

25 August 2017

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Parliamentary Standing Committee on Finance  
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Dear Sir

## **SAICA COMMENTS TO THE DRAFT TAXATION LAWS AMENDMENT BILL AND TAX ADMINISTRATION LAWS AMENDMENT BILL 2017**

### **Introduction**

1. The National Tax Committee on behalf of the South African Institute of Chartered Accountants (“SAICA”) welcomes the opportunity to make a submission to the Standing Committee on Finance (“SCoF”) on the Draft Taxation Laws Amendment Bill (DTLAB17) and Tax Administration Laws amendment Bill 2017 (DTALAB17).
2. We attach in Annexure A our submission to National Treasury (“NT”) as substantively the same concerns remain which are in addition to the concerns raised below in Annexure A.
3. We specifically note that the NT public consultations are only scheduled for the 4 and 5 September 2017 and therefore most of the below submissions have been made without consultation with NT. As noted in our submissions in March 2017 to SCoF, it does concern us that the executive only consults with the public on the proposals after they have submitted them to SCoF which we remain of the view is counterproductive for our engagement with SCoF.

### **Executive summary**

4. Our main submission in Annexure A addresses a considerable number of matters that arise from the tax bill proposals. However in summary we will address in our oral presentations to SCoF the following main points as set out in more detail in our submission in Annexure A:

- 4.1. Challenges with proposal repeal of the foreign income exemption (pg. 7)

The standardisation of the residence basis of taxation and efforts to eliminate double non-taxation is welcomed. However the current



exemption is a pragmatic solution to an administratively complex alignment. We recommend retaining the exemption but amending it to address the relevant concern of double non taxation. Should the exemption be repealed as proposed, we have noted the serious ramifications for both employees and employers in implementing such repeal without providing for any replacement regime that mitigates such negative ramifications. These include punitive negative tax cash flows for employees and significant cost of administration and doing business for employers.

4.2. Bargaining council amnesty (pg. 10)

We acknowledge that providing tax amnesty is sometimes a necessary evil for the greater benefit of the fiscal system as a whole which is why SARS and NT have provided amnesty in the form of VDP relief before. However, to ensure that the public interest is served these processes have always been of a general nature so as to not create a precedent that arbitrary tax relief will be tolerated for non-compliance to a select identified group. In respect of the current proposal, we specifically note that relief is in fact given to two separate parties, namely partially tax exempt bargaining councils and also their employees. We are especially concerned about the relief to the latter outside the current Fourth Schedule remedies and the VDP given that the EM noted that it was the interest and penalties for the bargaining councils that was mainly the concern. We recommend that the relief for the bargaining councils be separated from the relevant employees, who from the proposed relief seemed to have defrauded the fiscus by not declaring such income in their personal tax returns and relief should be dealt with in terms of current measures or measures of broader application.

4.3. Relief for dormant group company debt waivers (pg. 24)

We welcome the proposed relief by NT which addresses a pragmatic problem experienced by the lack of alignment of the relief for group debt capital waivers with revenue waivers. However the way that NT have proposed doing this alignment by defining a very restrictive concept of dormant undermines the purpose of the proposal. We recommend that the current capital relief provision be retained and that the principle just be extended to the revenue equivalent and if NT intends to refine the relief that it does not do it in such a narrow manner that the provision loses the scope of its current relief.

4.4. Share buy backs (pg. 30)

We note that NT are seeking to address avoidance in avoiding capital gains tax through using the dividend tax provisions applicable to share buy backs. We support the proposal that this should be principled based and that the tainted dividends that should be addressed are those that



are causally linked to the share sale. However the proposal is not just principled based but also rules based (e.g. all dividend 18 months before sale irrespective of reason) and the latter creates various anomalies that results in dividends that are not connected to the sale of shares to be caught under the anti-avoidance provision. The broad scope of the rules also results in instruments such as redeemable preference shares now be treated as being within the scope of the proposal. We recommend narrowing the scope of the rules based test to avoid the relevant anomalies.

4.5. Extension of CFC rules to Trusts (pg.37)

The proposal seeks to address avoidance through the use of trust to break the causal link between companies where a foreign held companies does not have a legitimate foreign based business. NT propose to address this in two ways by deeming the limited interest in a trust to be a look through for any participating rights in a company it holds shares in and also relying on the accounting IFRS 10 standard of consolidation to establish such right to control. The proposal is problematic as many of the concepts listed are undefined and are not implementable in its current form such as what is an interest in a discretionary trust? Furthermore the reliance on IFRS 10 is fundamentally flawed as the consolidation rules are substantially different to the imputation regime in section 9D.

Yours sincerely

**Pieter Faber**

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*The South African Institute of Chartered Accountants*



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## INDIVIDUALS AND TRUSTS

### *Individuals & Employment*

#### **Repeal of foreign remuneration exemption - Section 10(1)(o)(ii)**

- 1 In the Draft Explanatory Memorandum (the EM), NT and SARS have expressed the concern that the exemption contained in section 10(1)(o)(ii) of the Act has been excessively generous and, as a result, it is proposed that the current section 10(1)(o)(ii) exemption be repealed *in its entirety*. The proposed amendment will come into effect on 1 March 2019 and will therefore apply for the 2020 individuals' tax year.
- 2 As a point of departure, we would like to re-iterate that SAICA supports tax policy which seeks to prevent unfair avoidance through double non-taxation. However, any proposed remedy should be carefully balanced to ensure that the mischief is appropriately caught without unintended (or prejudicial) consequences for taxpayers who fall within the ambit of the proposed provision.
- 3 In this regard, SAICA jointly with other stakeholders, met with NT and submitted a joint submission thereafter on 15 May 2017, (the joint submission) detailing practical challenges, negative implications and complications should this exemption merely be repealed. The collective view is contained in paragraph 3 of the joint submission and deals specifically with the potential impact of the repeal of section 10(1)(o)(ii).
- 4 It is regrettable that none of the proposals or concerns were included or addressed in the DTLAB17, and even more so considering that the EM does not even recognise the negative impacts of the proposal in its current form.
- 5 Whilst it is understood that the aim is to align the tax treatment with world-wide taxation principles, which we agree with in principle, and whilst a reasonable delay for implementation is proposed, which we appreciate, *significant issues* arise from a practical implementation perspective, as well as the absence of any transitional provisions to deal with practical and legal issues as already highlighted in the joint submission.
- 6 We again highlight some of our concerns below, which need to be addressed in significantly more depth in the legislative drafting going forward.
  - Although double taxation agreements (DTAs) eliminate double taxation by allocating taxing rights between source and resident states, the resident state is not precluded from taxing the same income that the source state is allocated a right to tax. In instances where the resident state (the state where the taxpayer is a tax resident) imposes tax in respect of the same income that the source state (the state where the services are rendered) has a right to tax,



the resident state is required to provide relief by way of a foreign tax credit or exemption. Whilst the foreign tax credit is similar to the rebate available in terms of section 6quat of the Act, in some instances the relevant DTA requires a direct reliance on the section 6quat provisions. There are accordingly different ways in which the foreign tax credit will need to be claimed, depending on the individual circumstances and the foreign countries involved. Situations where a DTA is in place, as opposed to where no such DTA exists, must be distinguished, as they have differing consequences for the individuals concerned, as well as for the South African employer.

- Where a South African resident individual, employed by a South African employer, renders services abroad, such individual's worldwide remuneration will be subject to tax in both the source state and in South Africa. This has significant adverse cash flow implications, compared to the current position, further exacerbated by issues experienced in claiming refunds from SARS in terms of the Tax Administration Act, 28 of 2011 (the TAA).
- Expatriate employees affected by the proposed amendment will be provisional taxpayers, therefore prescribed estimates and payments of the tax liability must be made. These calculations are, however, considerably more complex than what is presumed to be the case, resulting in an onerous and potential costly liability for individuals, with a potentially unintended exposure to penalties and interest, paving the way for a significantly increased tax dispute pipeline, placing even more strain on resources for both SARS and taxpayers.
- Certain foreign self-assessment taxes do not require assessment from the foreign revenue authorities. Therefore, the only proof that the individual has of taxes abroad is what has been included in their foreign tax return. This further complicates the reliance on section 6quat as an effective mechanism to avoid double taxation.
- Different jurisdictions have different tax year ends for individuals, which adds to the complexity in calculating the tax paid for a particular tax period and in determining the correct foreign tax credits, in addition to obtaining employees' tax certificates for the relevant South African tax year.
- The revenue authorities in some foreign jurisdictions still have manual systems, which means that difficulties arise in obtaining timely proof of foreign taxes paid.
- Not all jurisdictions have the equivalent of an IRP5 certificate to substantiate the taxes which have been paid, which adds to the complexities around proof of foreign tax paid.



- In some low-tax jurisdictions, while personal income tax or employees' tax do not exist, high consumption taxes may be imposed which do not necessarily qualify for a claim for foreign tax credits.
- Compulsory contributions for social security in many countries is onerous and places a foreign employee at a disadvantage where no section 11(k) deduction is available. This would have to be addressed.

- 7 Submission: For the repeal of the foreign tax exemption to be equitable, it is proposed that significant improvements to and a comprehensive review of the foreign tax credit system are required for foreign taxes paid or incurred, whilst the categories of taxes which qualify for such foreign tax credits will need to be expanded based on empirical studies of applicable foreign liabilities. Changes are therefore required to section 6quat of the ITA, factoring in the impact for provisional taxpayers, amendment of the provisional tax returns, improved SARS processes, fast-tracking of refunds and simplified dispute resolution processes. It may even be necessary to consider proposals such as to defer PAYE in SA in its entirety and only have payment on assessment in instances where foreign employees' tax is confirmed by the employer as having been paid. In our view, making PAYE optional, on threat of sanction for qualifying and not complying, would only defer the problem for employees, as employers will not risk non-compliance due to foreign tax administration delays, as we have seen in many instances even under the current exemption.
- 8 Clarity is required on the level and form of the proof required to claim foreign tax credits and the provisions should not be applied restrictively. Efficient SARS' processes are required to deal with the anticipated increased administrative volumes and guidance is required for purposes of legal certainty on the nature and extent of supporting documents required.
- 9 To balance the policy needs of the fiscus and reduce the administrative cost in repealing the current exemption, due consideration must be given to introducing an appropriate 'high tax exemption' (i.e. similar to section 9D) or to introduce other anti-avoidance type measures that will address the concerns regarding double non-taxation, whilst avoiding the creation of unintended consequences, such as being overly punitive towards individuals which may fall within the ambit of the current exemption but in circumstances where there is no threat of double non-taxation.. It is imperative that the practical difficulties which have been highlighted are taken into account in the design of the new regime, i.e. the complexities of determining the South African taxable income for provisional tax payment purposes, differences in tax years and tax rates as well as the various foreign taxes that will not qualify for foreign tax relief
- 10 We propose a more comprehensive and efficient consultative process, whereby NT should host workshops to engage with impacted taxpayers and interested parties, with a view and commitment to finding an equitable solution, taking cognisance of the



macro-economic issues, including the negative impact on existing projects, foreign direct investment, the attractiveness of the head-quarter regime and the impact on the individual tax base, which currently is the highest contributor of tax revenues for SA.

- 11 We have noted that the EM states the exemption creates arbitrage between the private and public sector. However, it is unclear how NT has compared public sector officials who, firstly, are employed to mainly if not exclusively render services in SA (and definitely not for extended periods such as 6 months) and, secondly, where they actually render services in foreign countries (i.e. consulates etc.) Article 18 of the DTA would in most instances give SA exclusive taxing rights, thus preventing any double taxation or the need for double taxation relief through the application of a section 6quat credit.

- 12 Submission: This comment in the EM is, in our view, misplaced in justifying the repeal of the exemption.

### ***Tax relief for Bargaining Councils regarding tax non-compliance***

- 13 Whilst we do not object to the principle of providing amnesty for specific misconduct as a special remedy to ease compliance in specific circumstances, it must be specific to a specific transgression or transaction and available to all those taxpayers.
- 14 We do have a fundamental and in principle objection with granting amnesty to specific taxpayers, as is proposed for the benefit of Bargaining Councils.
- 15 The specific transgression referred to, namely an employer not complying with its requirements to withhold PAYE, is adequately dealt with in the remedy in paragraphs 5(2) and 5(5) of the Fourth Schedule to the ITA. By not obliging transgressors to follow the route available, it is questionable whether the requirements of paragraph 5(4) of the Fourth Schedule have been circumvented regarding the issuance of IRP5.
- 16 In essence, by proposing to circumvent the current remedies, NT is actually not proposing amnesty for the Bargaining Councils, but in fact to their employees for encashed leave and bonuses (i.e. year-end payments).
- 17 It is unclear why NT is of the view that this position is unique, as it does not appear to be so from our perspective. The EM also notes that the concern is the high penalties and interest, yet the capital tax is also proposed to be excused.
- 18 Other taxpayers are required to pay tax, penalties and interest in similar circumstances, which renders this proposal as being grossly unfair and discriminatory, which may lead to an erosion in the public trust in the tax system.



- 19 In our view, this proposal opens the door for future abuse, i.e. if the financial exposure of compliance is detrimental to the viability of the Bargaining Council, NT will be compelled to provide relief (i.e. the 'too big to fail' philosophy).
- 20 We are strongly of the view that the proposed relief sets the wrong precedent, whilst driving the wrong taxpayer compliance behaviour. There appears to be no legal basis for distinguishing Bargaining Councils from any other taxpayers and there is no apparent reason why they should be 'singled out' and treated differently to all other taxpayers in the same non-compliant circumstances, namely to avail of the dispute resolution remedies available within the framework of the TAA.

This includes among other things access to the voluntary disclosure programme, an estimate assessment to be issued by SARS and an agreement reached with SARS on the tax treatment subject to the standard terms and conditions prescribed in the TAA. The penalty regime must equally apply with the same behavioural tests taking into account the degree of intentional non-compliance, negligence or possible inadvertent error which gave rise to the non-compliance.

- 21 In our view, drawing a distinction in favour of Bargaining Councils is not legally justifiable within the constitutional framework which requires equality before the law as well as procedural fairness. SARS is entrusted with collecting taxes and as such must treat taxpayers on an equal basis.

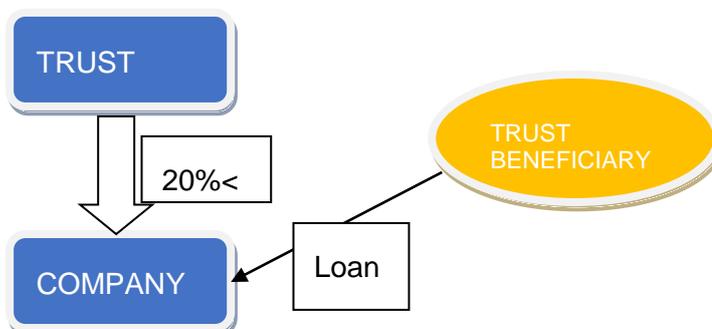
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| <p>22 <u>Submission</u>: We submit that the relief proposed for Bargaining Councils is inequitable and drives the wrong taxpayer behaviour and as such, the proposals should be scrapped in their entirety. The delinquent Bargaining Councils must be required to follow the same dispute resolution procedures as all other taxpayers, including availing themselves of the remedies which are available, and must at a minimum be forced to collect the taxes due from their employees.</p> |
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## ***Loans to trusts –section 7C***

### **Extension of s7C to company loans – Scope of the provision**

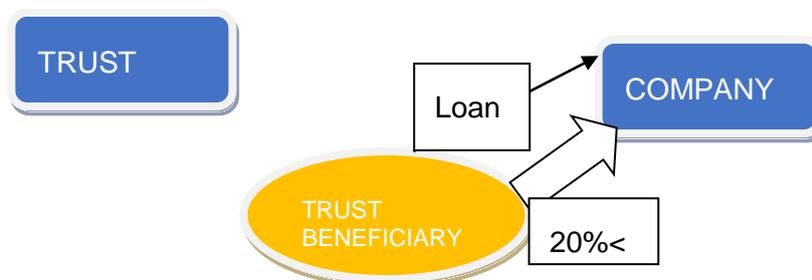
- 23 The insertion of section 7C(1)(a)(ii) makes the application of section 7C overly broad, rendering its application to transactions which could not have been intended to be subject to section 7C.

24 The EM appears to target the following scenario:



25 The purpose of this 'anti avoidance' extension is to prevent circumvention of section 7C by merely placing the assets and debt in a company held by the trust, regardless of whether this was achieved as an original structure or through a subsequent restructuring.

26 However, the current proposal does not require the trust to hold any shares in the company but merely relies on the connected person test, which makes it overly broad. It will now also apply to the following transaction which in our view was unintended:



27 In this instance, the beneficiary is connected to the company and to the trust which makes the company connected to the trust (para b(ii) of the "connected person" definition).

28 In this instance, the loan has nothing to do with the trust or any estate planning avoidance, as the relevant share and loan will form part of the trust beneficiary's estate.

29 Submission: It is submitted that at the very least a direct shareholding in excess of 50% together with any other connected persons (i.e. cannot be without trust holding shareholding) should exist between the relevant company and the trust, as no trust beneficiary will dispose of the debt and assets to an independent majority shareholder to merely avoid estate duty.



- 30 However, should NT only want to apply a lesser connected person shareholding requirement it could be achieved by amending the wording of section 7C(1)(ii), as follows:
- 31 “...a company that is a connected person, as contemplated in paragraph (d)(iv) of the definition of connected person in section 1(1), in relation to the trust referred to in subparagraph (i)”
- 32 Furthermore, it is submitted that the original intention of this provision was to address estate duty avoidance by ring fencing asset growth in a trust against issuance of a nominal value loan.
- 33 The connection directly or indirectly back to the acquisition or disposal of assets by the beneficiary or connected person to the trust should also be considered as a prerequisite for section 7C to apply.

#### **Extension of s7C to company loans – Person who receives donation**

- 34 We consider that the amendment to subsection 3 is aimed at merely cleaning up the existing provision of the Act in order to include companies in the specific provisions. The result is that where the loan granted results in a donation, that donation will be treated as a donation made to a trust (only) and not to the company that could have also received the loan.

- 35 Submission: We propose that the following be inserted in this provision “*“be treated as a donation made to the recipient of the loan, being either the trust or the company, by the person referred to in subsection (1)(a) ...”*”.

#### **Loan cessions - section 7C(1A) clarification of loan rights**

- 36 We note that the inclusion is aimed at covering instances where a loan is granted by a person and thereafter the loan is bequeathed or donated to another person. The phrase “person acquires a claim” is used, without including a definition of “a claim”, which leaves this broad term open to interpretation. For example, in the case of a deceased estate (of a person who granted a loan to a trust), upon death, the deceased estate is considered to be a person for purposes of the Act but the provisions of section 7C do not apply to a deceased estate. The executor of the estate is appointed to wind up the deceased estate and if there are distributions thereafter, these will be distributed to the heirs/ legatees of the deceased.
- 37 In this scenario, would the executor be treated as having acquired *the claim* of the loan to the trust? It follows however that the executor is not a connected person to the trust, in terms of the definition of connected person in relation to a trust. Would the applicability of section 7C then be switched off at death, since the claim of the loan is treated as having been acquired by the executor who is not a connected person to the trust?



- 38 If the executor is not treated as having acquired a claim to the loan, would the heirs/legatees (on the assumption that they are connected persons to the trust) be treated as having acquired the claim of the loan? If this is the case, at what date will the acquisition of such claim be, will it be on death of the funder of the loan or the date on which the estate is wound up and the loan remains for the inheritance of the heirs/legatees?
- 39 Furthermore, there is no guidance on how a claim is acquired. Is the acquisition of the claim validated and enforced by a paper trail, i.e. the existence of an agreement between the donor and the person acquiring the claim?
- 40 Furthermore, it is seemingly not required that the loan is 'acquired' (i.e. ceded) but merely that a claim to an amount owing is acquired. This also raises concern as to whether debt security cessions or other security arrangements are impacted.

- 41 Submission: We recommend that the word "claim" be defined in the Act.
- 42 To eliminate the scope for differing interpretations, we submit that clarity is provided on the term "acquisition of a claim", specifically in the context of deceased estates.
- 43 We further request clarity regarding how a claim in respect of this provision is acquired and how it is validated and effected.
- 44 Clarification in the legislation is also required as to whether a claim is a lesser or broader right than a ceded loan.

#### **Loan cession - section 7C(1A) refinement**

- 45 The insertion of subsection (1A) appears to be incomplete in respect of section 4(1)(b) in (1A)(b) by virtue of the words "on the date on which that person became a connected person in relation to that trust or person". (our emphasis).

- 46 Submission: We submit that the use of the word "person" seems overly broad and therefore is likely to lead to unintended consequences.
- 47 We propose that the following additional words be included in order to make the provision specific "...*on the date on which that person became a connected person in relation to that trust or person referred to in (b)(ii)*".

#### **Correcting the situation of double taxation-section 8C, 8C(1A), paragraphs 64E, 80(2) and 80(2A) of the Eighth Schedule**

- 48 The correction of the double taxation situation arising between a trust and an individual, as highlighted by various stakeholders and industry bodies, is welcomed.



### **Exclusion of employer share trusts from section 7C-Section 7C(5)(h)**

49 Whilst the amendment to exclude employee share scheme trusts is welcomed, we remind NT that it was proposed in the 2017 Budget Review that an exclusion for business trusts and therefore business companies held by trusts, would also be introduced.

50 Submission: The exclusion of bona fide employer share incentive trusts is welcomed and must be extended to business trusts as well business companies held by trusts.

### **Proposed wording for section 7C(4)**

51 The amended section 7C(4) provides that "... those persons must be treated as having donated, to *that trust*, the part of that amount ...". This does not seem to adequately address loans to a company.

52 In addition, the proposed wording of section 7C(4) appears to be ambiguous, as it is unclear what basis of allocation should be used in determining the portion of the deemed donation attributable to a person holding both equity shares and voting rights in the company that provided a loan, advance or credit to a trust.

53 It is noted that the proposed amendments referred to in section 4(2) of the DTLAB17 would be deemed to have come into operation on 19 July 2017 and that they would apply in respect of any amount owed by a trust or a company in respect of a loan, advance or credit provided to that trust or that company before, on or after 19 July 2017.

54 Submission: The deemed donation should be to "that trust or other company, as the case may be, ..."

55 We further submit that a proviso could be added to this subsection to indicate whether equity shares or voting rights should be given preference where any of the persons who instructed the loan, advance or credit holds both. Secondly, this subsection requires reference to the equity shares or voting rights held by the persons "during" the year of assessment in which the company provided the loan, advance or credit to a trust. It is unclear which proportion of equity shares or voting rights held by a person during the relevant year of assessment should be considered if a person's shareholding or holding of voting rights change during the relevant year of assessment. In order to address this ambiguity, a proviso could be added to this subsection that specifies the exact time during the year of assessment at which the portion of the equity shares or voting rights should be considered or whether an average holding should be calculated for purposes of determining the portion of the donation attributable to such a person.

56 The effective date of these amendments should not have retrospective effect having regard to the prejudicial nature of this to taxpayers.



### **Proposed wording of section 7C(5)**

57 Section 7C(5)(d) only makes provision for a loan to a trust for the funding of a primary residence whilst section 7C(5)(f) does not cater for a loan to a company.

58 Submission: We submit that these provisions should be amended to make provision for the exclusion of loans to companies in addition to trusts.

59 Our concern with the proposed amendment is that it does not address the situation where an employee share trust distributes the shares to the beneficiary, in which case paragraph 80(1) of the 8th Schedule will not apply with the result the market value of the shares distributed by the trust would be subject to income tax in the hands of the beneficiary in terms of section 8C. The capital gain of the trust is however also subject to tax in the trust.

60 Submission: Paragraph 80(1) should also be amended to remove the exclusion of section 8C equity instruments and be made subject to paragraph 64E, which should be amended to also cater for distributions of equity instruments by an employee share trust.

61 An exclusion should be provided for trusts that conduct an active trade as these trusts and the concomitant interest-free loans have not been set up with the sole or main purpose of avoiding Estate Duty or Donations Tax.

62 The trusts pay tax on their taxable income derived from an active trade and retained by the trust at the rate of 45%.

63 While hypothetically interest could be levied on such loans in order to avoid the penal consequences of section 7C(3), in many instances it will not be practically possible to do so. For example, the trust may have external borrowings in respect of which the levying of interest may result in a breach of any covenants, bearing in mind that the interest-free loan is effectively equity.

64 Submission: The exclusion of bona fide employer share incentive trusts is welcomed and must be extended to business trusts carrying on an active trade as well business companies held by trusts.

### **Incidental impact of section 7C – Charged interest and the National Credit Act No 34 of 2005 (the NCA)**

65 We have noted that loans that were interest free but are now interest bearing to minimise the impact of section 7C may have an unintended impact in terms of the NCA.



- 66 Simplistically, any loan granted to a trust will generally be termed a 'credit agreement', as defined in the NCA under the provisions of section 8(4)(f)<sup>1</sup> of the NCA. Alternatively, such loan granted to a trust may fall within the ambit of section 8(3)<sup>2</sup> of the NCA being a credit facility or section 8(5)<sup>3</sup> of the NCA being a credit guarantee.
- 67 This means that most loans, if interest bearing, are legally required to be registered with the National Credit Regulator.
- 68 In terms of the definitions in section 1 of the NCA, a trust is considered to be a juristic person if it has three or more trustees.
- 69 The scope of the NCA is to protect individuals and small businesses. There are exceptions contained in section 4(1)(a) of the NCA, however these tend to mainly apply to relationships between natural persons and juristic persons with an asset threshold above R1 million or where such loans do not exceed R250 000.
- 70 However, the determination of such amounts are at the time the loan was made. No transitional rules have seemingly been inserted in the NCA for pre-existing loans.
- 71 It would therefore seem that if Mr A sold his holiday house to the trust (its only asset) on loan account for R200 000 in 1965 (with a market value of R3m in 2017) interest

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<sup>1</sup> Section 8(4)(f) reads as follows: "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit transaction if it is –...  
(f) any other agreement, other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred, and any charge, fee or interest is payable to the credit provider in respect of –  
(i) the agreement; or  
(ii) the amount that has been deferred."

<sup>2</sup> Section 8(3) reads as follows: "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2) or section 4(6)(6), constitutes a credit facility if, in terms of that agreement-  
(a) a credit provider undertakes-  
(i) to supply goods or services or to pay an amount or amounts, as 40 determined by the consumer from time to time, to the consumer or on behalf of, or at the direction of, the consumer; and  
(ii) either to-  
(aa) defer the consumer's obligation to pay any part of the cost of goods or services, or to repay to the credit provider any part of 45 an amount contemplated in subparagraph (i); or  
(bb) bill the consumer periodically for any part of the cost of goods or services, or any part of an amount, contemplated in subparagraph (i); and  
(b) any charge, fee or interest is payable to the credit provider in respect of- (i) any amount deferred as contemplated in paragraph (a)(ii)(aa); or (ii) any amount billed as contemplated in paragraph (a)(ii)(bb) and not paid within the time provided in the agreement.

<sup>3</sup> Section 8(5) reads as follows: "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act 20 applies."



free, then by applying an interest rate after 1 March 2017 to accommodate section 7C, the NCA would apply, since the value of the trust's assets at the time the credit transaction was made was below R1m and also the loan amount was below R250 000.

- 72 Furthermore, such an arrangement between a beneficiary and the trust or a beneficiary and a company held by trust is not excluded by section 4(2) of NCA, as they are not deemed to be not acting at arms-length.
- 73 The charging of interest due to section 7C also affects the actual existence of the loan.
- 74 Section 89(2)(d), read with section 89(5)(a), of the NCA provides that a credit agreement is void from the date the agreement was entered into, where the credit provider was unregistered, but required to do so in terms of the NCA at the time the agreement was made. Such a null and void credit agreement trumps any provision of common law, any other legislation or any provision of an agreement to the contrary, in terms of section 89(5) of the NCA.
- 75 In the Supreme Court of Appeal (SCA) case *Visagie NO and Others v Erwee NO and Another* (unreported case no 734/2013), the appeal turned on whether an agreement of purchase and sale, which provides for interest to be payable on deferred payments amounted to a credit transaction under section 8(4)(f) of the NCA. Such agreement would be unlawful unless the party extending the credit is registered as a credit provider in terms of section 40 of the NCA. The court in this case declared the agreement to be null and void *ab initio*.
- 76 The legalities of charging interest must be considered by all parties to the agreement when considering whether or not to charge interest on a loan, advance or credit. These include the application of the , rule as proposed in section 7D of the ITA, which effectively means that the NCA will prohibit interest charging but section 7D will compel tax on the notional interest.

77 <u>Submission:</u> We recommend that NT and SARS consider the possible anomalous impact that the NCA has on loans which will now be interest bearing due to section 7C of the ITA.
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#### **Section 7C(5) – Loan subject to STC**

- 78 Section 7C(5)(g) of the Act currently excludes loans which were subject to section 64E(4). However, it does not address loans that were subject historically to section 64C, which loans are excluded from section 64E(4) to avoid double taxation.

79 <u>Submission:</u> It is submitted that section 7C(5)(g) of the Act be extended to include loans that were subject to section 64C.
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## ***Bursaries and Scholarships***

### **Increase of threshold for exemption of employer provided bursaries to learners with disability - section 10(1)(qA)**

80 Submission: The extension of the exemption to employer provided bursaries or scholarships for learners with disabilities is welcome.

## ***Skills Development Levies***

### **Amendment to section 3 of the Skills Development Levies Act, No. 9 of 1999**

81 Submission: The correction of the inadvertent deletion of the “leviable amount” paragraph in section 3(4) is welcomed and improves legal certainty.

## ***Unemployment Insurance Fund***

### **Section 4(1) of the Unemployment Insurance Contribution Act**

82 In terms of section 4(1)(b) of the Unemployment Insurance Contribution Act, No. 4 of 2002, employers and employees who entered into learnership agreements are currently exempt from contributing to the Unemployment Insurance Fund. As a result, learners are also not allowed to claim benefits from the Unemployment Insurance Fund. Further to this, foreign employees working temporarily in South Africa are exempt from contributing to the fund in terms of section 4(1)(d), which also restricts them from claiming benefits.

83 The concern is that with the promulgation of the proposed amendments, the employees/learners are now required to contribute to the Unemployment Insurance Fund, however there is no corresponding amendment to the Unemployment Insurance Fund Act to enable these employees/learners to claim benefits from the fund. The result is that employees/learners are in a position where they contribute to something which renders no benefit to them.

84 Submission: It is recommended that consultation between the Department of Labour and NT should take place to ensure that benefits and contributions legislation remain aligned, since changes to one without corresponding changes to the other creates disparity which should be avoided.



## **Retirement Reform**

### **Transferring retirement fund benefits after reaching retirement date**

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| 85 | <u>Submission:</u> The provision allowing the transfer of benefits after reaching retirement age is welcomed.                                  |
| 86 | An effective date must however be stipulated and given the implications this should not be an uncertain date such as when the bill is enacted. |

### **Postponement of the annuitisation requirement for provident funds to 1 March 2019**

- 87 The ongoing uncertainty regarding the implementation of the retirement reform is concerning, as it directly impacts on employees' ability to properly plan their retirement funding mechanisms.
- 88 It also means that employers and payroll software providers remain in 'uncertain times' as to the amount of changes and development that needs to be undertaken on payroll systems, including communicating such requisite changes to employers.

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| 89 | <u>Submission:</u> The ongoing uncertainty with regard to the full implementation of the retirement reform is concerning, given that NT concluded 2 years ago that it had consulted sufficiently with stakeholders on matters of policy and implementation. Perhaps the legislation should not have been enacted until such time as effective consultation had taken place. |
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### **Deduction of retirement contributions**

#### **Section 11F**

- 90 The transfer of the deduction for contributions to retirement funds from section 11 to section 11F will in our view not achieve the proposed results as section 11(x) brings every deduction within the scope of section 11, whilst the provisions of section 23(g) must also be considered. Therefore, it is not 'de-linked' from taxable income in its current form.

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| 91 | <u>Submission:</u> The problem identified by NT is section 11(k) correlation to taxable income as defined in section 1. The proposal does not solve this problem.   |
| 92 | Furthermore, it is submitted that the taxable income referred to in section 11F(2)(b)(ii) should also exclude taxable capital gains in line with the provisions of section 11F(2)(c), which limits the maximum deduction to taxable income excluding taxable capital gains. |
| 93 | It is presumed that the legislature did not intend to permit set off of the section 11F deduction against taxable income from retirement fund lump sum benefits, retirement   |



fund lump sum withdrawal benefits and severance benefits. The taxable income referred to in section 11F(2)(c) should therefore specifically exclude such amounts.

- 94 It is noted that section 11F would be deemed to have come into operation on 1 March 2016 and that it would therefore affect the taxable income computation of natural persons for the 2017 year of assessment. The proposed retrospective application of this amendment to 1 March 2017 is considered to be administratively unfair insofar that it is adversely impacting on taxpayer rights. In addition, administrative difficulties are created for SARS and taxpayers, for example, necessitating the rectification and resubmission of affected income tax returns that were already submitted for the 2017 year of assessment. This in turn significantly and adversely impacts on the normal dispute resolution timeframe available to taxpayers.
- 95 We further consider that it is prejudicial towards taxpayers to introduce this provision with retrospective effect as the maximum deduction permitted in terms of section 11(k) could potentially exceed the maximum deduction permitted under section 11F. In terms of section 11F, the deduction for retirement fund contributions may not exceed the taxable income as determined before applying this deduction, which expressly excludes taxable capital gains. Section 11(k) contains no such restriction and permits the deduction of retirement fund contributions against taxable capital gains. Section 11(k) is further not restricted to set off against “taxable income”, which means it can create (or increase) an assessed loss, whilst section 11F cannot.

- 96 Submission: The effective date should not be retrospective, whereby it impacts completed tax years. Therefore, it should be only applied from either 1 March 2017 in the current payroll cycle, where it can still be corrected in payroll (though would require manual intervention) or from 1 March 2018 with the new payroll cycle.



## LOCAL BUSINESS TAXES

### **Section 6quat**

97 It is noted that references to the repealed provisions of sections 11(n) and 18 have been deleted from section 6quat(1B)(i) and that the latter will only refer to the allowable deduction in terms of section 18A of the Act.

98 Submission: For purposes of consistency, it is proposed that the ambit of section 6quat(1B)(i) should be extended to the allowable deduction under section 11F of the ITA. In terms of its proposed wording, section 11F provides a deduction against “income” and must therefore also be deemed as being incurred proportionally in respect of income derived from sources within and outside South Africa.

### **Section 36(7EA) – Addressing the tax treatment of debt foregone for the benefit of mining companies**

#### **Direct vs. indirect funding**

99 We welcome the addition of section 36(7EA) of the Act which seeks to provide relief to mining companies similar to that provided to other companies in respect of debt foregone by these other companies.

100 We note that the provisions of section 19 and paragraph 12A of the Eighth Schedule apply where a debt was used to directly or indirectly fund any expenditure. However, the proposed section 36(7EA) refers only to a debt that was used to fund any amount of capital expenditure. This leads to uncertainty as to whether the mining provision applies only to direct financing of capital expenditure or also includes indirect funding.

101 Submission: The provision needs to be clarified to indicate whether it is applicable both to direct and indirect funding of capital expenditure or only to direct funding.

102 ‘Capital expenditure incurred’ is defined in section 36(11) of the Act, as being net of proceeds on disposal mining assets which qualified for deduction under section 15(a) of the Act.

103 Submission: if the intention is that this specific definition is not applicable in the circumstances, we propose that the first reference in the proposed subsection to “capital expenditure incurred” should rather be to “capital expenditure.”



### **Exclusions from application**

104 The proposed section 36(7EA) contains no exclusions from its application, unlike section 19 and para 12A of the Eighth Schedule. This would place miners at a significant disadvantage relative to other industries.

105 Submission: Given that the intention is to provide similar relief for mining companies as that which is provided to other companies (in similar circumstances), exclusions like those contemplated in section 19(8) and paragraph 12A(6) of the Eighth Schedule should be included in section 36(7EA).

### **Definition of capital expenditure**

106 The definition of capital expenditure includes certain notional amounts in the case of certain gold mines and debts from the disposal of low-cost residential units to employees. Such notional amounts would not be funded by any debt and therefore would seemingly not fall within the parameters of the proposed provision with the result that such capital expenditure cannot be reduced which would in turn result in no recoupment under paragraph (j) of gross income.

107 Submission: We submit that the proposed amendment must take into account the notional amounts contemplated in the definition of capital expenditure.

### **Exceptions provided for in para 56 of the Eighth Schedule**

108 Paragraph 56 of the Eighth Schedule contains a number of exceptions that allow for capital losses in the case of disposals of debts owed by connected persons which would ordinarily be disregarded. These exceptions include any reduction of expenditure in terms of paragraph 12A of the Eighth Schedule. No such similar exception is proposed in respect of reductions of capital expenditure in terms of section 36(7EA).

109 Submission: We submit that paragraph 56 of the Eighth Schedule should include an exception for reductions of capital expenditure in terms of section 36(7EA).

### **Section 36(7F) ring-fencing**

110 We note that the proposal does not take account of the manner in which the reduction of capital expenditure must be applied in the context of the 'per mine' ring-fencing provision contained in section 36(7F). It is therefore unclear as to whether capital expenditure of the mine, to which the debt applies, or the capital expenditure of other mines, must be reduced.

111 Submission: We submit that clarity must be given on the manner in which the reduction of capital expenditure must be applied having due regard to the ring-fencing provision.



## ***Addressing the tax treatment of debt foregone for dormant group companies***

### **Substitution of paragraph 12A(6)(d)**

112 In our view, the exclusion contained in paragraph 12A(6)(d), in its current form, is useful for genuine commercial situations and should remain.

113 Submission: Paragraph 12A(6)(d) should remain as is. Should the substituted version be legislated, please refer below for comments in this regard.

### **Restrictive requirements of dormant companies**

114 Whilst the proposed intention to provide relief for debt reductions of dormant companies is welcomed, we are concerned that the proposed requirements are too restrictive and could result in many dormant companies not qualifying for such relief. Specific concerns, together with proposals to address these, are set out below.

115 The requirement that the company must meet all of the requirements in the year of assessment of the debt reduction and the preceding three years of assessment is, in our view, too extensive. This means that groups of companies may be forced to keep dormant companies for four years before being able to wind them up.

116 Submission: The proposed period for which a company must be dormant should be reduced to the current year of assessment plus one. This would then align with the forfeiture of any balance of assessed loss.

117 The requirement that no assets must have been transferred to or from the company is too restrictive. It frequently happens that, in cleaning up dormant companies, various debts are transferred by way of cession in order to eliminate and consolidate group debts to leave a single consolidated outstanding amount. Broadly speaking, even cash (an asset) transferred to pay bank charges of the company could arguably result in the company falling foul of this requirement.

118 In our view, this requirement would result in taxpayers having to wait a further minimum three years before waiving the remaining outstanding debt and would not achieve the intention of the proposed amendments.

119 Submission: The requirement that no assets have been transferred to or from the company should be removed.

120 The requirement that no amounts must have been received or accrued to the company is too broad. As it stands, this would capture any receipts or accruals on the realisation of capital assets, including deemed proceeds (e.g. on the *in specie*



distribution of assets), and potentially even the repayment of debts. It may even include minimal interest earned on bank accounts.

121 Submission: We propose that the requirement that no amounts must have been received or accrued to the company should be limited to amounts in the form of gross income, in excess of a certain percentage, for example 5% (or such percentage as NT deems suitable) of the total assets of the company at the end of the year of assessment.

122 The requirement that the company not incur any liability is too restrictive. For example, any company is required to file an annual return with CIPC and pay the applicable fee. There may also be monthly bank charges incurred. Compliance with this requirement would penalise any dormant company. It may be that a dormant company could also incur other liabilities, notwithstanding that it does not carry on any trade.

123 Submission: The requirement that no liabilities are incurred should be removed. Alternatively, the value of liabilities incurred could be restricted to a percentage of total assets.

124 It is not clear why debt owing to non-resident group companies is excluded from the relief proposed, as the same impediments to winding up dormant companies equally apply to debt owing to non-resident group companies.

125 Submission: We submit that the relief should be extended to non-resident company debt.

### **Debts incurred in respect of assets disposed of in terms of corporate reorganisation rules**

126 The proviso states that the relief will not apply to debts incurred in respect of assets disposed of in terms of corporate reorganisation rules.

127 It is not clear what the perceived mischief is that leads to such an exclusion, but it could result in significant difficulties. Take the following example for instance:

*Company A holds all the shares in Company B. Company B acquired a property for R10 million funded by way of a loan from Company A. Company A intends to rationalise the group and transfer the property from Company B to Company A at a time when it is valued at R8 million*

128 A transfer of the property in settlement of the loan of R10 million would result in a debt reduction of R2 million and possible recoupment for Company B. However, a sale of the property for R8 million with the consideration set off against the loan would not result in a debt reduction. The subsequent waiver of the balance of the loan



would, however, result in a debt reduction and a tax liability for Company B which cannot be recovered by SARS. This approach does not logically follow the principle of the relief envisaged.

129 Submission: The exclusion for debts that were incurred in respect of assets disposed of under the corporate reorganisation rules should be removed.

130 The proviso also excludes any debt incurred or assumed to settle or take-over any debt incurred by any other group company. Again, it is not clear what the perceived mischief is which this exclusion seeks to address. However, it potentially significantly impacts the effectiveness of the relief by severely constraining its operation.

131 It is noted that the EM suggests that the debt reduction rules should not apply to group debt that is forgiven, which implies that the exclusion should be broader than just debt reductions through the issue of shares and that it should include waivers of group debt.

132 Submission: We submit that NT must consider removing the exclusion for debt incurred or assumed to settle or take-over any debt incurred by any other group company.

133 The effective date of 1 January 2018 is unclear as to whether it applies to debt reductions on or after that date or to years of assessment ending on or after that date

134 Submission: We submit that the effective date should be clarified to apply to debt reductions on or after 1 January 2018.

135 It is noted that the 2017 National Budget indicated that relief would also apply in the case of companies in business rescue. However, no such relief is included in the DTLAB17.

136 Submission: We submit that the proposed relief must be extended to companies in business rescue in line with the Budget proposals.

137 It is difficult to determine how a debt is incurred if one disposes of an asset, as is suggested in terms of proviso (aa) to paragraph 12A(6)(d) / section 19(8)(d).

Submission: If the proviso related to debts incurred in respect of assets disposed of in terms of corporate reorganisation rules is retained, we request that clarity is given in this regard.

138 Since the proposed section 19(8)(e) and paragraph 12A(6)(e) only deal with debt settled by the issue of shares in a group context, it is unclear whether the settlement of debt directly or indirectly by the issue of shares is permissible in a non-group context.



139 Submission: The words “take over” in the proposed section 19(8)(d) and (e) should be replaced with “assume” for purposes of clarity and consistency with the remainder of the Act.

**Debt capitalisation – Proposed addition of section 19(8)(e) and paragraph 12A(6)(f) of the Eighth Schedule**

140 The requirement that the person to whom the debt is owing, that is settled by issuing shares by the borrower, must form part of the same group of companies restricts the provision unnecessarily. It appears as if this requirement was incorporated as a basis ‘to trigger’ the proposed anti-avoidance provisions in the proposed section 19B.

141 Conceptually, there is no reason why debt capitalisation outside a group of companies should not place the borrower back in the tax position that it would have been if the debt has always been equity.

142 The current wording would exclude debt capitalisation transactions by investors in joint ventures and by minority shareholders, both categories of which may be measures to assist a company to return to financial health.

143 Submission: The provisions of the proposed section 19(8)(e) and paragraph 12A(6)(f) should not be limited to debt owing between companies that form part of the same group of companies. The anti-avoidance rule should be changed as indicated below to address avoidance concerns.

***Proposed section 19A***

**General**

144 The proposed section 19A is penal in the sense that it does not take into account the market value of any shares issued. Assume, for example, that the debtor company had debt of R1 000 and that the market value of the shares issued on conversion amounted to R700. Assume also that the amount of recoupable interest is R400.

145 In terms of the proposal, the full amount of recoupable interest of R400 will be recouped, notwithstanding that the debt reduction as contemplated in section 1 only amounts to R300.

146 Submission: The recoupment of any interest should be limited to the amount by which the face value of the converted debt exceeds the market value of any shares issued as consideration (subject to our preceding submission in which case it is the increase in market value of all the shares issued which is relevant).



### **Definition of recoupable interest-section 19A**

147 The proposed definition of “recoupable interest” includes all interest incurred in respect of converted debt, to the extent that the interest is or was allowable as a deduction and was not subject to normal tax in the hands of the creditor. By defining recoupable interest in this manner, it means that when the underlying debt is converted to shares, any interest incurred in respect of such debt is recouped, irrespective of whether such interest had actually been settled / paid by the debtor. If the specific interest has already been settled, the debtor no longer owes that interest and the interest is not included in the amount of the debt to be converted.

148 Submission: The proposed definition of “recoupable interest” should be amended to expressly exclude interest incurred and already settled, so that only interest amounts not settled and still reflected as outstanding will result in a taxable recoupment.

### **Interaction with the definition of contributed tax capital**

149 The interaction between the debt capitalisation rules and the determination of the contributed tax capital of the borrower company is unclear. Paragraphs (a)(ii) and (b)(ii) of the definition of ‘contributed tax capital’ in section 1(1) refer to amounts of consideration received by or accrued to the company for the issue of shares. It should be clarified that the amount of the capitalised debt should be added to the company’s contributed tax capital similarly to the cash consideration that the company would have received if the initial loan was in the form of an equity contribution.

150 Submission: In light of the intention to restore the tax position of the borrower to what it would have been had it been funded with an equity contribution from the start, as indicated on page 23 of the EM, we recommend that either: **(a)** paragraphs (a)(ii) and (b)(ii) of the definition of contributed tax capital be amended to reflect that the amount of the capitalised debt (excluding accrued interest recouped under the proposed section 19A) should be added to the contributed tax capital of the company, or **(b)** a new item to the above effect be added to the definition of contributed tax capital.

### ***Proposed section 19B***

151 The requirement in the proposed s 19B(1)(c) that the borrower and lender should remain part of the same group of companies (i.e. 70% shareholding threshold) for 5 years from the date of the debt capitalisation will place significant restrictions on the ability of the borrower company to obtain further equity funding to restore its financial health.

152 In a scenario where a parent holds 74% of the shares of a subsidiary whose debt has been capitalised and minority shareholders (for example, BEE shareholders) hold



26% it would be virtually impossible for the subsidiary to raise further equity funding as it could dilute the parent's shareholding to below 70%. Depending on the circumstances of the company, this could impact whether it is able to turn its financial position around or not. Tax requirements should not restrict a distressed company's ability to raise further funding in the market if it wishes to do so.

153 Submission: Our primary submission is that the proposed section 19B should be withdrawn. Alternatively, the de-grouping period should be substantially reduced from an effective six years of assessment to two years.

154 The reliance on the market value of shares issued to settle the debt as a mechanism for determining the deemed recoupment is flawed. In a wholly-owned group scenario, the number of shares issued to settle the debt is irrelevant. This mechanism is therefore open to manipulation (if too many shares are issued) or a trap for the unwary (if too few shares are issued).

155 It is very difficult to provide for a simple mechanism to remedy this flaw. Theoretically, regard should be had to the increase in the market value of all the shares of the debtor company at the time of the capitalisation (not at the time of de-grouping) compared to the face value of the debt reduced.

156 The recoupment in section 19B is not linked to a deduction. Assume for example that an intra-group debt was utilised to fund the acquisition of shares in another company in respect of which no deduction was available. No interest was charged in respect of the debt. The debt is capitalised as part of a restructuring of the company. In the event that there is a de-grouping within the six year period and an excess of the face value of the debt over the value of the face value of the shares, this would result in a deemed recoupment notwithstanding that the debt was in no way deductible expenditure. This position should be contrasted with that had section 19 applied to the debt reduction, in which case there would be no recoupment

157 Submission: Any recoupment in terms of section 19B should apply only to the extent that the debt funded deductible expenditure.

158 It is unclear whether the effective date of 1 January 2018 applies to debt reductions on or after that date or to years of assessment ending on or after that date.

159 Submission: We submit that the effective date should be clarified to the effect that it applies only to debt conversions that take place on or after 1 January 2018.



### **Addressing circumvention of anti-avoidance rules dealing with share buy-backs and dividend stripping**

- 160 It is submitted that the proposed provisions of section 22B and paragraph 43A(2) are excessively broad as they would apply to any dividend that was received by or accrued to the disposing company within a period of 18 months prior to the disposal of the shares, even if the dividend was not related to the buy-back.
- 161 For example, assume that Company A holds 100% of the shares in Company B. Company A disposes of the entire shareholding in Company B to a third party for an amount of R50 million. In the 18 months prior to the disposal, Company A received dividends amounting to R2 million from Company B in accordance with its dividend policy. As the proposal stands, the dividends of R2 million will be added to the proceeds on disposal. In this example, the dividend is not consideration for the sale of the shares, but is a dividend declared in the normal course of business. The proposed amendment in its current form would result in such a 'normal' dividend inadvertently being treated as income.
- 162 It is noted that the proposed amendments will be applied retrospectively in respect of disposals on or after 19 July 2017. It is proposed that these provisions should not be backdated as they are severely prejudicial to taxpayers. They will result in exempt dividends being taxed as capital gains, which will impose an enormous financial burden on affected companies.

163 Submission: Having regard to the above, it is submitted that the implications must be considered having due regard to the principles of procedural fairness and the requirement that taxpayer rights must not be adversely impacted in the manner proposed. We suggest that the 18 month rule should apply only to dividends received or accrued on or after 19 July 2017.

- 164 The definition of a qualifying interest includes a holding of at least 20% of the equity shares or voting rights if no other person holds the majority of the equity shares or voting rights. In order to escape this inclusion, this implies that another person must hold the requisite majority alone without taking into account that the person may hold control together with connected persons.
- 165 For example, Company A holds 20% of the shares in Company B. Company C and Person A each hold 40% of the shares in Company B, so individually neither of the two have majority shareholding individually. Person A holds all the shares in Company C. In such a scenario, the 20% shareholder would not have the same degree of influence as the other shareholders would have, based on their overall (direct and indirect) shareholding and control.



166 Submission: The holding of 20% to 50% of the shares and voting rights should not be a qualifying interest if another person, whether alone or together with any connected person in relation to that person, holds the majority of the equity shares or voting rights.

167 The provision catches dividends received in respect of non-equity shares where the company also holds a qualifying interest. It is submitted that dividends in respect of non-equity shares do not give rise to an avoidance concern as contemplated in these provisions. For example, Company A holds 75% of the equity shares in Company B. The balance of the equity shares are held by a BEECO. In order to fund Company B, Company A subscribed for redeemable preference shares carrying a right to dividends at a fixed rate. The effect of the provisions is that any dividends received by Company A in respect of the preference shares within 18 months of their redemption or as part of the redemption will be included in proceeds and will be subject to CGT.

168 Submission: We submit that the provisions should apply only to disposals of equity shares.

### **Section 7D - In duplum rule**

169 Whilst the *in duplum* rule presents issues around certain anti-avoidance rules, the *Woolidge case* must be considered. This case dealt with the application of the attribution rules in section 7 and not with any tax provision to which the official rate of interest applied. It was held that the *in duplum* rule did not apply where SARS sought to apply the provisions of section 7(3) so as to tax notional interest on an interest free loan. The *in duplum* rule in the context of the various anti-avoidance rules dealing with low or no-interest loans is broader in scope than just those anti-avoidance rules that apply the official rate of interest and could also extend to the CGT attribution rules in paras 68 to 73 of the 8th Schedule and to section 31.

170 It is likely that the principles sought to be achieved by virtue of the proposed changes to section 7D will be challenged in the Constitutional Court which means that the underlying principles will need to be thoroughly tested before the adoption of the proposed changes.

171 We further note that the official rate of interest is not defined in section 1 but in para 1 of the Seventh Schedule, or in section 7D.

172 The effective date is proposed to be years of assessment ending on or after 1 January 2018 and will therefore affect the determination of fringe benefits on loans for purposes of the Seventh Schedule. The employer will have a retrospective withholding obligation and therefore result in non-compliance and give rise to penalties and interest.



173 The content of the proposed new section is welcomed as it provides clarity as regards the timing of interest paid by SARS. However, the DTLAB17 and the DTALAB17 both seek to create a new Section 7D in the Income Tax Act. Section 7D in the DTALAB deals with the accrual of interest, whereas the Section 7D proposed in the DTLAB17 deal with the *in duplum* rule.

174 Submission: The retroactive operation of the provision must be removed and the exposure to penalties and interest must therefore also be addressed.

175 As the official rate of interest is now used in various parts of the Act, the definition should be moved from the 7th Schedule to section 1 and the provisions of section 7C and section 64E amended to remove reference to the definition in these sections.

176 It is suggested that SARS and NT collaborate more closely on the drafting of the DTALAB17 to avoid duplication of sections.

#### ***Assumption of contingent liabilities-section 44(4)***

177 For purposes of an amalgamation transaction, section 44(4) requires any assumed debt to have been incurred. By definition, contingent liabilities are not incurred. It could therefore be argued that the assumption of contingent liabilities would still not qualify for purposes of amalgamation transactions

178 It is suggested that section 44(4) be amended to more closely align it with the wording of section 42(8) which does not require debt to have been incurred for purposes of the going concern rule

179 A slightly different concern arises with regard to liquidation distributions. In this regard, section 47(3A) provides that rollover relief will apply only to the extent that the holding company has not assumed any debt incurred within 18 months unless it is the refinancing of debt incurred more than 18 months before the disposal or it relates to a business disposed of as a going concern. As contingent liabilities are not incurred, the inclusion in debt will result in rollover relief being available for contingent liabilities that have nothing to do with a going concern.

180 Submission: It is suggested that section 47(3A) should require any debt to be incurred more than 18 months before the disposal (or a refinancing of such debt) or if it arose in the course of a business disposed of as a going concern

181 Submission: We submit that a definition for “contingent liability” must be included.



## ***Amendments to section 22B and paragraph 43A of the Eighth Schedule***

- 182 The incentive regime in section 12J requires that investors subscribe for shares in a venture capital company (VCC) to qualify for a deduction in terms of section 12J(2). It further requires that the VCC must use these funds to subscribe for shares in qualifying companies. As a result, when the value of the qualifying companies increase, the gain could potentially be taxable in the hands of both the VCC upon the disposal of the qualifying company shares and at a later stage again in the hands of the investor when it disposes of the shares in the VCC. The two layers of capital gains tax on the same gain could make the VCC regime unattractive compared to other investment vehicles (for example, partnerships) where the gain would only be taxed at one level.
- 183 Currently, one of the ways in which this capital gains tax in two layers of the VCC structure on the same gain can be prevented is by way of a buy-back of the shares, which will give rise to an exempt dividend in terms of the current legislation. The proposed legislation will eliminate this alternative for significant holdings by the VCC in qualifying companies and therefore add to the relative unattractiveness of the VCC regime, contrary to the legislative intention.

184 Submission: In light of the inherent obstacles that already exists as a result of the requirement that the section 12J venture capital vehicle should be a company, it is submitted that an exception to the rule should be added for shares held in a qualifying company by a VCC in paragraph 43A, and possibly also in section 22B (even though it is debateable whether the VCC will hold the shares in the qualifying company as trading stock). By so doing, this will allow the gains arising on investments made by the VCC to only be taxed at the level of the shareholder if the VCC exits from a qualifying investment by way of a buy-back by the qualifying company.

### **Proposed substitution of paragraph 43A of the Eighth Schedule**

- 185 In terms of section 70(2) of the DTLAB17, the proposed substitution is deemed to have come into operation on 19 July 2017 and applies in respect of any disposal on or after that date. Paragraph 13 of the Eighth Schedule to the Act contains special rules which determine the “time of disposal” for purposes of the Eighth Schedule. It is unclear from the proposed amendments as to whether the time of disposal rules are to apply to the revised paragraph 43A such that transactions which were entered into prior to 19 July 2017 but which only become unconditional as a result of being subject to certain conditions precedent which are fulfilled after 19 July 2017 are subject to the new paragraph 43A as opposed to the existing law.
- 186 Agreements entered into, even if subject to conditions precedent, create binding rights and obligations between the parties and parties can therefore not simply “walk



away” from transactions which may now have different tax treatment to the anticipated treatment at the time that the agreements were entered into.

187 Submission: The effective date and scope should be clarified especially given that the time of disposal for CGT is legislatively determined.

188 In addition, and not less important, the DTLAB17 does not provide the necessary consequential changes required to deal with the revised paragraph 43A.

189 For example, if a company has a year of assessment ending on 31 July of each year, it is unclear how it should treat its provisional tax payments if it has received a dividend which under current law would be exempt. If the proposed amendment is ultimately promulgated in its current form, then such taxpayers may be liable to a penalty for under estimation and late payment of its provisional tax. The question arises whether the failure to deal with the provisional tax consequences indicates that the proposed law is not intended to apply retrospectively and if so, this should be made abundantly clear.

**Submission: Section 8G**

190 The wording of the proposed section 8G(2) is problematic and the calculation methodology to determine the contributed tax capital (CTC) in relation to the shares issued does not align with the stated intention of making the consideration for the shares received by the issuer “be deemed not to exceed the amount of the CTC available in the issuer for that same class of share immediately before the issue of the shares by the issuer” as it refers to contributed tax capital in the company acquired. It is furthermore unclear what would happen if the class of shares acquired was not the same as the class of shares issued.

191 It is submitted that the reference in section 8G(2) to consideration that was used directly or indirectly to acquire shares in the other company are too broad and that a time limit should be included or that the wording in this section should be cut down by, for instance, referring only to consideration that was used directly to acquire such shares. For example, shares could be issued to a fellow group company for cash on day 1. Several years later, cash in the bank account of the company that issued the shares is used to pay for shares in another company that forms part of the same group company as the issuer of the shares.

192 A retrospective adjustment to contributed tax capital appears to be necessary and furthermore, it would be difficult to determine the extent (if any) to which the consideration received initially was used to acquire the shares.

193 Submission: For ease of reference and to prevent this provision from being overlooked, the definition of CTC in section 1 should include reference to section 8G. Alternatively, the provisions of section 8G should be housed in the definition of CTC in section 1.



- 194 For purposes of consistency, it is proposed that the reference to voting rights in the definition of “group of companies” in section 8G must be removed since the definition of “group of companies” in section 1 of the Act makes no reference to voting rights.
- 195 The retrospective operation of the proposed amendment is considered unfair and prejudicial to taxpayers, adversely impacting on their rights and legitimate expectations and must only take effect prospectively after promulgation of the DTLAB17.

### ***Government Grants – Trading Stock***

- 196 The amendment to section 22(4) proposes that all trading stock received from government should be deemed to be at Rnil cost and will therefore be taxed at sale value in full.
- 197 The inclusion of the grant in para (IC) of gross income and its exemption in section 12P is contingent on its meeting the requirements in section 12P(2) & (2A).
- 198 However, the proposed amendment applies to all government grants irrespective of whether section 12P applies.
- 199 This creates a concern that the amount will be caught by the general gross income provision and the again on sale of the stock without any deduction.

- 200 Submission: Government grants ‘in kind’ for trading stock should then be specifically included in gross income and be excluded from section 22(4).

### ***Mining rehabilitation funds***

- 201 The proposed provisions appear to contain a contradiction insofar that on the one hand it is acknowledged that a mining company may not have the means to pay the penalty, yet in terms of the proposals seeks to impose a tax liability on the mining company in certain instances.
- 202 The proposed section 37A(6) seeks to impose a penalty of 40% of the highest market value of an impermissible investment during the year. This seems to be impractical as the market value of such investments would need to be determined for every day of the year. It is further implied that this assessment must also take into account market values for periods when the impermissible investment was not held, i.e. before it was acquired or after it was disposed of.
- 203 The highest market value approach is also proposed for impermissible distributions in section 37A(7), which also does not make sense in the context of distributions which would ordinarily entail distributions of money.



204 The proposed section 37A(8) applies in the case of contravention of any of the requirements of the section in circumstances where some of these contraventions are already covered by sections 37A(6) and (7) and is clearly impractical to implement.

205 Submission: The penalty for impermissible distributions should be based on the market value at a fixed point in time e.g. at time of distribution or end of the year of assessment.

206 The penalty in section 37A(8) should be based on the greater of the market value of the property at the beginning of the year of assessment at that at the end of the year of assessment.

207 The provisions of section 37A(8) should furthermore apply to any contraventions other than those contemplated in section 37A(6) and (7).



## INTERNATIONAL TAXES

### ***Extending the application of controlled foreign company rules to foreign trusts and foundations***

208 The proposed change entails *inter alia* an amendment to the controlled foreign company (CFC) definition in section 9D and the introduction of a new section 25BC.

209 The amendment to the definition of a CFC in section 9D will result in a foreign company being classified as a CFC where –

- one or more residents hold an interest in a non-resident trust or foreign foundation that directly or indirectly holds more than 50% of the participation rights in a foreign company or may directly or indirectly exercise more than 50% of the voting rights in that foreign company; or
- any foreign company where the financial results of that foreign company are reflected in the consolidated financial statements, as contemplated in IFRS 10, of any company that is a resident The imputation of income will be based on the proportion of profits of the foreign company which were included or reflected in the consolidated financial statements of any company that is a resident.

210 In terms of the new section 25BC, where an amount is received by or accrued to a beneficiary of a foreign trust or foreign foundation, which is a South African tax resident (other than a company) from that foreign trust or foundation, such amount must be included in the income of that person. That trust or foundation must hold participation rights, as defined in section 9D(1), in the foreign company and the foreign company would have been a CFC if the trust or foundation was a resident.

### **Interest in a trust - Sub-para (b)(i) of proviso to definition of CFC in section 9D**

211 Clause 13 of the DTLAB17 proposes the inclusion of the following to the proviso to the definition of CFC in section 9D:

*“Any foreign company, where one or more residents **hold an interest in a trust** that is not a resident or in a foreign foundation and that trust or that foundation directly or indirectly holds more than 50% of the total participation rights in that foreign company or may directly or indirectly exercise more than 50% of the voting rights in that foreign company”*

212 It is not clear what the term “**hold an interest in a trust**” means. The question arises, for example whether it could ever be said that a beneficiary of a discretionary trust holds an interest in a trust. In this regard, it is questionable whether a *spes* (hope) of



possibly receiving something from a trust would constitute “the holding of **an interest** in a trust”.

- 213 Whilst a person may be a beneficiary with some interest in a foreign trust, that person will not necessarily have a “participation right”, as defined in section 9D, in the underlying foreign companies. These are held by the foreign trust, not the beneficiaries (unless it is a vesting trust perhaps or there is something expressly stated in the trust deed). A discretionary beneficiary of a trust is too far removed to be regarded as holding a participation right in the shares of an underlying foreign company owned by a foreign trust. No amendment has been made to the definition of participation rights to cater for this problem. It must be considered that the mere fact that a person is a discretionary beneficiary of a trust does not imply that such person would ever receive any income or a capital distribution from the underlying companies. By way of example, a beneficiary may only have an interest in the capital of a trust and not its income; the trust deed may state that a particular beneficiary is only entitled to income in the event of some future event. It seems to be a highly subjective matter to accurately conclude whether a resident ‘hold’ an interest in a trust.
- 214 The current legislation is wide enough for a vesting trust to cause CFC status of the underlying foreign companies thereof. The question arises as to why this change is required since, based on the concept of “hold an interest in a trust”, the proposed amendment does not seem to capture anything other than a vesting trust, which arguably is already be covered.
- 215 The legislature may not be looking to attribute income to a beneficiary of a trust through section 9D, but rather for the link to arise by way of the proposed trust law provisions under section 25BC. If this is the case, then addressing the problem set out above will ensure that this proviso may address this requirement appropriately. However, it is submitted that section 25BC may be read with the current definition of CFC in section 9D without the addition of proviso b(i).

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| <p>216 <u>Submission:</u> We submit that the proposed amendment to proviso (b)(i) should be deleted or substantially clarified.</p> <p>217 Alternatively, we submit that the wording needs to be reconsidered to ensure that the intended consequences are achieved.</p> |
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### **Section 9D imputation**

- 218 It is unclear how the section 9D imputation must be determined in relation to discretionary beneficiaries. For example, if a discretionary trust has five beneficiaries and income is vested in the beneficiaries based on the discretion of the trustees, the imputation cannot be determined since the beneficiaries have no rights until the trustees exercise their discretion.



219 Submission: Clarification is required in this regard.

#### **Possible double taxation issue section 25BC**

220 It appears that the proposed change in legislation will lead to double taxation due to the fact that where a foreign trust or foundation holds more than 50% of the shares i.e. participation or voting rights exercisable, then the provisions of section 9D and section 25BC will both be met.

221 As such, there will be an amount included in the income of the resident beneficiary equal to the proportional amount of the CFC. Furthermore, should the trust or foundation make a distribution (received from the foreign company), the South African beneficiary will again be subject to income tax on the said distribution.

222 Section 25BC may lead to an additional tax charge, for example in the event of capital gains being distributed (i.e. the difference between the capital gains tax inclusion rate and income tax rate), or a dividend being distributed e.g. the difference between the section 10B fraction and income tax rate.

223 Submission: Clarification is required in this regard.

224 The proposed amendments furthermore refer to a “foundation”, which term should be defined as it is not a colloquial term in SA.

#### **Interaction between section 25B and section 25BC**

225 Section 25BC will apply to the beneficiaries of resident beneficiaries of a non-resident trust and to all amounts, both income and capital. Section 25B further deals with the income of beneficiaries of a trust.

226 Submission: We require clarification on the proposed interaction between sections 25B and 25BC.

#### **Sub-para (b)(ii) of proviso to definition of CFC in section 9D**

227 The EM proposes, in 5.3, that “the following changes be made in the Act in order for the controlled foreign company (CFC) rules to capture foreign companies that would have been held as CFCs, if no foreign company or trust had been interposed”.

228 The draft legislation includes sub-paragraph (b)(i) and b(ii) to the proviso to the definition of a CFC in section 9D of the Act in an attempt to achieve the above stated objective. Sub-paragraph b(i) talks to a foreign trust or foundation that directly or indirectly holds more than 50% of the participation rights or voting rights in a foreign company. Subject to the comment below, one would have thought that this sub-paragraph would be sufficient to include the companies that would have been CFCs if no foreign trust or foundation had been ‘imposed’, as is the stated objective.



- 229 Furthermore, there is no explanation of how, if (b)(i) is to be read independently of (b)(ii), such participation rights should be determined.
- 230 However, as sub-paragraph b(ii) is included as an alternative (i.e. there is an 'or' between the two sub-paragraphs), they must presumably be looked at separately.
- 231 The proposed proviso to section 9D(2) provides that "for purposes of applying this subsection the percentage of the participation rights of a resident in relation to a controlled foreign company is equal to the percentage of the financial results of that foreign company that are reflected in the consolidated financial statements, as contemplated in IFRS 10, for the year of assessment of the holding company, as defined in the Companies Act, that is a resident."
- 232 By virtue of the provisions of IFRS 10, it is possible that a company lying below a trust or foundation may be held less than 50% as to participation or voting rights. This often occurs in the world of investment companies where the management company, which will never receive any profits from the underlying company may be required to consolidate it (this arises because the concept of 'control' is different for IFRS 10 than it is for the CFC legislation). This is clearly not what was intended, as it is clearly stated that the legislature wishes to capture foreign companies "that would have been held as CFCs" were it not for the foreign trust or foundation.

This would also create anomalies in circumstances in which interests in a CFC are held by the ultimate SA parent indirectly through one or more SA subsidiaries in that section 9D inclusions are limited to the first layer of SA resident companies that hold the interest in the CFC. For example, if ultimate SA Holdco (H), which is the entity that produces consolidated financial statements holds 80% of the participation rights in SA Subco 1 (S) that in turn holds 70% of the participation rights in CFC, 56 percent of CFC would be consolidated into H in terms of IFRS. However, section 9D inclusions occur at the level of S and it would be anomalous for S to include 56 percent of CFC's net income for purposes of section 9D.

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| <p>233 <u>Submission</u>: It is proposed that the 'or' between the sub-paragraphs b(i) and b(ii) be changed to 'and' so that it is clear that where foreign companies are consolidated into a resident company's accounts, the underlying company must be such that it would have been a CFC if the foreign trust or foundation did not exist.</p> <p>234 Alternatively, it is submitted that b(ii) is in any event superfluous, and that b(i) captures all the underlying income from the foreign companies as intended. Thus, subparagraph b(ii) should be deleted.</p> <p>235 Presumably, this proviso should only apply to a CFC as contemplated in paragraph b(ii) of the amended CFC definition. We suggest that this should be stated clearly otherwise it creates confusion where there is no consolidation under IFRS 10.</p> |
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### **Section 25BC – Section 7(8) attribution**

236 Section 7(8) or the Eighth Schedule to the Act may require receipts by a foreign trust to be taxed in a donor's hands on receipt by the trust or in the beneficiary on distribution thus resulting in double taxation.

237 The following additional aspects around the proposed amendment to section 25BC are unclear and may lead to numerous unintended consequences:

- How the rules that apply to vesting trusts, with flow through tax treatment are proposed to interact with this section;
- Which rules cater for possible exempt amounts or partially exempt amounts, such as foreign dividends and capital gains;
- What the tax consequences are for individuals that hold their share scheme shares through a foreign trust and whether they are now also caught by this even though other rules apply, such as section 8C; and
- What are the capital gains tax implications and whether capital gains are sought to be taxed as income?

238 Section 25BC has the potential draconian effect of including in South African residents' income capital gains or tax-exempt amounts received by or accrued to such residents from foreign trusts or foundations. This in our view does not align with the intended amendments to section 9D in that such amendments have the effect that amounts retain their nature when included in the hands of the SA residents, whether as capital, dividends, interest, etc. Capital gains or contributed capital distributed by foreign trusts or foundations should retain their nature as capital in the hands of the SA resident recipients.

239 We note that neither paragraphs 72, 80, sections 7(8) nor 25B have been amended, which would in our view lead to double taxation in various instances and uncertainty in others.

240 Submission: We submit that section 25BC goes too far and the implementation thereof be delayed whilst the above issues are considered in further depth.

241 Clarity is required on the proposed interaction between section 25BC and section 9D, section 7 and the Eight Schedule attribution and distribution rules.

242 We further submit that the interaction with paragraphs 72, 80, section 7(8) and section 25B must be considered in the context of the proposed amendment to appropriately align the intended tax consequences.



### **Refinements of rules prohibiting deduction of tainted intellectual property - section 23I**

- 243 The proposed change will be effected through the amendment of section 23I, with the effect that the provisions prohibiting the deduction of tainted intellectual property will not apply in relation to a CFC that is subject to the high tax exemption.
- 244 Although the proposed amendments will address the unintended adverse implications of section 23I where there is a CFC that is subject to the high tax exemption, it does not fully address the concerns referred to in the EM i.e. -

*“While the purpose of the provisions of section 23I of the Act is to prevent the erosion of the South African tax base, it was never intended that section 23I of the Act would be overly restrictive in nature to the extent of discouraging South African companies from using South African resources where further minor ongoing maintenance of the existing intellectual property is necessary. As a result, where a South African company acquires an intellectual property rich foreign subsidiary which is licensed worldwide and utilises South African based expertise and infrastructure within the group to enhance the intellectual property which is also licensed for use in South Africa there is a risk that the group will be exposed to the application of section 23I of the Act.”*

- 245 This concern would remain in circumstances where the facts are the same as highlighted but the high tax exemption does not apply. The current section also applies where IP developed in South Africa is acquired at arms-length prices by an unconnected foreign person which subsequently makes that IP available in South Africa.
- 246 It is submitted that this is an ordinary commercial transaction that should not be prohibited by section 23I.

<p>247 <u>Submission:</u> Further clarification is thus required to the application of section 23I in that the section should not apply in the event where IP that was exported from South Africa is subsequently enhanced or further developed by a resident, and ownership of that IP rests with the offshore IP holder.</p>
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### **Section 24I: Adjustments to the definition of an affected contract**

- 248 It appears that the adjustment to the definition of affected contract was meant to cover a scenario where the hedge instrument covers more than one hedged item, some of which may not be a qualifying debt.
- 249 This scenario is described in the form of an example in the Interpretation Note on section 24I. In the relevant example, SARS provides that a “person may enter into an FEC to serve as a hedge for more than one item of debt. Some of those items of debt may not meet the requirements of an affected contract and some of the items of debt



may meet the requirements of an affected contract. For example, an FEC of \$200 000 is taken out to hedge debt of \$150 000 for goods delivered before the end of the year of assessment and debt of \$50 000 for the purchase of goods which will be delivered in the following year of assessment. The FEC will be an affected contract to the extent of \$50 000.”

250 Submission: Whilst the proposition may be understandable, we believe that the use of the words “to the extent” as was currently inserted in the definition may not necessarily meet this goal. At issue is whether the proposed wording refers to the effective portion and ineffective portion of the hedge or simply the situation as described by SARS in the Interpretation Note. It would be more helpful to be more specific. Arguably, the bifurcation of the hedge instrument in respect of qualifying and non-qualifying hedged items is already covered by the existing definition; which makes the change superfluous and adding uncertainty to the section rather than providing clarity.



## INDIRECT TAXES

### ***Amendment to section 8(23) of the VAT Act – deemed supplies to certain entities***

- 251 The current wording of section 8(23) of the VAT Act is amended by the removal of the words “which is approved by the Minister by regulation after consultation with the Minister responsible for Human Settlements”.
- 252 The EM does not deal with the reason or impact of the proposed amendment.
- 253 The proposed amendment envisages to rectify the amendment that was introduced in the Taxation Laws Amendment Act, 7 of 2010. In terms of the 2010 amendment the legislator introduced an additional requirement that the deemed supply in terms of section 8(23) of the VAT Act will only find application if the vendor’s services were made in terms of a national housing programme contemplated in the Housing Act, 1997 which are listed in a Regulation. This specific Regulation was never promulgated with the implication that section 8(23) could never have been invoked, with the further result that the zero-rating in terms of in section 11(2)(s) of the VAT Act not finding application. By removing the requirement in relation to programmes listed in a Regulation brings more clarity with regards to the ambit of section 8(23) of the VAT Act.

254 Submission: We view this amendment as broadening the scope of what was previously envisaged, i.e. individual housing subsidy programmes. Although we welcome the proposed amendment, we recommend an effective date of 1 April 2011 which is the date the previous amendment became effective.

### ***New section 8(28) of the VAT Act – changes in municipal boundaries***

- 255 Subsections (a) and (b) introduce new rules governing the VAT implication of restructuring municipalities to overcome unnecessary VAT adjustment when restructuring of municipalities as a result of municipal boundary changes.

256 Submission: We therefore welcome the adjustment and have no further comment in this regard.

### ***New section 8(29) of the VAT Act – leasehold improvements***

- 257 Section 75(1)(b) of the DTLAB17 proposes an amendment to section 8 of the VAT Act by introducing a new sub-section 29.
- 258 The wording of the DTLAB17 suggests that where a (vendor) lessee makes leasehold improvements for no consideration, in circumstances where the lessee will use the



property and improvements for taxable supplies or mixed supplies there will be a deemed taxable supply by the lessee to the lessor.

- 259 It is our view that the deeming provision is in fact not necessary, since there is an actual supply of goods by the lessee to the lessor, in respect of leasehold improvements affected, on the basis of accession. In the Supreme Court of Appeal Case (CSARS vs Marshall No (816/2015)[2016 ZASCA 158 3 October 2016]) between SARS and essentially the trustees of the SA Red Cross Air Mercy Service Trust, the court held that:

*“As contended by the Commissioner, the word ‘deemed’ is primarily appropriate when it is intended to imbue a person or thing with features or qualities he or it does not, in reality, have. The word is not appropriate when the person or thing actually has those features.”*

- 260 In other words, where an actual supply exists, there is no need for a deeming provision.
- 261 It is accordingly our view that the proposed amendment to section 8 would introduce unnecessary ambiguity. To illustrate:

#### Scenario 1

Where the lessee has an obligation in terms of the lease agreement to perform leasehold improvements it will make a taxable supply to the lessor in terms of the VAT Act.

#### Where the lessee does not pay a market related rent:

- Where the lessee receives a reduction in rent in return for the leasehold improvements (whether implicitly or implied i.e. the rent is not market related) the reduction in rent would be the consideration for the taxable supply and the normal rules would apply, subject to our comments below in relation to the valuation of the reduction in rent.

#### Where the lessee pays a market related rent:

- And the lessee does not charge the lessor any consideration for the leasehold improvements, section 10(23) of the VAT Act would apply;
- Conversely, where the lessee charges a consideration to the lessor the normal rules in terms of section 10 of the VAT Act would apply.

#### Scenario 2



Where the lessee performs leasehold improvements voluntarily, it will also make a taxable supply to the lessor in terms of the VAT Act.

Where the lessee does not charge the lessor any consideration for the leasehold improvements, section 10(23) of the VAT Act would apply.

Conversely, where the lessee charges the lessor for the leasehold improvements, the normal rules in terms of section 10 of the VAT Act would apply.

262 Submission: To overcome the potential difficulties with the application of the proposed amendment, we recommend that section 8(29) should not be introduced.

### ***New section 9(12) of the VAT Act – time of supply rule for leasehold improvements***

263 The proposed amendment contains the time of supply rule for a section 8(29) deemed supply.

264 Although the proposed introduction of section 9(12) would provide clarity in some cases as to the time of supply, it may also cause the time of supply to be suspended for an indefinite period.

265 To illustrate where the lessee or lessor disputes the completion of the leasehold improvements or where it is unclear what constitutes completion, the time of supply may not be triggered.

266 Submission: The proposed section 9(12) should be reconsidered, in light of the above comments. If it is to remain we recommend that a definition of “completed” be introduced to try to avoid ambiguity in relation to the time of supply.

### ***New section 10(28) of the VAT Act – value of supply rule for leasehold improvements***

267 The proposed amendment contains the value of supply rule for a section 8(29) deemed supply.

268 As illustrated where the lessee does not charge the lessor for the leasehold improvements (i.e. leasehold improvements are made voluntarily) section 10(23) of the VAT Act would apply. Where the lessee does charge the lessor consideration for the leasehold improvements (i.e. the lessee is obligated to perform leasehold improvements) sections 10(2) or 10(3) of the VAT Act would apply.

269 In our view, there may be a difficulty however for valuation purposes, where the lessee receives a reduction in rent. For example, to determine the consideration and the output tax due clarity should be obtained whether the reduction in rent should be calculated over the period for which the rent is reduced and whether output tax should



be declared on the total rent reduction at the time of supply of the leasehold improvements.

270 Submission: We recommend that the proposed section 10(28) be amended to address the valuation issue as discussed above.

### ***Section 11(1)(b) of the VAT Act– zero-rating of certain goods***

271 The proposed amendment replaces the words “repairing, renovating, modifying, or treating” with “processing, repairing, cleaning, reconditioning or manufacture”.

272 Paragraph 6.5 ii. of the EM provides the following reason for the proposed amendment: “However, section 11(1)(b) of the VAT Act does not permit the zero-rating of goods that are supplied in the course of manufacturing goods entered under Item 470 (temporary imported). There does not seem to be any policy rationale for this exclusion.”

273 The proposed amendment however has various unintended consequences. If the intention was to align all the activities referred to in section 11(1)(b) of the VAT Act with the activities referred to in sections 11(2)(g)(ii) and (iv) of the VAT Act, amendments are required to sections 11(1)(b) and 11(2)(g)(iv) of the VAT Act.

274 If the intention was to only align the activities referred to in section 11(1)(b) of the VAT Act to those referred to in section 11(2)(g)(ii) and (iv) of the VAT Act, the removal of the reference to “renovating”, “modifying” and “treating” will have the unintended consequence that supplying such goods to foreign going aircrafts and ships will not qualify to be supplied at the zero-rate of VAT, which runs directly contrary to the structure of the VAT Act, and in our understanding, tax policy.

275 Submission: We therefore recommend that the activities referred to in section 11(1)(b) of the VAT Act be extended by the addition of “manufacture” and that “renovating, modifying and treating” be retained in section 11(1)(b) of the VAT Act.

276 We further recommend that section 11(2)(g)(iv) be amended to read as follows: “the repair, maintenance, cleaning, reconditioning, renovating, modification, treating or manufacture of a foreign-going ship or foreign-going aircraft; or...”

277 The above amendments will ensure that goods and services supplied to foreign-going ships and aircraft are zero-rated where such goods are affixed to or become part of the foreign-going ships or aircraft.



### ***Section 11(2)(d) of the VAT Act – zero-rating of international travel insurance***

278 The proposed amendment ensures that international travel insurance is fully zero-rated is supplied under a single inbound or outbound insurance policy in respect of which a single premium is levied.

279 Submission: We welcome the proposed amendment and have no further comment in respect of the proposed amendment.

### ***Section 11(2)(g)(i) of the VAT Act - zero-rating of services relating to movable property situated outside South Africa***

280 The proposed amendment will result in charges to local (South African) recipients for the management of financial investments situated offshore, being subject to VAT at the standard rate of VAT.

281 In our opinion this amendment goes contrary to the general principal that where services are linked to/attach to any property, the location of the property determines the VAT rate. Where the property is situated outside South Africa, the service is consumed where the property is physically located.

282 Submission: Based on the above analysis, we do not believe that there is any convincing or persuasive argument to apply different rules to financial instruments.

283 We therefore recommend that the proposed amendment be reconsidered.

### ***Section 13(2A) of the VAT Act – value placed on goods supplied in-bond***

284 The proposed amendment will eliminate the special valuation rules governing the supply of goods while the goods are in bond under Customs control. The effective date of the amendment will be 10 January 2012, the date that the original amendment was introduced.

285 We agree with the scrapping of the section based on the practical challenges experience in practice, but are concerned about how supplies previously valued under the section should be dealt with.

286 Submission: We therefore recommend that the effective date of the amendment be made from a future date.



### ***Section 16(3)(k) of the VAT Act – special rules applicable to small scale farmers***

287 The current wording of section 16(3)(k) of the VAT Act is amended by the removal of the words “Minister of Agriculture and Land Reform” with the words “Cabinet member responsible for agriculture”.

288 This amendment is in line with previous similar amendments to generalise references to government officials.

289 Submission: We welcome the proposed amendment and have no further comments or recommendations.

### ***New section 18C – leasehold improvements – rules for the lessor***

290 Based on our discussion herein we are of the view that this section is not necessary. We also wish to point out that even with the introduction of section 8(29) in its current form, this section is not comprehensible, since a vendor (lessee) making mixed supplies will get the full input tax deduction whilst the lessor pays output tax which it cannot recover. If section 8(29) was to remain for whatever reason (which we cannot comprehend), section 18C should find application on the lessee, which will have the effect that the lessee is, in line with the general principles of VAT, ultimately only able to claim input tax to the extent to which the property is used for taxable purposes.

291 Submission: To overcome the potential difficulties with the application of the proposed amendment, we recommend that section 18C should not be introduced.

### ***Liability for tax and limitation of refund in respect of national housing programmes***

292 As mentioned above, the zero rating in terms of section 11(2)(s) read together with section 8(23) of the VAT Act could never technically have found any application based on the fact that the specific Regulation as envisaged in section 8(23) of the VAT Act was never promulgated. As a result, the proposed amendment to section 8(23) should be made effective from its inception on 1 April 2011.

293 The proposed section would lead to unfair tax legislation as not all taxpayers would have been treated equally.

294 Submission: We therefore recommend that the proposed amendment be reconsidered.



### **Section 68 of the VAT Act – change in reference to a special state official**

295 The current wording of section 68 of the VAT Act is amended by the removal of the words “Minister of Foreign Affairs” with the words “Cabinet member responsible for International Relations and Cooperation”.

296 This amendment is in line with previous similar amendments to generalise references to government officials.

297 Submission: We welcome the proposed amendment and have no further comments or recommendations.

### **Schedule 2 to the VAT Act – definition of brown bread**

298 The wording of Item 1 of Schedule 2 Part B has been amended to refer to the Regulation 186 published in Government Gazette No 30782 of 22 February 2008, defining brown bread.

299 Submission: We recommend that the amendment refer to the Regulation which is currently in force, namely Regulation 405 published in Government Gazette No 40828 of 5 May 2017.

300 We further recommend that the reference to ‘*brown bread*’ be amended to refer to ‘*brown wheat bread*’ as this reflects the clarification that was expressed in Practice Note 12 that was withdrawn with effect from 31 March 2016.

301 We recommend that the amendment be backdated to the effective date of Regulation 1 of the Regulations in terms of Government Notice 186 published in Government Gazette No. 30782 of 22 February 2008.

### **Section 18B of the VAT Act**

302 We noted that the relief period for property developers in respect of the temporary letting of fixed property developed for sale has not been extended beyond 1 January 2018.

303 Submission: We submit that the economic conditions which caused the relief provided for in section 18B to be included in the VAT Act still prevails.

304 We therefore recommend that the relief period provided for in section 18B of the VAT Act be extended by a further three years to 1 January 2021.



***Section 25(dA) of the VAT Act***

305 Submission: We submit that, in view of the fact that section 27(4B) was deleted, section 25(dA) should also be deleted.



## TAX ADMINISTRATION

### ***Taxation of reimbursive travel - Definition of “remuneration” in the Fourth Schedule***

- 306 The proposal is to subject a portion of reimbursive travel to PAYE on a monthly basis where the actual reimbursive rate exceeds the statutory rate.
- 307 The application of this is clear however the EM does not clearly indicate in any of the examples provided, particularly in example 3 on page where the kilometres exceed the threshold of 12,000 kilometres, what the treatment will be from a PAYE perspective or from an employer reporting obligation where the threshold is exceeded in addition to the rate or if the threshold is exceeded but the rate remains equal or less than the statutory rate.
- 308 Section 8(1)(a) includes into taxable income allowances and advances but excludes the amounts in section 8(1)(b)(ii) and (iii) i.e. does not tax such amounts and deems it expended on business. The interplay between the taxability of the excess rate per kilometre and the 12,000 kilometre threshold is not clear based on the new proposal.

309 Submission: We submit that guidance is necessary on the treatment to be applied for the 12,000 kilometre limitation for PAYE purposes.

310 We request that the income tax consequences as per the example are clarified.

### ***Dividends on share schemes - amendment of para 11A of the Fourth Schedule***

- 311 The proposed amendment seeks to clarify the taxation of dividends within a share scheme. However, the legislation it seeks to amend is fundamentally flawed from the outset. During numerous workshops with SARS and NT the practical considerations around taxing dividends as remuneration were highlighted and while most of the proposal as it stood then was withdrawn, an amendment was made to require the employer to withhold PAYE on certain transaction that resulted in dividends.
- 312 We highlight the difficulty in identifying an employee shareholder from normal shareholder in the listed company environment. All shares are processed via a CSDP, the CSDP will be unable to identify the employee shareholders from the normal shareholders as well as the shares held by employee in a share incentive scheme versus the shares held outright by the employee in a personal capacity.
- 313 The DWT system has 2 standard rates, 20% or 0%. A different rate can only be applied if a DTA so prescribes. In the employer-employee relationship the dividends cannot be separated from the CSDP process which will result in the 20% being deducted, alternatively the CSDP will have to rely on the employee providing a



declaration declaring that no DWT should be withheld as the dividends are subject to normal tax.

- 314 The DWT declaration is based on the nature of the person and not the nature of the income, which is problematic in the scenario where the individual holds the employer's shares in 2 capacities, one as a member of the share incentive and the other as an investor. There is no option for the individual to provide that 10 shares should be subject to DWT at 20% but the other 10 shares are deemed to be remuneration and taxable at marginal rates.

<p>315 <u>Submission</u>: This provision should be deleted as it is not possible to manage dividends taxable as remuneration under the current DWT and PAYE systems as they are vastly divergent.</p>
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## MATTERS NOT INCLUDED IN DRAFT BILLS

### ***Estate Duty – Section 25 accruals after L&D***

316 The Taxation Laws Amendment Act 25 of 2015 repealed the existing section 25 of the Act, and replaced it with a new section<sup>4</sup>. The main aim of this change was to align the gross income and capital gains consequences when taxable events occur while assets are still held by the Deceased Estate. The key change occurs with respect to the taxability of income in the Estate.

317 The “old” section 25 allowed for any income earned to be taxed in the hands of beneficiaries whereas the “new” section 25 intends that any income earned while the assets are still in the hands of the Estate should be taxed in the hands of the Estate.

318 Given that the section is now in force, we wish to highlight some practical challenges that arise from the application of this law.

319 Section 25(1) of the Act provides that: “Any income

*(a) received by or accrued to or in favour of any person in his or her capacity as the executor of the estate of a deceased person; and*

*(b) amount received or accrued as contemplated in paragraph (a) which would have been income in the hands of that deceased person had that amount been received by or accrued to or in favour of that deceased person during his or her lifetime*

*must be treated as income of the deceased estate of that deceased person.”*

### **Amounts received or accrued by an Executor**

320 It was held in *Geldenhuis v CIR* 43 SATC 159 that the words “received by” must mean “received by the taxpayer on his own behalf for his own benefit”. In turn *Lategan v CIR* 2 SATC 16 held that the meaning of the words “has accrued to or in favour of any person” meant “to which [any person] has become entitled”. The principle from the two cases has been imbedded into our law.

321 This provision is therefore seemingly anomalous as to creating a deemed receipt or accrual for a deceased estate on the basis that an executor cannot receive or accrue an amount in his/her favour or benefit based on case law principles that an amount should be recognised in income of the taxpayer when such amount becomes unconditionally due to a taxpayer for his/her own benefit.

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<sup>4</sup> Clause 48 of Taxation Laws Amendment Act 25 of 2015



- 322 The executor or administrator of an estate of a deceased person is the “representative taxpayer” in respect of the income received by, or accrued to, the deceased during his lifetime in terms of paragraph (e) of the definition of a “representative taxpayer” in section 1 of the Act, read with section 153(1) of the TAA.
- 323 The Administration of Estates Act also only allows the executor possession and not ownership or vested rights in assets and income of the deceased.

324 Submission: Section 25(1) should rather make provision for a deeming provision, i.e. that the executor is deemed to have accrued or received such income on behalf of the deceased estate.

### **Receipts and accruals after L&D account submission**

- 325 All estates must comply with the law contained in the Administration of Estates Act. With respect to the practical issues specifically, the executor is required to submit a Liquidation and Distribution Account<sup>5</sup> (the L&D account) to the Master.
- 326 Only once this account has been submitted and approved by the Master is the executor permitted to distribute any assets to the beneficiaries. The executor accepts personal liability for any assets that are distributed before this approval.
- 327 The exact form of the L&D account is regulated by Regulations. These require (amongst other things) that the L&D account must be a complete record of all assets and liabilities of the estate<sup>6</sup>. Once submitted, the L&D account must also be available for public inspection for at least 21 days<sup>7</sup> before it can be approved by the Master. In practice, the process to get the final L&D account approved by the Master takes about two months, though it may take longer if there is a dispute at this stage.
- 328 Generally, the estate will still be earning income in the form of interest or rental income from the date of death to the date of submission of the L&D account, as well as from the date of submission of the L&D account until the estate is finally wound up.
- 329 It must also be noted that capital gains tax may arise in an estate from the date of the L&D account until the estate is finally wound up, i.e. a property/investment could be disposed of after the L&D Account was submitted but prior to the estate being wound up, which could also give rise to capital gains tax being payable.
- 330 As noted above the new section 25 intends that the estate pays tax on the above income and capital gains tax. This creates a moving target for the executor, for example, interest accrues on a daily basis and should therefore be taken into account

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<sup>5</sup> Section 35 of the Administration of Estates Act

<sup>6</sup> Regulation 5(1)(c)

<sup>7</sup> Section 35(5)(a) of the Administration of Estates Act



when determining the income tax liability of the estate. This in turn increases the liabilities of the estate. Without an accurate quantification of the liabilities, the executor is unable to provide a final L&D account to the Master. Without a final L&D account approved by the Master, the executor is not permitted to distribute assets to the beneficiaries without incurring personal liability.

- 331 A secondary concern is that the executor will always need to retain a portion of the estate to pay the tax liability, which means that the interest earned on this cash again impacts the ability of the executor to submit the final tax return.
- 332 Chapter 16 of the Draft Comprehensive Guide to Capital Gains Tax provides that the income is no longer permitted to flow through to an ascertainable heir or legatee and the estate must account for all its income until the L&D account becomes final. The question however arises as to when such L&D account becomes final.
- 333 The Master's practice is to accept that any interest earned from the date of submission of the L&D account is then passed on to the beneficiaries in the same ratio as the cash should be paid out.

334 Submission: When the executor is in a position to submit the final L&D account to the Master for approval, all of the beneficiaries of the estate must have been identified. Their portion of the estate would also have been finalised at this point. It is submitted that this is a logical point at which the tax liability for the estate should end.

335 It would have the following benefits: (i) The beneficiaries are clearly defined and named in a public document. It would be easy to require the executor to provide a reconciliation to SARS of the final distributions made to the beneficiaries or a third party return. This would mean that the income would be included in beneficiaries' tax returns; (ii) It removes the circular liability issues with income that still accrues to the estate; (iii) Using the submission of the final L&D account as the cut-off point also allows the executor to settle the estate's liabilities with SARS in a timeous manner that ensures that amounts can be distributed to beneficiaries as quickly as possible<sup>8</sup>; and (iv) It will remove the uncertainty for executors.

336 To ensure that there is no leakage, the date of the income tax return for the estate should be determined with reference to the payment date to beneficiaries and include a schedule of the amounts accrued and received from date of L&D submission to date of payment.

337 We understand that this is the process in practice, but in our view this needs to be formalised either in a SARS ruling or Interpretation Note or possibly an amendment to the Legislation to reflect the current practice.

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<sup>8</sup> Section 35(13) of the Administration of Estates Act requires that all payments must be made to beneficiaries within two months of the final L&D Account being approved by the Master.



338 The proposed amendment to section 9C of the Estate Duty Act provides that the duty payable under this Act shall be paid on such date as may be prescribed in the notice of the assessment issued in terms of section 9(3).

339 Submission: We submit that the duty should be payable on a date that is objectively determined in terms of the primary legislative provisions based on an objective basis. The proposed amendment in our view is capable of arbitrary and unreasonable application and should therefore not be enacted.