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CC : Mr Franz Tomasek, South African Revenue Service
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CC : The Portfolio Committee on Finance, Parliament of the Republic of South Africa
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29 August 2008

Mr Smith,

ADDENDUM : Submissions in respect of the (draft) Revenue Laws Amendment Bills, 2008

In addition to the representations submitted to Parliament's Portfolio Committee on Finance on 13 August 2008 –in respect of which oral submissions were also made before the Committee on 20 August 2008– we present herewith our further submissions on the above-mentioned Bills.

We would request that these submissions be viewed together with those mentioned above and thus describe the current submissions as an "addendum" in relation to the first batch (dated 13 August 2008).

Yours faithfully

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Attached : Submissions (4 pages)

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SUBMISSIONS

Introductory note – References

"**NT Reference**" means the Annexure to the Media Statement released by National Treasury on 1 August 2008.[1]

"**ITA**" means the SA Income Tax Act (No 58 of 1962)

"**RLAB**" means the Draft Revenue Laws Amendment Bill, 2008 (which is the subject to these submissions) and "**RLAB2**" means the Draft Second Bill.

1 Nil CTC value on share cross-issues should only apply from effective date

- NT Reference : D.1.b – STC Reform, Revised dividend definition
- New "*contributed tax capital*" definition in s1 ITA
- S6(1)(*b*) RLAB

1.1 Whilst proviso (*a*) to the proposed new CTC ("*contributed tax capital*") definition is relatively clear that it will only apply to asset-transfers from 1 January 2009, there is no such clarity in respect of proviso (*b*).

1.2 With respect, it surely cannot be expected of taxpayer companies to retrospectively restate CTC as a result of all previous shares issued in return for shares issued.

1.3 Submission : Proviso (*b*) be expressly prefaced by the same introduction as in proviso (*a*), i.e. "*if on or after 1 January 2009*".

[1] National Treasury's Media Statement requested that submissions should be presented in the order listed in the Annexure to that Media Statement. As such, even though there is distinct numbering of our submissions for the purposes of this submission document, they follow the general sequence requested in the Media Statement.

2 Clarify opening CTC as at 1 January 2009

- NT Reference : D.1.b – STC Reform, Revised dividend definition
- New "*contributed tax capital*" definition in s1 ITA
- S6(1)(*b*) RLAB

2.1 Clarity is sought as to what the opening CTC (contributed tax capital) of a company will be on the effective date (1 January 2009), in the case of existing companies –i.e. in relation to the company's existing Share Capital and Share Premium on 31 December 2008.

2.2 Submission : The proposed new CTC definition should specify that the deemed CTC as at 1 January 2009 will be equal to the company's balance of Share Capital and Share Premium as at 31 December 2008 –excluding any portion thereof deemed to be profits in terms of the existing "*dividend*" definition's first proviso (commonly referred to as 'tainted capital').

3 Taxation of foreign dividends in PHCs

- NT Reference : D.2. – Passive holding companies
- S9E(2) ITA; Definitions of "*dividend*" and "*foreign dividend*" in s1 ITA
- S48 RLAB

3.1 It is not clear whether foreign dividends received by a PHC ("*passive holding company*") will also be subject to the additional tax proposed to be imposed by s9E(2).

3.2 It is submitted that, from a policy perspective, to the extent that the objective of the PHC regime is to :

(a) impose a tax equivalent to the DT (Dividends Tax): then foreign dividends should be excluded from the PHC regime since foreign dividends would in any event (in the absence of a PHC regime) not be subject to the DT; and

(b) impose a tax rate of 40% equivalent to Normal Tax: then foreign dividends that would qualify for the exemptions in s10(1)(*k*)(ii), should be excluded

3.3 It is submitted that to tax such foreign dividends would be to create a tax that would not have been suffered if the foreign dividends were received directly by SA-resident natural persons.

3.4 Submission : Foreign dividends should be excluded from the PHC regime (e.g. s9E(2) should apply only to dividends received from SA-resident companies) or alternatively, the tax imposed by s9E(2) should be subject to the exemptions in s10(1)(*k*)(ii) ITA.

4 Co-operative conversions (s40A & S40B ITA)

4.1 We oppose the deletion of s40A and s40B on the basis that it is arguably not, as suggested in the EM, superfluous.

4.2 It is stated in the EM[2] that simple conversions of close corporations to companies (or vice versa) and conversions of co-operatives to companies are merely changes in form and not in substance. Even though such conversions are on the face of it merely changes in form, it is submitted that the actions in terms of which such conversions are achieved are, in substance, actions which could fall within the parameters of the relevant taxing provisions of the ITA, thus potentially giving rise to adverse tax consequences for the entities involved.

4.3 To illustrate this with an example: Where a co-operative is converted to a company, it is required that any property of the co-operative 'must be *transferred*' to the company. See in this regard for example the wording adopted in s65(1) of the Co-operatives Act No. 14 of 2005 ('the 2005 Co-operatives Act'). Given the wording adopted in for example the recoupment provisions in s8, the Donations Tax provisions in Part V of the ITA and particularly the disposal rules in para 11, 8th Schedule, we are concerned that such a transfer of property could fall within the parameters of these taxing provisions, thus potentially giving rise to adverse tax consequences.

4.4 It is therefore submitted that the provisions of s40A and s40B are not superfluous and that their retention offers certainty in respect of the tax relief envisaged for such conversions. In addition, and once again in the context of our example above, the 2005 Co-operatives Act for example specifically provides for the transfer of such property by a co-operative to a company to be exempt from transfer duty, stamp duty or any other fee or charge. (A similar exemption for these kinds of taxes are also provided in s171 of the Co-operatives Act No. 91 of 1981.) It is submitted that this specific additional exemption for other potential taxes not imposed by the ITA, but that could also still arise as a result of such a conversion, adds further substance to the argument that the provisions of s40A and s40B are not superfluous and should be retained as a necessity for purposes of the ITA.

4.5 Submission : s40A and s40B should not be deleted.

4.6 For the same reasons, we would also oppose the deletion of sub-para (2) of para 78, 8th Schedule, although our reasons for opposing this deletion (and in addition also the deletion of sub-para (3) of para 78, 8th schedule) is not limited solely to the circumstances contemplated in s40A and s40B. See in this regard our comments at 23.9 of our main submissions dated 13 August 2008.

5 Provisional tax second payment (4th Schedule ITA)

5.1 The proposal to remove the "basic amount" safe harbour for the second provisional tax payment is (it is submitted) harsh.

5.2 Most taxpayers will find it very difficult to estimate their annual taxable income to within 90% accuracy before their year-end date. We point out that the estimate will

[2] At p93.

have to be made not at year-end but in fact *before* year-end since companies will have to ensure that the computation is completed before the last day so that submission and payment can occur timeously at the end of the tax year.

5.3 It would be simplistic to suggest that (for example) the internal management accounts for the first 11 months would be representative of $^{11}/_{12}$ of total annual taxable income, because of the impact of year-end adjustments (like audit adjustments, bonuses, tax Vs accounting adjustments on items like depreciation, prepayments, etc., and several other factors that are only finalised at the year-end date because of their annual nature). The accounting results for the year

5.4 In the light of the difficulty of achieving a 90%-correct estimate in advance of the year-end, it is submitted that it is harsh to penalise taxpayers for under-estimating.

5.5 Submission : The following alternatives should be considered :

– The minimum estimate should be 75% of actual taxable income (or perhaps the *higher* of the 'basic amount' and 75% of actual taxable income);

– If the 90% rule is retained, the penalty should be withdrawn. Perhaps the penalty can be applied to the top-up provisional payment;

– The common SARS practice of adding 10% p.a. to the most recent assessed year could be codified into the legislation for the purposes of the second provisional payment. So the 'basic amount' safe harbour could be retained but the basic will be a higher amount.