Draft Taxation Laws Amendment Bill, 2020

Presentation by **Kyle Mandy** to the **Standing Committee on Finance**
31 August 2021

Agenda

1. Retirement funds: proposed "exit tax"
2. Interest limitation rules
3. Proposed restriction on carry forward of assessed losses

Retirement funds: proposed “exit tax”

What is the problem that government is seeking to address?

- Emigration of South African residents with retirement savings, where (ito a double tax agreement between SA and the destination country, being the new country of residence) SA loses right to tax retirement benefits
- SA regime:
  - Deduction for contributions
  - Exempt growth
  - Tax on withdrawal/retirement
- Section 9(2)(i): lump sums, pensions and annuities (“retirement benefits”) payable by retirement funds: from a South African source if the relevant services were rendered in SA
- However: Destination country (now the country of residence) could seek to tax the retirement benefit on the basis that the individual is now a resident of that country
- Double Taxation Agreements (“DTAs”) based on the OECD Model Tax Convention: grant exclusive right to tax to the country of residence
- Problem: South Africa has granted tax benefits (deduction for contributions and exempt growth), but cannot tax the withdrawal

Retirement funds: proposed “exit tax” (2)

The proposal: new section 9HC

- On the day before the individual ceases to be a SA resident, will be deemed to have withdrawn from all retirement fund in which the individual has an interest - “exit tax”
- If no actual withdrawal: liability to pay tax (plus “associated interest”) will be deferred until there is an actual withdrawal
- Tax payable will be calculated based on applicable tables as at date of withdrawal; tax credits for difference between liability determined on date of deemed withdrawal and date of actual withdrawal

Concerns with the proposal

- Effect: overrides the negotiated terms of existing DTAs between SA and other countries, terms that were negotiated in good faith
- Doubtful that it will achieve objective - Netherlands and Belgium attempted similar exit tax and courts held that in contravention of the applicable DTAs - likely that SA courts will follow the same approach
- Could give rise to double taxation - implications for investment and attracting skills

Retirement funds: proposed “exit tax” (3)

Concerns with the proposal (cont)

- Significant practical and administrative challenges
- “One size fits all” approach - ignores situations in which SA does not lose the right to tax (but adds significant and unnecessary complexity)
- Unclear how the value of the retirement benefit is to be determined
- Administrative complexity

Recommendation

- We sympathize with the concern of government, **BUT**
- Proposal should be withdrawn in its entirety
- Although it may be a burdensome and protracted process, the correct approach is to renegotiate the DTAs with the countries that are of concern
- Should the proposal not be withdrawn, significant design issues need to be addressed

Interest limitation rules

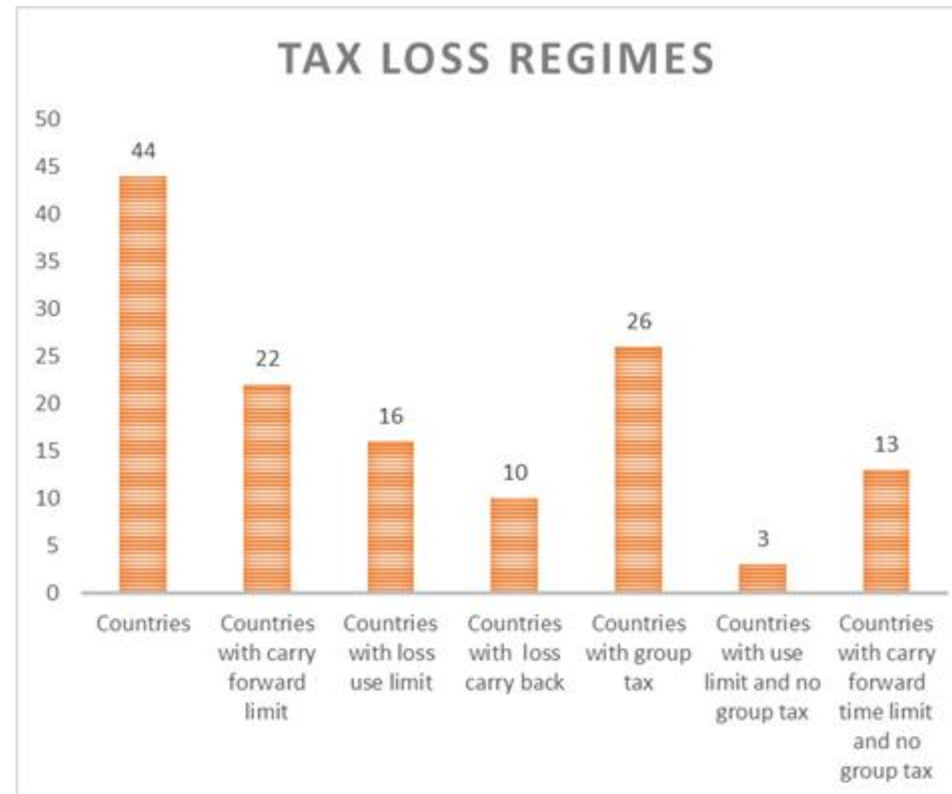
Broadly supportive of the proposal as part of base-broadening measures. However, significant concerns with various aspects:

- Numerous technical issues that Treasury needs to address
- Subject to tax at 28% rule draconian and inequitable (gross interest versus net interest)
- Immovable property: differential approach is required (entirely different debt profiles and risk)
- Inclusion of REITS in the limitation is inappropriate
- Mining: Uncertainties regarding application of the rules in the context of capital expenditure and ring fencing
- Public benefit projects: debt used to fund public benefit infrastructure should be excluded from the application of the rules
- *De minimis* rule: Limitations should only apply to larger companies with a net interest expense of > R20 million
- Safe harbour - debt:equity ratio of 1.5:1

Limitation on carry forward of assessed losses (1)

PwC is broadly supportive of the imperative to broaden the corporate tax base, and recognises that a limitation on assessed losses is part of this. However, we have significant concerns with the proposal as it is currently formulated:

- Policy coherence
  - Undermines certain incentives that provide for accelerated depreciation (effect is a partial clawback of incentives)
- Will result in SA having one of the most onerous assessed loss regimes in the world
  - No provision for use of group losses
  - No carry back of assessed losses
- Group tax rule is required



Limitation on carry forward of assessed losses (2)

- Timing: effects of COVID-19
  - Losses in certain sectors
  - A number of countries have temporarily relaxed their tax loss rules
  - Consider postponement; alternatively grandfathering (although would create complexity)
- Rule applies regardless of size of assessed loss/taxable income
  - Consider introducing a threshold (e.g. R15 million)
- Significant issues have not been addressed (e.g. mining, life insurance, REITS)