

Ref: #271931

18 June 2009

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Dear Sir

**CALL FOR COMMENT: DRAFT TAXATION LAWS AMENDMENT BILL 2009,
DRAFT TAXATION LAWS SECOND AMENDMENT BILL 2009 AND DRAFT
EXPLANATORY MEMORANDUM**

We refer to the call for comment on the above-mentioned documents. Set out below please find the SAICA National Tax Committee's submission regarding policy comments. As requested the comments follow the sequence of the Draft Explanatory Memorandum ("EM") (the numbering in this document refers directly to the numbering as contained in the EM).

**DRAFT TAXATION LAWS AMENDMENT BILL 2009 / DRAFT EXPLANATORY
MEMORANDUM**

MAIN AMENDMENTS

1. RATES AND THRESHOLDS

**1.1 TABLE XII: PROPOSED RATES FOR RETIREMENT LUMP SUM
WITHDRAWAL BENEFITS AND TABLE XIII: PROPOSED RATES FOR
RETIREMENT LUMP SUM WITHDRAWAL BENEFITS**

Problem statement

Taxpayers, especially in the current economic climate, are forced when they lose their employment to take their retirement fund savings in cash as these funds are in most cases the only means that these taxpayers have to support themselves. Due to the cumulative application of the withdrawal and retirement tables these taxpayers will lose part or all of the first R300 000 being exempt on retirement.

This is best illustrated by way of an example: Taxpayer receives R600 000 pre-retirement withdrawal benefits and paid tax according to Table XII on the R600 000 of R103 950. If the same taxpayer then receives an additional lump



sum of R100 000 upon retirement the taxpayer will pay tax of R27 000 on the R100 000 by way of application of Table XIII. Therefore on the R700 000 received in total the taxpayer paid total tax of R130 950. If the person would have retired and received R700 000 the tax would only have been R81 000. This is mainly due to the first R300 000 not being taxable on retirement.

Proposed solution

The difference between the R81 000 and R130 950 of R49 950 appears to be excessive and should be reconsidered. The principle or policy decision around the total R300 000 retirement exemption being “lost” should be reconsidered.

1.2 CLAUSE 7 – Fixing of rates of normal tax and amendment of certain amounts for purpose of the Income Tax Act No. 58 of 1962 (the Income Tax Act)

Sub-clause 7(5)(b) and (d)

Problem statement

Section 7(5)((b) and (d) - refers to employment company in section12E. There is no definition of “Employment Company” in section12E of the Income Tax Act.

Proposed solution

The definition of an “Employment Company” should be inserted into the Income Tax Act.

2. INDIVIDUALS AND EMPLOYMENT

2.2 UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS

CLAUSE 32: Section 18

a) Problem statement

In the EM it is stated that this proposed change will be tax neutral for both employers and employees. However, recent press articles in certain financial publications suggested that the employee will only get the deduction for contributions made by employers on assessment (up to 18 months later) as opposed to the current deduction through the payroll system.

Proposed solution

Although generally believed that the employee will still be entitled to a deduction through the payroll system, there appears to be confusion amongst taxpayers. It is therefore proposed that the EM be amended to indicate that the employee will be entitled to a deduction through the payroll system against taxable medical aid contributions made by the employer.



b) Problem statement

It is not clear whether the intention is that the contributions paid by the employer and included in taxable income as a fringe benefit rank for deduction under section 18(2)(c)(i) and section 18(2)(c)(ii) or only under section 18(2)(c)(ii). A strict reading of the proposed amendment seems to indicate that section 18(2)(c)(i) will apply first. This would be correct as the amount is included in gross income and if only section 18(2)(c)(ii) applies there may be no relief if the expenditure in question does not exceed 7.5% of taxable income.

Proposed solution

This uncertainty should be clarified in the EM.

2.11 CLAUSE BY CLAUSE PROPOSED AMENDMENTS RELATING TO INDIVIDUALS AND EMPLOYMENT NOT CONTAINED IN THE MAIN PROPOSED AMENDMENTS

A) EIGHTH SCHEDULE: PRIMARY RESIDENCE EXCLUSION

CLAUSE 89: Paragraph 45 of the Eighth Schedule

Problem statement

The proposed amendments provide that a natural person or special trust must (“the person”), when determining an aggregate capital gain or loss, disregard a capital gain or capital loss determined in respect of the disposal of the primary residence of the person, if the proceeds from the disposal of that primary residence do not exceed R2 000 000. However, clause 89(1)(b) states that this exclusion is not available to persons, who have not been ordinarily resident in that residence throughout the period on or after the valuation date during which that person or special trust held that interest, or, used that residence or part thereof for the purposes of carrying on a trade for any portion of the period on or after the valuation date during which that person or special trust held that interest.

Proposed solution

In our view, this is unnecessarily punitive. We recommend that the R2 000 000 exclusion also be made available to such persons, but on an apportionment basis.

B) SECTION 5(10) AVERAGE RATING FORMULA

CLAUSE 9: Section 5(10) of Income Tax Act

a) Problem statement

Section 5(10)(c) - “B represents the taxpayer’s taxable income (excluding any retirement lump sum benefit or retirement fund lump sum withdrawal benefit) for the said year”.



Proposed solution

This should be reworded to exclude any **lump sum benefit**. This will then tie in with the new definition inserted in section 1 by the same Act.

b) Problem statement

This clause amends the reference to the Second Schedule in section 5(10)(f). There should be an **end date of 1 March 2009 inserted** for the subparagraph to apply. This is to coincide with the use of the retirement tables from that date. If no date is inserted then both the rating and the new tables could apply to the same amounts.

Proposed solution

The proposed amendment should include an end date of 1 March 2009.

C) SECTION 9(g) CLARIFICATION REQUIRED REGARDING THE DETERMINATION OF “PERIOD DURING WHICH THE SERVICES RENDERED”

CLAUSE 13: Section 9(g) of Income Tax Act

Problem statement

In regards to the proposed amendments to section 9(1)(g) of the Income Tax Act dealing with the determination of the tax-free portion of a lump sum in circumstances where the taxpayer at some time during their career transferred their fund credit from a pension fund to a provident fund, we have the following comments—

There are currently two views regarding the determination of the period during which the services were rendered which could be applied. Supporters of one view argue that the tax-free portion of the lump sum should be determined with reference to period of *membership of the provident fund* and not with reference to taxpayer's *years of service* in respect of which they are now receiving the lump sum payment whereas supporters of the alternative view argue that in these circumstances the period during which the services are rendered relates to the taxpayers total career and not merely the period related to their membership of the provident fund.

Whilst it is evident from the provisions of section 9(1)(g) of the Income Tax Act, the calculation of the non-resident portion is totally dependent on the *years of service rendered in respect of which the pension or annuity is granted* and no reference is made at all to the period of *membership* of the particular retirement fund. It is unclear whether it can be said that the lump sum to which the taxpayer has become entitled to has been granted "in respect of services" rendered by the taxpayer, and if so, whether it is only in relation to the services rendered by the taxpayer whilst a member of the provident fund, or the total services rendered by the taxpayer to his employer.



It is apparent that the present provisions of section 9(1)(g) of the Income Tax Act, read together with paragraph 2(a) of the Second Schedule to the Income Tax Act, give rise to considerable uncertainty in application. Previously the tax-free portion of a lump sum derived on retirement was determined by reference to Formula A, and the effect of Formula A was determined by reference to the number of *years of employment taken into account for purposes of determining the amount of benefits payable to the taxpayer under the rules of the retirement fund*, this is no longer the case.

As a consequence of the benefit of taking years of employment (service) into account for purposes of Formula A the South African Revenue Service (“SARS”) allowed a provident fund in these circumstances to carry over the employee's service period under the pension fund on conversion. Having determined the tax-free portion of the lump sum, section 9(1)(g) of the Income Tax Act would then have been applied to determine the portion of the taxable amount of the lump sum that was regarded as being derived from a source in South Africa.

Had Formula A not been replaced by the graduated tax rate regime (thereby rendering the years of service rendered by the taxpayer redundant for purposes of determining the tax payable in respect of a lump sum), there would have been no doubt that the period of service referred to in Formula A and section 9(1)(g) of the Income Tax Act were the same years of service, namely, in the stated situation, those relating to membership of the pension fund *and* provident fund. It is only now that years of service rendered under a pension and provident fund in the case of *conversion are no longer relevant for purposes of determining the tax-free portion of the lump sum*, an argument that only the period relating to the membership of the last retirement fund, in this instance the provident fund, should be used, has arisen.

Proposed solution

Unfortunately, in the absence of any authoritative pronouncements concerning this conundrum, whether by text book writers or the SARS, we are of the view that this aspect be addressed and clarified in the proposed amendments to the legislation.

D) PROPOSED AMENDMENT OF PARAGRAPH 1 OF THE SECOND SCHEDULE TO THE INCOME TAX ACT, 1962

CLAUSE 68: Paragraph 1 of the Second Schedule of the Income Tax Act

Problem statement

If paragraph (b) of “Formula B” is deleted then the formula in the header of “Formula B”, $Z = C + E - D$ should also be amended. For example, if someone had a previous lump sum of R300 000 and 120 000 was exempt and contributions disallowed from the new fund being retired from amounts to R9 000. The formula then gives a negative result i.e. $Z = 0 + 9\ 000 - 120\ 000$. We presume this would be limited to nil



Proposed solution

We propose that the above problem be addressed.

E) CLAUSE 72 – Amendment of paragraph 4 of the Second Schedule to the Income Tax Act

Sub-clause (1)(a) and (b)

Problem statement

Clause (b) deletes clause (a) with an effective date of 1 March 2009. This means that subparagraph 4 of Paragraph 4 of the Second Schedule to the Income Tax Act will disappear from the Income Tax Act on 1 March 2009.

Proposed solution

We are not certain what was intended here as the dates have been removed from subparagraph 4 in the clause (a) amendment.

3. BUSINESS

3.1 CERTIFIED EMISSION REDUCTIONS – TRADABLE CARBON EMISSIONS REDUCTION CREDITS

CLAUSE 28: Section 12K of the Income Tax Act

Introduction

We believe that providing taxpayers with an incentive to invest in projects that result in carbon reductions or the reduction of energy use is the correct approach to address climate change mitigation in South Africa.

The new feed-in-tariffs set by NERSA for renewable power generation combined with the tax incentives proposed in the proposed sections 12K and 12L will allow more projects to be viable in South Africa and as a consequence reduce South Africa's carbon emissions.

The exemption of income received from carbon credits in the proposed section 12K will be an added incentive to invest in Clean Development Mechanism ("CDM") projects in South Africa. The incentive to improve energy efficiency in the proposed section 12L would encourage a reduction in energy usage in South Africa.

a) Problem statement

The proposed new section 12K provides for a tax exemption for the proceeds of certain CDM derived carbon credits. We are of the opinion, based on well established tax principles, that a tax event has already taken place at the time a carbon credit, being an asset measurable in money, vests in a project. There is therefore an accrual at this point.



Proposed solution

To give full expression to the worthy policy sentiments expressed as the sentiments underlying the introduction of the proposed section 12K, provision should also be made for a tax exemption of the upfront accrual that takes place on vesting or issuing of a carbon credit.

b) Problem statement

The proposed section 12K(2) allows income received from the disposal of a certified emission reduction (“carbon credits”) derived from a CDM project to be exempt from tax. It is proposed that the exemption is only applicable if the disposal occurs before 31 December 2012, the expiry date of the first commitment period of the Kyoto Protocol.

However, carbon credits are earned over a 10 year period or a seven year period with the option to renew the crediting period. If the option to renew is taken up the carbon credits will be earned and transacted over a 21 year period. Therefore the issuing of new carbon credits are not restricted to the expiry of the first commitment period of the Kyoto Protocol in 2012 but new projects cannot be registered after that unless a new commitment period is established. Consequently, as the legislation is drafted currently, only one year’s carbon credits can be disposed of tax free by the originator, where in actual fact a revenue stream of ten years or seven years with the option to renew is available to a taxpayer.

Proposed solution

We suggest that the proposed section 12K(2) state that any income received from the disposal of a carbon credit derived from a CDM project registered before 31 December 2012 should be exempt. The above should also allow income received from Clean Development Mechanism projects registered previously - before the introduction of the proposed section 12K - to be exempt in years going forward.

c) Problem statement

Funding of Clean Development Mechanism Project

In terms of the rules applicable to carbon credits the funder of a CDM project is the entitled recipient to a carbon credit. Therefore, should a European manufacturer finance a CDM project in South Africa he will be entitled to carbon credits. There is no need to reimburse the South African resident carrying out the project in South Africa. The above does not create a tax problem in South Africa if the European manufacturer is not a connected person to the South African resident. However, where the two parties are connected persons there may be unintended tax consequences.

Proposed solution

We suggest that legislation be introduced to avoid any unintended tax consequences.



d) Problem statement

Whilst clarity on the tax treatment of income received from the disposal of certified emission reductions (“CER”) is welcomed, no mention is made of the tax treatment of funds received or expenditure incurred in order to implement a qualifying CDM project. Would funds received be viewed as income in the hands of the recipient, would expenditure incurred be deductible?

Proposed solution

Since National Treasury accepts in the EM, that the lack of implementation of CDM projects in South Africa is mainly due to the high financial hurdle, it would seem prudent to clarify that expenditure incurred in the implementation of such projects should be deductible for income tax purposes, and that funding that may be received for the implementation of such projects should not be treated as taxable income in the hands of the recipient.

e) Problem statement

The date of introduction of this clause has not yet been inserted.

Proposed solution

It is respectfully requested that when deciding on the date of operation of the proposed section 12K, consideration is taken of the fact that such projects may date back to 2005.

The deduction of expenditure incurred in respect of income that is exempt from tax may deviate from the norm, however, it is submitted that this is justified given the importance of such projects. It should especially be kept in mind that such projects should benefit South Africa and its citizens in the future, and would be likely to generate future revenue.

3.2 ENERGY EFFICIENCY

CLAUSE 29: Section 12L

a) Problem statement

It is unclear from the wording of the proposed section 12L whether or not this is an incentive to use less energy or less electricity. Although the two are related, the emphasis could change the interpretation of section 12L. For instance, if it is intended to be an electricity usage reduction incentive, a taxpayer could switch to another energy feedstock such as diesel or gas. The use of electricity will decrease and the taxpayer would be able to claim an allowance on the reduced use of electricity. However, the same amount of energy would be used and from an environmental perspective switching fuels stocks may not result in reduced emissions.

When focusing on energy usage, what would constitute a saving? Will a process that is made more efficient by using waste to generate more energy, say steam, which reduces electricity usage, qualify for the allowance as overall



the same amount of energy is used? In this instance less electricity would be used and possibly less carbon emissions due to the efficiencies.

Proposed solution

We suggest that the wording of section 12L be change to clearly state what the incentive is for.

b) Problem statement

As per clause 118 of the Draft Taxation Laws Amendment Bill 2009 (DTLAB), the amendment to the Income Tax Act, would come into operation as from the commencement of the years of assessment ending on or after 1 January 2010. Consequently, a taxpayer with a February 2010 year end would be entitled to the proposed section 12L allowance. In terms of the proposed section 12L a baseline must be determined in accordance with the Regulations. Consequently, a taxpayer that wants to qualify for the allowance won't be able to do so as the regulations have not been released yet to provide for the 1-year lead time to develop the required baseline.

Proposed solution

We suggest that the regulations be released as soon as possible. Or perhaps the allowance should come into operation for years of assessment commencing on or after 1 January 2010 once the regulations have been released to provide certainty to the incentive.

c) Problem statement

“The Chief Executive Officer of the South African National Energy Development Institute must submit to the Minister any information that the Minister may require in the form and manner and at the place and within the time that the Minister prescribes.”

The abovementioned proposed section 12L(4) is not clear, and the wording is too wide and vague. The relevance of this section and how it relates to the proposed deduction is not apparent from the wording, and it is unclear which Minister is referred to. It would appear that this proposed section should allow the Minister of Minerals and Energy the power to request information from the CEO of SANEDI. This may very well be required, but how is this relevant to the income tax deduction proposed?

The validity of an empowering provision potentially relating to the Minister of Minerals and Energy within the Income Tax Act needs to be considered.

Proposed solution

The relevance of this subsection to the proposed section 12L deduction should be clarified. If it is indeed relevant to the proposed deduction, the type of information that may be required should relate to the deduction referred to in the proposed section 12L(2), and should be set out in greater detail than “any information”. The Minister that the proposed subsection refers to should be clarified, as should the Act empowering the Minister to request the



information. The empowering Act is presumably the National Energy Act, and if so, the Income Tax Act would be the incorrect forum for this empowering provision.

In the event that this subsection bears no relevance to the proposed deduction, it is recommended that it be deleted and perhaps be included where it may be of relevance, such as in the Regulations issued in terms of the National Energy Act No. 34 of 2008.

d) Problem statement

Whilst a deduction relating to energy efficiency is welcomed, and is indeed necessary to promote energy efficiency, it is submitted that the formula to determine the deduction (proposed section 12L(3)), the request for information from the CEO of SANEDI (proposed section 12L(4)) and the appeal relating to the energy certificate to the CEO of SANEDI (proposed section 12L(5)) should not be contained within the Income Tax Act. These are matters falling under the jurisdiction of the Minister of Minerals and Energy and not under the jurisdiction of the Minister of Finance.

The subsections refer to matters that are within the jurisdiction of the Minister of Minerals and Energy and/or the CEO of SANEDI. As a result it may be prudent to contain these within the National Energy Act, No. 34 of 2008 and/or the Regulations issued in terms thereof.

Proposed solution

Subsections (1) and (2) of the proposed section 12L should be retained. However, subsections (3) to (5) should be contained within either the National Energy Act, No. 34 of 2008 and/or the Regulations issued in terms thereof.

In addition subsection (2) may be amended to state –

“In determining the taxable income derived by any person in any year of assessment ending before 1 January 2020 from carrying on any trade, there shall be allowed as a deduction from the income of that person so derived an allowance as determined in accordance with the formula contained within the regulation issued in terms of the National Energy Act, No. 34 of 2008.”

3.3 PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING

CLAUSE 35: Section 22B

Problem statement

In the proposed section 22B(2), (2)(a),(b) and (c): the way it is drafted, it seems that (2)(a) stands alone as there is no "or" after it, whereas there is an "and" between (b) and (c). Thus it seems to read that the mere disposal of shares within two years will lead to an inclusion in income, without it necessarily being linked to the loan referred to in (c).



Proposed solution

The word "or" should be inserted, otherwise (a) is not co-joined with (c) and section 22(3) is then incomplete.

3.6 DIVIDENDS TAX: DISTRIBUTIONS OF SHARES AND SHARE RIGHTS

CLAUSE 67: Section 64R

Problem statement

The proposed wording of the proposed section 64R is incorrect. The terms "transfer of shares" or "transfer" are used in situations where the company issues capitalisation shares. A company does not transfer shares when it issues capitalisation shares.

Proposed solution

The wording of the proposed section must be amended to read as follows:

- "(1) Subject to subsection (2), a dividend paid by a company is exempt from the dividends tax if that dividend constitutes –*
- (a) an issue of shares by that company; or*
 - (b) an enhancement of the preferences, rights or other terms of any shares in that company.*
- (2) The provisions of subsection (1) do not apply where –*
- (a) the issue of shares or enhancement contemplated in that subsection results in a variation in the proportionate interest of any shareholder or any shares in that company; or*
 - (b) the payment of the dividend contemplated in that subsection confers –*
 - (i) a right to receive consideration other than an issue of shares; or*
 - (ii) a right to receive different types of shares or different preferences, rights, limitations or terms in respect of shares.*
- (3) If a dividend paid by a company constitutes an issue of shares or an enhancement contemplated in subsection (1) and is, wholly or partially, not exempt in terms of that subsection –*
- (a) in the case of an issue of shares, the contributed tax capital in relation to the class of shares in respect of which that issue is made will be increased by so much of that dividend as is not exempt; or*
 - (b) in the case of an enhancement, the contributed tax capital in relation to the class of shares in respect of which the enhancement is made will be increased by so much of that dividend as is not exempt."*



With reference to the commentary contained in the EM on the DTLAB, we note the following regarding situations where a capitalisation issue or share enhancement is not exempt from dividend tax by virtue of section 64R(2):

It is noted that the company is obliged to withhold the dividend tax but it may not have cash resources available to it - out of which such dividend tax can be paid. It also has no right to call on the shareholders to fund the dividend tax due. It is noted that this situation also applies to other distributions in specie. It is suggested in the EM on the DTLAB that the case required can best be raised by the company selling part of the assets being distributed. With respect, this is not commercially feasible other than possibly in the case of a capitalisation issue or a distribution in specie of a listed share. It most definitely is not possible, in the case of an unlisted company, to sell a few shares to raise the cash. In our view, the policy decision in regards to this aspect needs to be re-visited as a matter of urgency.

3.7 DIVIDENDS TAX – DEEMED DIVIDENDS

CLAUSE 64: Section 64O

a) **Problem statement**

In the proposed section 64O(2), financial assistance to a connected person triggers a deemed dividend. Unlike the corresponding STC provisions, there does not appear to be any relief if the loan is subsequently repaid or the guarantee extinguished. Does this not potentially give rise to economic double taxation?

Proposed solution

We propose that there should be relief if the loan is subsequently repaid or the guarantee extinguished. The relief could take the form of a credit against the dividend tax liability due on a subsequent dividend declaration or deemed dividend. If there is no dividend declared or deemed dividend which arises within a period of one year it is proposed that a refund can be claimed from SARS.

b) **Problem statement**

The definition of “financial assistance” refers specifically to:

“the payment of a guarantee”.

Based on the current proposed wording, it appears that a deemed dividend can only arise when *payment is made under the guarantee*. It is not clear whether this means that the *granting of a guarantee* does not constitute a deemed dividend.

Proposed solution

We recommend that the above be clarified. It is suggested the phrase “payment of a guarantee” be amended to read “payment under a guarantee”.



c) Problem statement

Section 64O(2)(b) provides that a resident company must be deemed to have paid a dividend where any adjustment has been made to the taxable income of that company in accordance with section 31. It is submitted that only the Commissioner has the authority to make an adjustment in terms of section 31 of the Income Tax Act. Consequently, we are of the view that no deemed dividend can arise if the taxpayer makes a transfer pricing adjustment to its taxable income in its return of income.

In addition, cognizance should be taken of the fact that the current wording of section 31(3)(a) of the Income Tax Act dealing specifically with thin capitalization provides that the Commissioner must disallow any excessive interest. There is thus not an ‘adjustment’ that needs to be made but rather a disallowance.

Proposed solution

In regards to the making of an adjustment, we understand that the Commissioner is not in agreement with the above interpretation. We, therefore, recommend that the wording of section 64O(2)(b) be amended so as to give clear expression to the intention of the legislature.

If the policy decision is that a deemed dividend should arise on the disallowance of excessive interest in the context of thin capitalization then the proposed section 64O(2)(b) should be reworded to replicate the current provision contained in section 64C(2)(e) of the Income Tax Act i.e. “... any adjustment to the taxable income or assessed loss of the company in the form of additional taxable income or reduced assessed loss is made in accordance with section 31 by virtue of any transaction with a connected person in relation to that company; or any amount of interest, finance charge or other consideration is disallowed as a deduction in accordance with the provisions of section 31”

d) Problem statement

Section 64O(5)(b) provides that the date on which a dividend is deemed to have been paid, in consequence of an adjustment made in terms of section 31, is the date on which the Commissioner notifies the company of the adjustment. It is not clear whether this refers to the assessment of the tax return, or some other notification.

Proposed solution

It is suggested that the Income Tax Act stipulates the nature and form of the notification referred to in section 64O(5)(b).

e) Problem statement

The whole tenor of the ‘deemed dividend’ provisions appears to be aimed at financial assistance in the form of loans, advances and guarantees. What is not clear, is the position where (for example) an asset is disposed of to a connected party at below market value? In such a scenario, there is no financial assistance



as defined but there is a benefit which would arguably have been a deemed dividend in terms of the current Secondary Tax on Companies regime? How are transactions outside of the context of financial assistance (as defined) to be dealt with under the new regime?

Proposed solution

We propose that consideration be given to all scenarios that may possibly give rise to a deemed dividend i.e. the shifting of value outside of the conventional dividend definition, and not only those that relate to financial assistance (as defined).

CLAUSE 65: Insertion of section 64P into the Income Tax Act

Problem statement

- i) The exemptions pertaining to financial assistance refer to terms that are “not more favourable than to a member of the general public in similar circumstances”. This is very difficult to determine, especially with regards to moneylenders such as banks, since the public receive a wide array of benefits when dealing with moneylenders. In South Africa, the prime lending rate is generally viewed as an arm’s length interest rate, and the prescribed rate is generally above the prime lending rate. However, the interest rate exemption only applies if the rate charged is not below the prescribed rate and also not below the rate applicable to the general public. This results in high interest rates being charged, while many companies obtain much lower interest rates from their banks – on arm’s length terms. We are of the view that this specific interest rate requirement is too high.
- (ii) Further, with reference to section 64P(c), it is not clear whether “throughout the term of the loan” means that the loan must bear interest throughout the term, at whichever rate is agreed upon (which must be at least equal to the prescribed rate) or whether the interest rate on the loan should at least be equal to the prescribed rate throughout the term of the loan.
- (iii) In addition, certain of the exemptions currently contained in section 64C of the Income Tax Act (dealing with deemed dividends for purposes of the Secondary Tax on Companies) have not been replicated in the proposed section 64P. These include—
 - i. Section 64C(4)(a) dealing with amounts that would be considered as ‘true dividends’. This exemption is necessary so as to avoid amounts being considered ‘true’ dividends and deemed dividends;
 - ii. Section 64C(4)(i) dealing with any loan or credit granted to a trust by a company to enable the trust to purchase shares in that company etc. This generally applies to share incentive trusts.

Proposed solution

- (a) It is suggested that, the specific interest rate requirement should be determined with reference to the repo rate only.



- (b) In our view, section 64P(c) should be amended so that it is clear that its requirements are to be met at the time that the financial assistance is first granted and, consequently, that no deemed dividend will arise in the event that the rate, at which the financial assistance bears interest, becomes less than the specified rate of interest as a consequence of an increase in the specified rate of interest.
- (c) In our view, the current exemptions as contained in section 64C of the Income Tax Act should be analysed and considered for inclusion in the proposed section 64P where appropriate so as to avoid unintended consequences and anomalies arising.

CLAUSE 66: Insertion of section 64Q in the Income Tax Act

Problem statement

Section 64Q(2)(b) states that tax does not have to be withheld on deemed dividends if the person to whom the dividend was deemed to have been paid forms part of the same group of companies, as defined in section 41, as the company that paid the dividend. However, section 64F(2) provides that a dividend, as defined in section 64D, paid to a resident company (which is the beneficial owner of the dividend) is exempt from dividends tax. It is unclear as to why the deemed dividend exemption should be limited to group companies only.

Proposed solution

In our view, all amounts deemed, in terms of section 64O, to constitute a dividend paid to a resident company (which is the beneficial owner of the dividend) should be exempt from dividends tax. The Income Tax Act should be amended accordingly.

3.13 ADJUSTING RING-FENCING OF LOSSES FOR FINANCIAL LEASING

CLAUSE 36: Amendment of section 23A of the Income Tax Act

Problem statement

The EM advises that it is proposed that losses from the leasing of affected assets are to be used against all income associated with the trade, not merely rent. It further advises that such income is to include any section 8(4) recoupments on the sale of these affected assets and any capital gains realised on the sale.

However, the proposed amendments to section 23A only refers to section 8(4) recoupments and, therefore, the scope of the amendment does not extend to that envisioned in the EM.

Proposed solution

It is suggested that either the Income Tax Act or the EM be amended so that the stated intention of the legislature is in agreement with the actual amendments proposed.



3.14 CROSS-ISSUE AVOIDANCE – REMEDYING UNINTENDED ANOMALY

CLAUSE: Section 24B(2C)

Problem statement

The proposed amendment does not, with respect, address the anomaly. With reference to the example used in the EM on the DTLAB, when Newco acquires the land in exchange for the issue of its shares, the base cost of the land in the hands of Newco is determined in terms of section 24B(1). Section 24B(2) is not applicable. Similarly, when a subsidiary of Newco acquires the land in exchange for its shares to Newco, section 24B(1) applies in order for the Newco Subsidiary to have a base cost for the land. Again, section 24B(2) is not applicable. It is therefore not necessary to introduce section 24B(2C) in order for Newco Subsidiary to have a base cost for the land.

The real problem that needs to be addressed is the base cost of the Newco Subsidiary shares which are acquired by Newco. If it is argued that Newco acquires those shares which are issued to it by reason or in consequence of its own issue of share to the seller of the land, section 24B(2) applies to deny Newco a base cost of those Newco Subsidiary shares. Newco has therefore disposed of the land in which it had a base cost in exchange for shares in which it does not have a base cost. Section 24B(2C) needs to provide that Newco will get a base cost of the Newco Subsidiary shares equal to its base cost of the land.

Proposed solution

The proposed wording of section 24B(2C) should be revised as follows:

"Notwithstanding any provision of subsection (2) to the contrary, if –

- (a) a controlling group company acquired any asset from a person (other than a share or debt instrument issued by that person) as consideration for shares or debt issued by that company; and*
- (b) by reason of or in consequence of and within a period of 18 months after that issue, any controlled group company in relation to that controlling group company acquires the asset as consideration for the issue of shares or debt by the controlled group company to that company, the controlling group company is deemed to have actually incurred an amount of expenditure in respect of the shares or debt issued to it by that controlled group company which is equal to the market value of the asset it acquired that asset: Provided that this subsection does not apply if, within 18 months after the acquisition contemplated in paragraph (b), any other company other than a controlled group company in relation to the controlling group company acquires the asset as consideration for the issue of shares or debt by that other company."*



3.15 LIQUIDATING, WINDING UP OR DEREGISTRATION OF EXCLUSIVE RESIDENCE COMPANIES

CLAUSE 90: Paragraph 51A of the Eighth Schedule

a) **Problem statement**

In essence, paragraph 51A exempts from capital gains tax the transfer of a domestic residence from a “domestic residence company” to a natural person during the two-year window period.

The term “domestic residence company” is, however, restricted to companies, the shares of which are all, from 11 February 2009, directly held by a natural person. This definition is problematic for the following reasons:

- Often more than one natural person (e.g. a husband and wife) has an interest in a domestic residence. However, in terms of the definition, should more than one natural person hold the shares in the company, the company cannot make use of this exemption. This seems incongruous with the purpose of the legislation.
- It is also unclear as to why this qualification is applicable as from 11 February 2009.
- Further, it is also not clear why the shares in the domestic residence company must be held directly by a natural person. Often shares in companies, which in turn own the domestic residence, are held by family trusts. These companies serve the same purpose as domestic residence companies held by natural persons.

Proposed solution

- The definition of “domestic residence company” is expanded to include companies, the shares of which are held by natural persons or trusts, the beneficiaries of which are natural persons who live in the residence.
- The reference to the date of 11 February 2009 be removed, or at least explained in the memorandum.

b) **Problem statement**

SAICA welcomes SARS’ intention to re-open a 2 year window period whereby primary residences held in a company / close corporation will be able to transfer these properties into the hands of the individuals with no CGT, Transfer duty or STC payable in deregistering and liquidating.

There are many cases where primary residences were placed in trusts, not the least of which is asset protection. In many cases, the reasons for placing primary residences into trusts have fallen away. Many residences are held in trusts where this is the only asset of the trust.

Hence these trusts have to comply with all the requirements of SARS at a cost which has now become unnecessary both for SARS as well as the trust.



Proposed solution

The window period should be extended to the transfer of primary residences out of trusts to the hands of the beneficial owners who actually reside in the property as was the case some years ago.

3.16 CLAUSE BY CLAUSE AMENDMENTS RELATING “BUSINESS” NOT CONTAINED IN THE MAIN AMENDMENTS

CLAUSE 8 – Amendment of section 1 of the Income Tax Act

a) Section 1 – definition of "contributed tax capital"

Although the current DTLAB does not deal with the definition of "contributed tax capital" contained in section 1, submissions have been made regarding the issue referred to below. These submissions and the concerns raised therein have, however, to date not been addressed.

Problem statement

The proviso to the definition of "contributed tax capital" ("CTC") definition contained in section 1 limits the CTC distribution to a shareholder to his effective shareholding percentage of the total distribution of CTC to all shareholders in the same class. This makes sense where there is an equal distribution to all shareholders of that class or a general share buy-back from all shareholders of that class, as it prevents the buy-back from being funded out of share premium for one shareholder, such as a non-resident, and out of reserves for another shareholder, such as a resident company.

Where, however, there is a specific buy-back from one shareholder – a transaction which is a common or a normal commercial transaction – the proportionate rule does not make sense. For example, say 10 shareholders all contributed R100 each to the company when they subscribed for shares. The CTC is therefore R1 000 or R100 per shareholder. Each shareholder therefore holds 10% of the shares in the company. At some time in the future the company buys back all the shares of one of the shareholders, i.e. 10% of the total shares for R100, the CTC of his shares. The proportionate rule provides that the total distribution to all the shareholders is R100 due to the fact that this one shareholder gets R100 and the others NIL. The CTC distribution to him is limited to 10% of R100, i.e. R10. Commercially the shareholder is getting back his R100 but it is made up as a capital distribution of R10 and a dividend of R90 (R100 – R10) which does not make any sense.

Proposed solution

The proviso should be amended to read as follows:

“Provided that the amount so transferred to a shareholder of any class of shares is deemed to be an amount that bears to the total of the amount of CTC in respect of that class of shares the same ratio as the number of shares of that class held by that shareholder bears to the total number of shares of that class;”



With reference to the example noted above, the proposed amendment will cause the shareholder whose shares are bought back for R100 to receive R100 of CTC, being 10% of the total CTC of R1 000 which is both logical and equitable and does not give rise to any tax arbitrage or mischief.

b) Section 1 – definition of "dividend"

Problem statement

Paragraph (b) of the proposed definition of "dividends", reads as follows: "*as consideration for the acquisition of any share in that company*". The proposed wording is unclear and confusing and needs to be reconsidered. For example, it is not clear whether the proposed paragraph applies to capitalisation issues as contemplated in section 64R or share buy-backs by a company or both.

Proposed solution

Assuming the scenario provided for in paragraph (b) of the definition is intended to deal with capitalisation issues only, the wording should be amended to read as follows: "*as consideration for the **issue of shares by that company***".

c) Section 1 – definition of "listed share"

Problem statement

There are a number of proposed amendments where the reference to "listed company" as defined in section 1 is to be replaced with a new definition, i.e. that of "listed share". The definition of "listed company" remains unchanged and is defined as "*means a company where its shares **or depository receipts in respect of its shares are listed on –***

- (a) *an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004; or*
- (b) *a stock exchange in a country other than the Republic which has been recognised by the Minister as contemplated in paragraph (c) of the definition of "recognised exchange" in paragraph 1 of the Eighth Schedule;"(our emphasis).*

The proposed definition of "listed share" is "*a share that is listed on an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004;*". Listed shares therefore do not include depository receipts in respect of a company which is listed on an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004. Consequently, any tax treatment previously afforded to a "listed company" no longer applies to depository receipts where the proposed amendments replace any reference to a "listed company" with the term "listed share".

Proposed solution

The proposed definition of "listed share" should be "*a share **or depository receipt in respect of that share** that is listed on an exchange as defined in*



section 1 and licensed under section 10 of the Securities Services Act, 2004;" (our emphasis).

Also refer to the comments made regarding section 10(1)(k)(ii)(dd) and section 64D below.

d) Sub-clause (n)(ii)

Problem statement

The last sentence of the paragraph is missing the word **this** ("*... that was established prior to the date that **this** section came into operation*").

Proposed solution

The word '*this*' should be inserted.

CLAUSE 15 – Amendment of section 10 of the Income Tax Act

Section 10(1)(k)(ii)(dd)

Problem statement

The existing exemption applies to dividends distributed by a foreign company which complies with paragraph (a) and (b) of the definition of "listed company". A resident shareholder who holds shares and/or depository receipts in a dual listed company is therefore exempt from tax on dividends received or accrued in respect of the shares and/or depository receipts. The substitution of the reference to "listed company which complies with paragraphs (a) and (b) of the definition of "listed company" in section 1" with "an uncertificated share as defined in section 64D and that share is a listed share" now causes a resident shareholder who holds depository receipts in a dual listed company to no longer be exempt from income tax. In addition, the same dividend will also be subject to dividend tax.

Proposed solution

The definition of "listed share" needs to be amended as noted above. Also refer to the comment made regarding section 64D below.

CLAUSE 26 – Amendment of section 12I of Income Tax Act

Although the current DTLAB includes a few minor amendments to section 12I, consideration should be given to an amendment which is considered vital for the success of the investment incentives provided for in the section.

Problem statement

The current version of section 12I(2) of the Income Tax Act which deals with additional investment and training allowances in respect of industrial policy projects provides as follows:



"In addition to any other deductions allowable in terms of this Act, a company may, subject to subsection (3), deduct an amount (hereinafter referred to as an additional investment allowance) equal to –

- (a) ...; or
- (b) ...,

*in the year of assessment during which that asset is first brought into use by the company as owner thereof for the furtherance of the industrial policy project carried on by that company, **if that asset was acquired or contracted for on or after the date of approval** and was brought into use within four years from the date of approval"* (our emphasis).

The requirement that the additional investment allowance would only be applicable to assets **which were acquired or contracted for on or after the date of the approval** of the industrial policy project is problematic for the following reasons:

- Industrial companies involved in the industrial environment continuously have to consider whether or not to expand or upgrade their current facilities. Equally, these companies or companies seeking to enter the industrial market have to decide whether or not to market and/or consider economical conditions – local or global – are conducive to the setting-up of a new industrial facility.
- There are a number of factors which are taken into account by these companies when the timing of these expansions, upgrades or new facilities are considered. One of the major considerations is the projected after-tax return-on-investment ("ROI") of the specific investment. The sensitivity of the ROI is usually tested against the movements of various variables such as
 - exchange rates in respect of
 - the acquisition or manufacture of the various components required to erect the expanded, upgraded or new facilities; and/or
 - the export of the end products;
 - other costs such as transport costs in respect of the components and/or raw materials required to manufacture the products and/or the delivery of the end products to the required markets;
 - projected/estimated demand for the product to be produced, taking into account economic cycles;
 - cost to manufacture the product vs price at which the product can be sold;
 - tax allowances and investment incentives.

All or any combination of the above and various other factors therefore could significantly impact the timing of any investments in these industrial projects.

The limitation of the application of the additional investment allowance to assets which **were acquired or contracted for on or after the date of the approval** of the industrial policy project is unrealistic as it ignores the practicalities surrounding the commencement of any industrial project of the



nature envisaged. One of the most significant practical issues is the lead times required by suppliers of components or plant for (i.e. assets) which are required for installation. Generally, these components or plant are not of the nature where the supplier would keep stock or be able to manufacture the same on demand. Further, the time required in manufacturing these components or plant may be months and in order to ensure that the specific components or plant are available for installation at the time required in terms of the steps identified to complete the project within the specified timeframe.

The argument that, the mere fact that a company has already acquired or contracted for "assets" which would qualify for the additional investment allowance had the assets not been acquired to or contracted for on or after the date of the approval of the industrial policy project, is an indication that the company intended to invest in the assets at this time, is in our view, unfounded. Not only would these companies at the same time be preparing the application for submission as required in terms of the regulations, but for the reasons noted above, these investments would, in the absence of the additional investment incentives, not produce a ROI which would meet the required hurdle rates of the company in respect of such returns.

Proposed solution

We propose that the limitation of the additional investment allowance to assets acquired or contracted for on or after the **date of the approval** be removed. Further, the additional investment allowance should be available in respect of all assets which form part of any industrial policy project which has been approved provided the assets were acquired or contracted for on or after **the effective date of the section**.

We accordingly propose that the wording of section 12I(2) of the Act be amended as follows:

“In addition to any other deductions allowable in terms of this Act, a company may, subject to subsection (3), deduct an amount (hereinafter referred to as an additional investment allowance) equal to –

- (a) ...; or
- (b) ...,

*in the year of assessment during which that asset is first brought into use by the company as owner thereof for the furtherance of the industrial policy project carried on by that company, if that asset was acquired or contracted for on or after the **effective date of this section** and was brought into use within four years from the date of approval”.*

CLAUSE 54 – Amendment of section 64D of the Income Tax

Problem statement

As noted in our comments regarding certain amendments proposed to section 10(1)(k)(ii)(dd) above, one of the consequences of the amendments to that section, is that depository receipts will no longer be exempt from income tax.



In addition, it is noted that the exclusion of depository receipts from the definition of "uncertificated share" causes these depository receipts to also be subject to dividend tax of 10%.

Proposed solution

The definition of "uncertificated share" must be amended to read as follows:
*"... a share **depository receipt in respect of that share** that is not evidenced by a certificate or written instrument and is transferable by entry without a written instrument"*.

4. INTERNATIONAL

4.1 CONVERSION OF THE CONTROL FOREIGN COMPANY (CFC) RULING EXEMPTIONS

CLAUSE 14: Section 9D - Definition of "foreign business establishment"

The new foreign business establishment definition is referred to in the EM, states that "the foreign business establishment" definition will be clarified and tightened to ensure that the foreign business establishment relied upon is economically meaningful. Under this opening framework, a foreign business establishment must consist of a fixed place of business located in a country of residence outside the Republic as long as the business is carried on continuously or regularly at that location.

Problem statement

The definition of a foreign business establishment ("FBE") is robust and is designed to ensure that genuine businesses offshore are exempted from the application of section 9D (in certain instances). However, it relates to an offshore business and should take cognizance of the global environment in which a CFC operates. By adding the word "continuous" to the definition (the definition stipulates that the "fixed place of business located in a country other than the Republic that is used for the continuous carrying on of the business of that CFC"), South Africa has certainly not taken into account the global recession that faces the world at the moment. There are CFCs in offshore jurisdictions, which are struggling for survival, and have had their operations cut back by their South African parents. These CFCs will still have managerial and operational employees, and satisfy every other criteria of the FBE definition, however their trades may reduce substantially. Since "continuously" has not been defined, taxpayers are expected to apply these without any guidance. How many trades per annum will satisfy the "continuously" criteria? The EM provides some additional guidance by indicating that it must be "continuously or regularly", however the proposed legislation only says "continuously".

Since the EM also explains the new definition as being necessary in order to ensure that the FBE relied upon is "economically meaningful", we submit that the economic circumstances of each CFC will have to be reviewed in detail in



order to determine if a CFC in a global jurisdiction, which has been negatively affected by the global crisis, will still satisfy the FBE definition.

Proposed solution

The word "continuously" needs to be defined, and an element of discretion should be afforded to the Commissioner in this regard in order to take into account the economic circumstances prevailing in a foreign jurisdiction at any point in time.

SUB-CLAUSE 14(1)(c)(iii): Section 9D

Problem statement

There is a problem with the wording “...is at least 75% per cent of the amount of normal tax that the controlled foreign company would have paid had the controlled foreign company been a resident for that foreign tax year”.

The wording should refer to normal tax payable (as in section 6). The wording currently could imply that section 6*quat* has already been taken into account as it refers to normal tax paid. Normal tax paid would be after rebates. This would defeat the purpose of the section as the tax would always be less than 75%.

Proposed solution

The wording must be changed to coincide with the wording in Section 6 and refer to normal tax payable.

4.2 FOREIGN PORTFOLIO DIVIDENDS

CLAUSE 54, 56 AND 63: Section 1(‘listed share’ definition): 6*quat* and 10(1)(k)(ii)(bb); 64D(1)(‘dividend’ definition); 64F(3); 64N]

Problem statement

The move to subject dividend flows on dual listed companies to the new dividend tax is surprising. Currently these dividends enjoy tax free treatment in the hands of the recipients. If a South African resident company accrues such amounts they would then be subject to STC when on distributed to the end shareholder. However, where a trust or an individual accrues such amounts, no further tax would arise. The proposed change now imposes tax at a rate of 10% on the gross amount of such dividends, even in the hands of individuals. This is a material change to the current position.

Foreign companies have been permitted to list on the JSE since 2003. However, the opportunity has not been widely utilised by the business community with most inward listed companies being the result of forced conditions attaching to foreign listing requests. The JSE and Reserve Bank continue to encourage foreign companies to list on the JSE. The one attractive attribute has been the ease surrounding the exchange control rules that attach to



such companies. Another key attraction has been the favourable tax treatment of dividend flows in the investor's hands.

Proposed solution

We would be concerned that introducing a 10% tax on such dividend flows would compromise the viability of inward listed structures, especially in a market that is so short on liquidity. We would therefore suggest that the current position be retained. We highlight that where such shares are owned through companies they will ultimately be subject to the withholding tax regime when paid out to the end shareholder while direct ownership would result a tax free result, in line with current practice.

5. SPECIALISED ENTITIES AND CIRCUMSTANCES

5.4 TRANSITIONAL PERIOD FOR REVISED TAXATION OF CLUBS

SUB-CLAUSE 44: Section 30A and section 10(1)(cO)

a) Problem statement

It is suggested in the EM that the partial system of taxation for Clubs that were fully exempt before 2006 will only commence for years of assessment commencing on or after 1 October 2010. Although the deferment of the implementation date is welcomed this does not appear to be part of the Amendment Act

Proposed solution

That the Income Tax Act be amended to give effect to the proposal in the EM.

b) Problem statement

It is suggested in the EM that the partial system of taxation for Clubs that were fully exempt before 2006 will only commence for years of assessment commencing on or after 1 October 2010. The partial system of taxation for clubs would originally have come into effect for years of assessment starting on or after 1 March 2007. Some clubs have therefore already submitted their 2008 tax return based on the partial system of taxation.

Proposed solution

A mechanism is created to enable clubs that have already submitted their 2008 tax returns on the partial system of taxation, to submit revised tax returns to ensure that they are fully exempt until the 2010 implementation date.



6. ESTATE DUTY

6.1 PORTABLE SPOUSE DEDUCTION

CLAUSE 5: Section 4A of the Estate Duty Act

Problem statement

The draft sub-paragraph (2) refers to “*all assets...*” being bequeathed to the surviving spouse. The EM explains that the provision is aimed at simple estates where the first dying bequeaths all the assets to the surviving spouse. On the strict reading of this provision, this means that in a case where the first dying leaves a specific asset to a child such as a motor vehicle then “*all assets*” are not left to the surviving spouse and hence these provisions will not apply. Surely this was not the intention of this legislation.

Proposed solution

The draft legislation should be amended to include specific assets bequeathed to immediate family members.

7. INDIRECT TAX

7.2 IMPACT OF VALUE-ADDED TAX ON REORGANISATIONS

Section 8(25) of the Value-Added Tax Act No. 89 of 1991 (the VAT Act) – Asset for shares transactions

a) Problem statement

Section 42 of the Income Tax Act is being removed from Section 8(25) of the VAT Act as SARS is concerned that vendors will use this provision incorrectly to include trading stock.

However Section 42 of the Income Tax Act deals with single asset or a large number of assets (such as the sale of a business) by a person to a company.

Proposed solution

Section 42 must not be excluded from section 8(25) and the application should only relate to the transfer of capital assets and sale of a business.

b) Problem statement

Even if it is accepted that section 8(25) should only apply to sale of going concerns and not to sales of single assets, we are of the opinion that there is no reason why section 42 of the Income Tax Act – asset-for-share transactions – should be excluded from section 8(25). A going concern may be sold by a vendor to another vendor in exchange for the issue of shares as contemplated in section 42 of the Income Tax Act, in which case the provisions of section 8(25) should apply.



Proposed solution

The deletion of section "42" should be removed.

Commentary in the EM

The EM on the DTLAB notes that the amendment to section 8(25) will apply from the date of the introduction of the Bill. It is not clear what is meant by the statement, i.e. is it from the date of introduction of the Bill to Parliament? We respectfully submit that this will not be acceptable in that it may affect current transactions. The effective date should be for transactions concluded on or after the date of promulgation of the Act.

DRAFT TAXATION LAWS SECOND AMENDMENT BILL / EXPLANATORY MEMORANDUM ON THE OBJECTS OF THE BILL

CLAUSE 14: Amendment of section 88 of the Income Tax Act

a) Problem statement

When considering a request by a taxpayer for the suspension of payment of an amount of tax pursuant to the lodging of an objection or appeal, the Commissioner for the South African Revenue Service ("the Commissioner") is to consider whether the taxpayer has an arguable case. This legislation is presumably proposed in order to enable the Commissioner to decide whether the taxpayer is employing dilatory tactics. However, it is objectionable that the Commissioner should decide whether a case is arguable or not at the start of the course of an ongoing objection or appeal process to which he is a party.

Proposed solution

It is proposed that section 88(4)(d) be deleted.

b) Problem statement

Section 88(3) states that the Commissioner may request information relating to the taxpayer's financial position where the taxpayer requests suspension of payment pending an objection or appeal. Section 88(4) sets out various factors that the Commissioner is to consider pursuant to a request by the taxpayer to suspend payment. One of the factors to be considered is whether the taxpayer has failed to furnish information requested under section 88(3).

Proposed solution

The interaction between section 88(3) and section 88(4) is to be clarified. It is unclear as to whether the Commissioner is to act in accordance with section 88(4) first, and is only to request information in terms of section 88(3) where such information will assist with the consideration of the factors listed in section 88(4). Should this be the case, it should be considered whether the information required in terms of sections 88(3) and 88(4) should rather be requested simultaneously in order to avoid unnecessary delays in the consideration of a request for suspension of payment.



c) Problem statement

Where an assessment is altered and an adjustment made, amounts short-paid by the taxpayer are recoverable with interest calculated in terms of section 89 of the Act.

This requirement is objectionable since it is inequitable that the Commissioner allows the suspension of payment, and thereafter requires interest paid on that amount from the date of the assessment in the case where the objection/appeal is denied. Since the word “suspension” is not defined in the Act, the ordinary dictionary meaning must be looked at. The ordinary dictionary meaning of “suspension” is:

“the action of stopping or condition of being stopped for a time; the action of putting off to a later time, deferment, postponement”

Therefore, in a matter where suspension of payment is indeed granted by the Commissioner, this has the meaning that payment of the tax charged in terms of an assessment has been placed on hold, deferred or postponed until the outcome of the objection/appeal (i.e. it is not payable until the objection/appeal has been decided on). Therefore, since no amount is payable during the period of suspension, no amount exists on which interest may be charged during that period. To allege that interest is chargeable is to hold that the suspension has been revoked retrospectively, which is inequitable. Since the Commissioner agrees to suspension of payment based on all the facts before him or her (as requested in terms of sections 88(3) and 88(4) of the Act), this is a concession granted to the taxpayer, and one which must be upheld. If it is not so upheld, little reason exists for a taxpayer to request suspension of payment.

Proposed solution

Section 88(6) should be clarified to state that:

“Where any assessment is altered in accordance with ... and amounts short-paid being recoverable with interest calculated as provided in section 89 from the date of the assessment forming the subject matter of the objection or appeal, provided that where the Commissioner has granted a request to suspend the obligation to pay the amount of tax in dispute in terms of subsection (4) pending the outcome of an objection or appeal, interest so charged in terms of section 89 shall be payable from the date of the outcome of the objection or appeal”.

d) Problem statement

Section 88 does not provide a timeframe within which the following events should occur:

- Within how many days after the receipt of an assessment, or the outcome of an objection, the taxpayer should lodge a request for suspension of payment of the tax so charged;
- Within how many days after the receipt of the aforementioned request the Commissioner should respond with a request for information in terms of both section 88(3) and 88(4);



- Within how many days after the receipt of the aforementioned request the taxpayer should provide the information to the Commissioner;
- Within how many days after the receipt of the information from the taxpayer, the Commissioner must notify the taxpayer of his or her decision to suspend payment; and
- Within how many days after the taxpayer has been notified by the Commissioner of a decision to revoke an agreement to suspend payment, must the taxpayer pay the tax charged in terms of the disputed assessment to the Commissioner.

Proposed solution

It is proposed that rules relating to timeframes in terms of requests for suspension of payment be inserted into the “Rules prescribing the procedures to be observed in lodging objections and noting appeals against assessments, the procedures for alternative dispute resolution and the conduct and hearing of appeals before a tax court” contained within the Regulations to the Income Tax Act, and promulgated in terms of section 107A of the Income Tax Act.

e) Problem statement

No clarity is contained within section 88 as to whether a taxpayer is required to pay the tax charged, *pending* a decision in terms of a request for suspension of payment.

Proposed solution

It should be clarified that payment is not required pending a decision relating to suspension of payment, that payment is due once the taxpayer’s request is denied, or if upheld, once the objection or appeal is decided, and that any interest due will be charged with effect from that date.

f) Problem statement

The calculation and implementation of daily compounded interest will increase the administration and compliance burden of both the taxpayer and the Commissioner.

Proposed solution

Taxpayers must be provided with clear guidelines as to how this calculation is to be made and implemented.

CLAUSE 20 : Paragraph 14 of the Fourth Schedule to the Income Tax Act

Problem statement

Paragraph 14 of the Fourth Schedule to the Income Tax Act is to be amended by the substitution of subparagraph (1) by the following paragraph:

“14. (1) Every employer shall in respect of each employee maintain a record showing –

(a)...

(d) such further information as the Commissioner may prescribe



such records shall be retained by the employer and shall be available for scrutiny by the Commissioner upon request.”

Proposed solution

It is not clear how the Commissioner is to prescribe the information to be retained. The requirements for compliance with paragraph 14(1)(d) of the Fourth Schedule must be clearly communicated to employees.

CLAUSE 22 – Amendment of paragraph 20 of the Fourth Schedule of the Income Tax Act

Paragraphs 19 and 20 of the 4th Schedule to the Income Tax Act

Introduction

SAICA made three written submissions and attended a number of meetings with SARS since the changes were introduced during 2008. Below is an executive summary of our submissions.

The Revenue Laws Amendment Acts of 2008 contained a significant change to paragraph 20 of the 4th schedule to the Income Tax Act. In terms of paragraph 20 of the 4th Schedule to the Income Tax Act, should the second provisional tax paid fall short of 80% of the amount as finally assessed, the taxpayer will be subject to 20% additional tax on such shortfall. With this change came the removal of the “basic amount” as a safe harbour option. Previously the provisional taxpayer could rely on the safe harbour of the ‘basic amount’ when calculating the second provisional tax payment. It is a safe harbour that avoided penalties on the underpayment of the second provisional tax payment.

The “basic amount” is the taxable income reflected in the most recent assessment from SARS. This “basic amount” excluded extraordinary items i.e. capital gains. If the estimated actual income for the year was greater than the “basic amount”, the taxpayer could previously use the “basic amount” without incurring any penalties.

As a result of this significant change SAICA together with other professional bodies successfully negotiated a transitional arrangement for taxpayers until 29 February 2009 which in essence delayed the implementation of the changes to 1 March 2009. We compliment SARS approach and stance taken in this regard and appreciate the transitional arrangement that was granted.

The difficulty was not however removed but was merely postponed with the transitional arrangement. We set out below the practical difficulties and proposed alternatives.

The changes introduced to the legislation create the following practical difficulties:

- The unfairness of an automatic penalty for missing a target that is uncertain (reliant on future uncertainties).



- The additional workload / systems strain and cost associated as a result of having to put together a detailed tax computation before year-end.
- Data only available at year end.
- As the vast majority of provisional taxpayers have a February year end, tax practitioners would not have time to attend to all their clients' needs in February.

Proposed solution(s):

Preferred solution

As our primary proposal, SAICA supports the reinstatement of the “basic amount” system for the 2nd provisional tax estimate, but subject to an automatic annual increase in this factor. Whilst a similar practice was previously applied by SARS (i.e. a 10% increase) our proposal differs in that:

- whereas (previously) the 10% increase was typically recommended where the taxpayer's immediately preceding tax year was not yet assessed (i.e. the most recent assessment was for 2 or more years prior to the current tax year), our current proposal suggests an immediate automatic increase on the assessment of the immediately preceding tax year. It also follows that if the immediately preceding year is not yet assessed, the basic amount would be subject to compounded annual increases depending on which tax year the most recent assessment does relate to.
- whereas the 10% increase was previously merely an unlegislated “suggestion”, our proposal is for a legislated automatic annual increase.

In our view, the two main areas for further consideration would be:

- (a) an appropriate annual increase factor (e.g. 10% or CPIX, etc.); and
- (b) whether this new rule should be applied for the 2nd payment only, or whether the increased amount should apply for the 1st payment as well. (In the latter case, the legislative solution would simply be to amend the “basic amount” definition in para 19(1)(d), 4th Schedule of the Income Tax Act, and then to reinstate the para 20(1) rules on the 2nd payment to the way they were before the 2008 Revenue Laws Amendments.

Alternative

As an alternative proposal, there is also support for the retention of the existing 80% rule, but subject to a deletion of the 20% penalty rule – and applying instead an interest charge to any underestimate below 80% of the actual taxable income. However, we would emphasise that this alternative proposal – albeit certainly preferred to the current penalty regime – enjoys substantially less support compared to our primary proposal.

Problem statement

Paragraph 19 now states that the “Commissioner may by notice in the *Gazette* prescribe the basis on which an estimate of taxable income in respect of a “designated class of taxpayer” must be made. This provision is extremely wide and can have serious implications on taxpayers. The term “designated class of taxpayer” is not defined.



As in the case of the amendment made last year, this was not widely communicated and hence taxpayers who rely on the principle of “reasonable expectation” and are not aware of this change will find that they are liable to substantial penalties/additional tax. SARS can now decide to make any further change to the basis on which taxable income is to be estimated, they are now empowered to do so by way of *Gazette* notice. We are extremely concerned as to how any change will be communicated to taxpayers.

The amendment would appear to be effective from the default date as contained in clause 118 of the DTLAB i.e. as from the commencement of years of assessment ending on or after 1 January 2010. This would imply that there is a period between 1 May 2009 and 31 December 2009 where provisional taxpayers will have to bear with the 2008 legislative changes.

Paragraph 20 of the 4th Schedule now provides that in cases where the taxpayer followed the basis on which to estimate the taxable income as prescribed by SARS, SARS is obliged to remit any additional tax due to the underpayment of the 2nd provisional tax payment. However, this provision states that in determining the basis “any loss to the fiscus” must be taken into account. This implies that in each case, additional tax may be remitted but interest will be payable on the tax shortfall from the year end onwards. In other words, interest will be payable in each case even though in most cases, there is no reasonable expectation that the taxpayer can accurately estimate the taxable income.

Proposed solution

The term “designated class of taxpayer” must be clearly defined in the Act. We propose that all taxpayers that do not meet the requirement of having to register with the SARS Large Business Centre be defined as a designated class of taxpayer within the context of paragraph 19 of the 4th Schedule (i.e. an unsophisticated taxpayer as referred to in the EM). The requirements for registration with SARS LBC should also be clearly defined.

The basis on which an estimate of taxable income in respect of a designated class of taxpayer must be made must be the “basic amount”. This must be legislated for in the Act. Any other basis will introduce further practical difficulties and may not be timeously communicated to provisional taxpayers.

We further recommend that the amendment be made effective from 1 March 2009.

There appears to be an interest charge from the year end onwards where the designated taxpayer chooses the determined basis which results in a loss to the fiscus. We request that the charging of interest be clarified. Will these provisional taxpayers now be liable for interest from year end?

We note that there is certain relief for a “designated class of taxpayer” which is referred to in the EM as unsophisticated taxpayers. We welcome this



stance/approach but note that there is no relief for larger entities particularly in these extremely tough economic times.

Large business concerns:

1. Data only available after year-end

Certain data only becomes available post year-end i.e.

- Trust distributions
- Value of agricultural crops held in pooling arrangements
- Value of trading stock on hand at year-end, debtors and creditors
- IT3 data, for taxpayers with investment income
- Actuarial valuations (insurers)
- Parliamentary approval (State-owned entities)
- Audit adjustments
- Bonus pay-outs

2. Limitations of management accounts

For entities that do produce reasonably up-to-date management accounts, the following factors render these internal accounts unsuitable for estimating taxable income (to within 80% accuracy):

- Management accounts are based on internal reporting lines (divisions, etc.) which include inter-departmental charges etc. They typically do NOT reflect the combined taxpayer-entity position. They also often use a theoretically computed stock value which may differ materially from the actual value of stock;
- Tax adjustments (e.g. depreciation vs. wear & tear; accounting gains vs. CGT; provisions; non-tax-deductible expenses; tax-exempt income; etc).

SAICA continues to support the retention of the basic amount with an automatic increase of this basic amount as referred to above (our primary proposal) even for larger entities. Our alternative proposal is the replacement of the penalty with interest charged instead which is considered more equitable.

CLAUSE 33, 34 AND 36 - Amendment of Sections 1, 6 and 23 of the VAT Act (Biometrical information required for VAT registration purposes)

Problem statement

The implementation of the biometrical information required for VAT registrations faces some challenges. In particular, where a non-resident entity has a VAT registration liability it is unclear whether a representative of the non-resident entity would be required to travel to SA to provide the information or whether a local representative of the non-resident (or the tax practitioner?) can provide the information.



Proposed solution

We recommend that SARS issues further information to clarify.

CLAUSE 2.35 – Section 20 of the VAT Act

a) Problem statement

The proposed amendment addresses the practical difficulties associated with the transitional period after a business or part thereof has been disposed of to another vendor. Obtaining supporting documentation (mainly tax invoices, debit and credit notes) in the acquiring entity's name often gives rise to documentary compliance difficulties.

The problem does not only arise in circumstances where section 8(25) is applied. It is also not limited to reorganizations and amalgamations as envisaged in section 44 of the Income Tax Act.

Proposed solution

We propose that alternative one be implemented (i.e. the alternative referring only to section 44). We further recommend that the ambit of the section be extended to transactions concluded in terms of section 45 of the VAT Act.

b) Problem statement

Taxpayers often request rulings from SARS to allow tax invoices issued and received (i.e. output and input tax) to be in the name of the disposing entity where section 8(25) applies. Since the disposal often requires systems to be amended and suppliers to be informed of such disposal, vendors are not always capable of updating their systems timeously and suppliers often take considerable time to amend their systems to correctly reflect the new entity's name.

Proposed solution

We recommend that section 20(5A) be amended to also cater for re-organisations in terms of section 42, 45 and 47 of the Income Tax Act and that the period be extended to 12 months.

c) Problem statement

The proposed amendment currently only deals with tax invoices received in the window period.

Proposed solution

We recommend that the ambit of the applicability of the section be extended to debit and credit notes.

We also further recommend that the amendments to section 20 be extended to cover other circumstances where relief in relation to documentation is required, for example in relation to going concern transfers in terms of section 11(1)(e) of the VAT Act or where a vendor has changed its name.



CLAUSE 37 – Section 36 of the VAT Act

Problem statement

The amendment is welcomed, but a number of issues that the Commissioner has to apply its mind to are too subjective.

The decision to defer payment

The amount of VAT concerned, per se, should not have an impact on the Commissioner's decision. This would generally be dependent on the size of the vendor's enterprise. Certain of the other proposed tests (e.g. "the risk of dissipation of assets by the vendor concerned during the period of suspension") would adequately address recovery risks. The mere quantum of the amount should not determine whether payment is suspended or not.

The test whether a vendor has an "arguable case" is very subjective and would potentially be in direct conflict with the reason why the Commissioner takes a case on appeal. By granting a vendor extension, the Commissioner would be admitting to weaknesses in its own case. Whether the Commissioner can apply its mind bona fide under these circumstances is questionable.

The decision to revoke deferment previously allowed

Especially the requirement that the Commissioner may revoke its previous decision where "it appears that the vendor does not have an arguable case" is of concern. This is by its very nature a subjective assessment of the situation which may be impacted by the need for cash collections at year end.

In addition, it is our view that the test envisaged by the proposed sub-section 5(c), i.e. that the Commissioner for SARS may revoke a decision to suspend payment if he/she is satisfied that the "vendor has employed dilatory tactics in conducting the objection or appeal" is also a subjective test that is likely to be subject of contentious interpretation and application by SARS.

Proposed solution

We propose that the tests of "the amount of tax involved", "whether the vendor has an arguable case", and "the vendor has employed dilatory tactics in conducting the objection or appeal" be removed from the draft legislation. Alternatively the Commissioner should issue an interpretation note to clarify how he intends applying the various tests in practice.

CLAUSE 38 – Section 39(4)(b) of the VAT Act

a) Problem statement

The amendment proposes that interest will accrue from "such date and for such period as the Minister may prescribe by Regulation". Whilst we acknowledge the rationale for the proposed amendment, we are concerned about the contents of the proposed Regulation, specifically about the contents of the Regulation and whether the Regulation will be in place by the time when the proposed amendment to section 39(4)(b) is promulgated into law.



Proposed solution

We recommend that the proposed Regulation should be issued in draft for public comments immediately and that the effective date and the application of the amended section 39(4)(b) be conditional upon the Regulation being issued by the Minister of Finance.

b) Problem statement

The test of what constitutes “circumstances beyond the control of the said person” is a very narrow and subjective test. Very few circumstances (if any) can be held to be completely outside of anyone’s control. It essentially only leaves acts of God and failures outside the business environment (for example a failure of the banking system to affect the electronic transfer of funds).

The purpose of charging interest is not to be a deterrent for specific behavior (as in the case of a penalty). It is merely aimed at ensuring that all parties are fairly compensated for the use of its funds by another party.

In the case of two vendors dealing at arms length, the fiscus will never suffer any financial loss if output tax has not been accounted for by one party but input tax has also not been claimed by the other party. For example, where two parties treat a transaction as a disposal of a going concern and the Commissioner subsequently treats the supply as a supply subject to VAT at the standard rate, interest will be payable by the supplier as it could never be argued that the non-payment resulted from circumstances beyond the control of the supplier. This could never have been the intention of the Legislator and goes against the general principle of the basis for charging interest.

Inter-group transactions may also give rise to similar incongruities. The proposed amendment will grant the Commissioner for SARS the discretion to levy interest in circumstances where interest would not have been levied in the past, for instance circumstances where there has been no loss to the fiscus. It is proposed that interest will apply in all circumstances where the Commissioner for SARS is not satisfied that the circumstances that have led to a failure to pay tax are 'circumstances beyond the control of the said person'.

Proposed solution

We recommend that subsections 39(7)(a)(i) and 39(7)(a)(ii) be retained. We further recommend that the circumstances where the Commissioner is given discretion to waive interest payable partially or fully, be extended with the consideration “was due to circumstances beyond the control of the said person”.

GENERAL

SAICA last year requested that a full day workshop be held post the public oral hearings. This process worked effectively as it ensured that written comments were properly understood by National Treasury and SARS. We this year again requests a rebuttal opportunity post the release of the National Treasury/SARS response document before the Standing Committee on



Finance. Should this process have been employed last year we are of the view that certain issues could have been resolved previously i.e. provisional tax changes.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully

M Hassan CA(SA)

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