ENSafrica
1 North Wharf Square
Loop Street Foreshore Cape Town 8001
P O Box 2293 Cape Town South Africa 8000
docex 14 Cape Town
tel +2721 410 2500
info@ENSafrica.com ENSafrica.com

memorandum

to	**Nombasa Langeni and Adele Collins**
from	ENSafrica
date	16 August 2018
Per email	Nombasa.Langeni@Treasury.gov.za; acollins@sars.gov.za

RE: SUBMISSION TO NATIONAL TREASURY ON THE 2018 DRAFT TAXATION LAWS AMENDMENT BILL

The Draft Taxation Laws Amendment Bill, 2018 ("Draft TLAB"), published for public comment on 16 July 2018, refers.

We have considered the Draft TLAB, received a number of submissions and wish to make the following comments in respect of various clauses of the Draft TLAB in terms of which amendments are proposed to sections of the Income Tax Act, 58 of 1962 ("Act"), the Mineral and Petroleum Resources Royalty Act, 28 of 2008 ("Royalty Act") and the Value-added Tax Act, 89 of 1991 ("VAT Act"). Where applicable, we have made references to the Explanatory Memorandum on the Draft Taxation Laws Amendment Bill, 2018 ("Explanatory Memorandum"), published on 16 July 2018.

1. **Section 11(j) of the Act**

1.1. Section 11(j) of the Act currently provides for a discretion to be exercised by the Commissioner of the South African Revenue Service ("SARS") ("Commissioner") in determining the amount that may be deducted by a taxpayer in respect of its doubtful debts.

1.2. The proposed amendment of section 11(j) in the Draft TLAB does away with this discretion by providing for a non-discretionary allowance of 25 per cent of either (1) the loss allowance relating to impairment (as contemplated in the IFRS 9 accounting standard) in respect of debt (other than debt in respect of lease receivables), if the IFRS 9 accounting standard is applied to such debt, or (2) so much of any debt (other than debt contemplated in (1)) due to the taxpayer that would have been allowed as a deduction under any other provision of Part 1 of Chapter II of the Act, had that debt become bad if that debt is 90 days or more in arrears.

1.3. The proposed non-discretionary doubtful debts allowance will accordingly not take into account the specific circumstances of taxpayers (as was previously the case). It is submitted

that this is an inflexible approach which will have significant adverse consequences for a number of taxpayers. Certain taxpayers employ statistically sophisticated and empirically accurate systems which allow them to very precisely determine their provisioning for doubtful debts. For such taxpayers, the fixed 25 per cent proposed doubtful debts allowance will generally be significantly less than their accurately estimated doubtful debts provisions. Accordingly, such taxpayers will be subject to tax on the accrual of amounts which they are unlikely to collect in future.

1.4. In addition, as it becomes clear to a taxpayer that the recovery of amounts owing by a debtor becomes more unlikely as time passes, it would be expected that the doubtful debts allowance would increase in line with the increased accuracy of the prediction that the recovery of amounts owing by a debtor is unlikely. However, the proposed amendment does not allow for this which will be prejudicial to taxpayers in such circumstances.

1.5. From the wording of the proposed amendment, it is not clear whether the 25 per cent allowance in section 11(j) will apply to all of the doubtful debt provisions in the Act. The wording of the proposed provision should be clarified in this regard (subject to our proposal set out in the final paragraph below).

1.6. Further, since the IFRS 9 accounting standard is used as the point of departure for the proposed amendment, it is submitted that it is not clear what the basis is for differentiating between groups of taxpayers (i.e. between taxpayers that constitute “covered persons” and those that do not) although such taxpayers use the same accounting treatment and who may well use substantially the same methodologies to determine their doubtful debts provisions.

Proposal

1.7. Based on *inter alia* the concerns raised above, it is submitted that the introduction of the proposed amendment to section 11(j) be deferred for further necessary consultation.

2. **Section 12J of the Act**

Proposal

2.1. In an attempt to close abusive schemes using the current venture capital company (“VCC”) regime, it is proposed that amendments be made in the definition of qualifying company and approval requirements for a VCC to limit the abuse of trading between an investor that invested in a VCC and a qualifying company in which that VCC takes up shares.

Comment

2.2. The amendments which are proposed to deal with the aforementioned abuse will render many VVCs non-compliant even though there is no or very minimal trading between an investor that invested in a VCC company and a qualifying company in which that VCC takes up shares.

2.3. The proposed amendments shall restrict VCCs and qualifying companies from issuing different classes of shares. These proposed amendments shall affect VCCs where the fund manager holds a different class of share from the investor and where the VCC issues different classes of shares for different capital raising periods. We recommend that these proposed amendments be withdrawn.

2.4. With regard to the actual abuse identified by National Treasury, we note that the proposed amendment limits but does not prevent trading between an investor in a VCC and a qualifying company in which that VCC holds shares. Corporate investors saw in section 12J the opportunity to invest indirectly into qualifying companies which form part of their supply chain through the VCC. We recommend that National Treasury arranges a workshop around these issues in order that clarity be obtained concerning the types of structures which fall within the centre ground of responsible tax planning and those which fall on the periphery of abusive structures.

3. **Section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act**

Proposal

3.1. It is proposed that equity loans be excluded from the ambit of the debt relief rules as provided for in section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act ("Eighth Schedule"), and that only interest-bearing debt that is converted into to equity should be subject to the debt relief rules.

Comment

3.2. The proposed changes to the definition of "concession or compromise" are welcomed, specifically the exclusion of equity loans from the ambit of the debt relief rules.

3.3. We recommend that the exclusion to the definition of "concession or compromise" as per paragraph (a)(ii) be clarified. The extent to which the exclusion will apply will depend on how the reference to "arrangement described in paragraph (b)" is interpreted. Does such arrangement only refer to (A) the act of capitalising a debt (whether interest bearing or not), (B) the capitalisation of an interest bearing debt, or (C) the capitalisation of an interest bearing debt where the creditor becomes a connected person to the debtor?

3.4. Such ambiguity creates the risk that the capitalisation of non-interest bearing debt could be a "concession or compromise" (per paragraph (a)(ii)), which, when referring to the Explanatory Memorandum, is not the intention of National Treasury. Additionally, it is unclear whether the capitalisation of interest bearing debt where the creditor does not become a connected person to the debtor would fall within the exclusion to the definition of "concession or compromise" per paragraph (a)(ii). Should the latter be the intention and the exclusion interpreted in this manner, by extension, the capitalisation of non-interest bearing debt may also not fall within the exclusion.

3.5. Furthermore, it is not clear how a debt could be extinguished through merger (i.e. *confusio*) by reason of the acquisition of the claim in respect of that debt by a person who is a connected person to the debtor, as this is one of the scenarios which is catered for by paragraph (a)(ii) of the definition of "concession or compromise". Merger takes place whenever the creditor steps into the shoes of his debtor by any title which renders him the subject of his debt. Where a connected person to the debtor acquires the claim, the debtor and creditor remain separate persons and merger cannot occur.

4. **New section 23(o)(iii) disallowance of expenditure regarded as "fruitless and wasteful expenditure"**

4.1. The proposed change to specifically exclude expenditure incurred constituting fruitless and wasteful expenditure as defined in section 1 of the Public Finance Management Act, 1 of 1999 ("PFMA") is not clear in that it will only apply to taxpayers who are subject to the PFMA. We recommend that it be made clear in this regard.

5. **Proposed amendments to section 25BA of the Act**

General background

5.1. A portfolio of a collective investment scheme (a "CIS") constitutes a regulated vehicle intended for purposes of pooling funds for investment purposes. The investors into CIS's include pension funds, insurers and members of the public. Investments into CIS's are often done in order to save and provide for retirement.

5.2. According to the most recently-published information, as at the end of 2017 there were 1626 registered CISs with assets under management of about ZAR2 trillion, with net inflows for the calendar year of ZAR134 billion (source: *www.asisa.org.za/statistics/collective-investment-schemes/foreign-fund-statistics*).

5.3. It is noted that internationally CISs typically constitute tax exempt or tax transparent vehicles. The investors into the CIS typically account for the taxes on the disposal of the underlying investments or income distributions.

5.4. Based on the Proposed Regulatory Framework for Foreign Member Fund ("FF Framework") which was released by Treasury earlier in 2018, in order to promote South Africa as an investment management hub for investment into Africa and the rest of the world, the Minister of Finance announced the introduction of another class of investment vehicles, called *foreign member funds* (FMF). The FF Framework envisages

- accommodating the FMF as a pooled investment vehicle in the regulatory framework established by Collective Investment Scheme Control Act, 2002;
- aiming to create a favourable regulatory environment that will facilitate the flow of foreign capital through South Africa and thereby make it seamless and attractive for foreign funds to invest into the rest of Africa (and beyond) through South Africa;
- that the FMF will be a locally registered CIS managed in South Africa that invests in foreign assets and securities, and that may source funds from non-residents and domestic investors.

5.5. In the light of recent reports that South Africa is currently in a recession (source: the South African Reserve Banks' Report dated 15 August 2018 delivered to Parliament's Standing Committee on Finance; Business Insider in https://www.businessinsider.co.za/bruce-whitfield-sa-may-be-in-recession-2018-8) attracting foreign investment should be an important consideration of policymakers. It is submitted that the proposed FMF dispensation will only be successful in attracting foreign investors if it offers tax certainty and a tax transparent vehicle which is in line with the internationally accepted CIS vehicles.

Proposal

5.6. Section 47(1) of the Draft TLAB proposes to amend section 25BA by the additions of subsections (3) – (5) relating to CISs. Subsection (3) proposes to deem an amount from the disposal of a financial instrument within 12 months of acquisition to be income and not of a capital nature. The Explanatory Memorandum states that the reason for the addition of sub-paragraph (3) is as follows:

> "*It has come to the Government's attention that some CIS are in fact generating profits from the active frequent trading of shares and other financial instruments. These CIS argue that the profits are capital in nature. They base this argument on the intention of long term investors in the CIS.*
>
> *The fact that the determination of capital or revenue distinction is not explicitly stated in the Act and reliance is based on facts and circumstances as well as the case law has led to different application of the law and this has resulted in an uneven playing field regarding the taxation of CIS."*

Comment

5.7. The Act does not contain an exemption for income received or accrued to the CIS which is not on-distributed to the holders of participatory interests in the CIS. It does contain a provision in terms of which the CIS's capital gains or losses are disregarded. Other than section 9C, normal principles apply to the CIS to determine if a gain upon disposal of a financial instrument is capital or revenue in nature. The proposed amendments to section 25BA, in particular the addition of section 25BA(3) will impact on this and will affect all CISs that dispose of assets within 12 months of the acquisition thereof, regardless of whether any gain realised may be capital in nature based on normal principles. In particular, it is noted that a CIS may be required to dispose of assets for various reasons which may not be as a result of the profit motive such as investors exiting and for liquidity reasons.

5.8. It is submitted that imposing a 12 month deeming rule which applies absolutely and affects all CISs is arbitrary and unfair as it doesn't take into account the valid commercial reasons for disposals within a year from acquisition which remain within the realm of a capital intention.

5.9. Furthermore, in the light of the economic climate and the objectives of attracting foreign investments as set out in the general background above, a CIS dispensation which is not aligned with international norms would not assist in attracting foreign capital and may be detrimental to the economic outlook of the country.

5.10. The current concerns could be addressed on a case by case basis by applying the normal principles to the relevant CISs or through the general anti tax-avoidance provisions rather than inserting a specific "catch all rule" which leaves no room for the types of scenarios described above.

6. **REITs: Interaction between sections 42(7), 44(5), 45(5) and 47(4) and section 25BB(5) of the Act**

Sections 42(5), 44(5),45(5) and 47(4) of the Act

6.1. The provisions of sections 42(7), 44(5), 45(5) and 47(4) of the Act stipulate the implications where a company ("Company") which acquired an asset in terms of an asset-for-share transaction (section 42), an amalgamation transaction (section 44), intra-group transaction (section 45) or a liquidation distribution (section 47), respectively, disposes of the asset within 18 months after such transaction.

6.2. In the case of an asset that constitutes a capital asset in the hands of the Company, so much of any capital gain determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date, *"may not be taken into account in determining any net capital gain or assessed capital loss"* of that Company, *"but is subject to paragraph 10 of the Eighth Schedule for purposes of*

determining an amount of taxable capital gain derived from that gain, which taxable capital gain may not be set off against any assessed loss or balance of assessed loss" of that Company.

6.3. Accordingly, any capital gain determined, not exceeding the amount that would have been determined had the asset been disposed of at the beginning of the 18 month period for its market value at that date, is not to be taken into account in determining the Company's "net capital gain or assessed capital loss", but is taken into account in determining a taxable capital gain in terms of paragraph 10 and may not be set off against any assessed loss or balance of assessed loss of the company.

Explanatory memorandum

6.4. With reference to the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002 ("2012 Explanatory Memo"), the purpose of the above mentioned sections was to prevent "built in" capital gains in respect of transferred assets being set off against losses of the Company.

6.5. In particular, the following was stated in the 2012 Explanatory Memo:

> *"Without these anti-avoidance rules, taxpayers could use the rollover mechanism to shift built-in gain assets into a transferee company with excess losses. Transferee companies could then immediately sell their transferred assets and setoff any gain against their own tax situation.*
>
> *Further proposed amendments clarify the operation of the anti-avoidance rule to prevent this form of built in gain transfers by providing for the ring-fencing of capital gains from capital assets disposed of within 18 months… In specific terms, a company transferee that disposes of a capital asset within 18 months after receipt in the abovementioned transactions is subject to restrictions on any gain stemming from that disposal. If the capital asset disposed of generates a gain, the company transferee cannot use any of its losses (i.e., any assessed loss, any balance of assessed loss, any capital loss, or any assessed capital loss) against so much of that gain, as was initially deferred under, for example, the company formation transaction, generated from that disposal."*

Section 25BB(5)(a) and 25BB(c) of the Act

6.6. Section 25BB(5)(a) of the Act provides that in determining the aggregate capital gain or aggregate capital loss of a company that is a "REIT" or a "controlled company" on the last day of the year for purposes of the Eighth Schedule, any capital gain or capital loss determined in respect of the disposal of immovable property of a company that is a REIT or controlled company at the time of the disposal, must be disregarded.

6.7. Accordingly, where the Company (constituting a REIT or a controlled company as defined) disposes of immovable property, the Company must disregard any capital gain or loss determined in respect of the disposal in determining its aggregate capital gain or aggregate capital loss (as the case may be).

6.8. Section 25BB(5)(c) of the Act provides that in determining the aggregate capital gain or aggregate capital loss of a company that is a REIT or a controlled company on the last day of the year for purposes of the Eighth Schedule, any capital gain or capital loss determined in respect of the disposal of a share or a linked unit in a company that is a "property company" at the time of that disposal, must be disregarded.

6.9. Accordingly, where the Company (constituting a REIT or a controlled company as defined) disposes of a share or linked unit in a company that is a property company (as defined) at the time of such disposal, the Company must disregard any capital gain or loss determined in respect of the disposal in determining its aggregate capital gain or aggregate capital loss (as the case may be).

6.10. However, should the Company (constituting a REIT or a controlled company as defined) acquire an asset envisaged in sections 25BB(a) or 25BB(c) in terms of a section 42, 44, 45 or 47 transaction and then dispose of such asset within 18 months of acquisition, it may be argued that, in terms of section 42(5), 44(5), 45(5) or 42(7) of the Act (as the case may be), the capital gain determined in respect of the disposal (not exceeding the amount that would have been determined had the asset been disposed of at the beginning of the 18-month period for its market value at that date) should be taken into account in determining the Company's taxable capital gain in terms of paragraph 10 of the Eighth Schedule.

6.11. Therefore, notwithstanding the fact that the Company (being a REIT) may disregard the capital gain realised on the disposal of the asset in determining its aggregate capital gain, it seems that it may be that, in terms of section 42(5), 44(5), 45(5) or 42(7) of the Act, the capital gain will be taken into account in determining the Company's taxable capital gain in the relevant year of assessment.

6.12. It is submitted that the fact pattern where a company constitutes a REIT or a controlled company as defined disposes of an asset contemplated in section 25BB(5)(a) or (c) which it acquired in terms of a section 42, 44, 45 or 47 transaction does not give rise to the "mischief" targeted by sections 42(7), 44(5), 45(5) and 47(4) of the Act, i.e. to prevent "built in" capital gains in respect of transferred assets being set off against losses of the transferee company.

6.13. On this basis it is submitted that it should be clarified that, unless the company has losses, a disposal by a company which constitutes a REIT or a controlled company of an asset contemplated in section 25BB(5)(a) or section 25BB(5)(c) of the Act does not fall within the ambit of sections 42(7), 44(5), 45(5) or 47(4) of the Act.

Proposal

6.14. The wording of sections 42(7), 44(5), 45(5) and 47(4) of the Act should be amended to clarify that where a company that is a REIT or a controlled company disposes of an asset envisaged in section 25BB(5)(a) or section 25BB(5)(c) of the Act, the capital gain will be disregarded in determining the aggregate capital gain or aggregate capital loss of the company, unless the company has losses as envisaged in sections 42(7), 44(5), 45(5) and 47(4) of the Act.

7. **Section 47 of the Act – Cost of administration relating to liquidation and "returns of capital" received from liquidating companies**

7.1. Further to our Annexure C submission to National Treasury dated 23 November 2017, we would like to make the following submissions in respect of section 47 of Act for inclusion in the Draft TLAB.

Liquidation distribution: Section 47(1)(b) of the Act

The legal nature of the problem

7.2. "Liquidation distribution" is defined in section 47(1) of the Act, which definition provides for two categories of liquidation distributions, being:

7.2.1. Section 47(1)(a) - the "liquidating company" and the "holding company" (as envisaged in section 47(1)(a)) are both resident companies; and

7.2.2. Section 47(1)(b) — the liquidating company is a controlled foreign company ("CFC") in relation to any resident and the holding company is a resident company or a CFC in relation to any resident.

7.3. Prior to the amendments contained in section 59 of the Taxation Laws Amendment Act, 43 of 2014 ("TLAA 2014"), section 47(1)(a) and (b) provided that a liquidation distribution is one in terms of which the liquidating company disposes of all of its assets, <u>other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade</u>.

7.4. The TLAA 2014 amended section 47(1)(a) to provide that a liquidation distribution means any transaction in terms of which the liquidating company, which is a resident, disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company <u>and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up</u>.

7.5. We note that the TLAA 2014 did not amend section 47(1)(b) to the same effect. Section 47(1)(b) therefore does not make provision for the liquidating company to retain assets to

satisfy liabilities to any government and the reasonably anticipated costs of administration relating to the liquidation, winding-up or deregistration.

7.6. In our view there is no reason why a similar exclusion should not also be contained in section 47(1)(b) of the Act as it would seem that the foreign liquidating company would otherwise not be able to settle its future liquidating costs and qualify for the relief in section 47 of the Act. It therefore seems, in our view, that this is likely to have been an oversight.

Impact of the issue identified

7.7. Where the liquidating company is a CFC (and the holding company is either a resident or a CFC in relation any resident) and such liquidating company does not dispose of an asset which it will use to settle any government liabilities or the costs of administration relating to the liquidation or winding-up, such liquidating company runs the risk of falling foul of the definition of a "liquidation distribution", in which case the provisions of section 47 of the Act will not find application. This could lead to adverse tax consequences which we submit could not have been intended.

Similar submission and amendment

7.8. We have previously identified a similar issue in relation to an "amalgamation transaction" as defined in section 44(1)(c)(i) of the Act and made a submission to National Treasury that section 44(1)(c)(i) should be amended to also provide as follows:

> *Amalgamation transaction means any transaction in terms of which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade <u>and other assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up</u>) to a resultant company which is a foreign company, by means of an amalgamation, conversion or merger.*

7.9. Following our submission, section 44(1)(c)(i) of the Act was amended by clause 55 of the Taxation Laws Amendment Act, 15 of 2016 which provided that section 44(1)(c) of the Act be substituted by the following paragraph:

> *Iin terms of which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade <u>and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to its liquidation or winding-up</u>) to a resultant company which is a foreign company, by means of an amalgamation, conversion or merger;*

Proposal

7.10. To ensure that foreign and resident companies are treated in an equal manner with regards to the definition of a "liquidation distribution", we propose that section 47(1)(b) be amended to provide as follows:

> *For purposes of this section "liquidation distribution" means any transaction —*
>
> *(b) in terms of which a liquidating company which is a controlled foreign company in relation to any resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy an reasonably anticipated liabilities to any sphere of Government of any country and costs of administration relating to the liquidation, winding-up or deregistration) to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company..."*

7.11. As set out above, in our view, it was likely due to an oversight that section 47(1)(a) was amended without a corresponding amendment to section 47(1)(b). As such, we submit that section 47(1)(b) should be amended with effect from 20 January 2015, which is the effective date of the corresponding amendments to section 47(1)(a) of the Act.

Return of capital: Section 47(5) of the Act

The legal nature of the problem

7.12. In terms of section 47(5) of the Act, where a holding company disposes of any equity share in a liquidating company as a result of the liquidation, winding up or deregistration of that liquidating company, or in anticipation of or in the course of the liquidation, winding up or deregistration of a liquidating company, a return of capital by way of a distribution of cash or an asset in specie by that company is received by or accrues to a holding company, the holding company must disregard that disposal or return of capital for purposes of determining its taxable income, assessed loss, aggregate capital gain or aggregate capital loss.

7.13. As set out above, section 47 of the Act may apply in the following instances:

7.13.1. Section 47(1)(a) - the "liquidating company" and the "holding company" (as envisaged in section 47(1)(a)) are both resident companies; and

7.13.2. Section 47(1)(b) — the liquidating company is a CFC (and therefore a non-resident) in relation to any resident and the holding company is a resident company or a CFC in relation to any resident.

7.14. A "return of capital" is defined in section 1 of the Act as any amount transferred by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company, subject to certain further requirements being met.

7.15. As a return of capital is defined in relation to an amount transferred by a company that is a resident, the relief provided in section 47(5) is limited to a return of capital received from a liquidating company that is a resident.

7.16. Where liquidating company is a CFC and it makes a distribution to its holding company, such distribution may constitute a "foreign return of capital", provided the requirements set out in the definition thereof in section 1 of the Act are met. However, the relief set out in section 47(5) does not make provision for the receipt of a foreign return of capital by a holding company from a liquidating company that is a CFC.

7.17. In our view there is no reason why similar relief should not also be provided in section 47(5) in respect of a "foreign return of capital", as there may otherwise be an unreasonable distinction between foreign and resident liquidating companies. It therefore seems, in our view, that this is likely to have been an oversight.

Impact of the issue identified

7.18. Where the liquidating company is a CFC as envisaged in section 47(1)(b) and the holding company receives a "foreign return of capital" from such liquidating company, section 47(5)(b) of the Act would not apply. This may lead to adverse tax consequences which we submit is unlikely to have been intended.

Proposal

7.19. We propose that section 47(5) of the Act be amended to provide as follows:

(5) Where -

(a) holding company disposes of any equity share in a liquidating company as a result of the liquidation, winding up or deregistration of that liquidating company; or

(b) in anticipation of or in the course of the liquidation, winding up or deregistration of a liquidating company, a return of capital or foreign return of capital by way of a distribution of cash or an asset in specie by that company is received by or accrues to a holding company,

the holding company must disregard that disposal, return of capital or foreign return of capital for purposes of determining its taxable income, assessed loss, aggregate capital gain or aggregate capital loss.

8. **Removing taxable benefit on low or interest free loans granted to low-income employees for low-cost housing (Paragraph 11(4) of the Seventh Schedule to the Act)**

8.1. The proposed change to remove the taxable benefit on low or interest free loans granted to low income employees for low costs housing is partially welcomed.

8.2. We note that in certain circumstances, specifically in the mining industry, the market value of a particular property can be higher due to the scarcity of immovable property in a particular area. In other words, due to the specific area where the immovable property is located and the supply and demand and other factors which could impact the availability of property, it is often found that houses and similar immovable property structures in rural areas attract a much higher market value than what would otherwise be the case. In addition, if the market value exceeds the R450 000.00 limit by a minimal amount (for example by R10 000.00), the relief of this proposed amendment will not apply, notwithstanding that the other requirements are met. We therefore submit that the requirement of placing a limit of R450 000.00 on the market value of the property will negatively impact some low-income employees who acquire a property that is valued higher than R450 000.00.

8.3. We therefore request that the limit of R450 000.00 be removed and be replaced by a requirement which makes it clear that the first R450 000.00 of the market value of a property will not be subject to or exempted from a taxable benefit requirement and that only the value in excess of R450 000.00 will be taken into account in determining the value of the taxable benefit. We also request that the amount of R450 000.00 be adjustable in accordance with the property price inflation on annual basis. If it is the policy intent to limit this relief to R450 000.00, the above recommended change will result in the amount of the interest free or low interest loan that exceeds the sum of R450 000.00 will continue to be treated as a fringe benefit, which is a more reasonable result.

9. **Amendment of section 6 of the Royalty Act**

9.1. The proposed amendment to section 6 of the Royalty Act replaces the current wording “expenditure incurred” with the original wording of the section before it was amended in 2009 i.e. “amount received or accrued”. The Explanatory Memorandum states that the proposed amendment seeks to clarify the original policy intent i.e. to exclude the costs of transport, insurance and handling of the final product or mineral as this would unintentionally increase the gross sales and accordingly a higher royalty tax payable. Therefore, the wording reverts to the original wording prior to 2009 with reference to the intended tax base for mineral royalties from a policy perspective.

9.2. We respectfully reject the proposed amendment for the reasons set out hereunder. The proposed amendment to section 6, which seeks to substitute “expenditure incurred” with “amount received or accrued” is open to interpretation and therefore may create uncertainty

as to whether the costs of transport, insurance and handling of the final product or mineral will be excluded or not.

9.3. In *United Manganese of Kalahari vs CSARS* (Case No. 74158/2016 delivered on 3 October 2017 in the Gauteng Provincial Division, Pretoria) (the "UMK case"), the court specifically interpreted section 6(3)(b) of the Royalty Act. The judge ruled in the application for a declaratory order that the gross sales amount must exclude the costs of transport, insurance and handling of the mineral. The judgment and interpretation of the court is in line with the policy intent as expressed in the Explanatory Memorandum. The current wording of section 6(3)(b) read with the UMK Case provides taxpayers with certainty and predictability.

9.4. To address the issue in a meaningful way, we recommend that the South African Revenue Service amend the "Draft Binding General Ruling (Mineral Royalty)" on the treatment of Transport, Insurance and Handling Expenses which is still in the public domain for comment to ensure that it aligns with the policy intent expressed in the Explanatory Memorandum and reflects the outcome of the declaratory judgment in the UMK case.

10. **Amendment to section 2 of the VAT Act (Cryptocurrency)**

10.1. The proposed addition to section 2 to include the issue, acquisition, collection, buying or selling or transfer of ownership of any cryptocurrency as a financial service (section 2(1)(o)) of the VAT Act brings cryptocurrency into the VAT net as an exempt supply, rather than treating it as "money" which is outside the scope of VAT.

10.2. The Explanatory Memorandum simply indicates that the amendment is intended to clarify the treatment of cryptocurrency and does not give guidance on why this decision has been taken. In our view there are significant unintentional consequences arising from including these transactions in cryptocurrency as an exempt supply.

10.3. Firstly, its inclusion in section 2 read with section 12, has the effect that transactions may qualify for exemption under section 11(2), being services supplied to a non-resident. Cryptocurrency is traded on many different global exchanges, of which three are currently in South Africa. From a practical perspective, all it takes to start an exchange is to either create or obtain exchange software (some of which is open source) and to host it on a server. You will therefore see new entrants to the market all the time. In order to buy from an exchange or to sell to an exchange, you need to register with that exchange, log into the exchange with your credentials and then set the parameters of the trades you want to make.

10.4. Consequently, any South African can decide to register on any exchange situated anywhere in the world and may thus be able to zero rate the transaction. This could lead to many additional VAT registrations and complications under section 11(3) as to the documentation acceptable to the Commissioner to support the zero-rating.

10.5. An unrelated and more immediate consequence is cryptocurrencies are already being accepted as payment for the supply of goods or services by some suppliers, for example, where a retailer accepts cryptocurrency as a means of payment. This practice is likely to increase. The original supply of goods or services is likely to be taxable. However, should the retailer subsequently sell or barter the cryptocurrency, such supply would be an exempt supply under the proposed amendment. The result will be that a potentially increasing portion of the retailer's supplies will be exempt from VAT, resulting in input tax apportionment issues in the hands of the retailer, which would be unfair as the retailer is accepting the cryptocurrency as an alternative to a cash or credit card payment.

10.6. We respectfully request that this amendment be reconsidered and consideration be given to it being treated as "money" and exclude it from the definition of "goods" and "services" in section 1(1). Due to the global nature of these transactions it is also suggested that the treatment in other jurisdictions be considered.

10.7. We further recommend that the term "cryptocurrency" be defined in section 1(1) to ensure that items such as digital vouchers are not inadvertently treated as cryptocurrencies.
