10 November 2021

Draft Response Document on the 2021 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2021 Draft Taxation Laws Amendment Bill, 2021 Draft Tax Administration Laws Amendment Bill and the Second Batch of the 2021 Draft Taxation Laws Amendment Bill and 2021 Draft Tax Administration Laws Amendment Bill

(Based on hearings by the Standing Committee on Finance in Parliament)

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1. BACKGROUND

1.1. PROCESS AND PUBLIC COMMENTS

Subsequent to the tax pronouncements made by the Minister of Finance (the Minister) as part of the 2021 Budget announcements on 24 February 2021, the 2021 Draft Tax Bills were published to give effect to the tax proposals announced in the Budget.

The 2021 Draft Tax Bills are split into two separate categories – money bills and ordinary bills. The two money bills in terms of section 77 of the Constitution (dealing with national taxes, levies, duties and surcharges are the draft 2021 Rates and Monetary Amounts and Amendment of Revenue Laws Bill (the 2021 Draft Rates Bill) and the draft 2021 Taxation Laws Amendment Bill (the 2021 Draft TLAB). The ordinary bill in terms of section 75 of the Constitution (dealing with tax administration issues) is the draft 2021 Tax Administration Laws Amendment Bill (the 2021 Draft TALAB).

The 2021 Draft Rates Bill was first published on the same day as the Budget (24 February 2021) and gives effect to changes in rates and monetary thresholds to the personal income tax tables and increases of the excise duties on alcohol and tobacco. The 2021 Draft Rates Bill was published for the second time on 28 July 2021 to solicit public comments.

The 2021 Draft TLAB and TALAB contain the remainder of the tax announcements made in Chapter 4 and Annexure C of the 2021 Budget Review, which are more complex, technical and administrative in nature. Due to the complex nature of these draft bills, greater consultation with the public is required on their contents. The 2021 Draft TLAB and TALAB were published for public comments on 28 July 2021.

This year, a separate Second Batch of the 2021 Draft TLAB and TALAB was published on 12 August 2021, which contains emergency tax measures in response to the continuing COVID-19 pandemic and recent unrest in the country. These measures are over and above the tax proposals made in the 2021 Budget on 24 February 2021.

The closing date for all public comments on the 2021 Draft Rates Bill, 2021 Draft TLAB, 2021 Draft TALAB, the Second Batch of the 2021 Draft TLAB and TALAB was 28 August 2021. National Treasury and SARS received written comments from 76 organisations and individuals (List of commentators attached as Annexure A). Workshops with stakeholders to discuss their written comments on the 2021 Draft Tax Bills were held on 7, 8 and 9 September 2021.

The National Treasury and SARS briefed the Standing Committee on Finance (SCoF) on the 2021 Draft Rates Bill, 2021 Draft TLAB, 2021 Draft TALAB and the Second Batch of the 2021 Draft TLAB and TALAB on 17 August 2021. Subsequently, oral presentations by taxpayers and tax advisors on these Draft Tax Bills were made at hearings held by the SCoF on 31 August 2021.

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Today, on 10November 2021, National Treasury and SARS present to the SCoF the Draft Response Document on the 2021 Draft Rates Bill; 2021 Draft TLAB; 2021 Draft TALAB and the Second Batch of the 2021 Draft TLAB and TALAB. The 2021 Draft Response Document contains a summary of draft responses from Treasury and SARS officials to the public comments received and proposed steps to be taken in addressing the key issues raised during the consultation process. In addition, it is proposed that the changes relating to emergency tax measures contained in the Second Batch of the Draft TLAB and TALAB be incorporated into the Draft TLAB and Draft TALAB. As a result, the second batch of the Draft TLAB and TALAB, will fall away. Once the responses are considered by SCoF, they will be presented to the Minister for approval, including to approve consequential amendments to the 2021 Draft Tax Bills, prior to the formal introduction/tabling by the Minister in Parliament in November 2021.

1.2. POLICY ISSUES AND RESPONSES

Provided below are the responses to the key issues raised by the public in respect of the 2021 Draft Rates Bill, 2021 Draft TLAB, 2021 Draft TALAB and the Second Batch of the 2021 Draft TLAB and TALAB in the form of written submissions and during the public hearings. These comments have been taken into account in finalising the Tax Bills to be tabled. Comments that are outside the scope of the Tax Bills are not taken into account for purposes of this response document.

1.3. SUMMARY

This response document includes a summary of all the written comments received on the 2021 Draft Rates Bill, 2021 Draft TLAB, 2021 Draft TALAB published for public comment on 28 July 2021, the Second Batch of the 2021 Draft TALAB and TALAB published for public comment on 12 August 2021, as well as a summary of all the written and oral presentations made during public hearings on the 2021 Draft Tax Bills held by the SCoF on 31 August 2021.

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Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill

2. CUSTOMS AND EXCISE ACT: INCREASE IN THE EXCISE DUTY ON TOBACCO

2.1. General increase in the excise duty on alcohol and tobacco by 8 per cent

(Main reference: Schedule No 1 to the Customs and Excise Act, 1964: clause 5 of the Draft Rates Bill)

Comments: The proposal to increase the excise rate by 8 per cent with the current status of a struggling economy and high unemployment rate of 32.6 per cent is inconceivable. The excise increase is unsustainable and detrimental to the continued survival of the already distressed legal cigarette industry in South Africa.

Response: Noted. Excise taxes on tobacco products are intended to reduce consumption and improve public health whilst generating revenue for Government. As stated in the 2021 Budget review, the World Health Organisation recommend an excise incidence of at least 70 per cent to effectively reduce consumption. An 8 per cent increase will shift the excise duty incidence to around 45 per cent.

Comments: The excise hike has placed the excise incidence on the cigarette's Most Popular Price Category (MPPC) at 45 per cent compared to a targeted incidence of 40 per cent as per the National Treasury's excise policy. The total tax incidence on the MPPC now sits at a significant 58 per cent against the background of falling consumer affordability. The excise increase is non-compliant to the extent to which it exceeds Government's own excise policy on tobacco products, being the higher of 40 per cent excise incidence on the MPPC or projected consumer price inflation.

Response: Noted. Though the proposed increases keep the tax incidence above the 40 per cent policy guideline, the industry has continued to absorb a portion of the excise increases as opposed to passing them through to consumers, which leads to an overestimated tax incidence. The adjustments correct for any price movements that tend to undermine Government's policy intention to reduce consumption and improve public health. The excise increases also seeks to ensure that tobacco products do not become affordable over time as this will increase consumption of tobacco products, which goes against public health policy objectives. The targeted incidence of 40 per cent is a policy guideline and need not be followed by Government every year. Given that the incidence has remained above the guideline in recent years, the 2021 Budget Review announced a review on the excise policy framework for tobacco.

Comments: The excise policy was communicated to all stakeholders including investors in the tobacco sector, thereby creating a legitimate expectation that Government will always abide by its own policy pronouncements. It is our respectful view that this clear disregard of the cigarette excise policy violates Government's commitment to fair

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administrative treatment of investors, as provided under the Protection of Investment Act and the Constitution. It has been stated that under the fair administrative treatment standard, Government is generally expected to implement changes to policies in good faith and in a manner that is not arbitrary, following due process. It is common cause that the excise policy is still in place and National Treasury only intends to review the policy during this current financial year. It is therefore improper for Government to openly ignore its own Excise Policy for four consecutive excise review periods.

Response: Not Accepted. The adjustments in excise duties do not disregard excise policy, they instead prioritise the policy objectives communicated to all stakeholders – discouraging consumption and revenue generation. The adherence to the policy guidelines is not only dependent on Government's annual excise rate increases but also on the behaviour of the industry regarding the excise pass-through and pricing of tobacco products. If the tobacco products' price increases are lower than excise rate increases, it's inevitable that the incidence will be exceeded.

Comments: National Treasury uses Peter Stuyvesant as the anchor brand in the calculation of the MPPC. However, according to an Ipsos Market Analysis, the MPPC now sits at the low value for money segment, with the anchor brand retailing for R 22.70 (Revised MPPC). Based on the proposed excise rate, excise alone will constitute 85 per cent of the MPPC against an excise policy of 40 per cent of the MPPC. The total tax incidence on the Revised MPPC is 99 per cent – and makes South Africa by far the leading country in the world in terms of total tax incidence on cigarettes. This position is clearly unsustainable and unreasonable. National Treasury should therefore determine the appropriate tax increases based on this Revised MPPC.

Response: Not Accepted. A revision of the MPPC to the proposed R22.70 will be a fundamental or substantive policy change with significant ramifications for tobacco control policy in South Africa. The current benchmarking using MPPC already has differential impacts on cigarette products in terms of excise burdens, so National Treasury does not envisage a situation where there is a reversal on the current levels of excise duty rates. However, as announced in the 2021 Budget Review, the excise policy framework for tobacco products is currently under review and some of these issues will be considered; inputs from all stakeholders will also be considered.

2.2 Excise duty on pipe tobacco

Comments: Pipe tobacco has an elevated toxicant profile compared to cigarettes. Ironically, the excise rate on pipe tobacco is only 21 per cent of the excise paid on factory manufactured cigarettes. The excise incidence on the weighted average price of pipe tobacco is as little as 29 per cent compared to an excise incidence of 45 per cent on the MPPC of factory manufactured cigarettes. Contrary to the National Treasury's position on this category, there is sufficient room to increase the price further, according to the toxicant continuum argument, without impacting sales in the significant way. It can also be argued that this favourable excise treatment of the pipe tobacco category amounts to unfair and discriminatory treatment of "like or similar" products, in violation of the national treatment principle as enshrined in many treaties to which South Africa is party to. Clearly, this position poses a legal challenge for

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Government in the future. Accordingly, we recommend that excise on pipe tobacco be increased to at least 75 per cent of the excise rate of cigarette excise. The foregoing is in line with best practice and ensures equality and fairness in the tax treatment of tobacco products in South Africa.

Response: Not Accepted. The reasons for the divergence in excise duty rates per category include the application of the benchmark guideline of 40 per cent of the retail selling price of the most popular brand within each product category (i.e. excise tax incidence) and the disproportionate pricing of tobacco products concerned. Also, cigarettes make up a larger proportion of the tobacco market. What is recommended here would be a fundamental departure from the current policy framework, however, the excise policy framework for tobacco products is currently under review and inputs from all stakeholders will be considered.

2.3 Excise duty on Heated Tobacco Products (HTPs)

Comments: The current excise duty on heated tobacco products (HTPs), being 25 per cent less than that of cigarettes, is significantly below the excise tax differential in most of the other countries where these products are now available and where switching from cigarettes, as the most harmful way of consuming nicotine, is being partly driven through excise tax policy. The excise tax for HTPs in the European Union (EU) is on average 72 per cent less than the excise tax on cigarettes. A low excise tax differential, as is the case in South Africa, could be viewed as de facto support for cigarettes and other combusted tobacco products.

Response: Not Accepted. Excise taxes on all tobacco products are intended to reduce consumption and improve public health. In line with the World Health Organisation's Framework Convention on Tobacco Control's guiding principles, specifically, the one contained in Article 4.2(b), we also intend to discourage initiation because Government recognises that all forms of tobacco use are harmful, including the use of HTPs. The concessionary rate given to HTPs should not be interpreted as de facto support for either cigarettes or HTPs, but as an introductory rate that is subject to review. A cautionary approach is necessary because as argued by the World Health Organisation (2020:8):

"…there is insufficient evidence to conclude that HTPs are less harmful than conventional cigarettes. In fact, there are concerns that while they may expose users to lower levels of some toxicants than conventional cigarettes, they also expose users to higher levels of other toxicants. It is not clear how this toxicological profile translates into short- and long-term health effects".

Comments: Considering the vastly different characteristics and risk profiles of non-combusted tobacco and nicotine products compared to combusted tobacco products, combusted tobacco products should be taxed significantly higher than non-combusted tobacco and nicotine products as this would accelerate a complete switch from cigarettes and other combusted tobacco products. It is recommended that the excise tax on non-combusted tobacco and nicotine products should be below the lowest excise tax level applied to any combusted tobacco product.

Response: Not Accepted. Even though the new generation products such as HTPs and ENDS are different from the traditional tobacco products, a cautionary approach should be taken with regards to significant rate differentiation as indicated in the response above.

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However, this is an interesting policy development area that will be monitored over the coming years as more evidence on the short- and long-term effects develops.

Comments: HTPs come in many different formats with different amounts of tobacco content applying per use to different technologies. Thus, a practical and equitable tax base would be the net weight of the tobacco mixture, rather than per stick or the gross weight of the consumable, which are both currently options in South Africa and open to possible tax loopholes and excise tax collection / administration difficulties. A system based on the weight of the tobacco mixture would also not necessitate changes to the tariff schedule each time a new format of HTP is introduced to the South African market. It is recommended that (i) Tariff Subheading 2403.99.90 be deleted; (ii) that Tariff Subheading 2403.99.05 remain but be amended to read "Products intended for inhalation without combustion" (removing the reference to "put up for retail sale in the form of sticks") as it will capture the whole heated tobacco product category; and (iii) that excise tax be levied on a per kg net basis to ensure a level playing field.

Response: Not Accepted. The HTPs (often referred to as "heat-sticks") are a fairly new category of tobacco products introduced into the tobacco excise policy framework. The provisions in the excise schedule cater for the formats currently available, however, National Treasury will be following any developments with this category of products and will be reviewed as and when required. The marketing and use of HTPs is in relation to its substitutability to conventional cigarettes, so its taxation may not be separated from conventional cigarette at this stage. As announced in the 2021 Budget Review, the excise policy framework for tobacco products is currently under review and some of these issues will be considered; inputs from all stakeholders will also be considered.

2.4 Increase in excise duty on alcohol

Comments: The impact of deviation from tax policy guidelines is a negative investor sentiment resulting in the inability for business to forecast; inability for business to plan; loss of jobs; reduced investment and reduced revenues. The tax incidence has far outgrown the economic viability relative to the inflation rate and that of the excise tax instrument, therefore, it can no longer be a viable economic growth or stimulus metric without due consideration for the related tax incidence. At minimum, given the factors under consideration, an increase in excise duties should be considered in line with or below the inflation rate.

Response: Not Accepted. The adjustments in excise duties prioritise the main policy objectives communicated to all stakeholders – discouraging harmful consumption and revenue generation. The incidence targets relating to wine, beer and spirits which are currently set at 11, 23 and 36 per cent of the weighted average of the retail price respectively apply, but only as a policy guideline.

Comments: We urge Government in the short to medium term to create a stable investment environment by operating within the existing policy framework. That may mean that in the next round of excise adjustments that Government, and National Treasury in particular, will have to consider freezing further adjustments until such time as Government returns to its policy framework, where after adjustments in line with inflation will give investors the certainty that they require to continue investing in the sector.

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Response: Not Accepted. There is an excise tax policy in place to increase the excise rates by at least inflation or targeted incidence, whichever is higher, on an annual basis. Also, the adherence to the policy guidelines is not only dependent on Governments annual excise rate increases but also on the behaviour of the industry regarding the excise duty pass-through and pricing of alcoholic products. If the price increases are lower than excise rate increases, it is inevitable that the incidence will be exceeded.

Comments: Excise tax increases impact more than just the beer manufacturer: packaging companies, equipment providers, technicians, transport, advertising agencies, bars, retailers, restaurants, moreover, the consumer. Tax legislation applicable to excise duties in beer are administered on a Duty at Source (DAS) basis. The excise duties incurred during manufacturing and removal are levied by the manufacturer but subsequently passed on throughout the supply chain. While this is an efficient mechanism for tax administration; the unintended consequence of DAS in the beer industry is that the excise duty levied at production is ultimately levied, with a multiplier effect, on the consumer. The consumer ends up partially absorbing the cost of the excise duty. Given this, it is contended that due consideration should be given to the consumer when considering excise duty increases, especially given the current economic climate and the impact that another above inflation rate increase of 8 per cent would have throughout the supply chain and ultimately the consumer.

Response: Noted. The alcohol tax regime applies a specific excise duty rate which is the same throughout the supply chain. The application of DAS is cost effective for the administration of the excise duty regime. Unfortunately, SARS (or National Treasury) cannot prescribe how the pricing mechanisms should work in the industry supply chain. The implementation of excise duties on alcoholic products is done with consumers in mind –only price increase that are felt by the consumer will reduce consumption

Comments: Products with low alcohol by volume (ABV) like beer, should not be viewed through the same lens as other alcoholic products with higher ABV, and the proposed tax rate should not be increased by the same relative percentage as that of other alcoholic products. It is common practice to regulate alcoholic beverages based on beverage type and strength. Many OECD countries tax spirits higher than beer, in terms of excise per litre of pure alcohol. In addition, many use progressive excise taxation within beer, encouraging production and consumption of even lower alcohol strength products. In relation to the harmful nature of alcoholic products, but differentiation with respect to beer, the position by Government expressed by the Minister of Finance in the 2021 Budget Speech that the increase in excise duty of 8 per cent on alcoholic products as a result of the harm associated with these products should not be uniformly adopted in relation to the beer industry. It is therefore advocated that a revised increase at inflation or below should be applied.

Response: Noted. Beer is taxed based on alcohol content and the excise duty rate is lower than for spirits (i.e. R115.08 vs. R230.18 per litre of absolute alcohol). Also, this rate structure ensures that beverages with lower alcohol content already have a relatively low tax burden compared to those with higher alcohol content within each category.

The suggestion of having a progressive excise duty structure within the beer category has to be taken in the context of administration costs related to having multi-tier tax structures. Before 1998, malt beer used to have an excise duty structure with eight duty bands which were consolidated and simplified. With regards to having differentiated percentage excise

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rate increases, it should be noted that everything is considered in the context of the overall fiscal and policy frameworks.

It is not always the case that excise rates will increase by the same rate, except in the past 3 financial years. However, as announced in the 2021 Budget Review, the excise policy framework for alcoholic products is currently under review, and inputs from all stakeholders will be considered once the review has been concluded.

Comments: The Craft Brewers Entrepreneurship and the related Small, Medium and Micro Enterprises (SMME) are vital for the economic recovery of South Africa. The 8 per cent increase in the excise duty, the pandemic, as well as bans have succeeded in killing the craft sector. Craft Brewers are on the brink of closing or have closed. Brewers were advised that they do not qualify for UIF TERS as well as other relief mechanisms that were offered to other industries, including the announcement by the President providing a relaxation on licences except for liquor licences. Further, within the current tax legislation, SMMEs in beer manufacturing, are not sufficiently recognised or provided relative relief in relation to excise duties to incubate growth in this sector. Furthermore, large corporates are not incentivised to support such SMMEs in their development. It is proposed that Craft Brewers should be given a degree of relief - like other SMMEs, they cannot afford the impact of an 8 per cent increase in excise duty; and large corporates should be incentivised by degrees of tax relief in their demonstration of developing this vital contributor to the South African economy.

Response: Noted. The excise duty rate is uniform based on the alcohol content, and not whether the product is craft beer or conventional beer. The excise duty rates for the beer sector are not intended to favour or promote one subsector over the other. With regards to relief or support and incentive measures for the craft subsector, those are dealt with in terms of a separate legislative process (i.e. Covid-19 tax relief measures) and the recommendations are beyond the scope of the excise duty regime and the Rates Bill.

Comment: At the commencement of the national budget cycle a letter was submitted to National Treasury dated 18 January 2021, acknowledging the productive engagements with the technical team at National Treasury as part of the annual excise review process. In particular, it was highlighted that a lower excise increase (at 50 per cent of inflation) presented an opportunity to return to 2019 levels of excise revenue sooner than the 2024/25 timeline forecast by National Treasury. The cumulative incremental excise revenue (if excise increases are sustained at this level over the next three years) is close to R5 billion (excluding multiplier tax effects throughout the value chain, VAT and CIT). Post the Budget announcement, we sought to engage Treasury on the rationale behind the above inflation increase in excise for 2021 in a letter dated 31 March 2021. We have not received any written or oral response to our letters ex-ante and ex-post the excise adjustment. This has created significant business uncertainty around the efficacy of the channels of engagement on tax related matters such as excise.

Response: Noted. National Treasury welcomes all comments from all taxpayers, and the department not only acknowledges receipt of the comments but also goes through all inputs. As a matter of course, National Treasury does not revert to taxpayers that submit proposals as to the reasons why some proposals made are accepted and some not. The Budget Review reflects and communicates the decisions, and the rationale for those decisions, after all proposals have been considered within the budgetary and fiscal framework.

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2.5 Illicit trade of alcohol and tobacco products

Comments: It's important for Government to use excise policy to suppress the growth of the illicit market, by closing the gap between duty not paid (DNP) and duty paid (DP) prices, through gradual excise increases typically in line with inflation. This allows the recapture of illicit volumes into the legal market and the meeting of public health objectives (which include the reduction of consumption from both the legal and illegal market).

Response: Noted. The problem of illicit trade cannot be sorted out through the excise rate adjustments but needs to be effectively addressed through robust compliance and law enforcement mechanisms. SARS has been working hard to rebuild internal capacity and has also, through the Inter-Agency Working Group (IAWG) on Illicit Trade, been implementing compliance and enforcement measures. This is evident from a number of raids, seizures and destruction of illegal cigarettes conducted recently as profiled in the media. Examples from the last 3 months:

- https://www.sars.gov.za/media-release/unregistered-tobacco-manufacturing-plant-uncovered/
- https://www.sars.gov.za/media-release/r10-million-of-illicit-cigarettes-declared-as-tissue-paper/
- https://www.sars.gov.za/media-release/sars-seizes-illicit-cigarettes-valued-at-r6-million/

Comments: It is only after an effective excise collection system, which evidently collects full excise from all manufactures and importers, has been put in place that the existing excise policy be reviewed. An effective customs and excise administration system for the tobacco industry must include: the immediate enforcement of the SARS Productions Counter Rules by all local manufacturers; production counters which will allow SARS to reconcile local production volume with excise payments and export declarations; end-to-end frequent and comprehensive audits of all manufacturers; stricter border control and enforcement; the ratification of the WHO FCTC Illicit Trade Protocol; and the implementation of an independent track and trace system consistent with the FCTC Illicit Trade Protocol and Guidelines.

Response: Not Accepted. It is possible for Government to concurrently oversee the implementation of an effective customs and excise administration system while reviewing the existing excise policy framework. The two processes are not mutually exclusive. SARS is implementing a number of compliance measures, including collaborating with other law enforcement agencies and industry to address issues in the tobacco supply chain. Furthermore, the National Department of Health is leading Government on the matter of ratifying the World Health Organisation's Protocol to Eliminate Illicit Trade in Tobacco Products.

Comments: Ipsos was commissioned to conduct a representative Retail and Wholesale price research and found that 41 per cent of the cigarettes sold in South Africa are below the minimum collectable tax (i.e. excise and VAT payable) for a pack of cigarettes. Further, 64 per cent were sold below the economically viable retail price of R26.55 for a pack. The

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economically viable retail price takes into account, the direct costs and the lowest possible margins required to bring a pack of cigarettes into the market. In our view, an effective customs and excise administration system for the tobacco industry must include the implementation and full enforcement of a Minimum Retail Sales Price of R28 for 20 sticks.

> *Response:* Noted. The issue of Minimum Retail Sales Price is a new proposal in terms of the current policy regime. The excise policy framework for tobacco products is currently under review. Inputs from all stakeholders such as this will be considered.

Comments: While the reasons provided for not adhering to policy focuses on the harm associated with the abuse of alcohol, in our view the said increase in alcohol taxes is not the solution, as it has some unintended consequences of increasing the illicit trade in South Africa. A recent Euromonitor Report (2020) confirms that the sale of illicit alcohol products in South Africa now accounts for 22 per cent of the alcohol market by volume, and 12 per cent by value, which equates to R20.5bn. The losses to the fiscus accounts for a staggering R11.3bn which has seen a growth of 20 per cent (CAGR), since the report was last commissioned in 2017.

> *Response:* Noted. Government is aware of the studies conducted regarding the problem of illicit trade in alcoholic products, especially during the various periods of trade restrictions imposed by Regulations issued in terms of the Disaster Management Act, 2002. Illicit trade is a concern for Government, both in terms of undermining public health and harm reduction objectives, and fiscal collections. There are however efforts from both SARS and the law enforcement agencies to address the problem.

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Draft Taxation Laws Amendment Bill

3 INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

3.1 Reviewing the nature of long service awards for fringe benefit purposes

(Main references: Paragraph I of the definition of "gross income" in section 1 of the Income Tax Act, paragraph 5(2)(b) and new paragraphs 6(4)(d) and 10(2)I of the Seventh Schedule to the Income Tax Act: clauses 4(1)(d) and 41 to 43 of the Draft TLAB)

The Income Tax Act permits an employer to grant a long service award (in the form of an asset or a non-cash benefit) to an employee as a no value fringe benefit provided that the value of this award does not exceed R5 000. Government recognises that the current prevailing practice is for employers to grant their employees a wide range of awards in recognition of long service, and such awards can take a variety of forms which can be considered as a non-cash benefit in terms of the Income Tax Act. Proposed changes were included in the 2021 Draft TLAB so that the current provisions as relates to tax free long service awards are not only limited to non-cash assets, but rather extended to apply to other reasonable awards granted for long service. In order to qualify as a no value fringe benefit, all the current requirements in the Income Tax Act should be met. For example, the number of years required to be considered a long service period together with the requirement that the value of long service awards should not exceed R5 000 will still apply.

Comment: Reference to gift voucher in paragraph 5 of the Seventh Schedule to the Income Tax Act creates confusion as gift vouchers are already included in the definition of asset. References to gift voucher should therefore be removed.

Response: Accepted. It is acknowledged that the meaning of asset referred to in paragraph 5 of the Seventh Schedule to the Income Tax Act is wide enough to cater for gift vouchers. Therefore, changes will be made in the 2021 Draft TLAB to remove the reference to gift vouchers in this paragraph.

Comment: The exemption contained in the gross income definition should rather be moved to section 10(1) of the Income Tax Act. This is necessary to ensure certainty that the amount is exempt.

Response: Not Accepted. Irrespective of whether the exemption is contained in the gross income definition or section 10(1) of the Income Tax Act the legislation is clear that the intention is to exempt long service awards that meet the necessary criteria. Where the exemption is placed is merely a matter of preference and it is not Government's view that this preference creates any kind of uncertainty with regards to legislative intention.

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Comment: Consideration should be given to increasing the exempt amount, amending the number of years required to qualify as a long service period as well as extending the amendment to bravery awards. These changes are recommended as a means of ensuring that the legislation is aligned with current employment trends.

Response: Not Accepted. While Government acknowledges and understands the reasons behind the requests made to increasing the exempt amount, amending the number of years required to qualify as a long service period as well as extending the amendment to bravery awards, it should be noted that these requests were not part of the 2021 Budget proposals, and are therefore not part of the 2021 legislative cycle.

3.2 Curbing abuse in the employment tax incentive

(Main references: Definition of “employee” and section 6 of the Employment Tax Incentive Act: clauses 58 and 59 of the Draft TLAB)

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to provide for employers of young workers by reducing the cost of hiring young people between the ages of 18 and 29. The ETI programme allows employers to reduce their pay-as-you-earn (PAYE) tax payments to the South African Revenue Service (SARS) for the first two years in which they employ qualifying employees with a monthly remuneration of less that R6 500, subject to certain limitations.

It has come to Government’s attention that some taxpayers have devised certain schemes to claim the incentive in respect of individuals who do not work for them but are rather engaged in training programmes with little to no employment characteristics (therefore failing to meet the definition of ‘employee’ as defined in section 1(1) of the ETI Act)). The nature of these schemes undermines the original objective of the ETI, which is to give new workforce entrants work experience in a formal working environment to ease their entry into subsequent employment. In order to address the above-mentioned contraventions, proposed changes to the ETI Act were included in the 2021 Draft TLAB to clarify that substance over legal form will be considered when assessing an employer’s ability to claim the ETI. As such, ‘work’ must actually be performed in terms of an employment contract and the employee must be documented in the employer’s records as envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act. In view of the fact that the proposed changes to the legislation are aimed at curbing abusive schemes, it was further proposed in the 2021 Draft TLAB that these amendments should apply retrospectively and come into operation on 1 March 2021.

Comment: It is noted that paragraphs (a) to (d) of the definition of employee in the ETI Act are intended to be applied cumulatively, (i.e. all of the five requirements must be met for the person to be an employee). It is however unclear how paragraph (c) is intended to apply in addition to paragraph (a); is paragraph (c) meant to be an alternative to paragraph (a)?

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Response: <u>Accepted.</u> Paragraph (c) of the definition of employee in the ETI Act is not intended as an alternative to paragraph (a) as the intention is for both paragraphs to apply simultaneously. The uncertainty created is however noted and changes will be made in the 2021 Draft TLAB to clarify this.

Comment: The proposed amendments to section 6 of the ETI Act result in what are actually legitimate ETI claims no longer qualifying for the incentive. As a result, instances where the employer provides on the job training, where the employer and employee have entered into a learnership or apprenticeship programme, or where the employee is on a secondment may no longer qualify for the incentive. Consideration should rather be given to clarifying that the employee should be given a cash payment in lieu of services rendered.

Response: <u>Accepted.</u> The incentive is intended to apply to all legitimate arrangements where the employee is not only engaged in the activity of studying, but rather gaining valuable work experience. In the event that some of the employee’s duties involve some sort of training or studying, the costs of said training or studying should ideally be borne by the employer. To ensure that the employee’s remuneration package is not solely allocated to costs associated with any required training or studying, qualification for the incentive shall further be based on the employee receiving a cash payment in lieu of services rendered. Changes will be made in the 2021 Draft TLAB to reflect this intention.

Comment: The proposed amendment’s effective date should rather be postponed. Consideration should be given to postponing the effective date from 1 March 2021 to 28 July 2021, which is the date of publication of the draft TLAB for public comment as the amendment in its current form results in legitimate claims made during the 2021/2022 tax year now being unlawful.

Response: <u>Partly Accepted.</u> Given the uncertainty around specific issues pertaining to the draft legislation and in the interest of ensuring that claims that would have otherwise been legitimate are not deemed unlawful, changes will be made in the 2021 Draft TLAB to postpone the effective date from 1 March 2021 to 1 March 2022.

3.3 Clarifying the timing of disposal rules in respect of an asset acquired from deceased estate

(Main References: New definition of “liquidation and distribution account” in section 1 of the Income Tax Act and section 25 of the Income Tax Act: clauses 4(1)I and 22 of the Draft TLAB)

When a person dies the Estate Duty Act makes provision for the assets of that person to be transferred to the estate of the deceased before the assets are distributed to their heirs. The Estate Duty Act also provides for the executor to administer the estate, which includes preparing and submitting the Liquidation and Distribution account to the Master of the High Court, submitting the relevant tax returns and making payment of the estate duty to SARS. Legally, the Liquidation and Distribution account must remain open for

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inspection at the Master of the High Court Office for 21 business days. Once the Liquidation and Distribution account is finalised the personal right ofof the heirs to claim delivery of the assets is triggered. At issue is a timing uncertainty around when the heirs are regarded as having acquired an asset from the estate of the deceased. In order to clarify the time of disposal of the heir's personal right to claim delivery of the deceased estate assets, proposed changes were included in the 2021 Draft TLAB so that the disposal of assets by the estate occurs on the date when the Liquidation and Distribution account becomes final.

Comment: Uncertainty is created as to what is to occur in the event that there is an interim disposal to heirs before the Liquidation and Distribution account is finalised. It is therefore proposed that the date of disposal is the earlier of the date of the interim disposal or the finalisation of the Liquidation and Distribution account.

Response: Accepted. Changes will be made in the 2021 Draft TLAB to clarify this.

Comment: The Liquidation and Distribution account lays open for inspection for a 21 day period until it is final. Uncertainty exists with regard to how income earned during this time is to be treated – will it be taxed in the hands of the estate? An amendment is required in section 25(1) to clarify who the income accrues to.

Response: Not Accepted. Government wishes to point out that the scope of the proposed amendment included in the 2021 Budget proposals and part of the 2021 legislative cycle was to clarify the date of disposal of assets to heirs as opposed to whom income accrues to.

3.4 Tax treatment of a cession of a right to receive an asset

(Main reference: New section 57B of the Income Tax Act: clauses 33 of the Draft TLAB)

The Income Tax Act makes provision for donations tax to be levied on the value of any property disposed of, whether directly or indirectly, under any donation by any resident. It has come to Government's attention that some taxpayers have devised schemes aimed at undermining the donations tax provisions. These schemes entail a service provider (for example an employee or independent contractor) ceding the right to receive or use an asset received from the person to whom services are to be rendered. The right to receive or use the asset is generally ceded to a family trust before services are rendered. In these instances, the service provider may be able to circumvent donations tax as the right to receive an asset would have been ceded to the trust before the services are rendered and a value can be attached to the asset. In order to address these types of schemes, proposed changes were included in the 2021 Draft TLAB to clarify that in instances where a right to receive an asset (which would otherwise have been acquired for services rendered) is disposed of, that asset will be deemed to be disposed of under a donation as envisaged in the Income Tax Act.

Comment: The event cannot be a donation if there is an amount received or accrued.

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Response: Comment Misplaced. The transaction is a two-legged transaction. The first transaction being between the employer and employee and the second being between the employee and the family trust. While it is noted that the transaction between the employer and employee cannot be a donation, the proposed section is aimed at the second leg of the transaction. As there is no *quid-pro-quo* when the asset is ceded, a donation has indeed occurred.

Comment: The amendment does not make reference to paragraph (i) of the gross income definition in section 1 of the Income Tax Act, this oversight needs to be corrected.

Response: Accepted. The 2021 Draft TLAB will be amended accordingly. This is based on the understanding that reference to paragraph (i) of the gross income definition in section 1 of the Income Tax Act is required if the asset is treated as a fringe benefit in the employee's hands.

3.5 Strengthening anti-avoidance rules in respect of loan transfers between trusts

(Main reference: Section 7C of the Income Tax Act: clause 5 of the Draft TLAB)

In 2016, anti-avoidance measures were introduced in the Income Tax Act to curb the tax-free transfer of wealth to trusts using low interest or interest-free loans in order to avoid estate duty and donations tax on the assets' subsequent growth in value. In 2017 and in 2020, further changes were made to counter new attempts to undermine these measures. Some taxpayers are continuing to undermine these measures by transferring loans, which finance high value assets, between trusts, where the founder of one trust holding the original asset is related to one or more beneficiaries of the other trust to which the loan asset is transferred. The 2021 Draft TLAB proposed that further changes be made in the legislation to ensure that these anti-avoidance measures also apply in respect of any loan, advance or credit that a trust, directly or indirectly provides to another 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. In view of the fact that the proposed measure is aimed at curbing further abuse, it was further proposed that these amendments should apply retrospectively from the date of the publication of the 2021 draft TLAB for public comment, i.e., 28 July 2021.

Comment: The proposed amendments aim to ensure that the anti-avoidance measures apply in respect of any loans, advances or credit that a trust, directly or indirectly provides 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. Section 7C was originally introduced to counter schemes whereby a person transfers his or her growth assets to a trust in return for a fixed loan without interest in order to avoid wealth taxes (donations tax or estate duty) on the growth asset (per the reasons / explanations provided in the 2016 and 2017 explanatory memorandum to the 2016 and 2017 Taxation Laws Amendment Acts). This proposed amendment should be withdrawn and alternative anti-avoidance measures aimed at the specific mischief, namely transactions that result in a tax free

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disinvestment in a company followed by an investment in a company in another jurisdiction, should be considered.

Response: Accepted. A risk was identified that through the use of low interest bearing or interest free loans between trusts, taxpayers could achieve tax free disinvestments from companies facilitated through loan arrangements. However, it is acknowledged that section 7C was introduced to specifically curb the use of low interest bearing or interest free loans. As such, the changes proposed in the 2021 Draft TLAB will be withdrawn and a more specific anti-avoidance measure will be considered in future.

3.6 Allowing members to use retirement interest to acquire annuities on retirement

(Main references: Definitions of “pension fund”, “pension preservation fund” “provident fund”, “provident preservation fund” and “retirement annuity fund” in section 1 of the Income Tax Act: clause 4(f), (h), (j), (l), (n), (o) of the Draft TLAB)

The Act provides that any member retiring from a retirement fund is, upon retirement, allowed to receive a maximum of one third of the total value of the retirement interest as a lump-sum. The remainder of the retirement interest must be utilisd to purchase or provide an annuity in one of three ways, namely: paid directly by the retirement fund to the member, purchased from a South African-registered insurer in the name of the fund or purchased by the retirement fund from a South African-registered insurer in the name of the retiring member. A member is therefore prohibited from uitilising the retirement interest to acquire other types of annuities. This prohibition limits flexibility in relation to the types of annuities a member can acquire with their retirement interest following commutation. In order to increase flexibility for a retiring member while ensuring maximizing on of the retirement capital available to provide annuities, Government proposes expanding the types of annuities a member can acquire upon retirement. In turn, the portion of the retirement interest to purchase each type of annuity must exceed R165 000. The R165 000 threshold is required to curb the circumvention of prevailing legislation.

Comment: The proposed wording of the amendment opens the section to being interpreted as requiring a member of a retirement fund with a value that is less than R165 000 to take the option to receive the value of the retirement fund as a lump sum payment only. The wording should be amended to clarify that this is not the case and that the member still has the option of taking a lump sum value and/or purchasing an annuity should the member elect accordingly.

Response: Accepted. This proposed amendment provides for flexibility in relation to the types of annuities a member can acquire with their retirement interest following commutation. Clarity will be provided in the 2021 Draft TLAB that a member has an option of taking a lump sum value or purchasing a single annuity should the member elect to do so.

Comment: We interpret this proposed amendment to mean that the intention is to permit retiring member to choose a combination of (for example) an in-fund and an

out-of-fund annuity. We are very supportive of this increased flexibility. We note that this was explicitly disallowed by SARS GN18, which has recently been withdrawn, and we understand that SARS intends to issue a binding ruling in this regard to confirm that a combination of an in-fund and out-of-fund annuity is permitted. We would welcome such a binding ruling as soon as possible, to make this explicitly clear.

Response: Noted. SARS is in the process of finalising the relevant general binding ruling which will provide more clarity in this regard.

3.7 Applying tax on withdrawals of retirement interest when an individual ceases to be a tax resident

(Main reference: Sections 9H and new 9HC of the Income Tax Act: clauses 11 and 12 of the Draft TLAB)

When an individual ceases to be a South African tax resident prior to retirement from a South African retirement fund and becomes tax resident of another country, that individual's interest in a retirement fund may, on payment of a lump sum or monthly pension, be subject to tax in the other country. The application of a tax treaty between South African and the country of tax residence may in some instances result in South Africa forfeiting its taxing rights – while the taxpayer benefited from tax concessions for contributions. Taxpayers who remain resident only have access to their retirement interest upon retirement, and face full tax consequences for withdrawals before that time. In order to address this, proposed changes were included in the 2021 Draft TLAB to ensure that before an individual ceases to South African tax resident interests in retirement funds are subject to taxation in South Africa at the tax rates applicable to a withdrawal benefit. As a result, Government proposed the following two-pronged approach.

- ***When an individual ceases to be a South African tax resident, and withdraws his or her interest in the retirement fund from a South African retirement fund prior to retirement or death***
  - The individual will be deemed to have disposed of his or her interest in a retirement fund on the day before he or she ceases to be a South African tax resident as envisaged in the Act.
  - The interest in the retirement fund will form part of the assets of the individual subject to tax applicable to withdrawal benefits, however, the tax payment will be deferred until a withdrawal payment is receivable from the retirement fund.
  - When the individual receives a payment from the retirement fund, the tax on the withdrawal benefit will be calculated based on the prevailing withdrawal tax tables.
  - A tax credit will be provided for the tax as calculated when the individual ceased to be a South African tax resident.
- ***When an individual ceases to be a South African tax resident, but retains his or her investment in a South African retirement fund, and only withdraws his or her interest in the fund when he or she dies or retires from employment***

- The individual will be deemed to have disposed of his or her interest in a retirement fund on the day before he or she ceases to be a South African tax resident as envisaged in the Act.
- The interest in that retirement fund will form part of the assets of the individual subject to tax applicable to withdrawal benefits, however, the tax payment will be deferred until payments are receivable from the retirement fund.
- When the individual ultimately receives payments from the retirement fund, the tax on those payments will be calculated based on the prevailing retirement fund lump sum tax tables or in the form of an annuity.
- A tax credit will be provided for the tax as calculated when the individual ceased to be a South African tax resident.

Comment: Bypassing tax treaties with domestic legislation is controversial and could potentially result in double taxation for members of retirement funds. Should the Government still wish to address the concern of erosion of the tax base due to emigration, the relevant DTA's that are of concern to the Government should be renegotiated accordingly. In addition, the proposed insertion of section 9HC will lead to involuntary withdrawals of retirement interests upon emigration. Members will therefore be required to withdraw from their retirement funds in South Africa, even if they did not envisage doing so and rather preferred to retain their retirement savings in South Africa. Consequently, the recent introduction of the 3-year rule still requires clarity from an administrative point of view, and taxpayers are still seeking clarity on its application; adding a new layer of complexity will further complicate the emigration process, resulting in expensive administrative costs to taxpayers.

> *Response:* Noted. Taking into consideration that although the rationale behind the amendment is understood by the public, numerous concerns that the amendment will result in a case of treaty override exist and these are noted by Government. Following the extensive public participatory deliberations with members of the public in Parliament and through public participatory initiatives hosted by National Treasury on the 2021 Draft Tax Bills, the proposed amendments regarding the introduction of section 9HC will be withdrawn from the 2021 Draft TLAB and further amendments will be considered in the next legislative cycle in order to address the complexities that were raised through the comment cycle.

3.8 Transfers between retirement funds by members who are 55 years or older

(Main reference: Definitions of "pension preservation fund" and "provident preservation fund" in section 1 of the Income Tax Act: clause 4(g), (i), (k) and (m) of the Draft TLAB)

The Income Tax Act stipulates that in the event that a member of a pension preservation of provident preservation fund (who has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the respective fund) makes a transfer into a similar fund, such transfer would be taxable in the individual's hands. As a result, any individual transfers between preservation funds where the transfer is between similar

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funds and the member involved has reached normal retirement age in terms of the fund rules but not yet opted to retire from the relevant fund will be subject to tax. This happens despite the fact that the policy intention is not to tax transfers from a less to a more restrictive fund or between similar funds. In order to address this anomaly, proposed changes were included in the 2021 Draft TLAB to allow for tax-neutral transfers from a preservation fund into similar funds by members who have already reached normal retirement age.

Comment: Consider allowing even greater flexibility in transfers (both before and after reaching normal retirement age) to enable individuals to consolidate their retirement savings in any type of retirement fund, including occupational funds. If the National Treasury does not have appetite to open this up for all types of transfers, then we would ask that the National Treasury consider this primarily for amounts transferred after normal retirement age, so that an individual can make use of their occupational pension or provident fund annuity options, which are likely to be more cost-effective than the retail alternatives.

> *Response:* Not Accepted. The concern with allowing transfers between occupational funds (be they transfers between same employer occupational funds or transfers between different employer occupational funds) is that the transferor and transferee retirement funds may have different rules with regards to their respective normal retirement ages. A member may therefore be able to access retirement benefits that were not available in the retirement fund transferred from.

3.9 Clarifying the calculation of the fringe benefit in relation to employer contributions to a retirement fund

(Main reference: Section 12D of the Seventh Schedule to the Income Tax Act: clause 44 of the Draft TLAB)

From March 2016 all employer contributions to a retirement fund on behalf of employees are considered taxable fringe benefits in the employees' hands. If the contribution contains a 'defined contribution component', the value of the fringe benefit will be the cash equivalent of that part of the contribution that pertains to that employee. In addition, the employer is not required to provide the employee with a contribution certificate. An anomaly arises in instances where a retirement fund provides both a retirement benefit in relation to a 'defined contribution component' and a self-insured risk benefit. The interpretation of the Income Tax Act would result in the classification of the total contribution to the said fund as a 'defined benefit component', subject to valuation in terms of the formula contained in paragraph 12D(3) of the Seventh Schedule to the Income Tax Act, as well as the issuance of a contribution certificate due to the fact that self-insured risk benefits are not considered a 'defined contribution component'. In order to address this anomaly, proposed changes were included in the 2021 Draft TLAB so that self-insured risk benefits are classified as a 'defined contribution component'.

Comment: Reference to "self-insured policy" is problematic. The term is not currently used in practice, thus opening room for confusion.

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Response: Accepted. In order to alleviate confusion, changes will be made in the 2021 Draft TLAB to use the colloquially used term “risk benefits”.

3.10 Second Batch of the 2021 Draft TLAB: Emergency tax measures – Extension of the expanded employment tax incentive age eligibility criteria and amount

(Main references: Sections 2, 3, 4 and 5 of the Disaster Management Tax Relief Act: clauses 3, 4, 5 and 6 of the Second Batch of the Draft TLAB)

In 2020, Parliament passed the Disaster Management Tax Relief Act and the Disaster Management Tax Relief Administration Act, containing exceptional tax measures which formed part of the fiscal package aimed at assisting taxpayers who experienced cash flow constraints as a result of the COVID-19 pandemic and the required national lockdown. One of the exceptional tax measures included in the above-mentioned Acts was an expansion to the ETI. This expansion was provided to assist employers retain employees, thus reducing the risk of low-income earners losing their employment as a result of the lockdown. Despite the recent relaxation of the national lockdown, various businesses and employees are still negatively impacted by the COVID-19 pandemic. These negative impacts are further exacerbated by the impacts of the recent unrest in the country that resulted in the destruction of businesses and infrastructure. Government therefore wishes to provide additional assistance to those who continue to be adversely affected by COVID-19, as well as assisting in the process of reconstructing businesses. Moreover, this support measure is aimed at supporting employment in the most vulnerable sections of the labour market. As a result, proposed changes were included in the second batch of the 2021 Draft TLAB, stating that the expansion of the ETI be reinstated for another limited four-month period. During this four-month period (starting 1 August 2021 and ending 30 November 2021) a tax subsidy of up to R750 per month will be available in respect of those private sector employees earning below R6 500 per month. To qualify for this relief, the employer must be tax compliant and registered with SARS as an employer by 25 June 2021.

Comment: There is concern that during the four-month period that the extended ETI is applicable for employers will not be able to claim the ‘normal’ ETI. Further amendments may be required to the Disaster Management Relief Act to ensure that both the normal and extended ETI apply during the relevant relief period.

Response: Comment Misplaced. As confirmed during the workshops, further legislative amendments are not required as the extension of the expanded ETI relief does not preclude the application of the normal ETI provisions.

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4 INCOME TAX: BUSINESS (GENERAL)

4.1 Strengthening the rules dealing with the limitation of interest deductions in respect of debts owed to certain persons not subject to tax

(Main Reference: Section 23M of the Income Tax Act: clause 20 of the Draft TLAB)

In 2013, the rules that limit interest deductions in respect of debts owed to persons not subject to tax were introduced in the Act, and apply in respect of amounts of interest incurred on or after 1 January 2015. The main aim of these rules is to limit excessive interest deductions in respect of debts owed to persons not subject to tax in South Africa, if the debtor and the creditor are in a controlling relationship.

On 26 February 2020, Government published a discussion document titled "***Reviewing the Tax Treatment of Excessive Debt Financing, Interest Deductions and Other Financial Payments***" to conduct a review of the current interest deduction limitation in respect of debts owed to persons not subject to tax, in line with the OECD/G20 BEPS Action 4 recommendations. The review highlighted that the following elements of the current rules requires reviewing:

- Meaning of the term "*interest*" for purposes of these rules
- Deductible interest limitation: Formula calculation
- Back to back loans
- Definition of "*adjusted taxable income*" as it applies to REITs
- Interaction between the level of tax on interest and the current rules

To address the above-mentioned issues, the following proposed changes to the Act were included in the 2021 Draft TLAB:

- ***Meaning of the term "interest" for purposes of these rules***

  It was proposed that for purposes of these rules, the meaning of the term "interest" should be expanded beyond the current definition of interest contained in section 24J, to include the following: (i) amounts incurred or accrued under interest rate swap agreements; (ii) the finance cost element included in finance lease payments; and (iii) foreign exchange differences.

- ***Deductible interest limitation: Formula calculation***

  It was proposed that the deduction of interest expenditure be limited to 30 per cent of "adjusted taxable income" instead of the current calculated percentage of adjustable taxable income. Therefore, part of the deduction formula which adjusts up and downwards based on the average repo rate for the year will be replaced. Further, it was proposed that consequential amendments be made in section 23M and section 23N.

- ***Back-to-back loans***

  To curb the circumvention of the rules applicable to back-to-back loans, it was proposed that changes be made to the current provisions of section 23M(2) so that the interest limitation rules apply in instances where a debtor incurs an amount of interest owed to a creditor that is in a controlling relationship with that debtor, if that creditor, directly or indirectly through another creditor that is in a controlling relationship with that creditor, obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that creditor or that other creditor.

- ***Refining the amount of interest deduction for REITs: Changes to the definition of Adjusted Taxable Income***

  It was proposed that a change be made to the definition of "adjusted taxable income" in section 23M(1) to add back the deductible "qualifying distribution" of a REIT.

- ***Interaction between the level of tax on interest and application of section 23M rules***

  It was proposed that changes be made in the legislation to achieve a more consistent treatment for all resident debtors paying interest, so that the restriction is not dependent on which country the payment is routed through. In instances where a resident debtor makes an interest payment and either the payment attracts withholding tax on interest at a rate of zero or it is not included in the recipient's income, the deduction for interest expense will be subject to section 23M as under the current rules. For cases where a resident debtor makes an interest payment and the payment attracts withholding tax on interest at a rate higher than zero, a portion of the interest expense will be subject to section 23M.

Comment: Companies' earnings have been severely affected by COVID-19. If this proposal is introduced in the years where the impact of the COVID-19 pandemic is felt, interest deductibility will be further impacted by the significantly lower tax EBITDA in the current and post COVID-19 pandemic years.

Response: Accepted. This measure was first proposed before Covid-19 reached South Africa. The current rules are an important tool to mitigate the use of excessive debt and interest payments that reduce taxable profits in South Africa. Government maintains the view that these rules need to be strengthened to protect the corporate tax base, but understands that many businesses may have had to rely on more debt to withstand the pandemic and its associated lockdowns. This coupled with lower earnings provides the rationale to postpone this proposal to provide space for recovery. For this reason, the proposal will remain in the 2021 Draft TLAB. However, the proposals will come into operation on the date on which the rate of tax in respect

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of the taxable income of a company is first reduced after announcement by the Minister of Finance in the Annual National Budget, and will apply in respect of years of assessment commencing on or after that date.

Comment: In its draft form, section 23M would seemingly not apply to limit the interest deduction for amounts in respect of leases, derivatives and certain exchange items. The wording needs to link to the debtor or the definition of debtor needs to be widened. Alternatively, a new definition for "debt" is required.

Response: Accepted. Changes will be made in the 2021 Draft TLAB in this regard.

Comment: The proposal goes against the fundamental principle that payments made under a finance lease are rentals and not finance related. Clarity is sought as these payments have always been treated as rental and not as capital and interest. Currently, the lease payments are typically deductible for income tax purposes. The proposal refers to IFRS 16, which mentions a lessor; however, it is the lessee that will be subject to section 23M.

Response: Partially Accepted. While these payments have always been treated in a certain manner, this proposal is trying to reduce the likelihood of interest payments being disguised as other payments to avoid the rules. The finance cost element of finance lease payments is akin to interest and is already separated from lease payments for accounting purposes. It is recognised that the reference to IFRS 16 is problematic in that the rules will apply to a lessee rather than a lessor. The proposed wording will be changed.

Comment: Interest rate swap agreements are usually in respect of a notional debt amount and do not represent a debt owed. The capital element of the interest rate swap could be caught under the proposal and this proposal is only acceptable if it applies solely to the interest rate element in swap agreements.

Response: Not Accepted. These agreements will only be subject to section 23M if the interest rate payments in question are paid between two parties in a controlling relationship (directly or indirectly) and to the extent amounts incurred or accrued under section 24K are not fully taxed in the hands of the beneficial owner. The capital portion will not be subject to section 23M.

Comment: Foreign exchange differences are not economically equivalent to interest. This proposal will include losses incurred as a result of fluctuating exchange rates rather than excessive debt. The Rand's volatility means that the inclusion of exchange differences can cause significant distortions and unintended consequences to the limitation. The proposal should be aligned with the OECD in that certain foreign exchange differences can be regarded as interest, but only those connected with the raising of finance.

Response: Partially Accepted. The OECD Report acknowledged that foreign exchange differences are not economically equivalent to interest, but still

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included them as an item to be restricted by interest limitation rules given the potential for relabelling to circumvent the rules. Both sentiment and fundamentals come into play in determining the volatility of the Rand. For example, a Rand-Dollar forward contract would price itself on the differential between the interest rate in both countries and the counter party would want to hold a dollar deposit to hedge. To do so, they would use the differential in the two interest rates to price the transaction. Swaps take all forms and can contain an embedded loan, for example, an upfront receipt of the notional amount in any currency repayable at the end of the contract being based on any currency and any yield to market. With respect to derivative swaps, if a taxpayer wants to convert a fixed interest rate loan to a variable rate, it can buy a swap to switch from fixed to variable and, depending on interest rate yields, it is possible to reduce the impact of section 23M. Similarly, a currency swap from a parent in Euros would result in a low interest rate. The cost of a forward contract or a swap to convert that to Rands will increase it to the Rand equivalent. If the mechanism for converting to Rands is ignored and section 24J used in isolation for the purposes of section 23M, section 24J will only focus on a low hard currency interest rate – rendering the application of section 23M less effective.

Comment: The proposal will not cover hedging arrangements where the counterparty to those arrangements is not in a controlling relationship with the debtor (e.g. a third-party bank) even though it may be connected to a debt to which the section does apply.

Response: Noted.

Comment: The misalignment in the definition of interest and hybrid rules could result in hybrid instruments distorting the interest deduction limitation formula by overstating or understating interest incurred and accrued.

Response: Accepted. Changes will be made to the definition of interest in section 23M in the 2021 Draft TLAB to exclude amounts that are deemed to be a dividend in *specie* as contemplated in section 8F and 8FA.

Comment: The proposed 30 per cent ratio is generally applicable to developed countries, not developing countries like South Africa. It will make South Africa unattractive as an investment destination.

Response: Not Accepted. South Africa is not the only developing country that has implemented these rules as recommended by the OECD/G20 BEPS Project. Countries like Botswana and India have also implemented a fixed ratio rule at 30 per cent. As stated in the Explanatory Memorandum, Government's analysis at the outset of these rules suggested that 40 per cent was too high even though interest rates at that time were higher than currently.

Comment: The definition of "controlling relationship" does not cover a scenario where a company is under the joint control of persons and creates a loophole as a result. For example, if in a large multinational setting – a loan is advanced from a treasury

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company that is a fellow-subsidiary of the South African borrower, the interest expense will not be subject to the rules.

> *Response:* Accepted. Changes will be made to the definition of "controlling relationship" in the 2021 Draft TLAB to cover companies that are directly or indirectly under a common controlling relationship.

Comment: The proposed provisions to deal with back-to-back loans do not result in the desired outcome as the interest income will never be subject to tax in the hands of the ultimate lender. The full amount of interest incurred by the debtor will only ever be subject to (or not subject to tax) in the hands of its immediate creditor. Based on the current proposed wording of section 23M(2)(i)(aa), it is not clear how the proposed amendment will mitigate the risk of base erosion identified in these types of back-to-back loan arrangements.

> *Response:* Accepted. Changes will be made in the 2021 Draft TLAB to take this issue into account.

Comment: The proposed proviso to section 23M(2) is not aligned to the proposed wording referred to in section 23M (clause 20(f)): "*subject to tax in the hands of the person to which the interest accrues or the other creditor referred to in paragraph (c)*". The proviso only refers to "*interest incurred or paid is not included in the income of the person to which that interest accrues or is paid*" and would therefore not apply where the interest is paid to a person that is subject to tax, but that person obtained funding from a person that is exempt from tax.

> *Response:* Accepted. Changes will made to the proviso in section 23M(2) in the 2021 Draft TLAB in this regard.

Comment: The proposal should apply only to interest that is not subject to tax – it is inappropriate to adjust for rate considerations, particularly when the tax base is completely different. The proposal will result in interest that is subject to interest withholding tax at 15 per cent being subjected to the partial application of section 23M in addition. The proposal should be with reference 15, not 28 per cent.

> *Response:* Partially Accepted. As explained in the Explanatory Memorandum, the current rules have a different application depending which country the affected interest payments are flowing to, due to reduced interest withholding tax rates. Government is of the view that it is fairer to equalise the treatment depending on how much tax is actually paid. To recognise that the tax base for corporate income tax and withholding taxes is different, changes will be made in the 2021 Draft TLAB to replace the reference to the current corporate income tax rate of 28 per cent with the standard dividends tax rate of 15 per cent.

Comment: In determining an "assessed loss", a taxpayer must take into account any limitation imposed on interest deductions in terms of sections 23M and 23N, read with section 11(x). However, until the calculation in terms of section 23M and/or section 23N is performed, one cannot determine the "assessed loss" of the taxpayer.

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The definition of "adjusted taxable income" in sections 23M and 23N should be amended to remove the circular reference. This could be done by amending paragraph (b)(iii) of the definition of "adjusted taxable income" to refer to an "assessed loss before the application of this section".

Response: Accepted. Although the "assessed loss" referred to in the definition of "adjusted taxable income" can, by current application and interpretation, only be determined before the application of section 23M, changes will be made to the definition of "adjusted taxable income" to take this issue into account.

Comment: There is lack of clarity with respect to the ordering of applying section 23M and section 31.

Response: Noted. While Government has always maintained that applying section 31 should precede the application of section 23M, Government is of the view that an interpretation note would be the best mechanism to address this uncertainty. This will clarify that a taxpayer should calculate taxable income that includes any section 31 adjustments before calculating section 23M.

Comment: The proposal uses a metric derived from EBITDA, which is inappropriate for the banking sector as interest expense is its largest operating expense.

Response: Not Accepted. While the OECD recommendations use an NIE/EBITDA ratio and suggest that it is unlikely to be appropriate for the banking sector, the South African rules are crafted slightly differently as it was recognised at inception that the NIE/EBITDA ratio would be problematic for certain companies, such as banks. Interest income (reduced by interest expense not subject to section 23M) is added to the percentage of EBITDA to recognise the position of companies in the financial sector earning profits from interest.

Comment: The proposal will increase the interest that is allowed as a deduction for a listed REIT, relative to the unlisted property sector in which these amounts are being limited. As a result, there will be a negative impact on the return on investments of unlisted property companies, making them unattractive to institutional investors.

Response: Not Accepted. The Act currently makes a distinction between the tax treatment of listed REITs versus unlisted property companies, and the rationale for the different tax treatment stems from the fact that listed REITs are regulated by the JSE.

Comment: The rationale of extending the 30 per cent rule to section 23N as opposed to it being limited to section 23M has not been dealt with properly. There are fundamental differences in the nature of the funding arrangements which trigger the provisions of sections 23M and 23N. The proposal is misplaced given that the lenders in these arrangements would be subject to tax in South Africa.

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Response: Accepted. Government recognises that section 23N was not the subject of review and that changes will be made in the 2021 Draft TLAB to remove all the proposed amendments to section 23N.

4.2 Restricting the set-off of the balance of assessed losses in determining taxable income

(Main Reference: Section 20 of the Income Tax Act: clause 19 of the Draft TLAB)

In determining taxable income, the Act enables taxpayers to set off their balance of assessed losses carried forward from the preceding tax year against their income. An unutilised balance of assessed losses may be carried forward to future years of assessment to be set off against future income (provided that the non-individual taxpayer's trade continues without interruption). Accordingly, taxpayers will only be liable for income tax once they have earned a taxable profit and their assessed loss balance is depleted. The purpose of providing for the deductibility of assessed losses for corporate taxpayers is to smooth the tax burden for companies whose primary business is cyclical in nature and not in line with a standard tax year, and for start-up companies that are not profitable in the early years of trading.

Over the past few years, there has been an international trend to restrict the use of assessed losses and reduce the corporate income tax rate. To improve the country's competitiveness, reduce the appeal of base erosion and profit shifting, encourage investment and promote economic growth, the Minister of Finance announced (in the 2020 Budget Review) Government's intention to restructure the corporate income tax system over the medium term by broadening the base and reducing the corporate income tax rate in a revenue neutral manner. In line with the 2020 Budget announcement, in the 2021 Draft TLAB, Government has proposed broadening the corporate income tax base by restricting the offset of the balance of assessed losses carried forward to 80 per cent of taxable income. The proposal covers the balance of assessed losses at the time of implementation, (i.e. it is not only the accumulation of losses starting from the date of implementation that will be subject to the new rules). This will contribute to providing the fiscal room for Government to lower the corporate tax rate. The effect of the proposed restriction is that only companies that would be in a positive taxable income position before setting off the balance of assessed losses would be affected. While the overall tax liability will not change, a portion of the tax liability will be brought forward.

Comment: Most commentators understand and appreciate the overall objective of broadening the corporate tax base and lowering the tax rate. However, one of the biggest concerns raised was timing – that the proposal is too harsh given the continuing Covid-19 pandemic and recent unrest in the country. Many businesses have suffered losses as a result of the pandemic and associated lockdowns. Having to use cash to pay tax on 20 per cent of taxable income rather than using cash flows to recover and reduce debt will place an additional burden on companies that are trying to recover from these adverse events. Many countries have temporarily relaxed their tax loss regimes as part of the relief measures to support businesses in these times.

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Response: Accepted. This measure was first proposed before Covid-19 reached South Africa. Government holds the view that a broad tax base with as few distortions as possible, combined with a lower rate, will be more efficient – an important tax policy design principle. It is also acknowledged that businesses have faced difficult economic circumstances in the past 19 months. Some businesses are in survival mode and providing the space for recovery is important. For this reason, the proposal will remain in the 2021 Draft TLAB. However, the proposals will come into operation on the date on which the rate of tax in respect of the taxable income of a company is first reduced after announcement by the Minister of Finance in the Annual National Budget and will apply in respect of years of assessment commencing on or after that date.

Comment: South Africa will be in a very small minority of countries that, while imposing a limit on either the time to use tax losses or the amount that can be used, have no group tax system. Without group tax, the proposed regime for tax losses will be one of the most onerous in the world, thereby significantly impacting South Africa's competitiveness from a tax perspective.

Response: Not Accepted. South Africa currently falls within a small group of countries (6 other countries) with no group tax regime and no restriction on losses. Many countries impose loss restrictions and do so by limiting the number of years that losses can be carried forward – some restricting the carry forward to as little as 3 or 5 years. It is Government's view that this is a more punitive means of restricting losses as the balance of assessed losses is lost after this time period. Further, a time-bound limit has a large effect on symmetry and stabilisation, and has an uneven effect across different business models. The current proposal would shift South Africa into a large group of about 33 countries where there is no group tax regime and losses are restricted. Even so, South Africa's proposal will still be more generous than the restrictions in this group as many countries in the group limit the carry-forward years or their quantum limit is lower than 80 per cent of taxable income, resulting in a permanent loss of the assessed loss balance on expiry, or a higher taxable income on which the tax liability is calculated. Given the desire to work towards an efficient corporate tax regime with a broad base and lower rate, a quantum restriction, which is relatively generous at 80 per cent, is considered the most appropriate policy stance for South Africa to balance the effects for businesses and Government. South Africa's proposal to restrict the set-off of the balance of assessed losses to 80 per cent of taxable income will be one of the least restrictive once implemented, given that companies will not forfeit any losses and the balance of assessed losses will continue to be carried forward indefinitely.

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Comment: The proposal will reduce the real value of tax incentives (with a negative impact on investment).

> *Response*: Not Accepted. The overarching policy goal for reforming corporate income tax is to create a tax policy environment that is conducive to broad-based economic growth and that avoids complicated incentives for specific sectors or groups of taxpayers. Part of the objective was to reduce the generosity of accelerated depreciation while providing a corresponding benefit through a lower corporate income tax rate. The impact on the real value of investment is minimal considering that the assessed loss balance can be set off against 80 per cent of taxable income and the remainder remains deductible in future years.

Comment: Commentators raised a number of concerns with respect to the impact on different types of businesses (e.g. cyclical, start-ups, smaller businesses) and specific sectors.

> *Response:* Partially Accepted. As a general stance, Government is not in favour of providing carve-outs because they provide special treatment to some taxpayers and can lead to complexity. This has the potential to create vested interests for those that benefit – making it difficult to adapt the original policy choice if it becomes apparent that it is not ideally designed or no longer fit for purpose. It also often means that Government is continually exposed to lobbying from those who do not benefit because they also consider themselves eligible for special treatment. Although the proposed quantum restriction is relatively generous at 80 per cent and one of the least restrictive given that companies will not forfeit any losses and the balance of assessed losses will continue to be carried forward indefinitely, Government recognises that not all businesses are equally equipped with cash on hand once taxable income turns positive for the first time after a sustained period of accumulated losses. To cater for all sectors and recognise that not all companies have sufficient cash flow to face an additional tax burden in the first year they become profitable, Government proposes that changes be made in the 2021 Draft TLAB to include a *de minimis* threshold beyond which the proposal takes effect. The aim is to provide relief for a variety of companies that may experience cash flow challenges at different times. To the extent that the balance of assessed loss exceeds 80 per cent of current-year taxable income, companies will be able to set off the higher of R1 million or 80 per cent of taxable income when calculating the tax liability. While other countries have higher thresholds, they also have more stricter restrictions in place. This threshold means that the corporate income tax package will not move too far away from its aim of revenue neutrality given the currently constrained fiscal space.

Comment: Commentators from the agricultural sector raised concerns that this measure would have a negative impact on them, given the cyclical nature of their business and the negative impact of Covid-19 and its associated lockdowns.

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Response: Partially Accepted. In line with Government's general stance on carve-outs, no special treatment will be provided for the agricultural sector, however the *de minimis* of R1 million will help smaller farmers who experience cyclical profitability. Taxpayers sent written comments prior to the Parliamentary hearings (held on 31 August 2021) and taxpayer workshops (held on 7 September 2021). In the workshops, slides were presented to explain the rationale behind the corporate tax package and the mechanics of this proposal. A representative from the agricultural sector recognised that there was initially a partial misinterpretation and welcomed the fact that losses can continue to be carried forward, i.e. they will not be forfeited.

Comment: The proposal, combined with no extension of the tax benefits for REITs to unlisted property companies, means that most (if not all) unlisted property funds will pay tax. This reinforces the uneven playing field between listed REITs and unlisted property companies.

Response: Partially Accepted. Government accepts that this uneven playing field is a challenge for the unlisted companies. However, the proposal itself is not the root cause of this challenge, so providing a carve-out is, in Government's view, not deemed appropriate. The underlying challenge is a lack of regulation of unlisted property companies.

Comment: There is a need for the individual policyholder fund (IPF) to be carved out of the proposed amendment as the policyholders of the IPF consist solely of individuals who are not intended to fall within the scope of this amendment. IPFs would not get relief from a reduced company tax rate as would any other company.

Response: Not Accepted Government acknowledges that this measure would affect individuals with investments in IPFs. However, the tax rate of 30 per cent applied to these funds is already lower than the majority of the individual policyholders marginal tax rates. While Government would prefer actual marginal tax rates to apply on an individual basis, it is recognised that this is not a solution for the challenge and commits to reinvestigate the tax rate applied in respect of the IPF. No special treatment will be applied to the IPF in respect of this proposal.

Comment: From a technical perspective, commentators noted that the proposed wording does not specifically refer to the ability to carry forward assessed losses. From comments received, it also appears that many commentators understood that the restriction will mean that losses are forfeited and cannot be carried forward.

Response: Noted. The balance of assessed losses can currently be carried forward indefinitely, based on prevailing common law – even though the current legislation does not specifically state this. However, to enhance certainty for taxpayers, SARS will consider whether interpretive guidance should be given in this regard. The policy intention underlying the proposal is that the practice of carrying forward the balance of assessed losses indefinitely continues as before. In the taxpayer workshop held on 7 September 2021, an example was

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presented to illustrate the carry forward implication. The updated Explanatory Memorandum will include the presented example that incorporates additional years. The example showed that the proposal results in a timing difference and the overall tax liability remains the same for all companies.

4.3 Clarifying the definition of "Contributed Tax Capital"

(Main Reference: Section 1 of the Income Tax Act: clause 4(1)(c) of the Draft TLAB)

The contributed tax capital (CTC) of any company is a notional and ring-fenced amount derived from contributions made to a company by holders of a class of shares as consideration for the issue of that class of shares by that company. It is reduced by any capital amount that is subsequently transferred back by the company to one or more shareholders of that class of shares (commonly known as a capital distribution) utilising the notional tax amount so received. The policy rationale of this provision and the wording of the current proviso to the definition of CTC specifically requires that no holder of shares within a particular class of shares may receive CTC in excess of an amount per share derived by dividing the total CTC by the number of shares in that class immediately before that distribution. It has come to Government's attention that some companies are exploiting the current provisions of CTC by allocating CTC on the basis of an alleged "share premium" contributed by a particular shareholder but not to all shareholders holding shares in the same class of shares. The 2021 Draft TLAB proposed that changes be made to the definition of CTC to clarify the principle that shareholders within the same class of shares should share equally in the allocation of CTC as a result of a distribution.

Comment: The proposed amendment seeks to clarify the principle that shareholders within the same class of shares should equally, in relation to their shareholding, share in the allocation of CTC as a result of a distribution. However, the proposed wording potentially has a much wider impact than intended, especially on the corporate actions of elective share buy-backs (per section 48 of Companies Act) and redeemable preference shares. Elective share buy-backs generally only apply to specific shareholders in a particular class and as such, and by the very nature of the proposed amendment, any elective share buy-back action will be automatically excluded from the utilisation of CTC and classified as a dividend as not all shareholders within that class, will benefit from that repurchase (distribution) through CTC. On a similar basis, redeemable preference shares, whilst in the same class, redemptions may be staggered over a number of tranches, maturity dates or where different holders are redeemed at different times. As such it is recommend that both elective share buy-backs and redeemable preference shares are excluded from the ambit of the proposed proviso in the TLAB 2021. Companies effecting a specific share buy-back should be permitted to return CTC proportionally to the percentage of shares which are the subject of the repurchase.

Response: <u>Partially Accepted.</u> Changes will be made in the 2021 Draft TLAB to exclude a general repurchase of listed shares (share buy-backs) by companies listed on the JSE or other South African exchange.

Comment: The current proviso to the definition of CTC states that "*the amount transferred by a company…must not exceed an amount that bears to the total amount of contributed tax capital to that class of shares immediately before the transfer the same ratio as the number of shares of that class held by that person bears to the total number of shares of that class*". This wording creates unintended tax consequences for a shareholder that makes a large capital contribution to a company, but by virtue of the wording of this proviso, may only be able to receive a portion of a distribution by that company as CTC, proportionate to its diluted shareholding and not its shareholding in the company because of its actual capital contribution.

> *Response*: Not Accepted. The comment falls outside the context of the proposed amendment in 2021 Draft TLAB. However, it is important to note that the current wording included in the 2021 Draft TLAB is aimed at striking a balance between the extensive administrative burden required to match every CTC contribution and then the ease of applying any form of ratio.

Comment: The proposed further proviso will be deemed to come into effect on the date of publication of the Draft TLAB for public comments. Given that there are potentially a number of transactions that are currently in progress which would be impacted by the additional proviso, it potentially could result in adverse tax consequences for transactions that are being implemented from the date of the publication of the Draft TLAB for public comments and its ultimate promulgation which in turn also creates uncertainty in the market.

> *Response*: Accepted. Changes will be made in the 2021 Draft TLAB to change the effective date of the proposed amendment from the date of publication of the 2021 Draft TLAB for public comment, i.e., 28 July 2021 to 1 January 2022.

4.4 Limiting potential for double taxation under the hybrid debt anti-avoidance rules

(Main References: Sections 8F, 8FA and 50A of the Income Tax Act: clauses 8, 9 and 32 of the Draft TLAB)

The Act contains hybrid debt anti-avoidance rules aimed at curbing artificial generation of interest deductions by an issuer if the debt instrument qualifies as a hybrid debt instrument, or if the yield is determined not to constitute bona fide interest. These rules recharacterise interest labelled returns as dividends *in specie* paid in respect of a share. Concerns have been raised that the deeming provisions, which deem any return from tainted debt instruments or any tainted returns to be dividends *in specie* in respect of a share to be declared and paid by the issuer to the person to whom the amount accrued, do not specifically deem the return to be the accrual of dividends *in specie* for the holder or recipient of the return. As a result, the return may not qualify for an interest deduction, dividends tax may be payable by the issuer if no exemption applies and the holder may be taxed on the interest. Such a result would be too harsh as the return would be regarded as interest and thus also be taxable for the holder of a tainted instrument or recipient of a tainted return,

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leading to economic double taxation. Proposed changes were included in the 2021 Draft TLAB to explicitly extend the deeming provision to apply to the holder of a tainted instrument or recipient of tainted return. In addition, consequential amendments are proposed to the tax treatment of the reclassified return for purposes of withholding tax on interest in terms of the Act.

Comment: It is understood that the proposed changes are intended to be a clarification of policy. In this regard consideration should be given to having an effective date aligned with the introduction of section 8F and 8FA (subject to any limitation the fiscus considers necessary to prevent refund claims in respect of instances where the receipt has previously been treated as taxable). Clarifications through legislative changes usually come into effect on the date that the amendment act is promulgated. A specific effective date in this regard is not necessary.

Response: Partially Accepted. Changes will be made in the 2021 Draft TLAB to change the effective date from 1 January 2022 to the date of promulgation of the 2021 Taxation Laws Amendment Act.

4.5 Clarifying the meaning of "interest" under the debt relief rules

(Main References: Section 19(8)(f) and paragraph 12A(6)(g) of the Eighth Schedule to the Income Tax Act: clauses 18 and 45 of the Draft TLAB)

The Act contains debt relief rules that trigger tax consequences in respect of a waiver, cancellation, reduction or discharge of a debt owed by a taxpayer. In 2017, rules dealing with the tax treatment of converting debt into equity were introduced, along with changes to ensure that the debt relief rules trigger a debt benefit that is subject to tax if the face value of the reduced amount of the debt prior to the entering into of that arrangement exceeds; (i) the market value of the shares acquired by reason or as a result of the implementation of that arrangement, in the instance that the creditor held no interest in the shares in the debtor prior to the arrangement; or (ii) the amount by which the market value of the interest in the shares held by that creditor in that debtor company after the implementation of that arrangement exceeds the market value of the interest in the shares held by that creditor in the debtor company prior to entering into of that arrangement, in the instance that the creditor held an interest in the shares in the debtor prior to the arrangement. Concerns have been raised regarding the meaning of the word "interest" in the debt relief rules. To provide clarity as to the meaning of the word "interest" for purposes of applying the debt relief rules, it was proposed in the 2021 Draft TLAB that the meaning of the word "interest" be clarified to mean interest as defined in section 24J of the Act.

Comment: The amendments proposed are supported. In 2020, legislative changes were made to paragraph 12A which contains the debt relief rules under the capital gains tax provisions of the Act. The 2020 legislative changes in this regard, pertain to a comma that was inserted after the term 'trading stock' in para 12A(2)(*b*) of the Eighth Schedule. This insertion has the effect of rendering para 12A meaningless because the words that follow the comma "in respect of which a deduction or

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allowance was granted in terms of this Act" now relate to the expenditure instead of the trading stock. Expenditure which is allowed as a deduction under the main body of the Act does not form part of base cost under para 20(3)(*a*), leaving paragraph 12A without any expenditure to which it can be applied.

Response: Accepted. Changes will be made in the 2021 Draft TLAB to delete the comma and restore the meaning of the provision.

4.6 Refining the interaction between anti-value shifting rules and corporate reorganisation rules

(Main Reference: Section 40CA of the Income Tax Act: clause 25 of the Draft TLAB)

The Act contains rules in sections 24BA and 40CA that curb the use of structures that shift value between taxpayers free of tax. Section 24BA applies to transactions involving asset-for-share exchanges and triggers a capital gain or deems a distribution of an asset *in specie* (in respect of which dividends tax is payable) where these exchanges are not effected on a value-for-value basis. Section 40CA prescribes a base cost for assets acquired by companies in exchange for the issue of their shares to the seller of those assets as the sum of the market value of the shares it issued and the amount of the capital gain triggered by the application of the provisions of section 24BA to ensure that there is no double taxation on the future disposal. On the other hand, the Act contains corporate reorganisation rules that allow for the tax neutral transfer of assets between companies that are part of the same group of companies and provide that assets transferred in terms of the corporate reorganisation rules are subject to the roll-over base cost rules that deem the acquirer and seller to be one and the same person for purposes of the base cost determination. The interaction between the anti-value shifting rules in sections 24BA and 40CA and the corporate reorganisation rules in Part III of Chapter II of the Act gives rise to anomalous results as the capital gain triggered under the anti-value shifting rules is only added to the base cost of an asset acquired in exchange for the issue of shares by a company in terms of section 40CA, which is outside of the corporate reorganisation rules. To rectify this anomaly, it was proposed in the 2021 Draft TLAB to provide for additional expenditure incurred equal to any deemed capital gain resulting from the application of the anti-value shifting rules in section 24BA for corporate reorganisation rules. However, because the additional base cost is not required until a taxpayer subsequently disposes of an asset by way of a transaction that is not tax deferred in terms of the corporate reorganisation rules, it was proposed that a company will be deemed to have incurred expenditure equal to the triggered deemed capital gain immediately before a subsequent disposal of an asset, previously acquired in terms of the abovementioned reorganisation provisions, in a transaction that falls outside corporate reorganisation rules.

Comment: The changes proposed are welcomed in so far as it provides for an increase in the relevant base cost in respect of tax actually paid. However, it is noted that the proposal for the additional base cost only to be deemed to arise immediately prior to a subsequent disposal introduces an additional, and unnecessary, level of complexity and administration. In particular, there are

concerns around the complexity this will lead to when making determination for deferred tax as it becomes debatable what the base cost is of an asset that was subject to the anti-value shifting rules and has not yet been disposed of outside of the corporate reorganisation rules. As such, it is requested that the additional base cost uplift should be granted upfront immediately after an asset-for-share transaction that is subject to the anti-value shifting rules.

Response: Accepted. Changes will be made in the 2021 Draft TLAB to ensure that the additional expenditure incurred uplift is granted immediately after an asset-for-share transaction that is subject to the anti-value shifting rules. As a consequential amendment, an additional legislative change will be made to section 41(2) of the Act to ensure that the re-organisation rules are made subject to this immediate base cost uplift.

4.7 Clarifying the rules that trigger additional consideration in asset for share transactions when a debt is assumed by a company

(Main Reference: Section 42(8) of the Income Tax Act: clause 26 of the Draft TLAB)

The corporate reorganisation rules contain asset-for-share transaction rules in section 42 of the Act that allow for the tax neutral transfer of assets when a person (transferor) disposes of an asset to a company in exchange for the issue of shares by that company to that transferor or when a transferor disposes of an asset that was acquired using debt and as part of that disposal, that debt is assumed as consideration by a company acquiring that asset. These rules are subject to an anti-avoidance measure that is aimed at preventing a permanent loss to the fiscus, instead of a tax deferral and the measure provides that a proportional part of any qualifying debt that was assumed by a company as part of an asset-for-share transaction will constitute an amount received by or accrued to the transferor in respect of the disposal of any of the shares in the company acquired in terms of the asset-for-share transaction, when such shares are subsequently disposed of by the transferor. Consequently, a transferor must account for any debt assumed under an asset-for-share transaction as additional proceeds upon the disposal of the shares. It has come to Government's attention that the above-mentioned anti-avoidance rules that trigger additional consideration upon disposal are undermined when the shares are subsequently transferred in terms of a further corporate reorganisation transaction as the further corporate reorganisation rules will enforce the rolled-over base cost of the previous asset-for-share transaction. To prevent the rules from being undermined, it was proposed in the 2021 Draft TLAB that these anti-avoidance rules should be amended so that the additional consideration accrues to the transferor in relation to any assumed debt immediately before any subsequent disposal of the shares acquired in terms of an asset-for-share transaction. Consequently, a transferor would, irrespective of whether such a subsequent disposal of the shares is in terms of tax deferred transaction or not, be subject to tax on the additional consideration that is triggered immediate before that subsequent disposal of the shares.

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Comment: Why is the additional deemed expenditure only capable of being added to the base cost immediately before any disposal, and is not allowed to be added immediately? It could be many years before the asset is sold and the ability to add the deemed expenditure to the base cost is available, and by then memories may have faded and records might be lost, and it simply will not be done, even though the legislature intends that it be claimed.

The company selling the asset may inadvertently omit to bring the amounts to account for tax purposes. It would be far more sensible if the legislation provides that the amount equal to the amount of the liabilities assumed, be deducted from the base cost of these shares immediately (and this conforms with commercial and accounting practice). It is also submitted that the more appropriate measure would be to roll forward the deferred proceeds.

> *Response*: Not Accepted. Both the current provisions of section 42(8) and the proposed provisions contained in the 2021 Draft TLAB aim to tax a proportionate part of any qualifying debt that was assumed by company acquiring an asset from a person in return for shares as part of an asset-for-share transaction. In the current rules this is achieved by deeming the proportionate part of assumed debt to be an amount received by or accrued to that person in respect of the future disposal of those shares. The proposed rules result in two differences, providing a prescribed timing to tax the proportionate part of the qualifying debt (i.e. the subsequent disposal of the shares acquired in terms of a geared asset-for-share transaction, irrespective of the application or non-application of any of the reorganisation rules) and the deeming of that proportionate part as either a return of capital (in respect of shares not held as trading stock) and income (in the case of trading stock). The timing proposed is the most prudent and practical given the conflicting stakeholder preferences for either an upfront trigger or a much further deferred tax event. Lastly, it must be reiterated that the reason for the introduction of this provision was and still is to counteract the rolled over base cost rule applicable to any shares acquired where an asset is disposed of and qualifying debt is assumed as part of the consideration. For example, where an individual borrowed R1000, used the funds to acquire an asset and subsequently decides to dispose of the asset to a company when it has grown in value and is valued at R1500 onon the date of disposal. It is expected that the value of the shares to be received by the Individual will be R500 (being the net asset value). However, as a result of the operation of the roll over base cost rule in section 42, the base cost at which the individual acquires the shares will be deemed to be equal to the base cost at which that individual acquired the asset (i.e. R1000). This artificially creates an embedded loss on the date of the transaction of R500. The proposed rules adjust the base cost if the shares are not held as trading stock and triggers additional income if they are held as trading stock. The amount to be determined is limited to the proportion of the debt outstanding and assumed as relates to the number shares disposed of.

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4.8 Clarifying the early disposal anti-avoidance in intra group transactions

(Main Reference: Section 45(5) of the Income Tax Act: clause 27 of the Draft TLAB)

The corporate reorganisation rules contain intra-group transaction rules in section 45 of the Act that allow for tax deferral in respect of a disposal of an asset or a business as a going concern between companies that form part of the same group of companies at the end of the day of that disposal transaction. These intra-group transaction rules contain anti-avoidance measures that make provision for the early disposal rules to apply when an acquirer of an asset in terms of an intra-group transaction disposes of that asset within 18 months of such an acquisition. For example, a company may dispose of its asset (in respect of which a capital gain was anticipated on the date of an intra-group transaction) to a fellow group company with an assessed loss in order for that fellow group company to offset any capital gain on the disposal of that asset outside the group companies to a third party. Applying the early disposal anti-avoidance rules in the given example, the rules entail that the company that is disposing of an asset within 18 months of acquiring it in terms of a tax deferred intra-group transaction, must ring-fence the resultant tax consequences of such a disposal (i.e. the capital gain in the example provided) and not offset it against its losses, thus enforcing that tax must be paid on such capital gain. It has come to Government's attention that in some instances, a capital gain may have been anticipated from the disposal of an asset at the date of the intra-group transaction, yet, at the date of the early disposal of an asset (disposal of an asset within 18 months after the acquisition in terms of the intra group transaction), a capital loss arises in respect of that asset. The difference in the nature of the resultant consequences in respect of the disposal of an asset on the date of the intra-group transaction and the date of the early disposal creates ambiguity in the application of the early disposal anti-avoidance rules. In order to address this ambiguity, it was proposed in the 2021 Draft TLAB that changes be made in the legislation to ensure that any capital gain, capital loss or income arising in the hands of a transferee company from any early disposal of an asset that was previously acquired in terms of an intra-group transaction should be ring-fenced without regard to any capital gain, capital loss or income that would have arisen on the date of the intra-group transaction.

Comment: We disagree with the proposed changes put forward in this regard and are concerned that a taxpayer, having legitimately made use of the roll-over provisions of section 45 in respect of an initial transaction could be placed in a worse-off position in respect of a so called 'early disposal' than if the initial transaction had not 'benefitted' from the rollover provisions. It is submitted that the triggering of anti-avoidance measures which seek to reverse deferral relief previously obtained should not place the parties in a position which is worse than that which would have applied where the deferral relief was not obtained and should indeed be limited to reversing the relief actually obtained in respect of the initial transaction.

Response: Accepted. It is acknowledged that the proposed formulation results in the entire capital gain, loss or taxable income being subject to ring-fencing without regard to the tax consequences that would have resulted had the asset transfer not qualified for roll-over. As such, the proposed amendment in the 2021 Draft TLAB will be replaced by a further proviso to subsection 45(5) which will clarify that the ring-fencing provisions of subsection 45(5) will not apply in instances where the tax consequence arising from the actual disposal of the asset differs from the tax consequences that would have arisen had roll-over not been available on the date of the intra-group transaction.

4.9 Refining the provisions applicable to unbundling transactions

(Main References: Sections 46 and 46A of the Income Tax Act: clauses 28 and 29 of the Draft TLAB)

The corporate reorganisation rules contain unbundling provisions in section 46 of the Act that allow for a tax neutral transfer of shares in instances where shares in a resident company (unbundled company) that are held by another resident company (unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. These unbundling rules contain anti-avoidance measures, namely, exclusion from tax deferral of distributions to disqualified persons and limitation of expenditure in respect of shares held in an unbundling transaction, aimed at limiting or discouraging abuse by taxpayers from distributing shares on a tax neutral basis if the shareholders do not fall within the South African tax net. In 2020, changes were made to the anti-avoidance measure dealing with exclusions of distributions to disqualified persons to make provision for the roll-over relief not to apply in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5 per cent of the equity shares in the unbundling company immediately before an unbundling transaction. The 2020 changes resulted in the “pro rata” application of the anti-avoidance measure dealing with exclusions of distributions to disqualified persons and results in a more equitable outcome in respect of unbundling transactions as only shares distributed to persons that are not disqualified persons will benefit from the roll-over relief and the rest will be subject to normal tax and dividends tax rules applicable on distribution.

It was proposed in the 2021 Draft TLAB that changes be made to ensure that shareholders in an unbundling company that qualifies for tax deferral for an unbundling transaction should receive an additional base cost that is reflective of the tax paid by the unbundling company in respect of their shares in the unbundled company, in accordance with their respective shareholding. In addition, it was proposed in the 2021 Draft TLAB that further changes be made in the anti-avoidance measure dealing with limitation of expenditure in respect of shares held in an unbundling transaction to ensure that this measure only applies to shares that

are acquired by way of an unbundling and not to those shares that are acquired through either subscription or acquisition for a full consideration.

Comment: An unbundling company will pay tax on so much of the distribution in terms of an unbundling transaction that is distributed to shareholders that are disqualified persons. The tax paid is indirectly borne by all shareholders, both qualifying and disqualified. Outside of the roll over provided under the corporate reorganisation rules, and in particular unbundling transactions, the market value of the unbundled shares becomes the base cost in the hands of the shareholders while the base cost of the shares in the unbundled company remains intact. Under the unbundling relief, the base cost of the shares in the unbundling company is split between the unbundling company and the unbundled company shares based on relative market values.

Response: Not Accepted. Company distributions of assets (for example shares in a subsidiary) effected outside of the corporate reorganisation rules, that are not dividends, are taxed as though the company making the distribution disposed of those assets at market value. The recipient of the distribution is treated as having acquired the asset at market value. In this instance, where this treatment applies, tax is fully paid in respect of those assets. This is unlike in a partially taxed unbundling transaction where the unbundling company (as the party paying the tax) pays tax on the portion of the distribution that is made to disqualified persons. A rebasing for qualifying persons who were meant to receive shares in respect of which tax was not paid is unjustified and that is why Government seeks to, as a minimum, uplift their base cost with the amount of tax paid and subject to the expenditure determination of those qualifying persons.

4.10 Clarifying rehypothecation of collateral within collateral lending arrangements

(Main Reference: Section 1 of the Securities Transfer Tax Act: clause 56 of the draft TLAB)

The Act contain rules that allow for an outright transfer of listed shares or local and foreign government bonds in collateral lending arrangements. As a result, if a listed share, local or foreign Government bond is transferred as collateral for an amount owed by the transferor to the transferee, there are no income tax (including capital gains tax) and securities transfer tax implications provided that identical shares or bonds are returned to the transferor by the transferee within a limited period of 24 months from the date of transfer of the collateral. At issue is the rehypothecation of collateral, where the bank, broker dealer or collateral taker (transferee) intends to use collateral received through a tax-neutral collateral arrangement for trading or as security for its own borrowing. The use of collateral for purposes other than subsequent collateral arrangements is against the policy rationale for the introduction of these provisions and could result in the avoidance of securities transfer tax or capital gains tax. It was proposed in the 2021 Draft TLAB that changes be made to clarify the policy

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intention that the shares or bonds transferred as collateral in terms of a collateral arrangement may subsequently only be used for collateral and not be used for trading or in other financial transactions. As a consequential amendment it is also proposed that the same policy clarification be extended to Government's ability to identify and sanction the improper use of the collateral received by the transferee during the 24-month time frame of collateral arrangements. In view of the fact that the proposed amendments are aimed at curbing abuse, it was proposed that these amendments should apply retrospectively and come into operation on the date of the publication of the 2021 draft TLAB for public comment. i.e. 28 July 2021.

Public comments received during public comment period

The following comments on the changes proposed to section 1 of the Securities Transfer Tax Act (STT Act) in the 2021 Draft TLAB were received as part of the written submissions submitted during the comment period ending on 28 August 2021 and discussed during the public workshop held on 8 September 2021.

Comment: There is no need to introduce the proposed legislative limitation on the rehypothecation of collateral (or a need for any amendment) as the existing legislation is perfectly adequate in ensuring that any re-use of collateral outside of a further collateral arrangement or a lending arrangement, would fall within the tax net.

Response: Not Accepted. The tax-free measures in support of collateral arrangements are an incentive and deviate from general tax principles which necessitated extensive engagement with financial sector participants in the run-up to the 2015 introduction of 'collateral arrangements' within the STT Act and the Income Tax Act. It was widely accepted then that financial sector participants understood the assumptions of the tax-free flow of collateral and what the inferred tax implications would be if that transactional flow of collateral fell outside of the intended legislated structure. However, several financial sector participants have requested clarity on the policy intent and scope of rehypothecation under collateral arrangements.

Comment: It is recognised and supported that Government should have the ability to clarify policy intent or to identify and sanction the improper use of collateral which possibly results in the avoidance of tax. However, the current proposed wording is very wide in its impact and also threatens to have a material negative impact on both regulatory conduct and then the liquidity, stability and attractiveness of the South African capital markets, through the:

- inability of banks and pensions funds to meet regulatory obligations, the very underlying purpose of introducing the 2015 collateral arrangement dispensation, including:
    - banks being unable to re-use collateral for HQLA purposes;
    - inability of pension funds to now meet Regulation 28 requirements;
    - re-use of collateral for security optimisation within a bank or pension fund;

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- the sale and transfer of securities (generally Government bonds) by the banks to the SARB, which securities include outright non-cash collateral taken by banks; and
- the Large Exposures Framework (LEX): regulations in terms of Basel III, which will become effective in January 2022.

Response: Partially Accepted. Changes will be made in the 2021 Draft TLAB to accommodate the following regulated transactions and current market and regulatory developments:

- A repurchase agreement entered into with the South African Reserve Bank in terms of section 10(1)(j) of the South African Reserve Bank Act;
- Complying with Regulation 28 of the Pension Funds Act;
- Securing overnight cash placement in order to comply with the Basel III Supervisory Framework for measuring and controlling large exposures..

Comment: The retrospectivity of the proposed legislation, which is the date of publication of the 2021 Draft TLAB for public comment has resulted in significant practical concerns. The proposed amendment not only requires the collateral taker to not re-use the collateral for non-collateral purposes, but also requires the collateral taker to contractually agree to this. Thus, even if a collateral taker were not to re-use collateral for non-collateral purposes, without amending the industry standard agreement governing collateral, that any collateral placed on or after 28 July 2021 would fall outside the proposed contractual ambit of the tax-free collateral arrangements' dispensation. Agreements governing collateral transactions are based on widely accepted international standards/templates and amending these agreements, barring the required sufficient lead time nationally, puts South Africa at a disadvantage as international counter parties might be unwilling to agree to any contractual inclusion of a restriction on the re-use of the collateral.

Response: Accepted. Changes will be made in the 2021 Draft TLAB to remove the contractual requirement and that the effective date be postponed from the date of publication of the 2021 Draft TLAB for public comment to 1 January 2022.

Consultative meeting: 4 October 2021

Following the public workshops which were held on 7, 8 and 9 September 2021 to discuss the public comments received on the 2021 Draft Tax Bills (including comment to the proposed amendments to collateral arrangements), a further consultative meeting was held with the stakeholders on 4 October 2021, to engage further on this matter.

The following comments were raised during this consultative meeting:

Comment: Any proposed amendment should either be drafted or strategically placed within the legislation, and in such a manner, that any subsequent rehypothecation of the collateral by the collateral taker be sufficiently far removed

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from any preceding collateral arrangement to ensure that the proposed legislation only has a tax impact on the transaction for the party that actually undertakes that rehypothecation.

Response: Noted. At issue is the possible lack of legislated clarity on the subsequent rehypothecation of collateral received and the possibility of tax implications on those subsequent rehypothecation transactions deemed to fall foul of the relevant legislative requirements which ultimately can affect a legitimate preceding transaction, depending on the facts and circumstances. However, Government will endeavour to ensure sufficient clarity to taxpayers applying the legislation to any rehypothecation transaction.

Comment: The policy purpose of the collateral arrangement dispensation in 2015 was to ensure the tax neutral treatment of collateral transfers to enable participants in the financial sector to comply with increasing regulatory requirements. Just as tax legislation regarding collateral arrangements has developed since its introduction so has the participants application and use of rehypothecation as a result of the availability of the tax neutral treatment of collateral transfers within the South African financial markets. As such, it would be difficult to apply a clarification on original policy intent without considering the development of the financial market over the past 5 years.

Response: Partially Accepted. In order to ensure absolute policy clarity on allowable rehypothecation, changes will be made in the 2021 Draft TLAB to specifically list the following allowable and required regulatory conduct through rehypothecation, by any collateral taker:

- repurchase agreement entered into with the South African Reserve Bank in terms of section 10(1)(j) of the South African Reserve Bank Act;
- compliance with Regulation 28 of the Pension Funds Act;
- securing overnight cash placement in order to comply with Basil III Supervisory Framework for measuring and controlling large exposures

5 INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)

5.1 Refining the deduction formula for taxable long term insurer policyholder funds

(Main reference: Section 29A of the Income Tax Act: clause 24 of the Draft TLAB)

In 2012, changes were made to section 29A of the Act by revising the deduction formula for selling, administration and indirect expenses for long-term insurers. In general, this formula is based on taxable income divided by net economic income. For purposes of the denominator, the concept of “net economic income” is intended to reflect total taxable income as well as non-taxable dividends, exempt foreign dividends and realised and unrealised capital gains that are not taxed. At issue is that unrealised gains to be accounted for in the denominator does not specifically

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refer to any level of aggregation of unrealised gains and losses and is inconsistent with dividends, foreign dividends and realised capital gains which refer to an aggregation of amounts. In order to address this anomaly, it was proposed in the 2021 Draft TLAB that changes be made in the deduction formula so that unrealised gains and losses should also be aggregated for all assets allocated to the relevant policyholder fund.

Comment: The proposed amendment is welcomed however a further anomaly in the so called 'expense ratio' as it relates to in *specie* dividend distributions was identified. That is, if the in *specie* dividend distribution meets the definition of a 'dividend' and is exempt from normal tax, then the dividends component in subparagraph (D)(AA) in the expense ratio is increased by the amount of the exempt *in specie* dividend distribution. Those exempt dividends should be excluded from the denominator.

Response: Not Accepted. This request is not part of the 2021 Budget proposals, therefore not part of the 2021 legislative cycle. The proposed amendment is only catering for the aggregation of unrealised gains and losses for all assets allocated to the policyholder fund.

6 INCOME TAX: BUSINESS (INCENTIVES)

6.1 Refining the time frames of compliance requirements of Industrial Policy Projects (IPP) tax incentive

(Main reference: Section 12I of the Income Tax Act: clause 16 of the draft TLAB)

In 2009, the IPP tax incentive was introduced in section 12I (the section 12I tax incentive) to support investment in manufacturing assets that would improve the productivity of the manufacturing sector. The section 12I tax incentive offers support for both capital investment and training, with qualification for the incentive based on points scoring criteria reviewed by an adjudication committee constituted in terms of section 12I(16) of the Act. The adjudication committee assesses projects for approval, and if approved, monitors these projects in terms of their compliance. Section 12I(19)(a) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade, Industry and Competition to extend the time periods within which approved projects must comply with the provisions of the section, by one year. The section 12I tax incentive initially had a sunset date of 31 December 2015. In 2015, the sunset date was extended by two years to 31 December 2017. In 2017, the date was again extended by two years 3 months to 31 March 2020. The sunset date of 31 March 2020 fell during the COVID-19 pandemic. As a result, many beneficiaries of the section 12I tax incentive experienced some challenges during the 2020 COVID-19 national lockdown. This disruption is expected to last throughout 2020 and the whole of 2021. Should these compliance requirements not be met, it would lead to a withdrawal of approval for projects in terms of section 12I of the Act. This would

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place additional strain on the manufacturing sector in an environment where projects face severe challenges in reaching completion, and many businesses struggle to remain operational. In order to ensure that approved projects have a better chance of complying with section 12I provisions and are not adversely affected by COVID-19 and consequent restrictions on economic activity resulting in non-compliance, the following amendments are proposed in section 12I of the Act. Extension of the time period that the adjudication committee can recommend to the Minister of Trade, Industry and Competition within which approved projects must comply with the provisions of section 12I of the Act. Extension of "compliance period" within which approved projects must fully comply with the provisions of section 12I of the Act. The proposed amendments will be deemed to have come into effect on 1 January 2020

Comment: Although this addresses the impact of COVID-19 on some Industrial Policy Projects, the timing of the legislative process and the requirement of projects to receive adjudication committee approval for the extension of these time periods, will create further delays for projects which have already reached the time limits outlined in the Act and thus create uncertainty. Stated differently, with applicants currently required to submit a motivation to the adjudication committee for an additional extension to be granted, this leads to:

- additional administrative burden,
- uncertainty and delays.

It appears that a transitional period may have to be included, which can assist in mitigating the administrative burden and addressing the backlog.

> *Response:* Not Accepted. The interposition of the adjudication committee is an intentional measure to protect the fiscus by limiting the benefits of the relief to *bona fide* cases where compliance was not possible due to COVID-19 challenges, as opposed to projects that would not have complied with the section 12I criteria despite COVID-19.

Comment: The extension of the compliance period in section 12I is welcomed. However, consideration was not given to the interaction between sections 12I and 12L in light of both the impact of the COVID-19 pandemic and the nearing sunset date within section 12L. As such, it is kindly requested that an extension of the section 12L energy efficiency incentives for a minimum of 5 years be granted to enable business to confidently implement planned energy efficiency initiatives.

> *Response:* Not Accepted. This request is not part of the 2021 Budget proposals, therefore not part of the 2021 legislative cycle.

7 INCOME TAX: INTERNATIONAL

7.1 Clarifying the controlled foreign company anti-diversionary rules

(Main reference: Section 9D(9A) of the Income Tax Act: clause 10 of the Draft TLAB)

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The Act contains Controlled Foreign Company (CFC) anti-avoidance provisions in section 9D aimed at taxing South African residents on the net income of a CFC. In order to strike a balance between protecting the South African tax base and the need for South African multinational entities to be competitive, the CFC rules contain various exemptions of certain types of business income, for example, the foreign business establishment exemption. This exemption makes provision for CFC income to be exempt if that income is attributable to a foreign business establishment as defined in section 9D of the Act. In order to limit tax avoidance, the foreign business establishment exemption does not apply if the CFC foreign business establishment income is regarded as diversionary foreign business income in terms of the CFC anti-diversionary rules. It has come to Government's attention that certain taxpayers are circumventing the rule by merely entering into a contract of purchase in the country of the CFC that implies that the purchase of goods took place in the country of residence of the CFC when the goods are never physically present in that country. It was proposed in the 2021 Draft TLAB that the diversionary rules focussing on the purchase of goods by CFCs be amended to provide clarity on the tax policy intent that when a CFC purchases goods, they should be delivered in the country of residence of that CFC.

Comment: The concern relating to the mere conclusion of contracts in the country of residence of the CFC is acknowledged. The proposed amendments are too restrictive to CFCs that enter into genuine business transactions with persons outside of the country of residence of the CFC. The proposed amendments should be withdrawn or alternatively the requirement for delivery should relate to the delivery of goods from the country of residence of the CFC to the South African resident rather than the delivery of goods to the CFC in its country of residence.

Response: Not Accepted. Firstly, while Government acknowledges business practices, this loophole in the diversionary rules should be closed. Secondly, the alternative proposal suggested would still allow for the diversion of profits from South Africa, as a CFC, for example, in Country A, that signs a purchase contract with a third-party supplier in Country A, but with goods originating from another country and are delivered directly to SA. That transaction would arguably not result in imputation of net income from that transaction to South African residents.

Comment: The references in the Explanatory Memorandum of "anti-diversionary rules for CFC outbound sale of goods" in the "Reasons for change" as well as in the "Proposal" section is inappropriate.

Response: Accepted. Changes will be made in the 2021 Draft EM on the TLAB to delete the references to "anti-diversionary rules for CFC outbound sale of goods".

7.2 Refining the tax treatment of capital flows: Limiting the application of dividend and capital gain exemptions in loop structures

(Main reference: Section 9D of the Income Tax Act: clause 10 of the Draft TLAB)

The 2020 TLAA contained amendments that were aimed at the changes that were stated in Annexure E of the 2020 Budget Review that the relaxation of exchange control rules in respect of loop structures will take effect after the tax amendments to address the effect of reducing South Africa's tax base by an offshore company in a loop structure are implemented. These amendments contained rules that may reduce the risk of loop structures that may arise from the exemptions available for dividends and capital gains derived from the disposal of shares in foreign companies to non-residents with effect from 1 January 2021. With respect to dividends, changes were made to the CFC legislation so that a non-resident company that is a CFC include a portion of a dividend that is received or accrued from a resident company in net income. The 2021 proposed amendment seeks to give effect to the policy intention of the amendment in the Taxation Laws Amendment Act of 2020 aimed at limiting the application of the dividend exemption in loop structures. To give effect to this policy, it was proposed in the 2021 Draft TLAB that changes be made in the formula used to determine the portion of a dividend that is not exempt in the calculation of the net income of the CFC.

Comment: The proposed amendment does not specify an effective date, which then means that the amendments come into effect from date of promulgation. However, dividends would have flowed between the effective date of the 2020 amendment that is, 1 January 2021 and the date of promulgation.

Response: Accepted. Changes will be made in the 2021 Draft TLAB t insert an effective date of 1 January 2021.

Comment: The proposal does not cater for instances where dividends tax that is payable by a CFC is, in terms of a Double Taxation Agreement (DTA), limited to 15 per cent.

Response: Accepted. The formula in the 2021 Draft TLAB will be changed to cater for dividends tax paid at a rate of 15 per cent.

7.3 Reviewing of the "affected transaction" definition in the arm's length transfer pricing rules : Section 37 of the Taxation Laws Amendment Act, 2019 (Act 34 of 2019)

(Main reference: Section 31 of the Income Tax Act: clause 66 of the TLAB)

In 2019, changes were made to the "affected transaction: definition in section 31 of the arms-length transfer pricing rules. As such, the "affected transaction" definition in section 31 of the Act was expanded to cover transactions between associated enterprises. After publication of the 2019 Draft TLAB for public comments, taxpayers submitted comments that the term "associated enterprise" in the OECD model tax convention is not intended to represent a standard benchmark definition. Its incorporation into the South African domestic tax law will create significant uncertainty as to when the transfer pricing rules are applicable. Furthermore, the new definition would require further elaboration and clarification of participation,

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control, management and enterprise. In response to these comments documented in the 2019 Response Document to the Standing Committee on Finance and Select Committee on Finance in Parliament, it was stated that SARS would provide guidance on the interpretation of the term “associated enterprise” and in order to give SARS and taxpayers more time to consider the interpretation of the term “associated enterprise”. It was proposed that the effected date of this provision be postponed until the interpretation note is issued and engagements have been done between SARS and taxpayers.

Comment: The “associated enterprise” amendment has been deferred to 1 January 2022. However, in the current draft 2021 TLAB the postponement has not been made to give enough time for SARS and taxpayers to engage on the definition of “associated enterprise”.

Response: Accepted. Changes will be made to the 2021 Draft TLAB to defer the effective date will be deferred to 1 January 2023 to give SARS and taxpayers enough time to engage on the interpretation note on associated enterprises.

8 VALUE-ADDED TAX

8.1 Zero rating of super fine maize meal

(Main reference: Schedule 2; Part B of the VAT Act: clause 55 of the Draft TLAB)

In South Africa, the grading of maize products is regulated in the Agricultural Products Standards Act 119 of 1990. Before 2016, the Agricultural Products Standards Act allowed for 18 grades of maize products, including the below mentioned to be sold in South Africa. In turn, Item 2 of Part B of Schedule 2 of the VAT Act 1991 provides for a list of zero-rated items, which includes the following grades of maize meal: super maize meal; special maize meal; sifted maize meal or unsifted maize meal. In 2016, another grade of maize meal, namely, super fine maize meal was added to the list regulated by the Agricultural Products Standards Act, to make it 19 graded maize products. When changes were made to the list regulated by the Agricultural Products Standards Act to add super fine maize meal as another grade of maize meal to be regulated in this regard, there was no consideration to make amendments in Item 2 of Part B of Schedule 2 to the VAT Act to allow for zero rating of super fine maize meal. In order to allow for zero rating of super fine maize meal, it was proposed in the 2021 Draft TLAB that Item 2 of Part B of Schedule 2 to the VAT Act should be updated to include super fine maize meal.

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

Response: Not Accepted. The update to Schedule 2 Part B of the VAT Act dealing with zero rated foodstuff is the prerogative of the Minister of Finance with Parliamentary oversight. Item 2 of Schedule 2 Part B makes no reference to any regulations regulating maize products. Therefore, updates to Regulations relating to the grading, packing and marking of maize products by the Department of Agriculture, Forestry and Fisheries does not automatically make any maize product VAT zero rated. The merits of this item for zero-rating were not analysed in 2016. The significant risk referred to in the comment implies there are VAT vendors who have been zero rating the product without the necessary legislative support. The request to apply this amendment retrospectively seeks to condone the unlawful actions of such taxpayers. Further, retrospective amendments in tax legislation is usually only done in cases of anti-avoidance measures.

8.2 VAT treatment of temporary letting of residential immovable property

(Main references: Sections 9(6), 10(29) and 18D of the VAT Act: clauses 51,52 and 54 of the Draft TLAB)

The VAT Act makes provision for the supply of residential fixed property by a VAT vendor (being a property developer) to be subject to VAT at the standard rate of 15 per cent. While the VAT Act recognizes the sale of residential fixed property by a property developer as a taxable supply, the leasing of residential fixed property is an exempt supply which would generally result in the VAT incurred being denied. Property developers are entitled to deduct input tax on the VAT costs incurred to build residential fixed property (dwellings) for sale. However, where the property developer is unable to sell the residential fixed property and enters into a lease, until a buyer is found, the property developer is required to make an output tax adjustment based on the open market value of the residential fixed property when the residential fixed property is leased for the first time. In 2010, an announcement was made in Chapter 4 of the 2010 Budget Review (Heading titled: VAT and residential property developers on page 79 of the Budget Review) to investigate and determine an equitable value and rate of claw-back for property developers as the current treatment is disproportionate to the temporary rental income. As a result, changes were made in the VAT Act by inserting new section 18B, for a short period, from January 2012 to 1 January 2018. This section ceased to apply on 1 January 2018. Concerns have been raised again regarding the application of the VAT provisions in this regard, especially the inequitable value attributed to this change in use adjustment. In order to address these concerns, it is proposed that changes be made in 2021 Draft TLAB by inserting a new section in the VAT Act that will deal with the deemed change in use adjustment when the residential fixed property is leased for the first time, including whether that deemed change in use adjustment results in the residential fixed property exiting the VAT net or not and the VAT consequences of the subsequent deemed sale of the residential fixed property..

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Comment: The change in use adjustment is in relation to fixed property that is temporarily let. The word "temporary" is linked to the intention of the vendor and as such, is subjective in nature and this is what creates the uncertainty. As such, a time limit as a proxy for intention will assist in providing certainty.

Response: Accepted. The proposed amendments will be further amended to specify what is envisaged by the words "temporarily applied" by introducing a new definition in section 18D.

Comment: The proposed amendments are not clear on what the situation would be where the developer chooses to permanently apply the fixed property for rental income.

Response: Accepted. The proposed amendments will be further amended to clarify that in such instances the change in use will be a permanent change in use as envisaged by section 18(1),), and that section 18(1) will be applicable.

Comment: The VAT payable on the change in use adjustment when the fixed immovable property is leased for the first time is still disproportionate to the exempt income earned by the developer and it is suggested that a formula be used for the adjustment which should be similar to the formula used in Australia.

Response: Partially Accepted. The proposed provision is designed to ease the output tax burden faced by property developers when the fixed property is leased for the first time because the proposed provision requires the developer to make an output tax adjustment on the *adjusted cost*, not the *open market value* of the fixed property. However, the proposed amendment will be further amended to provide clarity on the input tax and output tax adjustments.

Comment: When the property is subsequently sold, such a sale is not required to be deemed because it is an actual supply.

Response: Accepted. The reference to a deemed supply in this instance will be removed.

Comment: The wording in its current form creates the perception that the purchaser of the property will only be liable for the payment of VAT to the extent of the difference between the purchase price and the adjusted cost. In order to achieve the correct result in the circumstances, it is recommended that section 18D(4) be reworded.

Response: Accepted. The section will be reworded to split out the input tax and the output tax adjustments. This rewording should also clarify the situation where the vendor sells the property at a loss.

Comment: 1st April 2022 is considered too late to assist developers who have been struggling with cash flow difficulties, it should be backdated to 1st January 2018 when

the first relief was withdrawn or from when there was a first lockdown (26th March 2020).

Response: Not Accepted. Amendments to tax legislation are usually only made retrospectively in instances of anti-avoidance measures. These amendments provide relief to a specific sector of vendors.

8.3 Reviewing the section 72 decision with regard to the VAT treatment of telecommunication services

((Main reference: Section 11(2)(y) of the VAT Act: clause 63 of the Draft TLAB)

In 2019, changes were made to section 72 of the VAT Act, which provides the Commissioner with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption from tax provided for in terms of the VAT Act, provided that the Commissioner is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise with regard to the application of the VAT Act. These changes had an impact on the arrangements or decisions made in terms of this section before 21 July 2019. In the 2020 Budget Review, Government undertook to address these concerns by reviewing the impact and the role of these arrangements and decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72.

One of the arrangements and decisions made in terms of section 72, which was impacted by these changes is the VAT treatment of telecommunications services. South Africa is a signatory to the International Telecommunication Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR) as well as the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai in 2012 (effective 2015) (Dubai ITR). In terms of these ITRs, the SA vendors may only levy VAT on these charges if the customer has a South African billing address. SA vendors supplying roaming and other services to non-resident telecommunications suppliers are thus obliged, in terms of the Dubai ITR, to zero rate these charges levied to their non-resident counterparts. In 2020, changes were made to the VAT Act to introduce a new zero-rating provision in order to ensure that the provisions of the Dubai ITR are upheld, in line with the section 72 rulings that were previously given to taxpayers. However, in the Response Document to the 2020 TLAB, it was noted that any further proposed amendments regarding the implementation of the Dubai ITR could be considered in the subsequent legislative cycle. Based on the above, in the 2021 Draft TLAB, it was proposed that further amendments be made to the provisions dealing telecommunications services in order to align these provisions with the Dubai ITR, but subject to certain limitations.

Comment: The proposed amendment is welcomed. However, the term "international roaming services" must be defined.

Response: Not Accepted. The term is universally understood. This sector is constantly evolving at a rapid pace. Introducing a definition to this may box the applicability of this legislation to what could soon become outdated parameters.

9 CARBON TAX

9.1 Clarifying renewable energy premium beneficiaries

(Main reference: Section 6(2)(c) of the Carbon Tax Act: Clause 63 of the draft TLAB)

In terms of Section 6(2)(c) of the Carbon Tax Act, provision is made for electricity generators liable for the carbon tax to offset the cost of their additional renewable energy purchases against their carbon tax liability. This provision was intended to address stakeholders' concerns of possible double taxation due to the introduction of the carbon tax in addition to the "renewable IPP tariff" already applied under the Renewable Energy Independent Power Producers Procurement Programme (REIPPPP). It came to Government's attention that some taxpayers are of the view that the Carbon Tax Act was ambiguous on the intended beneficiaries of this concession and requested clarity on whether renewable-based self-generation with electricity wheeling arrangements through Eskom would also be eligible to claim the renewable energy (RE) premium deduction. To address this concern, it is proposed that only entities that are liable for the carbon tax, conduct electricity generation activities and purchase additional primary renewable electricity directly either under the REIPPPP or from private independent power producers (IPPs) would be eligible to claim the tax deduction for its renewable energy purchases.

For purchases under the REIPPPP or privately, this would apply where a power purchase agreement (PPA) exists. Amendments were made to Section 6(2)(c) of the Carbon Tax Act to clarify that the Renewable energy premium to be deducted for purchases of additional renewable electricity is the product of the amount of RE purchased (kWh) under a power purchase agreement and the applicable rate for that technology as specified in the Renewable Energy Premium Notice gazetted by the Minister of Finance, that is: **Deduction (B) =** quantity of renewable electricity purchased (kWh) × rate (Rand) per technology as per the Gazetted notice . The proposed amendments will come into operation on 1 January 2021

Comment: The proposed amendments were welcomed. Stakeholders were however concerned that reference to allowing only renewable energy purchases made in terms of a power purchase agreement (PPA) could create uncertainty as different types of PPAs may exist. It is understood that inclusion of a PPA in the eligibility criteria for the renewable energy premium deduction would imply participation of a third party who would supply the renewable energy either through wheeling the electricity through the national grid or directly supplying electricity to the taxpayer. However, it was unclear

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whether a taxpayer that generates electricity from fossil fuels, has a power purchase agreement in place with a third party to purchase renewable energy and that third party supplies the electricity directly to the taxpayer that is, on-site solar PV project and not through the national grid, would be eligible to claim the RE premium deduction. Some stakeholders also requested clarity on whether lease agreements would be included in the definition of a PPA. It was recommended that examples of eligible renewable energy purchases for the different PPAs are provided in the explanatory memorandum.

> *Response:* Accepted. Changes will be made in the 2021 Draft EM to the 2021 Draft TLAB to include examples of eligible renewable energy purchases under the different types of PPAs. A power purchase agreement is a long term electricity supply agreement between a power producer and electricity consumer (buyer or off taker). PPAs can exist for onsite renewable electricity purchases where there is direct supply of electricity to the buyer, and offsite electricity purchases where the producer supplies electricity to the buyer through the national grid and not directly to the buyer. Renewable electricity purchases by taxpayers in terms of an offsite PPA would be eligible however, onsite PPAs would not be eligible as it resembles self-generation for own use and would be not constitute additional electricity purchases.

Comment: There were request for clarification on whether the Renewable Energy Premium deduction can only be claimed against the carbon tax liability that arises from the generation of electricity from fossil fuels. That is, if a taxpayer generates electricity from fossil fuel to supply its own manufacturing process and it purchases renewable electricity then it can only claim the deduction against the tax liability that arises from the generation of electricity from fossil fuel and not its total carbon tax liability including its tax liability from other emissions that arise from its own manufacturing process.

> *Response:* Noted. For the first phase of the carbon tax until December 2022, government committed to electricity price neutrality by providing a credit for the electricity generation levy and additional renewable electricity purchases against the carbon tax liability of electricity generators. The current RE premium deduction is a therefore a deduction against the total tax liability of a taxpayer generating electricity from fossil fuels. However, to address any ambiguity in the legislation, a limitation on the RE premium deduction to be claimed against the tax liability from electricity generation emissions will only be considered.

9.2 Clarifying the definition and scope of carbon Sequestration-Limitation on biological sequestration to forest plantations

(Main reference: Section 6(3) and (4) of the Carbon Tax Act: Clause 63 of the draft TLAB

In November 2020, a methodological guideline document was published by the Department of Forestry, Fisheries and Environment (DFFE) to provide methodologies for taxpayers to use for quantifying greenhouse gas emissions sequestration in the forestry industry. This methodological guideline covers

reporting and accounting parameters for sequestration across the forestry, paper and pulp, and manufacturing of harvested wood products (HWPs) industries. For forestry plantations, the DFFE provides for emissions sequestered directly by forests to be deducted from fuel combustion emissions as well emissions embedded in harvested wood products (HWPs) in line with the Intergovernmental Panel on Climate Change (IPCC) Guidelines. Aligning the definition of sequestration in the Carbon Tax Act with the DFFE methodological guidelines is problematic for the following reasons. First, although the IPCC provides guidelines for the decay rate of HWPs, there are concerns about the permanence of emissions sequestered in harvested wood products, as it would be difficult to track how long the products remain in circulation or are burnt to release emissions. Second, the emissions reporting boundary is the mill gate with forestry companies not having operational control on processes beyond the mill gate. Due to concerns about the permanence of sequestered emissions in HWPs and lack of control of the production processes by forestry companies beyond the mill gate and the robustness of the available emissions calculation methodologies, it is proposed that only actual forestry plantation sequestered emissions should be eligible for the deduction under the Carbon Tax Act. The 2021 Draft TLAB proposed that the definition of biological carbon sequestration in section 6(3)/(4) of the Carbon Tax Act is limited only to directly sequestered emissions by forest plantations. For Section 4(1), only sequestration of greenhouse gases in forestry plantations would be deductible; and for Section 4(2)(a), sequestration of greenhouse gases in geological / carbon reservoirs and forestry plantations would be deductible. The proposed amendments will come into operation on 1 January 2021

Comment: The industry indicates that it has engaged extensively with the Department of Forestry, Fisheries and Environment (DFFE) over a number of years on the development of the Draft Methodological Guidelines for Quantification of Greenhouse Gas Emissions – Carbon Sequestration in the Forestry Industry to Support the Implementation of the Greenhouse Gas Emission Reporting Regulations. It is of the view that the methodological guideline does address concerns around the permanence of sequestered emissions in harvested wood products (HWPs), the lack of control of the production processes by forestry companies beyond the mill gate and the lack of robustness of the available calculation methodologies. Taking into account the extensive consultations on the methodological guideline to be used to verify and certify sequestered greenhouse gas emissions, it is suggested that the definition and scope of the sequestration deduction in the Carbon Tax Act is aligned with the methodological guideline. It also notes that the draft methodological guideline has been finalised by DFFE and will be published shortly.

Response: Accepted. Changes will be made to the 2021 Draft TLAB to expand the scope of the sequestration deduction to include harvested wood products for the pulp, paper and print activity. In the short term, the mass flow approach combined with the landfill approach to account for sequestered emissions as proposed in the DFFE Carbon Sequestration Guideline is accepted and will be adopted to account for emissions. From an emissions accounting perspective, for forestry management and HWP pools it will be important to account for gains and losses occurring from within

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the mill's operational boundaries. As recommended in the Carbon Sequestration Guidelines, for future carbon tax periods the 100-year accounting approach should be developed once industry specific studies are completed on suitable half-life (product decay rates) and product use period assumptions.

9.3 Aligning schedule 2 emissions activities and thresholds with the greenhouse gas emission reporting regulations of the DFFE

(Main reference: Schedule 2 of the Carbon Tax Act: clause 65 of the Draft TLAB)

The Carbon Tax Act came into effect on 1st June 2019. The tax base for the carbon tax are the greenhouse gas emissions that are reported annually by taxpayers to the DFFE as required under the National Greenhouse Gas Emission Reporting Regulations. Schedule 2 of the Carbon Tax Act outlines the activities that are subject to the carbon tax and is based on Annexure 1 of the National Greenhouse Gas Emission Reporting Regulations as reported emissions are subject to the carbon tax. On 11 September 2020 the DFFE published the amendments to the National Greenhouse Gas Emission Reporting Regulations. Annexure 1 of the GHG emissions reporting regulations was amended to include changes to the activities required to report their emissions and thresholds, and the inclusion of new activities now reportable to DFFE. Amendments to Schedule 2 of the carbon tax act are required to ensure alignment with the amended GHG Emissions reporting regulations. It is proposed that Schedule 2 of the Carbon Tax Act be amended to reflect the changes set out in the Amended National Greenhouse Gas Emission Reporting Regulations. This includes changes to the thresholds and the inclusion of a new activity which has been added to the emissions reporting regulations. The proposed amendments will be deemed to have come into operation on 11 September 2020. This is aligned with the date of gazetting of the Amended National GHG Emissions Regulations

Comment: In terms of the Carbon Tax Act, the tax period is from 1 January to 31 December. Stakeholders were of the view that a change that is effective from 11 September 2020 will apply to the tax period from 1 January 2020 to 31 December 2020, and result in a retrospective change in legislation. It will also result in an administrative burden as the tax returns for the tax period 1 January 2020 to 31 December 2020 had already been submitted as they were due for submission on 29 July 2021. It is recommended that the amendments to Schedule 2 of the Carbon Tax Act shall apply to tax periods commencing on 1 January 2021, and aligned with the announcement in Annexure C of the 2021 Budget Review.

Response: Accepted. Changes will be made in the 2021 Draft TLAB to change the effective date for the Schedule 2 amendments from 11 September 2020 to 1 January 2021.

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Draft Tax Administration Laws Amendment Bill

10 Income Tax: Administration

10.1 Information required in receipts issued for tax deductible donations

(Main reference: Section 18A of the Income Tax Act, 1962: clause 2 of the Draft Bill)

Comment: The proposed amendment may increase the compliance burden on public benefit organisations (PBOs), especially the smaller and unsophisticated ones that are already struggling with high compliance costs. In effect, the Commissioner may, as a result of the proposed amendment, require PBOs to file third-party returns in the future in respect of section 18A receipts issued. These smaller PBOs may not be able to comply with the third-party reporting requirements.

Response: Noted. This amendment is not required for third party reporting. The proposed amendment simply ensures consistency of the section 18A certificates with such reporting.

SARS is cognizant of the impact third party reporting may have on smaller PBOs and is therefore considering a differentiated approach for example by providing a simpler mechanism for third party reporting by smaller PBOs.

The aim of third party reporting is to make it easier for those receiving the receipts (donors), as well as those issuing the receipts (PBOs), to comply with their obligations. SARS will be able to auto populate returns thereby making it easier for donors to claim their valid donations. It will encourage donations to PBOs by donors and lessen the burden on PBOs where taxpayers approach them for additional documentation requested by SARS during the verification process. PBOs will also be protected from fraudulent claims using their details and the reputational impact such claims have.

10.2 Administrative non-compliance penalties for non-submission of six-monthly employees' tax (EMP 501) returns

(Main reference: Paragraph 14(6) of Fourth Schedule; clause 6 of the Draft Bill)

Comment: The proposed paragraph 14(8) references to a subparagraph (6A). It appears that the reference should be to subparagraph (7).

Response: Accepted. This incorrect cross-referencing will be corrected in the final draft Bill to be submitted to Parliament.

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Comment: While it is clear that the purpose of levying penalties is to act as a deterrent against non-compliance, it is proposed that further clarity be provided on how the estimation will be calculated.

Response: Noted. The PAYE administrative non-compliance penalty will be estimated using data readily available to SARS; for example, prior monthly or six-monthly liability details where such liability is not available for the reconciliation period that is outstanding. In addition, SARS may use information relating to salary paid per the corporate income tax return in order to estimate the PAYE liability on which to base the PAYE administrative penalty calculation.

Comment: Where the employees' tax is overestimated, this will result in a higher interim penalty being levied. Upon correction at a later stage, an adjustment to a lower penalty amount may increase the unallocated payments against the taxpayer's SARS account.

Response: Noted. Account and payment processing needs will be monitored. The current legislation permits SARS to adjust the administrative penalty in line with changes in the liability of the taxpayer and this principle applies to personal and corporate income tax administrative penalties as well.

Comment: It appears that an EMP501 submitted via e@syfile is regarded as not being submitted on eFiling if SARS performs an Employment Taxes Verification (ETV) on the return. It is submitted than an EMP501 should not be regarded as not being submitted if it is subject to the SARS ETV process. The EMP501 should be reflected on the SARS system as being submitted but it should then be flagged as being under review, to prevent the proposed non-submission penalty from being raised incorrectly.

Response: Accepted. e@syFile and eFiling submissions are treated in the same manner and all submissions may go through the ETV process. When the reconciliation is submitted, the status is updated to received, regardless of the ETV process being initiated or not. This matter has been further discussed with the commentator, which undertook to raise it through the recognised controlling body (RCB) channels for SARS to investigate should it resurface with the RCB member who raised it or more broadly.

10.3 Removal of a double penalty

(Main reference: Paragraph 17 of Seventh Schedule; clause 9 of the Draft Bill)

Comment: Whilst we expect the proposed amendment would be welcomed by most tax practitioners and taxpayers, consideration should be given to whether the paragraph 17 penalty should remain. Additional safeguards must be in place to ensure accurate determination of fringe benefits – hence the paragraph 17 penalty. At the same time, however, taxpayers should not be penalised under the Fourth and the Seventh Schedules where the mistake is the understatement of PAYE merely because of the understatement of fringe benefits. It is therefore proposed that the Seventh Schedule penalty should only apply where an employer has understated the value of fringe benefits on the IRP5 but not for the purpose of completion of the EMP201.

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Response: Not Accepted. The PAYE penalties are wide-ranging, and it is submitted will always be imposable in situations where the fringe benefit was not declared on the certificate to the detriment of the *fiscus*.

11. Customs and Excise: Administration

11.1 Interpretation of expression "Trade and Industry" where it occurs in certain provisions of the Customs and Excise Act, 1964

(Main reference: Sections 4, 21A, 43, 48, 53, 55, 56A, 75 and 114 Customs and Excise Act, 1964; Clause 10 of the draft Bill)

Comment: The proposed provision is drafted in such a way that it doesn't actually amend the expressions in the Customs and Excise Act, but merely requires them to be read in a certain way. This would result in the Customs and Excise Act always having to be read with the TALAA, 2021. The changes should be made by way of amendments to the Customs and Excise Act.

Response: Partially Accepted. Rather than amend multiple provisions in the Customs and Excise Act relating to the name change clause 10 will be replaced by an amendment of section 1 of the Customs and Excise Act providing for the insertion of the interpretation provision as a new subsection (5A).

11.2 Expanding the purposes for which air cargo may be moved to degrouping depots to include consolidation and removal to transit sheds for export

(Main reference: Section 6 of the Customs and Excise Act, 1964; Clause 11 of the draft Bill)

Comment: The proposed amendment is welcomed as it enhances and streamlines the process and usage of de-grouping facilities in order to avoid unnecessary delays and congestions at transit sheds.

Response: Noted.

11.3 Deletion of reference to accreditation for purposes of changes in SARS' accreditation system

(Main reference: Section 38A of the Customs and Excise Act, 1964; Clause 12 of the draft Bill)

Comment: The amendment is as a result of the announcement in the Budget Review, 2021 that indicates that SARS is changing its accreditation system to more closely reflect the requirements of the SAFE Framework of Standards issued by the World Customs Organisation. A simultaneous amendment to section 21(3)*(c)* of the Customs and Excise Act, is proposed so as to ensure uniformity with the announcement that was contained in the Budget Review, 2021.

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Response: Not Accepted. Rules under section 64E containing detail with respect to the new SARS accreditation system were promulgated on 23 July 2021. These rules contain transitional provisions and provide for the lapsing of Level 1 accredited client status in terms of the rules under section 64E as it existed immediately before that date. The effect of the new accreditation system is that certain provisions in the Act requiring a person to have accredited client status were reviewed, for example section 38A(2)*(a)*(i).

Section 21(3)*(c)* providing that only importers who are accredited may store imported goods which are free of duty in special customs and excise storage warehouses for export, is retained. The reason being that the payment of VAT on these goods is deferred while the goods are stored in a special customs and excise storage warehouse. This is still considered a benefit that only accredited importers should have.

11.4 Increasing the minimum thresholds for underpayments of duty by taxpayers to ease administrative burden

(Main reference: section 47(1) of the Customs and Excise Act, 1964; clause 13 of the draft Bill)

Comment: A consequential amendment is proposed to the Value-Added Tax Act, 1991, to ensure alignment of the minimum values as it relates to VAT levied upon importations.

Response: Partially Accepted. The suggestion deserves further consideration but the interaction between VAT and duty raises difficult questions in this context. As a result this amendment is withdrawn for further consideration of the potential for an integrated approach.

11.5 Expanding the scope of SARS investigation to confirm diesel refund claims to accommodate "wet" contractors

(Main reference: Section 75(1C)*(a)* of the Customs and Excise Act, 1964; Clause 15 of the draft Bill)

Comment: One of the current requirements is that, in order for a user to qualify for a diesel refund, the contracts must be on "dry" basis. This means that the user must supply the diesel to the contractors, and they must just bring their own equipment. The proposed amendment now allows contractors to purchase the fuel themselves and just invoice the user ("wet" basis). This is a welcomed development because it will ensure that smaller users are not excluded as they often collect and dispense their diesel purchases directly for use without it being stored at the user's premises. It further allows for convenience because the contractors can get the diesel at their own time and just invoice the user.

Response: Noted.

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11.6 Increasing the minimum thresholds for payments of refunds by SARS to ease administrative burden

(Main reference: Section 76(5) of the Customs and Excise Act, 1964; Clause 16 of the draft Bill)

Comment: A consequential amendment is proposed to the Value-Added Tax, 1991, to ensure alignment of the minimum values as it relates to VAT amounts paid upon importation on which refunds are claimed.

Response: Partially Accepted. The suggestion deserves further consideration but the interaction between VAT and duty raises difficult questions in this context. As a result this amendment is withdrawn for further consideration of the potential for an integrated approach.

11.7 Unlawful possession or use of customs uniform an offence

(Main reference: Section 79 of the Customs and Excise Act, 1964; Clause 17 of the draft Bill)

Comment: The amendment is welcome as it clearly displays SARS' intent to curb corruption.

Response: Noted.

12. Tax Administration

12.1 Extension of period within which taxpayer can request revision of an assessment based on an estimate

(Main reference: Section 95 of the Tax Administration Act, 2011; clause 18 of the Draft Bill)

Comment: In order to achieve and clarify what the amendment sets out to do, i.e. to provide SARS with the opportunity to extend the period in which a taxpayer may request a revision of an estimated assessment for up to forty days after the prescription date, the following wording is proposed:

"(7) A senior SARS official may extend the period referred to in subsection (6) within which the return or relevant material must be submitted, for a period not exceeding forty business days after the relevant period referred to in section 99(1)."

Response: Not Accepted. The proposed wording does not take account of the fact that the end of the initial period to request a reduced or additional assessment may fall after the prescription date, so the forty-day extension may fall later than forty days after the date. It also provides for an extension past prescription, even where prescription is not an issue due to the timing of the making of an assessment based on an estimate. The current wording of the proposed amendment is regarded as clear as to the purpose it seeks to achieve.

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Comment: To the extent that the taxpayer has submitted the relevant information before the prescription date, the Commissioner is mandated to revise the assessments to reflect the correct outcome. It now appears that the taxpayer's submission of the relevant information to the Commissioner before the expiry of timelines does not guarantee the issuing of the revised assessments, as such a decision will depend on the Commissioner's discretion.

Response: Noted. Based on the proposed revised wording of section 95(5) and (6), once a taxpayer submits the relevant material as required in terms of section 95(6), SARS has one of the following three options and the taxpayer may respond accordingly:

- *Option 1:* After review SARS accepts the relevant material and makes a reduced or additional assessment as requested by the taxpayer
- *Option 2:* After review SARS does not accept some of the relevant material and makes a reduced or additional assessment accordingly. In this instance, the reduced or additional assessment will be subject to objection and appeal in the ordinary course, since it replaces the assessment contemplated in section 95(1)*(a)* or *(c)*
- *Option 3:* After review SARS does not accept any of the relevant material, does not make a reduced or additional assessment and relies on the assessment based on an estimate. In this regard the proposed new section 95(8) clarifies that, should SARS decide not to make a reduced or additional assessment, the taxpayer may object and appeal within the normal timeframes from the date of the decision.

Comment: The proposal that the Commissioner may extend prescription or not in terms of his/her discretion may have adverse consequences against the taxpayer. It is requested that some certainty is required in terms of how the Commissioner's discretion will be exercised or alternatively, the relevant factors that the Commissioner will consider when exercising his/her discretion.

Response: Partially Accepted. SARS' discretion in granting the extension requested under section 95(7) is governed by section 33 of the Constitution, 1996, read with Promotion of Administrative Justice Act, 2000, (PAJA) which gives effect to section 33. It is required to be lawful, reasonable and procedurally fair as required by the circumstances of each case. As such circumstances will differ from case to case, it is not possible to legislate the criteria for all foreseeable circumstances that can lead to a request for an extension. The requirements for a valid administrative decision are set out in PAJA and need not be restated for each of such decisions in each statute. In instances where SARS does not grant the requested extension, that decision will be subject to review in a court of law or alternatively the taxpayer may approach the Office of the Tax Ombud if the taxpayer believes SARS did not act in a lawful, reasonable and procedurally fair manner in the circumstances. However, it is proposed to align the wording with the approach taken in the Tax Administration Act in respect of certain other extension decisions, namely that SARS may extend the period if reasonable grounds for an extension are submitted by the taxpayer.

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Comment: Section 95 should include some wording that requires the Commissioner to request the relevant information within a reasonable timeframe, such as the proposed 40-day period before prescription to afford the taxpayer sufficient time to adequately address the request from the Commissioner. Affording the Commissioner the opportunity to raise assessments first "without the reasonable timeframe requirement for the Commissioner to request information" may disadvantage the taxpayer.

Response: Not Accepted. Where SARS raised an assessment based on an estimate under section 95(1)*(c)*, it would be in instances where SARS requested relevant material from the taxpayer on more than one occasion, without receiving a response to those requests. Section 95(6), read together with section 95(7), then provides the taxpayer with up to 80 business days to submit the relevant material even when prescription is an issue. This is regarded as sufficient time in order for the taxpayer to comply with the requirements of section 95(6).

Comment: The addition to subsection (7) provides for an additional period for the submission of a return or relevant material pursuant to the issuing of an estimated assessment by SARS. It is proposed that SARS include a practical example in the draft explanatory memorandum to assist taxpayer with the counting of the 40-day period.

Response: Accepted. A practical example will be provided in the Memorandum of Objects.

Comment: Clarity is sought as to the form of the notice that SARS will issue to a taxpayer in the event of a taxpayer submitting relevant material in terms of section 95(6), where SARS finds that the material does not support an adjustment to the estimated assessment.

Response: Noted. In the event that SARS finds that the return or relevant material submitted does not support the making of a reduced or additional assessment, a letter will be issued to the taxpayer, containing SARS' grounds for the decision.

12.2 Extension of prescription in certain instances

(Main reference: Section 99 of the Tax Administration Act, 2011; clause 19 of the Draft Bill)

Comment: While it is acknowledged that prescriptions would have to be extended in the circumstances envisaged by section 95(7), the proposed amendment seemingly results in prescription never applying to the tax period in question. The extension of prescription should be only for a limited period and not in perpetuity.

Response: Comment misplaced. Where a taxpayer submits a request in terms of section 95(7) for an extension of the initial 40-business day period, such extension is limited to a maximum of 40 business days post the initial 40-business day period under section 95(6) and prescription would not apply to the extent that this period exceeds the relevant prescription periods contained in section 99(1). That is to say

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for a maximum of 80 business days. In the light of the following comment, however, the proposed amendment to section 99(2)*(e)* will be replaced by a proposed amendment to section 99(2)*(d)*(iv) to provide that prescription will not apply to the extent that it is necessary to give effect to a reduced or additional assessment requested under section 95(6).

Comment: The current proposal only allows SARS to reduce an assessment post prescription if the period within which the request should have been was extended post prescription in line with the proposal in clause 18 of the draft Bill. It is proposed that section 99 be further amended to allow SARS to issue a reduced assessment post prescription where the section 93(1)*(f)* reduced assessment request was made prior to prescription, similar to section 99(2)*(d)*(iii) in respect of section 93(1)*(d)* reduced assessment requests. In our view, this is required especially absent any time period within which SARS must issue reduced assessments under section 93(1)*(f)* (we will submit this matter as part of the Annexure C proposals).

Response: Accepted. The amendment to section 95 to include the proposed new subsection (7), read with the amendment to section 99(2)*(d)* to include the proposed new item (iv), allows SARS to issue a reduced assessment post prescription where the reduced assessment request was made within the prescribed period.

13. Disaster Management Tax Relief Administration Bill

13.1 Expansion of deferral of payment of employees' tax liabilities for tax compliant small to medium sized businesses

(Main reference: Definition of qualifying taxpayer in section 1 of the Disaster Management Tax Relief Administration Act, 2020; Clause 1 of Second Batch of draft Tax Administration Laws Amendment Bill, 2021)

Comment: To qualify for the new PAYE and ETI relief, a taxpayer must be a 'qualifying taxpayer' which is defined as a person conducting a trade. Public Benefit Organisations (PBOs) approved in terms of section 30 of the Income Tax Act and many other exempt organisations such as recreational clubs, professional bodies and schools are effectively excluded from this definition as most of them do not conduct a trade.

As these organisations, especially PBOs, play a significant role in our society and have been affected dramatically by the COVID-19 lockdown (and will be affected for many months thereafter as they may no longer receive donations that they previously relied upon), we submit that the definition of 'qualifying taxpayer' should be amended to include these organisations as mentioned above.

Response: Not Accepted. The design of these measures mirrors that of the measures in 2020 in order to enable their speedy implementation without significant systems development on the part of employers, payroll providers and SARS. As noted when a similar comment was made with respect to the Disaster Management Tax Relief Administration Bill, 2020, automatic PAYE relief is targeted at small to medium sized businesses. Gross income, which is a key

requirement, is a poor measure of PBOs' size, since their receipts are often of a capital nature. PBOs may apply for case-by-case relief by SARS, where their actual circumstances can be properly considered. The concept of a qualifying taxpayer is not used in the ETI relief measure.

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ANNEXURE A: LIST OF COMMENTATORS

1. AGBIZ
2. AGRI NOTHERN CAPE
3. AGRI SA
4. AJM
5. AMANDLA
6. ARCELORMITTAL
7. ASISA
8. BAT SOUTH AFRICA
9. BDO TAX SERVICES (Pty) LTD
10. BOWMANS GILFILLAN
11. BUSA
12. CLIFFE DEKKER HOFMEYR INC
13. CONSUMER GOODS COUNCIL OF SOUTH AFRICA
14. DELOITTE &TOUCHE
15. DEPARTMENT OF SMALL BUSINESS DEVELOPMENT
16. DISCOVERY LIMITED
17. ENS AFRICA
18. ERNST & YOUNG ADVISORY SERVICES (Pty) LTD
19. ESKOM HOLDINGS SOC LTD
20. EVCC LEGAL AND FINANCIAL CONSULTING
21. FINGLOBAL
22. FORRESTRY SOUTH AFRICA
23. FUTUREGROWTH ASSET MANAGEMENT
24. GOVERNMENT EMPLOYEE PENSION FUND (GEPF)
25. GOLD FIELDS
26. HARMONY
27. HARTZENBERG INC
28. HORTGRO
29. IRFA INSTITUTE OF RETIREMENT FUNDS AFRICA
30. JA TRANSACTION SOLUTIONS (Pty) LTD
31. JOHANNESBURG INSTITUTE FOR ADVANCED STUDY (JIAS)
32. JOHANNESBURG STOCK EXCHANGE (JSE)
33. KPMG SERVICES (Pty) LTD
34. LIMPOPO TOBACCO PROCESSORS (Pty) LTD
35. LOYSON CONSULTING
36. MAZARS-TAX CONSULTING
37. MPACT
38. MTN, TELKOM, VODACOM
39. OLD MUITUAL GROUP
40. OLD MUTUAL PROPERTY
41. PAG
42. PAMSA
43. PHILIP MORRIS SOUTH AFRICA (Pty) LTD
44. PIETER VAN DER ZWAM AND ASSOCIATES
45. PKF CHARTERED ACCOUNTANTS & BUSINESS ADVISERS

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46. PLENNERGY
47. PWC
48. REUNERT LIMITED
49. RICHARDS BAY INDUSTRIAL DEVELOPMENT ZONE
50. RSM SA CONSULTING PROPRIETARY LIMITED
51. SAAFF
52. SAB
53. SAIA
54. SAICA
55. SAIPA
56. SAIT
57. SANLAM
58. SAPOA
59. SAPPI SOUTHERN AFRICA
60. SASA
61. SASLA
62. SASOL
63. SAVCA
64. SOUTH AFRICA TOBACCO TRNSFORMATION ALLIANCE
65. SOUTH 32
66. TAX CONSULTING SA
67. THE BANKING ASSOCIATION SOUTH AFRICA
68. THE BLACK TOBACCO FARMERS ASSOCIATION
69. TRIBUTUM CONSULTING
70. VAT IQ
71. WEBBER WENTZEL
72. WEGKANER
73. WERKMANS INC
74. WILLIS TOWERS WATSON
75. INDIVIDUAL
76. INDIVIDUAL

DRAFT