect of contributions to retirement funds
(Clauses 19 of the Draft Bill: Section 11F of the Act)

- As part of the wider retirement reform objectives, the tax deductibility of contributions to retirement funds was harmonised across all retirement funds through a replacement of section 11(k) from 1 March 2016, where the same deduction now applies to both employer and employee contributions to pension funds, provident funds and retirement annuity funds.
- This inclusion has created technical complications, since the opening proviso in section 11(k) requires carrying on of a trade. However, not all allowable contributions to retirement funds relate only to income generated from the carrying on of a trade, which led to a specific exemption for retirement annuity funds under 11(n)(i)(ff) before 1 March 2016.
- It also creates administrative anomalies, such as generating an assessed loss if contributions are above the allowable limit when taxable capital gains are a part of the higher limit.
- It is proposed that a new section be inserted to remove the inconsistences and anomalies that arise from the current location of the provisions. Additionally, a new limiting criteria for the allowable deduction is proposed to avoid circumstances that can create an assessed loss.
- Effective date: 1 March 2016 – to accommodate deductions that stem from the original amendments.

GENERAL BUSINESS TAXES

Tax implications of debt relief

- In the current economic climate, there are various mechanisms by which a debtor may settle a debt with the creditor or a creditor may relinquish a claim to have a debt repaid.
- However, the Act provides rules that give rise to tax implications in instances where a debt is cancelled, waived, forgiven or discharged in return for a payment that is less than the amount of the principal debt or for no payment. The tax implications depend on how the debt that is cancelled, waived, forgiven or discharged was utilised.
- If a debt was used to finance operating expenses, e.g., rental expenses or employee salaries, which qualified as tax deductible expenditure, section 19 of the Act makes provision for the reversal of the income tax deductions previously granted in respect of operating expenses by subsequently adding the amount so deducted to the taxpayer's income.
- If a debt was used to acquire a capital asset used for business purposes which qualifies for specific capital allowance deductions, paragraph 12A of the Eighth Schedule makes provision for the amount of debt that is reduced, cancelled, waived, forgiven or discharged to reduce the base cost of such capital asset. This will result in a higher capital gain when such capital asset is sold in future.

Addressing the tax treatment of debt relief for the benefit of mining companies
(Clause 48 of the Draft Bill: Section 36 of the Act)

- The capital gains tax rules provided in paragraph 12A of the Eighth Schedule (mentioned in the previous slide) dealing with the tax implications in respect of debt that was used to acquire a capital asset do not apply to mining companies.
- This is due to the fact that mining companies have a special tax regime and are required in terms of section 36 of the Act to account for their capital expenditure in respect of capital assets differently from companies in other sectors.
- In order to address this disparity and to assist in the current economic climate, the 2017 Draft TLAB proposes that specific rules dealing with the tax treatment of debt that is reduced, cancelled, waived, forgiven or discharged be introduced for mining companies.
- This will align the rules dealing with the treatment of debt funded capital asset for mining companies with the other tax rules applying in respect of other sectors.

Addressing the tax treatment of debt relief for dormant group companies (Clauses 30 and 68 of the Draft Bill: Section19 and paragraph 12A of the Eighth Schedule to the Act)

- Paragraph 12A(6)(d) of the Eighth Schedule makes provision for an exemption for debt that is reduced, cancelled, waived, forgiven or discharged in respect of loans between companies forming part of the same group of companies in South Africa. This implies that where a debt between South African group companies is reduced, cancelled, waived, forgiven or discharged and that debt was used to acquire a capital asset, the amount of debt that is now reduced, cancelled, waived, forgiven or discharged is not to be applied to reduce the base cost of that capital asset.
- The above-mentioned intra-group relief provided in paragraph 12A(6)(d) of the Eighth Schedule is limited to apply in instances where a debt was used to acquire a capital asset as envisaged in paragraph 12A of the Eighth Schedule and does not extend to apply to instances where a debt was used to fund operating expenditure as envisaged in section 19.
- Absence of this relief creates technical impediments in the case of dormant group companies that wish to wind up the company as they would not have resources to pay tax on the debt recouped.
- In order to assist companies in financial distress, the 2017 Draft TLAB makes provision for the current relief for group companies available in paragraph 12A(6)(d) of the Eighth Schedule to be extended to situations envisaged in section 19 and be made more specific to assist only dormant companies.

Addressing the tax treatment of conversion of debt into equity and artificial repayment of debt

(Clauses 30,31and 68 of the Draft Bill: Sections 19, 19A,19B and paragraph 12A of the Eighth Schedule to the Act)

- One of the mechanisms of settling a debt is the conversion of debt owed by a company into equity in that company. For example, a debt may be settled by a debtor by the issue of shares in the debtor company where the market value of the shares reflects the face value of the debt.
- This type of debt settlement is usually entered into in respect of loans advanced to the company by the controlling shareholder of that company.
- In order to assist companies in financial distress, the 2017 Draft TLAB makes provision for the conversion of debt into equity, provided that the debtor and the creditor are companies that form part of the same group of companies.
- In order to ensure that this concession is not abused, it is proposed that any interest that was previously allowed as a deduction by the borrower in respect of that debt be recouped in the hands of the borrower, to the extent that such interest was not subject to normal tax in the hands of the creditor.

Addressing tax avoidance involving share buy backs and dividend stripping (Clauses 33 and 70 of the Draft Bill: Section 22B and paragraph 43A of the Eighth Schedule to the Act)

- The Companies Act makes provision for a company to be able to buy back its own shares.
- Share buy backs result in the cancellation of the shares and a reduction of the company's reserves. This has an impact on the amount of reserves available for distribution by the company, i.e. for declaration of dividends.
- As a result, the Act makes provision for the proceeds of share buy backs to be included in the definition of dividend and subject to dividends tax at a rate of 20%.
- That said, the Act makes provision for outright exemption from dividends tax in respect of dividends paid by a resident company to another resident company. The current exemption of company to company dividends has created a loophole in the tax system.
- Several schemes have been identified where taxpayers structure their sale of share transactions using share buy backs in order to obtain proceeds that are regarded as dividends that are exempt from dividends tax, thereby also avoiding paying CGT (companies 22.4%) and normal tax on income (companies 28%) on the sale of shares.
- For example, if a company shareholder sells its shares to the acquirer, the sale proceeds would be ordinarily subject to CGT or normal tax on income. In order to avoid CGT and normal tax on income, the current shareholder's shares are acquired by the target company in a share buy back transaction, of which proceeds are regarded as dividends and thereby exempt from dividends tax.

Addressing tax avoidance involving share buy backs and dividend stripping
(Clauses 33 and 70 of the Draft Bill: Section 22B and paragraph 43A of the Eighth Schedule to the Act)

- With the introduction of dividends tax in 2012, the Act contains rules in section 22B and paragraph 43A of the Eighth Schedule aimed at tax avoidance schemes known as dividend stripping.
- Dividend stripping occurs when a resident shareholder company that is a prospective seller of the shares in a target company avoid paying CGT (companies 22.4%) or normal tax on income (companies 28%) arising on the sale of shares in that target company by ensuring that the target company declares a dividend to that resident shareholder company prior to the sale of shares in that target company to a prospective purchaser.
- Such a pre-sale dividend to a resident shareholder company is exempt from dividends tax. The pre-sale dividend also decreases the value of the shares in the target company. As a result, the prospective seller extracts value from the company by effectively selling the shares in return for a tax free dividend or by selling shares the value of which has been lowered by the pre-sale dividend. As a consequence of this, the prospective seller can sell the shares in that target company at a lower amount, thereby avoiding a much larger capital gain.
- Section 22B and paragraph 43A of the Eighth Schedule attempt to prevent taxpayers from entering into these dividend stripping schemes by making provisions to treat a pre-sale dividend as income subject to normal tax or proceeds from disposal of an asset subject to CGT, provided that those pre-sale dividends are indirectly funded by the prospective purchaser of those shares.

Addressing tax avoidance involving share buy backs and dividend stripping
(Clauses 33 and 70 of the Draft Bill: Section 22B and paragraph 43A of the Eighth Schedule to the Act)

- In order to curb the use of share buy backs schemes as well as circumvention of dividend stripping rules, the 2017 Draft TLAB proposes that the current dividend stripping rules be broadened to also cover share buy back schemes.
- As a result, the dividend stripping rules will apply in the following circumstances:
  - The person disposing of the shares in another company must be a resident company; and
  - The company disposing of the shares (together with connected persons in relation to that company) must hold at least 50% of the equity shares or voting rights in that other company or at least 20% of the equity shares or voting rights in that other company if no other person holds the majority of the equity shares or voting rights; and
  - An exempt dividend was received or accrued within 18 months prior to the disposal of the target company shares or an exempt dividend was received or accrued by reason of or in consequence of the disposal of the target company shares.
- In view of the fact that this is an anti-avoidance measure aimed at preventing the erosion of the tax base, it is proposed that this provision should come into operation on the date of publication of the 2017 Draft TLAB for public comment, i.e. 19 July 2017.

Addressing abuse of contributed tax capital provisions
(Clause 11 of the Draft Bill: Definition of contributed tax capital in section 1 and section 8G of the Act)

- Contributed Tax Capital (CTC) is a notional amount derived from contributions made to a company by holders of a class of shares as consideration for the issue of that class of shares by that company. It is reduced by any capital amount that is subsequently transferred back by the company to one or more shareholders of that class of shares (commonly known as capital distribution) by utilising the notional tax amount so received.
- A distribution to shareholders which leads to a reduction of CTC does not constitute a dividend and is specifically excluded from the definition of dividend in the Act. That said, any transfer by a company to a shareholder that does not constitute a return of CTC is regarded as a dividend.
- Government has identified transactions in terms of which South African subsidiary companies with foreign parent shareholders are increasing their CTC, thereby avoiding payment of dividends tax through capital distributions to its foreign parent shareholders, as these capital distributions do not qualify as dividends, and thereby not being subject to dividends tax.
- These capital distributions are generally not subject to CGT in the hands of foreign parent shareholders, if the underlying assets are not immovable property situated in South Africa and therefore not within the South African CGT net.
- It is proposed that amendments be made in the Act to address the abuse of CTC. In view of the fact that this is an anti-avoidance measure aimed at preventing the erosion of the tax base, it is proposed that this provision should come into operation on the date of publication of the 2017 Draft TLAB for public comment, i.e. 19 July 2017

Interaction between the "in duplum" rule and the tax legislation
(Clause 5 of the Draft Bill: Section 7D of the Act)

- The *"in duplum"* rule is a common law principle that has been applied in South African case law for over 100 years. The main aim of the *"in duplum"* rule is to protect debtors by providing that interest on a debt will cease to accrue once the total amount of the arrear interest is equal to the outstanding principal debt.
- Taxpayers sometimes enter into a loan arrangement where the lender will advance the loan to a borrower at a zero or low interest in order to make the loan favourable by saving on interest costs. The use of a zero or low interest loan creates a loss to the fiscus as it often leads to e.g., less PAYE collection where such loan is between an employer and employee; avoidance of estate duty on the growth in the value of assets where a person transfers assets to a trust in exchange for a zero or low interest loan.
- In order to counter the tax benefit as a result of the use of zero or low interest loans, the Act contains various anti-avoidance measures that tax the difference between the amount of interest that would have been incurred at the official rate and the amount of interest actually incurred, for example, paragraph 11 of the Seventh Schedule and section 7C.
- It has come to Government's attention that anti-avoidance provisions in the Act may be undermined on the basis of the "*in duplum*" rule applying to loan or funding arrangement.
- Some taxpayers may rely on the rule to distort the quantification of the tax benefit derived from a zero or low interest loan or funding arrangement between the connected persons. They argue that there is no tax benefit in respect of a period during which the "*in duplum*" rule applies as no interest can accrue or be incurred during that period.
- It is proposed that the Act be clarified so that the anti-avoidance rules for zero or low interest loans should apply in spite of the application of the "*in duplum*" rule.

Extension of collateral and securities lending arrangement provisions
(Clauses 32 and 87of the Draft Bill: Section 22 of the Act and section 1 of the Securities Transfer Tax Act)

- The Act and STT provide income tax, CGT and STT relief if a listed share or government bond is transferred in a securities lending arrangement, provided that the identical share or government bond is returned to the lender by the borrower, within a specified period of time.
- In 2016, amendments were made in the Act and STT Act to include listed South African government bonds as allowable instruments under securities lending arrangements and collateral arrangements qualifying for securities lending arrangements qualifying for the above-mentioned relief.
- At issue is the fact that the 2016 amendments are limited to listed South African government bonds and do not apply to listed foreign government bonds.
- In order to address this concern, the 2017 Draft TLAB makes provision for the above-mentioned tax relief to be extended to apply to listed foreign government bonds.

TAXATION OF FINANCIAL INSTITUTIONS AND PRODUCTS

Changes to the tax treatment of banks and financials institutions due to the introduction of IFRS9
(Clause 43 of the Draft Bill : Section 24JB of the Act)

- In 2018, the financial reporting of financial assets and liabilities will no longer be governed by International Accounting Standard 39 (IAS 39), but will be governed by International Financial Reporting Standard 9(IFRS 9).
- Some of the provisions of the Act, in particular section 24JB (dealing with tax treatment of banks and some other financial institutions), follow the accounting treatment contemplated in IAS 39.
- In order to take into account the changes in the accounting standard, the 2017 Draft TLAB proposes to align the tax treatment of banks and some other financial institutions as referred to in section 24JB with IFRS 9, subject to certain exceptions.

Exclusion of impairment adjustments from the determination of taxable income in section 24JB
(Clause 17 of the Draft Bill : Section 11(jA) of the Act)

- On 17 February 2012, SARS issued a directive for the tax treatment of doubtful debts by banks, with effect from the 2011 year of assessment.
- The SARS directive only applied to banks and does not apply to other financial services providers. This directive only applied to banks as long as IAS 39 is applied by banks for financial reporting purposes.
- In the 2017 Budget Review, it was proposed that as IAS 39 is being replaced by IFR 9, the principles of the SARS directive be reviewed and incorporated in the Act.
- Furthermore, section 24JB (dealing with the tax treatment of banks and some other financial institutions) should exclude impairment adjustments provided for under IFRS 9 as these impairment adjustments aim to provide for future risks instead of focusing solely on the current losses in the determination of taxable income as contemplated in section 24JB.
- In view of the fact that banks are registered in terms of the Banks Act, are treated differently from other financial services providers in that they are highly regulated by the SARB and subject to stringent capital requirements in order to avoid a negative impact on the banking sector, it is proposed that amendments be made in the legislation to allow banks to claim the following:
  - 25% of IFRS 9 impairments based on annual financial statements;
  - 85% instead of 25% of amount classified as being in default in terms of regulations issued under the Banks Act and administered by SARB.

Amendments to the tax valuation method for long term insurers due to the introduction of SAM and tax treatment of DAC
(Clause 46 of the Draft Bill : Section 29A of the Act)

- In 2016, amendments were made in the Act to cater for the tax treatment of long term insurers as a result of the introduction of Solvency Assessment and Management Framework (SAM) and the new Insurance Act.
- Although the 2016 tax amendments are explained clearly in the 2016 EM, there are certain aspects that may still cause uncertainty in applying the legislation. These aspects include changes to the definitions of "*adjusted IFRS value*" and the "*phasing-in amount*".
- In order to address these concerns and to clearly give effect to the policy rationale as explained in the 2016 EM, it is proposed that further changes be made in the legislation.
- It is further proposed that changes be made in the Act to include a prescribed method for the tax treatment of Deferred Acquisition Costs (DAC) by long term insurers.

TAX INCENTIVES

Clarifying the scope of tax deductible donation status for international donor funding organisations
(Clause 29 of the Draft Bill: Section 18A of the Act)

- Currently, the Act makes provision for donations to *"specialized agencies"* as defined in the Diplomatic Immunities and Privileges Act, 2001, to qualify as tax deductible donations in terms of section 18A.
- It has come to Government's attention that "*specialized agencies"* referred to above do not include all the agencies of the UN operating in South Africa, which form part of the UN-SA Strategic Cooperation Framework.
- In order to encourage support of the UN agencies operating in SA, it is proposed that the Act be amended so that specified UN agencies operating in SA in terms of the UN-SA Strategic Cooperation Framework should qualify for tax deductible donations in terms of section 18A of the Act.

Strengthening anti-avoidance measures related to mining environmental rehabilitation trust
(Clause 38 of the Draft Bill: Section 13*quat* of the Act)

- The Act contains rules to cater for environment rehabilitation by mining companies as envisaged in the Mineral and Petroleum Resources Development Act and National Environmental Management Act. As a result, contributions by mining companies to mining rehabilitation trusts or companies are tax deductible, subject to certain conditions.
- In order to ensure that the above-mentioned tax benefit obtained in respect of mining rehabilitation funds is used for its intended purpose, the Act makes provision for penalties to be imposed for contraventions of these provisions.
- It has come to Government's attention that the funds contributed to mining rehabilitation trusts/companies are being withdrawn and used to fund activities not related to rehabilitation or the closure of the mine, despite the current penalties contained in the Act.
- In addition, the penalty provisions provided in the Act are difficult to enforce due to the fact that they provide for the inclusion of an amount, depending on the nature of contravention, in the taxable income of the mining company or mining rehabilitation fund.
- By the time SARS becomes aware of the contravention, the mining company or mining rehabilitation fund may no longer have taxable income or means to pay tax in respect of the penalty amount included in the taxable income. As a result, the impact of the penalty provisions can be circumvented or greatly reduced.
- In order to curb non-compliance, the 2017 Draft TLAB proposes certain amendments regarding penalty provisions as well as reporting requirements to be imposed on mining rehabilitation funds.

Extending the scope of non-recoupment rule for venture capital companies
(Clause 26 of the Draft Bill: Section 12J of the Act)

- In 2008, Government introduced a Venture Capital Company (VCC) tax regime as one of several measures to encourage investments into small and medium sized enterprises as well as junior mining companies.
- Taxpayers investing in a VCC are allowed an upfront deduction equivalent to the expenses incurred by a taxpayer in acquiring shares issued to that taxpayer by a VCC.
- However, the deduction is reversed and included as a recoupment in a taxpayer's income should that taxpayer dispose of those shares in a VCC within 5 years after acquiring them.
- Similar to any other investment, investors investing in a VCC need to obtain a return on their investments. Generally, investors obtain a return on investments through several channels, for example, dividends or return of capital.
- Currently, a return on investment from a VCC in the form of a return of capital instead of a dividend may result in a recoupment of the upfront tax deduction mentioned above, even if the taxpayers has held those shares for longer than 5 years.
- In order to address the above-mentioned inconsistent treatment of recoupments of tax deductions, it is proposed that amendments be made to the Act for the tax deduction not to be recouped in respect of a return of capital on a VCC share if that share has been held by the taxpayer for a period of longer than five years.

Industrial Policy Projects: Window period extension
(Clause 25 of the Draft Bill: Section 12I of the Act)

- The Act contains rules that allow taxpayers an additional investment and training allowance in respect of Industrial Policy Projects, provided that they meet certain criteria prescribed by way of regulation.
- The additional investment allowance ranges from 35% to 100% of the cost of any new and unused manufacturing assets used for the project, depending on whether the project has qualifying status or preferred status and whether it is located in an industrial development zone or designated special economic zone.
- In order to assess the overall effectiveness of the Industrial Policy Projects, Government will evaluate the relevant tax expenditure before it is considered for renewal at the end of the stipulated window period, which is set for 31 December 2017.
- In order to allow sufficient time for review of the Industrial Policy Projects incentive to be completed, it is proposed that the window period should be extended from 31 December 2017 to 31 March 2020.
- While the above-mentioned window period for the tax incentive is extended, the current approval threshold of R20 billion in potential investment and training allowances will not be increased, due to the fact that currently, tax revenues are under severe pressure in a fiscally constrained environment.

INTERNATIONAL TAXATION

Refinements of the domestic treasury management company regime qualifying criteria
(Clause 1 of the Draft Bill: Section 1of the Act)

- In 2013, Government introduced a domestic treasury management company regime for exchange control and tax purposes.
- The regime was aimed at encouraging listed South African multinational companies to move their treasury operations to South Africa. Under this regime, listed South African multinational companies are allowed to establish one subsidiary in South Africa, per foreign currency, to manage the group treasury functions without being subject to exchange control restrictions that apply to companies incorporated in South Arica.
- For tax purposes, the regime provides relief in respect of unrealised foreign currency gains and losses in that the domestic treasury management company is permitted to use its functional currency in South Africa, other than the Rand, as base currency for currency translations.
- In order to qualify as a domestic treasury management company, a company must satisfy all the following criteria, namely, it must be incorporated in South Africa and must have its place of effective management in South Africa and must not be subject to exchange control restrictions by virtue of being registered with the SARB.
- In order to make the domestic treasury management company regime more effective, it is proposed that the requirement that a company must be incorporated in the Republic be removed.

Refinements of rules prohibiting deduction of tainted intellectual property
(Clause 37 of the Draft Bill: Section 23I of the Act)

- The Act contains anti-avoidance measures aimed at disallowing the deduction for payments made to a foreign person in respect of the use or right to use tainted intellectual property.
- The main aim of these anti-avoidance measures is to prevent erosion of the South African tax base resulting from assigning South African intellectual property to foreign entities subject to a lower effective tax rate in the foreign country, followed by the licensing of that intellectual property back to South African taxpayers.
- Although the concerns that led to the introduction of the above-mentioned anti-avoidance measures are understood, these anti avoidance measures may affect legitimate business transactions, thereby discouraging the use of existing South African based group infrastructure where further minor ongoing maintenance and development of the existing intellectual property is necessary.
- In order to address these concerns, it is proposed that the rules prohibiting the deduction of tainted intellectual property will not apply to a controlled foreign company of foreign taxes payable are comparable (at least 75%) to South African Income Tax that would have been payable had the company been a South African tax resident.

Extending the application of controlled foreign company rules to foreign companies held via foreign trusts and foundations
(Clauses 13 and 45 of the Draft Bill: Sections 9D and 25BC of the Act)

- South African residents are subject to tax on a worldwide basis.
- In order to curb avoidance, the Act contains CFC rules aimed at preventing South African residents from shifting tainted forms of taxable income offshore by investing in CFC's. These rules make provision for an amount equal to the net income of a CFC to be attributed and included in the income of South African resident shareholders.
- Since 2008, Government has been concerned that the current CFC rules do not capture foreign companies held by interposed foreign trusts or foreign foundations.
- Of particular concern is the use of foreign discretionary trusts or foreign foundations in order to escape the application of CFC rules even if the participation or voting control requirements are met.
- This is achieved through interposing a foreign discretionary trust or foreign foundation, between South African tax residents and a foreign company, despite the fact that the foreign trust or foreign foundation and the foreign company are part of the same group and consolidated by the South African tax resident group for financial reporting purposes.
- The BEPS report on CFC also recommends amongst others that non resident companies that are consolidated in the accounts of a resident company in terms of IFRS should be treated as CFCs.
- In order to address these concerns, amendments are proposed in the 2017 Draft TLAB.

Value added tax (VAT)

VAT vendor status of municipalities
(Clause75 of the Draft Bill: Section 8 of the VAT Act)

- The Local Government elections that took place on 3 August 2016 resulted in structural changes such as disestablishment or merger of certain municipalities.
- As a result, the affected municipalities had either to cancel their VAT registrations or apply for new VAT registrations, and transfer assets where applicable.
- In order to address unintended consequences as a result of structural changes to certain municipalities, it is proposed that transitional measures be made in the VAT Act.

Clarifying the VAT treatment of leasehold improvements
(Clauses 75, 76, 77 and 81 of the Draft Bill: Sections 8,9,10 and 18C of the VAT Act)

- Currently, the VAT Act does not provide guidelines in respect of the VAT treatment of leasehold improvements effected by the lessee to the leasehold property during the period of lease agreement.
- The lack of clarity in the Act has led to inconsistencies on the VAT treatment.
- It is proposed that amendments be made in the VAT Act to clarify that leasehold improvements by a lessee on leasehold property qualify as a taxable supply of goods to the lessor, subject to certain conditions.

Clarifying the zero rating of international travel insurance
(Clause 78 of the Draft Bill: Section 11(2)(d) of the VAT Act)

- The VAT Act makes provision for insurance and the arranging of insurance related to international travel to be zero rated.
- However, the zero rating does not extend to insurance cover provided during the period that the insured is transported to and from the insured's original point of departure (e.g. while en-route to or from the airport); and not being physically transported while on the international journey (e.g. while the insured stays in a hotel).
- In order to address these practical concerns, it is proposed that the zero rating provisions pertaining to insurance cover provided as part of an international journey be clarified.

Tax Administration Laws Amendment Bill (TALAB)

Contents: Main amendments

- Income Tax Act
- Customs and Excise Act
- Tax Administration Act
- Customs Duty Act and Customs Control Act

Income Tax Act

- To prevent practical difficulties where interest payable by SARS accrues over more than one year of assessment it is proposed that interest is deemed to accrue on the date of payment (clause 3 of Draft Bill: section 7D of Income Tax Act)
- It is proposed to mitigate administrative penalties for micro businesses that have grown sufficiently to migrate into the small business corporation system (clause 4 of Draft Bill: section 48C of Income Tax Act)
- To facilitate and simplify calculation and administration of employee tax it is proposed that only the portion of travel expenses reimbursed by an employer that exceeds the rate fixed by the Minister be regarded as remuneration for PAYE purposes (clause 9 of Draft Bill: paragraph 1 of the Fourth Schedule)
- To clarify application of annual cap on contributions to retirement funds it is proposed that R350 000 be spread over tax year (clause 10 of Draft Bill: paragraph 2 of Fourth Schedule)
- As 'remuneration' in Fourth Schedule now includes dividends it is proposed that the person paying such remuneration be considered an employer and deduct PAYE in respect of dividends (clauses 5 to 8 and 11 of Draft Bill: sections 64K, 64L, 64LA, and 64M of Income Tax Act and paragraph 11A of Fourth Schedule)

Customs and Excise Act

- To more closely reflect data needs of government to research, formulate, and apply trade-related policies it is proposed that the provisions for sharing of trade statistics with organs of state be updated (clause 14 of Draft Bill: section 4 of Customs and Excise Act)
- To underpin the comprehensive review of the administration of diesel refunds it is proposed that amendments to delink diesel refunds from the VAT system be made (clause 19 of Draft Bill: section 75 of Customs and Excise Act)

Tax Administration Act

- To facilitate a low cost internal remedy it is proposed to expand an existing internal review process to decisions by SARS, given effect in an assessment or notice of assessment that is not subject to objection and appeal (clause 25 of Draft Bill: section 9 of the Tax Administration Act)
- To clarify transitional rules for the accrual and calculation of interest until Chapter 12 of the Tax Administration Act comes into operation it is proposed that interest applies to income tax understatement penalties under Tax Administration Act in same manner that interest applied to additional tax penalties under tax Acts (clause 32 of Draft Bill: section 270 of the Tax Administration Act)
- To facilitate the phased implementation of the new interest scheme under Chapter 12 of the Tax Administration Act it is proposed that the Minister may determine dates on which the relevant provisions comes into operation per tax type (clause 33 of Draft Bill: section 272 of the Tax Administration Act)

Customs Duty and Customs Control Acts

- To combat fraud and irregularities, additional regulations in relation to applications for and payment of refund and drawback are proposed (clauses 34 and 35 of Draft Bill: section 65A of the Customs Duty Act)
- To accommodate operational implementation, amendments are proposed to allow for:
  - the submission of departure reports before departure where submitted by on-board operator of private vessel or aircraft
  - the exclusion by rule of prescribed mandatory information in clearance declarations
  - additional scenarios where trans-shipment goods are transported by public road

  (clauses 40, 42, 51, 52, 54, 58, 60, 61, 62 and 64 of Draft Bill: sections 53, 59, 249, 251, 257, 303, 346, 350, 354 and 385 of the Customs Control Act)
- To facilitate transition to the new Acts it is proposed that rules regulating registration, licensing and deferment benefits under the new Acts may be drafted and decisions in terms of rules may be taken prior to the Acts coming into operation, but will only be effective when the new Acts come into operation (clauses 78 and 79 of Draft Bill: sections 935A / 942A of the Customs Control Act)

Other – not in these Bills

Partial ownership of land donated under land reform initiatives

- In the 2017 Budget Review, the following announcement was made:

  In 2016, amendments were made to the Income Tax Act to provide for an exemption from donations tax and capital gains tax on land reform initiatives, as outlined in Chapter 6 of the National Development Plan. These changes provide for an exemption where full ownership of the land is transferred. As full ownership of the land transferred is not always envisaged in the National Development Plan, it is proposed that the current exemption be extended to allow partial ownership of land under appropriate circumstances.

- In view of the fact the proposed tax changes are based upon the land reform initiatives that are driven by the Department of Rural Development and Land Reform, National Treasury consulted with the relevant stakeholders and Department of Rural Development and Land Reform.
- Upon further investigation and after consultations with stakeholders and Department of Rural Development and Land Reform, it is submitted that changes to the tax legislation should be delayed until such time the Department of Rural Development and Land Reform finishes its processes and an MOU is entered into between the relevant stakeholders and Department of Rural Development and Land Reform in this regard.