**Report of the Standing Committee on Finance on the Tax Laws Amendment Bill [B22 - 2021] (National Assembly- section 77), dated 24 November 2021**

The Standing Committee on Finance, having considered the Tax Laws Amendment Bill [B22- 2021] (National Assembly- section 77), referred to it, and classified by the JTM as a Money Bill, reports the Bill with amendments [B22A – 2021] as follows:

## 1. INTRODUCTION AND BACKGROUND

1.1. The Tax Laws Amendment Bill (TLAB) was tabled in Parliament by the Minister of Finance on 11 November 2021, together with the 2021 Medium-Term Budget Policy Statement. The TLAB is a section 77 (of the Constitution) Bill dealing with national taxes, levies, duties and surcharges.

1.2. As is usually the case, the tabling of this Bill was preceded by the publication of the draft version of the Bill (Draft TLAB) on 28 July 2021, together with the Draft Tax Administration Laws Amendment Bill (Draft TALAB), and the second publication of the 2021 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (Draft Rates Bill).

1.3. The Draft TLAB contained some tax proposals made in Chapter 4 and Annexure C of the 2021 Budget Review. A separate second Batch of the Draft Tax Bills were published on 12 August 2021 containing emergency tax measures in response to the continuing COVID-19 pandemic and the recent July unrests. These latter measures were over and above the tax proposals that were announced with 2021 Budget on 24 February 2021.

1.4. The changes relating to emergency tax measures contained in the second batch of the 2021 Draft TLAB are incorporated into the Draft TLAB.

## 2. PUBLIC PARTICIPATION

2.1. The Committee was briefed by National Treasury and SARS on the Draft Bills on 17 August 2021 and held public hearings on 31 August 2021.

2.2. On 10 November 2021, National Treasury and SARS presented their detailed responses to the Draft Bills to the Committee, addressing all the comments made during the public hearings and Committee briefings and deliberations.

2.3. The National Treasury and SARS reported that they received 76 written submissions from the public and responded to these comments during their own consultation processes. They also hosted workshops which ran for three days on 07, 08 and 09 September 2021.

2.4. The Committee received written and oral submissions from the following organisations and/or individuals: South Africa Tobacco Transformation Alliance (SATTA), British American Tobacco South Africa (BATSA), Limpopo Tobacco Processors (LPT), Phillip Morris (PM), South African Liquor Brandowners Association (SALBA), Beer Association of South Africa (BASA), AgriSA, Agbiz, Dr. Seun Muller, Banking Association of South Africa, South African Institute of Taxation (SAIT), South African Institute of Chartered Accountants (SAICA), PwC, Tax Consult. It also received only written submissions from the Johannesburg Stock Exchange (JSE) and the Black Tobacco Farmers Association (BTFA).

## 3. OVERVIEW OF THE KEY TAX PROPOSALS IN THE TLAB

**3.1.** The TLAB amends the provisions and, in some instances, definitions, Schedules, Preambles, long titles and/or effective dates, and makes new provisions to some of the following statutes: the Transfer Duty Act, 1949; the Estate Duty Act, 1955; the Income Tax Act, 1962; the Customs and Excise Act, 1964; the Value-Added Tax Act, 1991; the Securities Transfer Tax Act, 2007; the Employment Tax Incentive Act, 2013; the Taxation Laws Amendment Act, 2013; the Carbon Tax Act,2019; the Disaster Management Tax Relief Act, 2020; and the Taxation Laws Amendment Act, 2020.

3.2. Under the category of employment individuals and savings taxes, the proposals specifically dealt with the following amendments:

3.2.1. Reviewing the nature of long-service awards for fringe benefit purposes (Clauses 4(d), 42 & 43 of the Draft TLAB: Paragraph (c ) of the definition of gross income,paragraph5(2)(b) & new paragraphs 6(4)(d) and 10(2)( e) of the Seventh Schedule to the Income Tax Act);

- 3.2.2. Curbing abuse in the Employment Tax Incentive (Clauses 58 & 59 of the Draft TLAB: Definition of "employee" and section 6 of the Employment Tax Incentive Act)
- 3.2.3. Clarifying the timing disposal rules in respect of an asset acquired from a deceased estate (Clauses 4 ( e) and 22 of the Draft TLAB: Definition of "liquidation and distribution account" in section 1 and section 25 of the Income Tax Act )
- 3.2.4. Tax treatment of a cession of a right to receive asset (Clause 33 of the Draft TLAB: New section 57B of the Income Tax Act)
- 3.2.5. Strengthening anti-avoidance rules in respect of loan transfers between trusts (Clause 5 of the Draft TLAB: Section 7C of the Income Tax Act)
- 3.2.6. Applying tax on a retirement interest when an individual ceases to be a tax resident (Clauses 11 & 12 of the Draft TLAB: Section 9H & new section 9HC of the Income Tax Act)
- 3.2.7. Allowing members to use retirement interest to acquire annuities on retirement (Clause 4 (f),(g), (h), (i), & (j) of the Draft TLAB: Definitions of retirement annuity fund, pension fund, pension preservation fund, provident fund, provident preservation fund of the Income Tax Act)
- 3.2.8. Transfers between retirement funds by members who are 55 years or older (Clause 4 (g), (k), of the Draft TLAB: Definitions of gross income, pension preservation fund & provident preservation fund of the Income Tax Act)
- 3.2.9. Clarifying the calculation of the fringe benefit in relation to employer contributions to a retirement fund(Clause 44 of the Draft TLAB: Paragraph 12D of the Seventh Schedule to the Income Tax Act

3.3. Under the category of general business tax, the proposals specifically dealt with the following issues/amendments:

- 3.3.1. Strengthening the rules dealing with limitation of interest deductions in respect of debts owed to certain persons not subject to tax (Clause 20 of the Draft TLAB: Section 23M of the Income Tax Act);
- 3.3.2. Restricting the set-off of the balance of assessed losses in determining taxable income (Clause 19 of the Draft TLAB: Section 20 of the Income Tax Act);
- 3.3.3. Clarifying the definition of "Contributed Tax Capital" (Clause 4 (c) of the Draft TLAB: Section 1 of the Income Tax Act);
- 3.3.4. Limiting potential for double taxation under the hybrid debt anti-avoidance rules (Clauses 8, 9, 32 of the Draft TLAB: Sections 8F, 8FA and 50A of the Income Tax Act);
- 3.3.5. Clarifying the meaning of "interest" under the debt relief rules (Clauses 18, 45 of the Draft TLAB: Section 19(8)(f) and paragraph 12A(6)(g) of the Eighth Schedule to the Income Tax Act);
- 3.3.6. Refining the interaction between anti-value shifting rules and corporate re-organisation rules (Clause 25 of the Draft TLAB: Section 40CA of the Income Tax Act);
- 3.3.7. Clarifying the rules that trigger additional consideration in asset for share transactions when a debt is assumed by a company (Clause 26 of the Draft TLAB: Section 42(8) of the Income Tax Act);
- 3.3.8. Clarifying the rules that trigger additional consideration in asset for share transactions when a debt is assumed by a company (Clause 26 of the Draft TLAB: Section 42(8) of the Income Tax Act);
- 3.3.9. Clarifying the early disposal anti-avoidance rules in intra group transactions (Clause 27 of the Draft TLAB: Section 45(5) of the Income Tax Act);
- 3.3.10. Extending the reversal of the nil base cost rules to apply on the sixth anniversary of an intra-group transaction (Clause 27 of the Draft TLAB: Section 45(3B) of the Income Tax Act);
- 3.3.11. Clarifying the interaction between early disposal anti-avoidance rules and the nil-base cost anti avoidance rules (Clause 27 of the Draft TLAB: Section 45(3B) of the Income Tax Act)
- 3.3.12. Refining the provisions applicable to unbundling transactions (Clauses 28 & 29 of the Draft TLAB: Sections 46 & 46A of the Income Tax Act); and
- 3.3.13. Clarifying rehypothecation of collateral within collateral arrangement provisions (Clause 56 of the Draft TLAB: Section 1 of the Securities Transfer Tax Act)

3.4. Under the category of taxation of financial institutions and products, the proposals dealt with the following issues/amendments:
   3.4.1. Clarifying the transfer of liabilities in respect of insurance business between short term insurers (Clause 23 of the Draft TLAB: Section 28 of the Income Tax Act); and
   3.4.2. Refining the deduction formula for taxable long term insurer policyhold funds (Clause 24 of the Draft TLAB: Section 29A of the Income Tax Act).
3.5. Under the category of tax incentives, the proposals dealt with the following issues/ amendments:
   3.5.1. Extension of the Urban Development Zone (UDZ) tax incentive (Clause17 of the Draft TLAB: Section 13 *quat* of the Income Tax Act);
   3.5.2. Extension of the learnership tax incentive sunset date (Clauses 15 of the Draft TLAB: Sections 12H of the Income Tax Act); and
   3.5.3. Refining the time frames of compliance requirements of Industrial Policy Projects (IPP) tax incentive (Clause 16 of the Draft TLAB: Section 12I of the Income Tax Act).
3.6. Under the category of international tax, the proposals dealt with the following issues/ amendments:
   3.6.1. Clarifying the controlled foreign company anti-diversionary rules (Clauses 10 of the Draft TLAB: Sections 9D (9A) of the Income Tax Act);
   3.6.2. Clarifying the interaction between provisions dealing with a foreign company ceasing to be a cfc and the participation exemption (Clauses 11 of the Draft TLAB: Sections 9H(5) of the Income Tax Act);
   3.6.3. Clarifying the rules dealing with withholding tax exemption declaration (Clauses 31, 34 & 35 of the Draft TLAB: Sections 49E(2)(b), 64G(2)(a) and 64H(2)(a) of the Income Tax Act);
3.7. Under value added tax, the proposals dealt with the following issues/ amendments:
   3.7.1. Zero rating of super fine maize meal (Clause 55 of the Draft TLAB: Schedule 2; Part B of the VAT Act);
   3.7.2. VAT treatment of temporary letting of residential immovable property (Clauses 51, 52 & 54 of the Draft TLAB: Sections 9(6), 10(29) and 18D of the VAT Act);
   3.7.3. Reviewing the section 72 decision with regard to the VAT treatment of telecommunication services (Clause 63 of the Draft TLAB: Section 11(2)(y) of the VAT Act);
3.8. On carbon tax, the proposals dealt with:
   3.8.1. Clarifying renewable energy premium beneficiaries (Clause 63 of the draft TLAB: Section 6(2)(c) of the Carbon Tax Act);
   3.8.2. Clarifying the definition and scope of carbon sequestration- Limitation on biological sequestration to forest plantations (Clause 63 of the draft TLAB: Sections 6(3) and 6(4) of the Carbon Tax Act);
   3.8.3. Clarifying the definition and scope of carbon sequestration- Sequestration deduction for fuel combustion emissions (Clause 63 of the draft TLAB: Sections 6(3) and 6(4) of the Carbon Tax Act);
   3.8.4. Clarifying the carbon budget allowance (Clause 64 of the draft TLAB: Section12 of the Carbon Tax Act); and
   3.8.5. Aligning schedule 2 emissions activities and thresholds with the greenhouse gas emission reporting regulations of the Department of Forestry and Fisheries (Clause 65 of the draft TLAB: Schedule 2 of the Carbon Tax Act).

## 4. KEY ISSUES RAISED IN THE PUBLIC HEARINGS

4.1. The issues raised by the public during the public hearings on the Draft TLAB covered the following areas: employment, individuals and savings taxes; general business tax; international tax; value added tax and; carbon tax.
4.2. The key issue raised on the Draft TLAB on employment, individual and savings taxes during the public hearings were;

4.2.1. Applying tax on withdrawals of retirement interest when an individual ceases to be a tax resident (Clauses 11 of the Draft TLAB: New section 9HC of the Income Tax Act);
4.2.2. Curbing abuse in the Employment Tax Incentive (Clauses 58 & 59 of the Draft TLAB: Definition of "employee" and section 6 of the ETI Act); and
4.2.3. Strengthening anti-avoidance rules in respect of loan transfers between trusts (Clause 5 of the Draft TLAB: Section 7C of the Income Tax Act).

4.3. On Business Tax, the main issues raised were on:
4.3.1. Strengthening the rules dealing with limitation of interest deduction in respect of debts owed to certain persons not subject to tax (Clause 20 of the Draft TLAB: Section 23M of the Income Tax Act);
4.3.2. Restricting the set-off of the balance of assessed losses in determining taxable income (Clause 19 of the Draft TLAB: Section 20 of the Income Tax Act);
4.3.3. Clarifying rehypothecation of collateral within collateral lending arrangements (Clause 56 of the Draft TLAB: Section 1 of the Securities Transfer Tax Act);
4.3.4. Clarifying the definition of "contributed tax capital" (Clause 4(1)(c) of the Draft TLAB: Section 1 of the Income Tax Act); and
4.3.5. Refining the interaction between anti-value shifting rules and corporate reorganization rules (Clause 25 of the Draft TLAB: Section 40CA of the Income Tax Act)

4.4. On international tax, the main issue raised was on:
4.4.1. Clarifying the controlled foreign company (CFC) anti-diversionary rules (Clause 10 of the Draft TLAB: Section 9D(9A) of the Income Tax Act);

4.5. On value added tax, the issue was on:
4.5.1. VAT treatment of temporary letting of residential immovable property (Clause 54 of the Draft TLAB: New section 18D of the VAT Act).

4.6. And on carbon tax, the main issues were on
4.6.1. Clarifying renewable energy premium beneficiaries (Clause 63 of the Draft TLAB: Section 6(2)(c) of the Carbon Tax Act);
4.6.2. Clarifying the definition and scope of carbon sequestration- Limitation on biological sequestration to forest plantations (Clause 63 of the Draft TLAB: Sections 6(3) & 6(4) of the Carbon Tax Act); and
4.6.3. Aligning schedule 2 emissions activities and thresholds with the greenhouse gas emission reporting regulations of the DFFE (Clause 65 of the Draft TLAB: Schedule 2 of the Carbon Tax Act).

4.7. Following consultations, the workshops held by NT and SARS with stakeholders and public hearings in Parliament, some initial proposals in the Draft TLAB were modified or changed in the Bill that was tabled with the MTBPS on 11 November 2021. These changes are detailed in the draft response document of NT and SARS presented to the Committee on 10 November 2021.

Some key issues raised on applying tax on withdrawals of retirement interest when an individual ceases to be a tax resident (Clauses 11 of the Draft TLAB: New section 9HC of the Income Tax Act):

4.8. The background to this amendment is that when an individual ceases to be a South African tax resident, before retirement, and becomes a tax resident of another country, that individual's retirement fund interest may be subject to tax in that other country, due to the application of the tax treaty between South Africa and that other country. The provisions of the tax treaty between South Africa and the other country regards the individual to be a tax resident in that country, thereby in some instances resulting in South Africa forfeiting its taxing rights, while the taxpayer benefited from tax deductions in respect of contributions to the retirement fund. The proposal in the Draft TLAB sought to address this base erosion by ensuring that when an individual ceases to be a South African tax resident, the retirement fund interest will form part of the assets that are subject to retirement withdrawal tax.

4.9. Stakeholders strongly raised issue with this new provision, submitting that it seemed to bypass the tax treaties between South Africa and other countries through domestic legislation and could potentially result in double taxation for members of retirement funds. They submitted that should the South African government wish to address the concerns of base erosion due to emigration, the relevant Double Tax Agreements of concern should be renegotiated with the concerned countries accordingly. They submitted further that the proposed insertion of the new section 9HC could lead to involuntary withdrawals of retirement interests upon emigration as members will 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.

4.10. In its response, National Treasury conceded that the proposed amendments could result in "treaty override". As a result of this, the National Treasury decided to withdraw this proposal and it is not included on the TLAB tabled by the Minister of Finance on 11 November 2021.

Some key issues on curbing abuse in the Employment Tax Incentive (Clauses 58 & 59 of the Draft TLAB: Definition of "employee" and section 6 of the ETI Act)

4.11. The Employment Tax Incentive (ETI) programme was introduced in January 2014 to provide for employment of young workers and make provision for 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.

4.12. The National Treasury stated that it had 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 using training institutions, with no employment characteristics (therefore failing to meet the definition of 'employee' as defined in section 1(1) of the ETI Act).

4.13. In order to counter this abuse, amendments were proposed in the 2021 Draft TLAB in order to clarify the concept of 'work'. A requirement was added that work must 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 section31 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 also proposed that these amendments should apply retrospectively and be deemed to have come into operation on 1 March 2021.

4.14. Stakeholders made various comments that sought to clarify the proposed changes and their effective date (which will now be 1 March 2022), which the National Treasury accepted and effected in the tabled TLAB.

4.15. The Committee believes that National Treasury should closely consider criticisms that the ETI is not achieving the goals for which the incentive was introduced for. There were criticisms from some stakeholders that the ETI is being paid for workers that companies would have employed anyway, and might therefore not be creating any new jobs. The effect of this is that companies claim this incentive without contributing to the goals of the scheme and the state loses tax revenues without any correspondent increase in employment. The Committee will request the National Treasury to provide it with a report on the effectiveness of the ETI since it was introduced.

Some key issues raised at the public hearings on the strengthening anti-avoidance rules in respect of loan transfers between trusts (Clause 5 of the Draft TLAB: Section 7C of the Income Tax Act).

4.16. Anti-avoidance measures to curb the tax-free transfer of wealth to trusts using low or interest-free loans in order to avoid estate duty and donations tax on the assets subsequent growth in value were introduced in 2016. In 2017 and in 2020, further changes were made to counter new attempts to undermine these measures. Government is concerned about further tax avoidance schemes 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.

4.17. To address this, it was proposed that the anti-avoidance rules should also apply in respect of any loan, advance or credit that a trust, directly or indirectly, provides to another trust whose beneficiaries or the founder are connected persons. It was also proposed that the changes should apply retrospectively and be deemed to have come into operation on the date of the publication of the 2021 Draft TLAB on 28 July 2021.

Some key issues raised at the public hearings on strengthening the rules dealing with limitation of interest deduction in respect of debts owed to certain persons not subject to tax (Clause 20 of the Draft TLAB: Section 23M of the Income Tax Act);

4.18. The background to this amendment is that in 2013, rules that limit interest deductions in respect of debts owed to persons not subject to tax were introduced in the Income Tax Act (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.

4.19. On 26 February 2020 – the 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 rules in comparison to the OECD/G20 BEPS Action 4 recommendations. To strengthen the rules in line with the recommendations, the following proposed changes were included in the 2021 Draft TLAB (as part of a corporate tax package): expanding the meaning of the term "interest" for purposes of these rules; moving to a fixed ratio (30% of earnings) restriction rather than one based on a formula; reducing opportunities to avoid the rules with back-to-back loans; and amending the definition of "adjusted taxable income" as it applies to REITs.

4.20. Stakeholders pleaded that companies' earnings have been severely affected by COVID-19. They said that 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 Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) in the current and post COVID-19 pandemic years. The NT accepted this and added that this measure was first proposed before Covid-19 reached South Africa. Is said that the current rules are an important tool to mitigate the use of excessive debt and interest payments that reduce taxable profits in South Africa.

4.21. NT stated that government maintained 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. As a result of this, NT decided to postpone the implementation of this proposal to provide space for recovery. While the proposal remains in the tabled TLAB, it will only 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.

Some issues raised on restricting the set-off of the balance of assessed losses in determining taxable income (Clause 19 of the Draft TLAB: Section 20 of the Income Tax Act);

4.22. The background to this proposed amendment is that in determining taxable income, taxpayers can 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.

4.23. 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.

4.24. NT explained that 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 the 2021 Draft TLAB (as part of the corporate tax package), Government 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. It said that 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.

4.25. Stakeholders commenting on this proposal said that they understood and appreciated the overall objective of broadening the corporate tax base and lower 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. They said that many businesses (in different sectors, large and small) had 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 for other immediate needs to stay float will place an additional burden on companies that are trying to recover from these adverse events. They also stated that many countries had temporarily relaxed their tax loss regimes as part of the relief measures to support businesses in these trying times.

4.26. NT, in its response, acknowledged that this measure was first proposed before the Covid-19 pandemic hit our shores. It said that the South African government holds the view that a broad tax base with as few distortions as possible, combined with a lower rate, will be more efficient. It also acknowledged that businesses were facing difficult times and providing the space for their recovery was important. To provide some balance, it said that the proposal will remain but only come into operation after an announcement by the Minister of Finance in the Annual National Budget. It also assured that this measure will not be applied retrospectively.

4.27. With regards to comments about the impact of this measure in various specific sectors such as agriculture, and cyclical, start-ups and small businesses, NT stated that as a general stance is that Government is not in favour of providing carve-outs because they provide special treatment to some taxpayers and can lead to complexities. It submitted that 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 added that this 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.

4.28. NT further stated that although the proposed quantum restriction is relatively generous at 80 per cent and is one of the least punitive given that companies will not forfeit any losses as the balance of assessed losses will 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. It said that in order to cater for all sectors, changes were made in the tabled Bill to introduce a *de minimis* threshold beyond which the proposal takes effect. It said that to the extent that the balance of assessed losses 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 their tax liability.

Some issues raised on clarifying rehypothecation of collateral within collateral lending arrangements (Clause 56 of the Draft TLAB: Section 1 of the Securities Transfer Tax Act)

4.29. The background to this amendment is that the Securities Transfer Tax Act contains tax relief rules that allow for the tax neutral transfer of collateral (listed shares or local and foreign government bonds) between the parties to a collateral arrangement. At issue was the rehypothecation of collateral, where banks, broker dealers or collateral takers (transferee) intend to use that collateral received for trading or as security for borrowing. The National Treasury stated that the use of collateral for purposes other than subsequent collateral arrangements was against the policy rationale for the introduction of these provisions and could result in the avoidance of securities transfer tax or capital gains tax.

4.30. The proposals to curb such abuse in the Draft TLAB were aimed at ensuring that the assets transferred as collateral in terms of a collateral arrangement may only be used for such purpose and not for trading or in other financial transactions. A requirement was also added that the transferee should enter into a contractual arrangement and agree that the assets transferred will either be held by that transferee for the duration of the arrangement or be used for purposes of providing security in respect of an amount owed by that transferee. The Draft TLAB proposed that this amendment be applied retrospectively and come into operation on the date of the publication of the 2021 Draft TLAB on 28 July 2021.

4.31. Many stakeholders argued against this proposal on the basis that it was unnecessary as existing laws were adequate to ensure that any reuse of collateral outside a collateral arrangement would fall within the tax net and therefore not result to any tax avoidance. Others raised concerns on the retrospective application of the proposed provisions, especially the practicality of the requirement that contractual agreements be entered into between the parties. In response to the latter, the National Treasury clarified that the proposal will no longer apply retrospectively, but from 1 January 2022, in order to avoid having to amend existing contractual agreements within the parties in this regard. Due to further engagements between Industry, NT and the Committee, the operation of this clause was further postponed to 01 January 2023 to enable further consultation.

Some issues raised on clarifying the definition of “contributed tax capital”
(Clause 4(1)(c) of the Draft TLAB: Section 1 of the Income Tax Act)

4.32. The background to the proposed amendment is that 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 provision 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.

4.33. NT explained that it had 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 proportionally in the allocation of CTC as a result of a distribution.

4.34. Stakeholders contended that this proposed wording had 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. They recommended that both elective share buy-backs and redeemable preference shares should be excluded from the ambit of the proposed provision in the TLAB. NT conceded and agreed to exclude a general repurchase of listed shares by companies listed on the Johannesburg Stock Exchange or any other South African exchange. The operation of this provision is 1 January 2022 and is no longer retrospective as had been initially proposed.

4.35. On 22 November, the Committee received a further submission from some stakeholders highlighting that the final proposal still did not exempt share buy-backs from the provisions of this proposal, asking the Committee to not pass this provision because it will have a negative impact on the share buy-back transactions. As a compromise, the National

Treasurer further postponed the operation of this provision 01 January 2023 to enable it to further consult.

Some issues raised on refining the interaction between anti-value shifting rules and corporate reorganization rules (Clause 25 of the Draft TLAB: Section 40CA of the Income Tax Act)

4.36. The Income Tax Act contains anti-value shifting rules in sections 24BA and 40CA that curb the use of structures that shift value between taxpayers free of tax. On the other hand, the corporate reorganisation rules allow for the tax neutral transfer of assets between companies. NT explained that the interaction between the anti-value shifting rules in sections 24BA and 40CA and the corporate reorganisation rules gives rise to anomalous results as the capital gains 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.

4.37. Stakeholders commented that 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. They 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, they explained, 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. They submitted 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.

4.38. NT accepted this submission and explained that 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. It further explained that 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.

Some issues raised on clarifying the controlled foreign company anti-diversionary rules (Clause 10 of the Draft TLAB: Section 9D(9A) of the Income Tax Act)

4.39. The Income Tax Act contains Controlled Foreign Company (CFC) anti-avoidance provisions in section 9D. These are aimed at taxing South African residents on the net income of a CFC. NT explained that 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. It said that 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. NT explained that in order to limit tax avoidance, the foreign business establishment exemption does not apply if the CFC foreign business's establishment income is regarded as diversionary foreign business income in terms of the CFC anti-diversionary rules.

4.40. NT stated that it had come to Government's attention that certain taxpayers were circumventing the rule by merely entering into a contract of purchase in the country of the CFC. It said that this 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. NT explained that it was proposed in the 2021 Draft TLAB that the diversionary rules focusing 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.

4.41. Stakeholders said that while they acknowledged the concern relating to the mere conclusion of contracts in the country of residence of the CFC, 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. They submitted that the proposed amendments 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.

4.42. NT rejected this submission by highlighting that while Government acknowledges business practices, this loophole in the diversionary rules should be closed. Secondly, NT said that 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.

Some issues raised on the VAT treatment of temporary letting of residential immovable property (Clause 54 of the Draft TLAB: New section 18D of the VAT Act)

4.43. 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. This would entitle property developers to claim input tax credits. However, the leasing of residential fixed property is an exempt supply which would generally result in the input tax being denied. NT explained that 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. It further explained that concerns have been raised regarding the application of the VAT provisions in this regard, especially the inequitable value attributed to this change in use adjustment.

4.44. NT explained that in order to address these concerns, changes were proposed in the 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 sale of the residential fixed property.

4.45. Stakeholders commented that the change in use adjustment is in relation to fixed property that is temporarily let. They said that 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. They said that as such, a time limit as a proxy for intention will assist in providing certainty.

4.46. NT accepted this submission and explained that the proposed amendments will be further enhanced in order to specify what is envisaged by the words “temporarily applied” by introducing a new definition in section 18D.

4.47. Stakeholders further commented that 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.

4.48. NT responded that 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 current open market value of the fixed property. It said that the proposed amendment will be further enhanced to provide clarity on the input tax and output tax adjustments.

4.49. Some stakeholders submitted that 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. NT accepted this submission and stated that the proposed amendments will be further enhanced 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.

4.50. Stakeholders commented that the wording of the proposed amendment 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. They said that in order to achieve the correct result in the circumstances, it is recommended that section 18D(4) be re-worded. NT accepted this submission and re-worded the provision to split out the input tax and the output tax adjustments. It said that the re-wording in the tabled Bill now clarify the situation where the vendor sells the property at a loss.

4.51. Some stakeholders submitted that the 1st April 2022 is too late to assist developers who have been struggling with cash flow difficulties. They proposed that the proposed amendment be backdated to 1st January 2018 when the first relief was withdrawn or from when there was a first lockdown (26th March 2020). NT did not accept this submission, clarifying that amendments to tax legislation are usually only made retrospectively in instances of anti-avoidance measures and this proposal is aimed at providing relief to a specific sector of vendors (property developers registered for VAT).

Some issues raised on clarifying renewable energy premium beneficiaries
(Clause 63 of the Draft TLAB: Section 6(2)(c) of the Carbon Tax Act)

4.52. Section 6(2)( c) of the Carbon Tax Act makes provision for electricity generators liable for the carbon tax to offset the cost of their additional renewable energy purchases against their carbon tax liability. NT explained that this provision was intended to address stakeholders' concerns on 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).

4.53. NT explained that it had come 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 premium deduction. It said that to address this, proposals were made in the 2021 Draft TLAB to clarify that: only entities that are liable for the carbon tax, conduct electricity generation activities and purchase additional primary renewable energy directly either under the REIPPPP or from private independent power producers would be eligible to claim the tax deduction for their renewable energy purchases, provided that the power purchasing agreement/contract exists.

4.54. Stakeholders commented that although clarifications were welcomed, they were 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. They said that it was unclear 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 for example, onsite solar PV project, and not through the national grid, would be eligible to claim the RE premium deduction. They recommended that examples of eligible renewable energy purchases for the different PPAs are provided in the explanatory memorandum (EM).

4.55. NT accepted that submission and explained that 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. It said that 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 not constitute additional electricity purchases. It said that examples would be provided in the Explanatory Memorandum of the tabled Bill.

Some issues raised on Clarifying the definition and scope of carbon sequestration-limitation on biological sequestration to forest plantations (Clause 63 of the Draft TLAB: Sections 6(3) & 6(4) of the Carbon Tax Act)

4.56. NT explained that 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. It said that this methodological guideline covers reporting and accounting parameters for sequestration across the forestry, paper and pulp, and manufacturing of harvested wood products (HWPs) industries. It explained that for forestry plantations, the DFFE provides for emissions sequestered directly by forests to be deducted from fuel combustion emissions as well as emissions embedded in harvested wood products (HWPs) in line with the Intergovernmental Panel on Climate Change (IPCC) Guidelines.

4.57. NT said that aligning the definition of sequestration in the Carbon Tax Act with the DFFE methodological guidelines is problematic. It said that 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, changes were made in the 2021 Draft TLAB that only actual forestry plantation sequestered emissions within the mill gate should be eligible for the deduction under the Carbon Tax Act. Also, changes were made to the definition of biological carbon sequestration in section 6(3)/(4) of the Carbon Tax Act to limit it only to directly sequestered emissions by forest plantations.

4.58. Stakeholders commented that the industry had engaged extensively with the Department of Forestry, Fisheries and Environment (DFFE) over several 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. They said that they were 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.

4.59. They suggested that the definition and scope of the sequestration deduction in the Carbon Tax Act be aligned with the methodological guideline. NT accepted that submission and stated that changes will be made in the 2021 Draft TLAB to expand the scope of the sequestration deduction to also include harvested wood products for the pulp, paper and print activity. It said that the sequestered emissions will be determined using the mass flow approach combined with the landfill approach to account for sequestered emissions as per the DFFE Carbon Sequestration Guideline, in the short term. NT explained that from an emissions accounting perspective, for forestry management and HWP pools it will be important to account for gains and losses occurring from within the mill's operational boundaries. It said that for future carbon tax periods, as recommended in the Carbon Sequestration Guidelines, the 100-year accounting approach will be developed once industry specific studies are completed on suitable half-life (product decay rates) and product use period assumptions.

Some issues raised on aligning schedule 2 emissions activities and thresholds with the greenhouse gas emission reporting regulations of the DFFE (Clause 65 of the Draft TLAB: Schedule 2 of the Carbon Tax Act)

4.60. The Carbon Tax Act came into effect on 1 of 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.

4.61. NT explained that on 11 September 2020 the DFFE published the amendments to the National Greenhouse Gas Emission Reporting Regulations. It said that 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. Proposed changes were made in the 2021 Draft TLAB to Schedule 2 of the carbon tax act to ensure alignment with the amended GHG Emissions reporting regulations.

4.62. Stakeholders commented 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. They explained that in terms of the Carbon Tax Act, the tax period is from 1 January to 31 December. They added that this 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. The stakeholders 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

NT accepted this and made the necessary changes in the Bill to make the effective date 1 January 2021.

## 5. COMMITTEE OBSERVATIONS

5.1. On applying tax on withdrawals of retirement interest when an individual ceases to be a tax resident (Clauses 11 of TLAB: New section 9HC of the Income Tax Act), the Committee notes that this proposal was withdrawn as a result of submissions from stakeholders. The Committee supports all measures aimed at dealing with erosion of the tax base and believes that the National Treasury should explore ways of dealing with the issue of 'treaty override' before reintroducing this proposal.

5.2. On curbing abuse in the Employment Tax Incentive (Clauses 58 & 59 of TLAB: Definition of "employee" and section 6 of the ETI Act), The Committee believes that National Treasury should closely consider criticisms that the ETI is not achieving the goals for which the incentive was introduced for. There were criticisms from some stakeholders that the ETI is being paid for workers that companies would have employed anyway, and might therefore not be creating any new jobs. The effect of this is that companies claim this incentive without contributing to the goals of the scheme and the state loses tax revenues without any correspondent increase in employment. The Committee will request the National Treasury to provide it with a report on the effectiveness of the ETI since it was introduced.

5.3. The Committee notes that while the proposal on strengthening the rules dealing with limitation of interest deduction in respect of debts owed to certain persons not subject to tax (Clause 20 of TLAB: Section 23M of the Income Tax Act) remains in the tabled TLAB, it will no longer apply retrospectively but after an announcement by the Minister of Finance in the Annual National Budget.

5.4. On restricting the set-off of the balance of assessed losses in determining taxable income (Clause 19 of TLAB: Section 20 of the Income Tax Act), the Committee notes that NT, in its response, acknowledged that this measure was first proposed before the Covid-19 pandemic hit our shores. It said that the South African government holds the view that a broad tax base with as few distortions as possible, combined with a lower rate, will be more efficient. It also acknowledged that businesses were facing difficult times and providing the space for their recovery was important. The Committee welcomes any relief provided to taxpayers in distress as a result of COVID-19 and notes that this amendment will no longer apply retrospectively.

5.5. On clarifying rehypothecation of collateral within collateral lending arrangements (Clause 56 of TLAB: Section 1 of the Securities Transfer Tax Act), the Committee notes that this provision will no longer apply retrospectively, but from 1 January 2023, in order to avoid having to amend existing contractual agreements between affected parties who had already entered into legitimate transactions. The Committee however believes that this is an important amendment and fully supports it as it is aimed at curbing possible abuse (where it occurs) of an incentive scheme in order to avoid securities transfer tax and/or capital gains tax, and therefore result in base-erosion.

5.6. On clarifying the definition of "contributed tax capital" (Clause 4(1)(c) of the Draft TLAB: Section 1 of the Income Tax Act), the Committee notes that the effective date for this proposal is being postponed again although NT had assured that it will no longer apply retrospectively and set the effective date as 1 January 2023. The Committee wishes to caution against the making of too many concessions, especially on provisions that are directed at protecting the country's tax base.

5.7. There are many other progressive amendments in the Bill, some of which no submissions were received. The Committee wishes to acknowledge the extensive consultative processes between NT and stakeholders which were held of 3 days in September.

## 6. AMENDMENTS AND COMPLIANCE WITH THE MONEY BILLS ACT

6.1. On 24 November 2021, the Committee received a letter (dated 23 November) from the Minister of Finance, Mr Enoch Godongwana, to request corrections to clause 4 and 56 of this Bill, in line with section 8(4) and 11(3) of the Money Bills Amendment Procedure and Related Matters Act, 2009. The technical amendments correct the effective date for the proposed amendments from 1 January 2022 to 1 January 2023 as follows:

- Clause 4 - The proposed amendment seeks to address tax avoidance concerns and clarify the definition of contributed tax capital and exclude the general repurchase of listed shares (share buy backs) by companies listed on the JSE or other South African Exchanges from the proposed anti-avoidance measure. In the 2021 TLAB, the effective date for the proposed amendment was 1 January 2022. It is proposed that the effective date should be postponed to 1 January 2023, to give both National Treasury and stakeholders more time to deliberate the impact of the proposed amendment.
- Clause 56 - The proposed amendment seeks to address tax avoidance concerns and clarify that the use of collateral for purposes other than subsequent collateral arrangements or proposed limited regulated transactions 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. In the 2021 TLAB, the effective date for the proposed amendment was 1 January 2022. It is proposed that the effective date should be postponed to 1 January 2023, to give both National Treasury and stakeholders more time to deliberate the impact of the proposed amendment.

6.2. The Committee notes and agrees with these amendments.

## 7. CONCLUSION

7.1. The Standing Committee on Finance, having considered the Tax Laws Amendment Bill [B22-2021] (National Assembly- section 77), referred to it, and classified by the JTM as a Money Bill, reports the Bill with amendments [B22A – 2021]

The Democratic Alliance (DA) reserve their position.

Report to be considered