27 August 2021

The Minister of Finance

National Treasury

Tax Policy Depository

Per e-mail: 2020AnnexCProp@treasury.gov.za ; acollins@sars.gov.za

RE: COMMENTS ON THE DRAFT TAXATION LAWS AMENDMENT BILL, 2021

1. **Introduction**

1.1. We refer to the Draft Taxation Laws Amendment Bill, 2021 (the "**Draft Bill, 2021**") as well as the Draft Explanatory Memorandum ("**Draft EM, 2021**") (collectively the "**Proposed Amendments**") thereon, published by the National Treasury on 28 July 2021.

1.2. We set out herein Agri SA's comments to the Proposed Amendments as well as our recommendations in respect thereof (where relevant). You are reminded that Agri SA is the largest federation of agricultural organisations. Our mission is to promote agriculture in South Africa to encourage its development and to make it more profitable, stable and sustainable. Agriculture is the cornerstone of the South African economy (as further explained below in paragraph 3).

2. **Submissions**

2.1. We specifically make submissions in respect of the following proposed amendments to the Income Tax Act No. 58 of 1962 ("**the ITA**"):

2.1.1. Section 20 of the ITA ('Set-off of assessed losses').

2.1.2. Definition of "contributed tax capital" in section 1 of the ITA.

2.1.3. Section 7C of the ITA ('Loan, advance or credit granted to trust by a connected person').

2.2. In addition, we also make submissions in respect of the proposed amendment to Part B of Schedule 2 (as read with section 11(1)(j)) of the Value-Added Tax Act, No. 89 of 1991 ("**the VAT Act**") in terms whereof it has been proposed that the schedule will be amended to include super fine maize meal in the list of grades of maize meal that qualify for zero rating.

2.3. Our most critical submission relates to the proposed change to section 20 of the ITA. Paragraph 4.1 sets out how the proposed amendment will negatively impact the agricultural sector and hinder South Africa's economic recovery and food security. There are various reasons why the proposed change specifically affects the agricultural sector but the two most critical aspects are:

2.3.1. The cyclicality of farming; and

2.3.2. Farming requiring long-term investment.

3. The Role of Agriculture in the South African economy

3.1. The South African economy remains in the doldrums, exacerbated by the global pandemic. Set on this backdrop, the agricultural sector has been the silver lining – a beacon of hope. According to data released by Stats SA, the South African economy shrunk by 7% for the year 2020. However, the one shining star was the agricultural sector that recorded a 5.9% growth in the fourth quarter of 2020, expanding by 13.1% on a year-on-year basis. The impressive performance was attributed to a few known factors, which include, but are not limited to favourable weather conditions (as we have seen the La Nina climatic event play out) and to a large degree, the classification of the sector as an essential service from the initial lockdown restrictions, which allowed for the farming activity to continue as most of the economy came to a halt. Further to this was the good performance across sub-sectors, from the second-largest grain harvest to the impressive performance of horticulture, led by citrus exports, and the recovery in the livestock industry.

3.2. While the pandemic has worsened South Africa's unemployment rate which now stands at 34.4%, it is the highest level since the Quarterly Labour Force Survey (QLFS) began in 2008, it has presented a real-life experiment on many aspects and has now gifted us with data that shows that amongst other things, the agriculture sector remains the beacon of hope in tackling many of the ailments in

the economy – including unemployment. The sector employs approximately 800 000 people, which accounts for 4% of the labour force and remains low-hanging fruit to absorb more into the sector. This is attributed to the sector being labour intensive, particularly in long-term crop sub-sectors.

3.3. A big contributor to the success of the sector is the correct policy regime that ensures a conducive environment for the role players to conduct their farming businesses. Take for example international practices, particularly in the United States where the farming sector is subsidised by the government, enabling them to be insulated from many various market shocks. Unfortunately, in South Africa, the sector is not directly subsidised by the government, and the role players must rely on re-investing into the businesses. This is confirmed by the Organisation for Economic Co-Operation for Development (known simply as the "**OECD**") who noted that, in 2019, South African farmers only received (on average) 2.9% of gross farm receipts in support from the Government (producer support percentage ("**PSE**")).[1] By comparison, the PSE for Mexico, during the same period, was 10.09%.

3.4. On a global scale, South Africa ranks as one of the highest when it comes to re-investment into farming by farmers themselves. Accordingly, the sector relies on indirect measures to insulate itself from various shocks, one of which is the tax regime. One such benefit is the current structure that allows for assessed losses to be carried forward to the next tax year. This is particularly beneficial owing to the seasonality of the farming, which translates to profits not being realised constantly.

3.5. Lastly, South Africa remains a leader in food security according to the Global Food Security Index, albeit having retreated in standing compared to previous years. One of the challenges identified in the index which contributed to SA's slide was the lack of policy commitments and as such, a favourable policy that includes economy stimulating tax structures is imperative and therefore requires continuous support.

---

1 Agricultural support, Producer support (PSE), % of gross farm receipts, 2000 – 2020 (oecd.org)

3.6. In sum: the agricultural sector has done well (on average) despite the odds and the very limited assistance that it garners from the Government. This, in turn, has advanced the attainment of food security in the country.

4. Income Tax

4.1. Proposed amendments to sections 20 of the ITA

4.1.1. The National Treasury has proposed amendments to section 20 of the Act to limit the offsetting of accumulated assessed losses carried forward by taxpayer to 80% of the amount of taxable income derived by the taxpayer.

4.1.2. Per the Draft EM 2021, the proposed amendment has been proposed to *inter alia*, improve the country's competitiveness, reduce the appeal of base erosion and profit shifting, encourage investment and promote economic growth.

4.1.3. In respect of companies with long lead times between investment and the realisation of profits, the Draft EM 2021 provides that the limitation of offsetting of assessed losses should have a lesser impact than the limitation of the carry forward period to a set number of years.

Issues(s)

4.1.4. Revenue laws must ensure a balance between collecting revenue for the benefit of the *fiscus* and stimulating the economy. This regime realises optimal economic growth and this bodes well for continuous tax revenue too. The rollover of net losses from one year to the following benefits the agricultural sector and directly results in economic stimulation. The proposed amendments in this regard will negatively impact sustainable economic growth and future tax revenue. Moreover, as outlined above, farmers obtain little to no assistance from the Government and must depend on indirect measures (such as section 20 of the ITA) to insulate themselves against tough times.

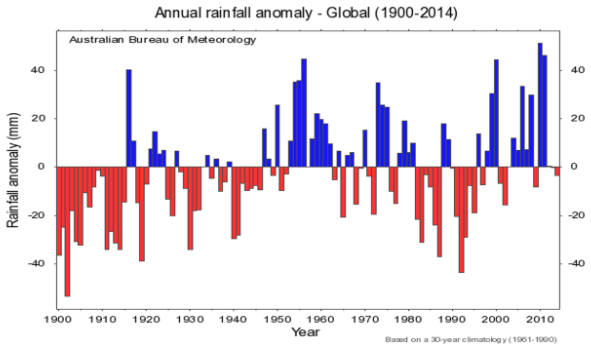
4.1.5. As mentioned earlier, there are various reasons why the proposed change specifically affect the agricultural sector but the two most critical aspects are:

4.1.5.1. The cyclicality of farming; and

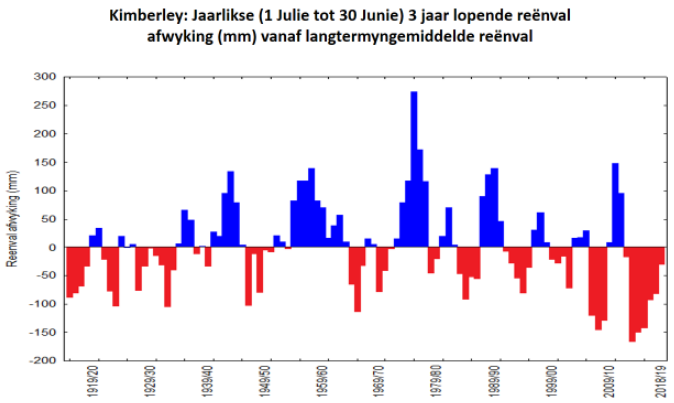
4.1.5.2. Farming requires long-term investment and outlook.

4.1.6. We discuss these aspects below in more detail and other factors. We note that at the time of this submission we would have preferred to provide more statistics, examples etc. that supports our contentions herein. Should NT require any further examples or information, we would provide it upon request.

4.1.7. It is important to understand the cyclicality of the agricultural sector experienced worldwide which is mainly influenced by rain fall patterns. It is also important to note that the cycles span over more than 1 year of assessment. Refer below to the graph compiled by the Australian Weather bureau that reflect the yearly rain fall from 1900.



4.1.8. Specific to South Africa, the graph below shows the rainfall patterns for Kimberley, which is currently experiencing a period of drought.



4.1.9. The graphs above clearly show the phenomenon that areas experience good rain fall for a few years, then a drought period, then rain fall again and so on.

4.1.10. Prices for commodities are also cyclical. For example, international grain prices cycle around every 3-5 years.

4.1.11. The impact of this is that farmers experiences losses in these periods of uncontrollable circumstances. The accrual of losses in these periods and the following recognition for tax purposes in profit periods certainly helps the farmers rebound and be in full production again soon after. This ability has a definite impact on total production of the farming sector, food prices, taxable income and at the end food security. If the current proposal comes into place where only 80% of losses can be set off against future profits, this will certainly have an impact on the ability to rebound. It will compromise the ability to recover for the next down cycle and will lead to more government and disaster support being required. Farmers should rather be allowed to set-off the losses suffered in full from the "down" time to rebuild tolerance and resilience to enhance long term sustainability.

4.1.12. While the agricultural sector performed well on average in 2020, the same is also not true across the country. The National Treasury should take notice that three provinces in South Africa have been declared national drought disaster provinces. The Northern Cape is most severely affected; 50% of its surface area is experiencing disaster drought conditions. As indicated below by the Department of Agriculture (Northern Cape) 'Early Warning Study' published May 2021:

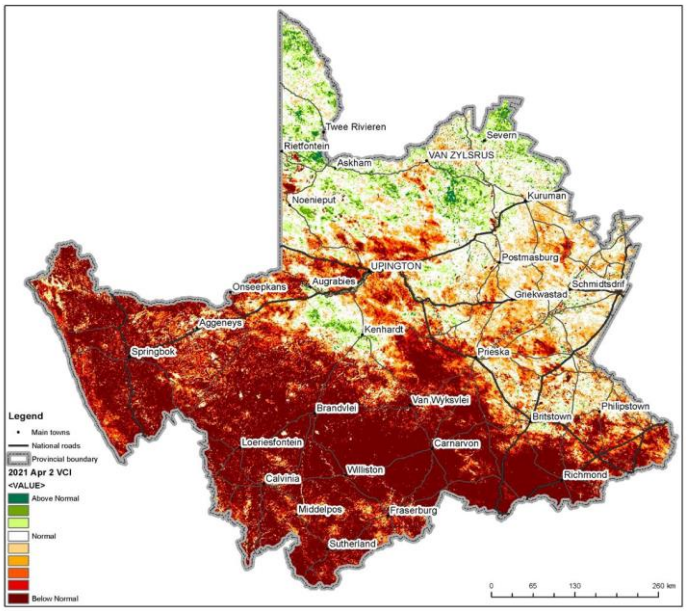


Figure 1: Drought-stricken areas of the Northern Cape Province

4.1.13. Farmers must rebuild their livestock in the three years that follow the abatement of a drought. As an example, data from slaughterhouses and livestock agencies currently shows only 30% capacity in certain areas to 50% in the rest of the affected areas are left. That means that capital-poor farming entities are seriously prejudiced in year 1 following the drought as they must invest cash to recover their livestock numbers (in order to return their farming operations to full potential), but also pay to the *fiscus* at least 20% of their taxable income. It is clearly more desirable (for both the *fiscus* and taxpayers) to secure a stable tax income over a few years rather than to restrict the business from reaching its full potential by imposing a tax burden in year 1. The monies spent in tax could be better utilised in rebuilding the farmers operations.

4.1.14. Although our example above is stated in the context of a drought, similar adverse effects could be caused by other natural disaster, epidemics, temporary customer behaviour changes, economic downfalls and recessions. If a company is taxed in Y1 after recovery, the need to source alternative (and potentially expensive) sources of working capital cannot be avoided. This, in turn, could lead to additional loan funding and interest expenditure. Apart from the fact that interest is deductible for income tax

purposes, the overall negative impact of the business is severe. This means that the business will take longer to recover, which is also detrimental to the *fiscus*.

4.1.15. In periods of losses, farmers are reflecting on cost cutting measures to be able to survive. One of the costs where farmers can save is in jobs. So, some job shedding takes place in non-profit periods, and when it turns into profitable periods again, the faster the farmers can recover, the faster they can create jobs again. Refer to the link to a BFAP report illustrating the farming sectors ability to shed jobs in struggling times, but also to re-employ in times of bigger profit (https://www.bfap.co.za/wp-content/uploads/2021/08/Employment_Brief2021Q2.pdf). If farmers are not allowed to utilise the losses in full, this may impact the creation of jobs in the profitable periods.

4.1.16. The seasonality of the agricultural sector is another aspect that should be considered to fully appreciate the impact that the tax proposal of limiting assessed losses will have on the corporate agricultural companies in South Africa.

4.1.16.1. For instance, fruit orchards are multi-year crops that take 5-7 years to bear fruit (and thus to start generating income). The investments into the industry is capital intensive with severe cash-flow constraints experienced during the initial development. Should the set-off of the assessed losses be limited to 80% of the accumulated losses once the company start to generate income, it will only serve to exacerbate the cash-flow constraints already experienced during the development years. This will especially be harsh to new and emerging farmers, many of whom are Black.

4.1.16.2. Apart from fruit-growers, the grain industry will also suffer under these proposed changes. For example, maize farmers prepare their soil in October and plant during the months of October to December each year. However, these crops are only harvested during May to July in the following year. There is clearly a mismatch between incurring of costs and the earning of income. The same is true for all grain and oilseed farmers.

4.1.17. A further distinguishing factor of the sector is that established farmers with, for instance orchards or permanent crops that are already in production, may also suffer

significant losses for several years (or seasons) due to many factors beyond the control of the farmer. These factors include the following (but are not limited to):

4.1.17.1. Weather (this is the most pertinent external factor that adversely affects farmers – more on this below).

4.1.17.2. Sales Price (determined 90% off-shore).

4.1.17.3. Currency fluctuations and volatility.

4.1.17.4. Cost of input supplies (mainly imported).

4.1.17.5. Increased labour costs and labour unrests.

4.1.17.6. Export capacity of the South African ports.

4.1.17.7. Availability of freight.

4.1.18. For example, although the fruit industry experienced a good previous season due mainly to the La Niña climatic event, the same may not hold this season. Many fruit producing companies may incur huge losses this season due to the factors mentioned above.

4.1.19. We also point out that farmers are price-takers and cannot pass the effect directly to the consumer. There is a great correlation between the changes in the value of intermediary products and food inflation. In the broader context, any changes in production will influence the greater economic equilibrium through the whole value chain. If the losses cannot be carried over, Net Farm Income (NFI) will decrease and the supply curve will probably move to the left, over time.

4.1.20. We attach hereto as “Annexure A” a document that shows information on the turnover of subsectors for the past few years. Refer specifically to the 5-year turnover average percentage. This shows the magnitude of losses suffered in various commodities. For those commodities that reflect a “green” 5-year growth average, the numbers should be read with caution. The reason being these commodities could be produced in more than one area in the country, for example, table grapes that are grown in many regions

of the country. One may think that the entire complex is on a firm footing but upon further investigation, producers in the Klein Karoo (for example), literally have no trees left and this has been due to losses suffered for 8 years because of the drought.

4.1.21. Most of the commodities listed on the turnover tables in Annexure A have been identified as the potential job creators in the Agriculture and Agro-Processing Master Plan (the "**Master Plan**"). This is particularly imperative as one of the Master Plan's objectives seeks to unlock the untapped potential of the agricultural sector. As it stands, there is 3% high potential land that is underutilized and the key to unlocking this, is investment, it is through new entrants into the sector as well as re-investment by current role players. This would translate to a competitive sector internationally and more importantly, an even healthier agricultural job market. The Master Plan could be hampered if the proposed change is effected and applies to the agricultural sector as re-investment would be impacted and new entrants will likely be fewer.

4.1.22. Although section 26 of the ITA, read with Schedule 1 to the Act, provides for a specialised farming tax regime (including an accelerated capital expenditure deduction against farming income), these provisions are only applicable to taxpayers who conduct "farming operations". For instance, this special regime is not applicable to upstream and downstream operations in relation to the farmer. Conceivably, many of these operations depend on farmers and they, too, are affected by the same adverse conditions that may be relevant to farmers (as outlined above). It is in any event not entirely clear how the proposed amendments to section 20 of the Act will interplay with the special tax regime that applies to farmers.

Recommendation(s)

4.1.23. The proposed amendment would, in our view, create an undue burden on taxpayers in the agricultural sector, and we recommend that the Proposed Amendment not be implemented.

4.1.24. Alternatively, we suggest that the National Treasury not forge ahead with this proposed amendment during the current legislative cycle. Greater consultation is required to understand the full impact of this proposed amendment. In this regard,

we, as Agri SA, have not had an opportunity to consult extensively with our members and affiliates or to prepare financial models, forecasts, and/or other supporting evidence in respect of the effects of the proposed amendment.

4.1.25. Further consultation is necessary to clarify the application of the amended section 20 and section 26 of the Act (as read with the First Schedule to the Act).

4.1.26. As a last resort, we recommend that the proposed amendment to section 20 excludes all companies trading as primary farming companies, which could be linked to VAT registration that is specific to farming operations. However, we note that this may not cover all farming operations carried on in companies as some micro or small business farmers conducting farming through a company may not be registered for VAT.

4.2. **Proposed amendments to definition of "contributed tax capital" in section 1 of the ITA**

4.2.1. It is proposed in the Draft Bill 2021 that the definition of "contributed tax capital" ("**CTC**") be amended to include a proviso that any amount transferred which constitutes CTC in terms of paragraph (a) or (b) of that definition will not comprise a transfer of CTC unless all holders in that class participate in the transfer and are allocated an amount of CTC based on their proportional shareholding.

4.2.2. The Draft EM provides that the proposed amendment was necessitated by some companies that exploit the current provisions by allocating CTC on a basis of an alleged "share premium" contributed by a particular shareholder but not to all shareholders holding the shares in the same class of shares.

Issue(s)

4.2.3. The concept of "share premium" no longer exists from a Company Law perspective, and all shares (should) have been converted from par value shares to no par value shares. The reference to "share premium" in the Draft EM is therefore unclear.

4.2.4. As the definition stands, CTC is allocated per class of shares issued. Therefore, currently, the CTC relating to a particular class of shares will be allocated amongst all of the shareholders of that class of shares. Where a transfer of CTC is made to one shareholder (and not the balance of the shareholders who hold that class of shares), the CTC of that class of shares will be reduced by the amount of CTC so transferred. Therefore, there will be less CTC available for transfer to other shareholders.

4.2.5. The resultant effect of the proposed amendment is that a shareholder who, for instance, disposes of their shares by way of a buy-back, would not be eligible to receive a return of CTC upon such buy-back as the other shareholders (who wish to remain invested in the company) would not receive a proportional transfer of CTC.

Recommendations(s)

4.2.6. It is unclear what mischief the National Treasury is attempting to address with this proposed amendment. Furthermore, this amendment would result in specific share repurchases not being able to be made from CTC.

4.2.7. We therefore recommend that this Proposed Amendment not be implemented.

4.3. **Proposed amendment to section 7C of the ITA**

4.3.1. The National Treasury has proposed an amendment to section 7C in terms whereof the rules will be expanded to include loans advanced by a trust, directly or indirectly, to a trust in relation to which its beneficiaries or the founder are connected persons in relation to the founder or beneficiaries of the trust that provided the loan, advance or credit.

4.3.2. The Draft EM, 2021 explains that this change is necessary because further schemes are being devised to increase the base cost of high value trust assets and in particular, shares in offshore companies. These schemes purportedly result in loan arrangements between South African trusts that are not subject the anti-avoidance measures.

Issue(s)

4.3.3. Within the agriculture sector, trusts are used for normal commercial purposes and for private (family) purposes, and often for both. The current proposed amendment is too wide in that it would include *bona fide* commercial transactions between trusts which is not the intention of the National Treasury as clarified in the Draft EM, 2021.

Recommendation(s)

4.3.4. The National Treasury is requested not to proceed with the amendment as the ambit of section 7C of the ITA is already sufficiently wide, further as read with the general anti-avoidance rules in sections 80A to 80L of the Act.

5. Value-Added Tax

5.1. Proposed amendment to Part B of Schedule 2 (as read with section 11(1)(j)) of the VAT Act

5.1.1. The National Treasury has proposed an amendment to Part B of Schedule 2 to the VAT Act to include "super fine maize meal" as a zero-rated good. The Draft EM, 2021 explains that this change is necessary to align the VAT Schedule to the Agricultural Products Standards Act and Regulations relating to the Grading, Packing and Marking of Maize Products intended for sale in the Republic of South Africa, as gazetted in Government Gazette No. 39613, dated 22 January 2016.

Issues(s)

5.1.2. While the inclusion of super fine mail meal in the list of zero-rated products available to consumers is welcomed, the effective date of 1 April 2022 creates significant risks for suppliers of this product. The EM makes it clear that the reason for the change is to align the VAT Schedule to the Regulations relating to the Grading, Packing and Marking of Maize Products intended for sale in the Republic of South Africa, issued under the Agricultural Products Standards Act, as gazetted in Government Gazette No. 39613, dated 22 January 2016.

5.1.3. There is significant risk in the supply chain where the effective date of this amendment is not the same as the date of the Regulation that introduced this specific product and alignment can only be achieved when the dates are also aligned.

Recommendation(s)

5.1.4. The effective date of the proposed amendment of the VAT Act should coincide with the relevant Regulation and be 22 January 2016.

Yours sincerely,

Christo van der Rheede
Agri SA: Executive Director