18 June 2009

Mr. B. Viljoen
Standing Committee on Finance (SCOF)
Parliament
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Dear Sir

RE: CALL FOR COMMENT – DRAFT TAXATION LAWS AMENDMENT BILL 2009; DRAFT TAXATION LAWS SECOND AMENDMENT BILL 2009

Thank you for the opportunity to comment on the draft Taxation Laws Amendment Bill 2009 and the draft Taxation Laws Second Amendment Bill 2009.

Set out below please find the comments provided by the National Technical Committee of the Institute.

1 DRAFT TAXATION LAWS AMENDMENT BILL 2009

Clause 5: Section 4A of the Estate Duty Act No. 45 of 1955

- It is worrying that the Estate Duty concession as announced in the 2009 Budget Speech has now been severely restricted as it applies only in the very limited circumstances where all of a deceased spouse's assets are bequeathed to the other spouse/s. In this form, hardly any couples will benefit, as in the vast majority of cases it is likely at perhaps one or more assets may be bequeathed to a child/ PBO/ relative, etc. This restriction is unnecessarily restrictive and should be removed. The delay in the implementation of this provision is also questioned. Why wait until 1 January 2010? We recommend that the effective date be 1 March 2009.

- Sub-paragraph (2) refers to "all assets" being bequeathed to the surviving spouse. The explanatory memorandum however explains that the provision is aimed at simple estates where the first dying spouse bequeaths all the assets to the surviving spouse. It is our submission that this means that in a case where the first dying spouse leaves one asset to another person then all assets are not bequeathed to the surviving spouse with the result that these provisions will not apply. Surely this is not the intention? We recommend that sub-paragraph (2) be amended to address this anomaly, and possibly list specific assets.

Clause 7: Fixing of rates of normal tax and amendment of certain amounts for purpose of the Income Tax Act No. 58 of 1962

- Sections 7(5)((*b*) and (*d*) refers to "employment company" as defined in section 12E, however, there is no such definition of "employment company" in section12E.

- The tax rates as fixed in terms of the amended section 7 refer, in section 7(5)(b) and (d) to an "employment company". This term was removed from s 12E in 2008 and section 7(5)(b) and (d) must therefore be amended accordingly. This change (removal of reference to "employment company") must also be made in para 5 of Appendix 1 (setting out the various tables).

- Section 7(5)(e) refers to "any personal service provider", which includes both companies and trusts. This therefore means that both companies and trusts which fall within this definition will be taxed at the rate of 33%. This seems to be incorrect. (See also para 6 of Appendix 1).

- Further on Appendix 1: paragraph 9 (dealing with micro businesses) should simply refer to "...in respect of any year of assessment ending on 28 February 2010" as all micro businesses have to have a February year-end.

Clause 8: Amendment to section 1 of the Income Tax Act No. 58 of 1962

- The amendments to section 1 of the Income Tax Act No. 58 of 1962 unfortunately does not address the issue of what constitutes a foreign dividend. Section 4 of the 2008 Revenue Laws Amendment Act No. 60 of 2008, substituted the definition of "foreign dividend" with the following:

  'means any dividend, as defined prior to the coming into operation of Part VIII of Chapter II of this Act, received by or which accrued to any person from a foreign company as defined in section 9D;'

  It is regrettable that the legislature has chosen to refer to a definition that will not be located in the principal Act when defining the term "foreign dividend". It would be far preferable if the Act itself contained a comprehensive definition of foreign dividend, without taxpayers having to refer to a definition that is tucked away in an Act prior to its amendment. It is noted that the current bill amends many provisions dealing with dividends and it would be appropriate to rectify this deficiency in the current bill.

Clause 14: Amendment of section 9D of the Income Tax Act No. 58 of 1962: definition of "foreign business establishment"

- The definition of "foreign business establishment" contained in section 9D of the Act is amended. Paragraph (e) of the proposed definition introduces a test that requires a determination to be made as to the purpose for which the fixed place of business is created. To introduce a criterion having regard to the postponement or reduction of tax in any other country is too wide. If, for example, a South African company decides to locate a foreign subsidiary in Switzerland over the United Kingdom because the tax rate in Zug may be less than the tax due in the United Kingdom should not result in the foreign company failing to meet the new "foreign business establishment" test.

- The term "continuously" is not defined. However, it is unclear how many trades per annum will satisfy the "continuously" criteria? We are concerned that this may result in different interpretation by SARS and taxpayers. The explanatory memorandum, however, do provide some guidance by stating that it must be "continuously" or "regularly", however the proposed legislation only read "continuously". We recommend that this be clarified and explained.

Clause 23: Amendment of section 12E of the Income Tax Act No. 58 of 1962

Definition of "small business corporation" (s 12E)

- We appreciate the expansion of the list of permitted investments to include dormant companies; however, many small businesses are precluded from benefiting from the small business tax concessions because one or more of the shareholders / members has a share / interest in a property-holding company or other dormant company that may once have traded. It seems unnecessarily restricted to prohibit these shareholdings and we recommend that this be revisited. This will enable the small business tax concession, which is very good in principle but

little used, to be enjoyed by many more deserving businesses. This is especially important in the current economic climate, which is extremely challenging to the survival of small businesses.

- The same recommendation applies to "micro businesses" (see clause 80: para 3 of the Sixth Schedule).

Clause 28: Section 12K of the Income Tax Act No. 58 of 1962

- We commend Government for providing taxpayers with an incentive to invest in projects to mitigate climate change. We are, however, concerned that that a tax event has already taken place at the time a carbon credit vests in a project, with the result that an accrual has taken place already. We recommend that section 12K also be available in these circumstances (i.e. for the upfront accrual).

Clause 44: Section 30A and section 10(1)(cO) of the Income Tax Act No. 58 of 1962

- Extending the date for registration to 30 September 2010 and then allowing SARS the discretion to back-date the club's registration only opens the clubs to more uncertainty. The extension of the date is largely due to SARS' inability to administer the amended tax laws within the time initially prescribed, and it is therefore unfair to leave the clubs exposed to the uncertainty of whether or not they will be exempt, partially-exempt or fully taxable until 30/9/2010. A more pragmatic solution would be to retain the previous legislation until the new date. This will not result in much (if any) loss of tax to the fiscus and will save a huge additional administrative cost to the clubs.

- The explanatory memorandum 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 deferment of the implementation date does, however, not appear in the amendment Acts. We recommend that the Income Tax Act No. 58 of 1962 be amended to give effect to the explanatory memorandum.

Clause 63: Insertion of section 64N in the Income Tax Act No. 58 of 1962 - "Foreign Portfolio Dividends"

- It appears that the inward listings of foreign companies will face a disadvantage *vis-à-vis* other companies once the new dividends tax rules come into operation. The issue is best explained by way of an example. Assume that a South African company is owned by a non-resident company that is inwardly listed on the Johannesburg Securities Exchange ('JSE'). As and when the SA company pays dividends to the non-resident listed company, the 10 % tax must be paid over to SARS as the dividend is paid to a company that is not a resident. Later, when the listed company declares dividends to South African shareholders the dividend will attract tax again as the dividend is paid by a non-resident company listed on the JSE to SA resident shareholders. To the extent that dividends are paid by the non-resident listed company are paid to non-residents of South Africa, no tax is required to be paid. We recommend that should be amended to cater for inward listed non-resident companies to prevent the dividend tax being paid on more than one occasion.

Clause 64: Insertion of section 64O in the Income Tax Act No. 58 of 1962

- The proposed section 64O (2) will trigger a deemed dividend when "financial assistance" is provided to a connected person. However, no provision is made for situations where the loan is subsequently repaid by the connected person. We recommend that relief be given under these circumstances that will correspond with the STC provisions.

- It is clear that the 'deemed dividend' provisions are aimed at "financial assistance" in the form of loans, advances and guarantees. Is it the intention to exclude other forms of financial assistance, for example, asset is disposed of to a connected person at below market value? We recommend that the explanatory memorandum clarifies the position / intention of the legislature. It appears as if the current definition of "financial assistance" is too narrow which is surely not the intention? We

recommend that the explanatory memorandum clarifies how other forms of "financial assistance" will be dealt with under the new regime.

Clause 66: Insertion of section 64Q in the Income Tax Act No. 58 of 1962

- There is an anomaly between sections 64Q (2)(*b*) and 64F(2). We are concerned with the fact that the deemed dividend exemption should be limited to group companies only. The problem with this approach is that this treatment may be seen to be in contravention of the equality clause of the Constitution of the Republic of South Africa. We recommend that deemed dividend exemption also be extended to private companies.

Clause 67: Insertion of section 64R in the Income Tax Act No. 58 of 1962

- We submit that the wording of the proposed section 64R is incorrect as the words "transfer of shares" is used in situations where the company issue capitalisation shares. It is common cause that a company does not transfer shares when issuing capitalisation shares. We recommend that section 64R be amended to refer to "an issue" rather than "transfer of shares".

Clause 68: Amendment of paragraph 1 of the Second Schedule of the Income Tax Act No. 58 of 1962

- It is proposed that paragraph (*b*) of "Formula B" is to be deleted. However, we recommend that the formula in the header of "Formula B", Z = C + E – D should also be amended to give effect to this deletion.

Clause 90: Amendment of paragraph 51A of the Eighth Schedule to the Income Tax Act No. 58 of 1962

- We welcome this amendment, but it is unclear why the effective date is only 1 January 2010. Surely there is no risk in making the date earlier? We recommend that the effective date be 1 March 2009.

Clause 105: Amendment of section 8(25) of the Value-Added Tax Act No. 89 of 1991

- It is proposed that the reference to section 42 be removed from section 8(25) of the Value-Added Tax Act No. 89 of 1991 ("VAT Act") because "section 42 mainly deals with single asset transfers". However, a single asset can comprise an enterprise activity which is separately identifiable, for example, a commercial building which is a separately identifiable rental enterprise. Section 42 should therefore not be removed from the ambit of section 8(25) of the VAT Act.

- Section 18A is only applicable in respect of supplies made in terms of section 11(1)(e) of the VAT Act. If section 18A is to be made applicable as contemplated by proviso (i)(bb), the section 18A(1) must be amended accordingly.

2 DRAFT TAXATION LAWS SECOND AMENDMENT BILL

Clause 14: Amendment of section 88 of the Income Tax Act No. 58 of 1962

- In general we welcome the proposed amendment of section 88 as we accept that SARS has a reasonable concern that taxpayers may seek to lodge trivial objections to postpone the inevitable payment of tax due. Furthermore, we believe that the Commissioner needs the power to insist on timeous payment of the tax where a taxpayer lodges a trivial objection, failing which payment the *fisc* would be in an invidious position. However, it is imperative that there be a balance of the need for SARS to have legislation to enforce paying tax, thereby ensuring the proper collection of taxation, and the rights of taxpayers.

The proposed amendment is, however, problematic for the following reasons:

1. Currently section 88 is only applicable to ". . .appeals or other decisions by a court of law under section 86A. . ." of the Income Tax Act No. 58 of 1962. The proposed amendment to include ". . .during the duration of an objection. . ." will mean that once SARS assessed a taxpayer, the tax must be paid. We are concerned that this extension of the "pay-now-argue-later" principle to assessment stage is extremely onerous. The proposed amendment is aimed at income tax and we submit that income tax represents an amount payable only once SARS assesses the tax return submitted by the taxpayer. A taxpayer who is aggrieved is then allowed to object to the Commissioner, where after the taxpayer is allowed to appeal to the Commissioner's decision not to allow the objection. We are concerned that the proposed amendment to extension of the "pay-now-argue-later" principle to assessment stage may infringe upon the right of access to court, guaranteed under section 34 of the Constitution, and could not be justified under the limitation clause as envisaged in section 36.

   In the *Metcash Trading Ltd vs The Commissioner: SARS and the Minister of Finance* (63 SATC 13), the Constitutional Court referred to the provisions of fiscal statutes in other countries and indicated that most other countries, which have a VAT system, follow the "pay-now-argue-later" rule. We submit that this is not the case with income tax. In *Taxpayer's Rights and Obligations: A Survey of the Legal Situation in OECD Countries*, a survey of twenty-two countries in 1990 evaluated whether there is a suspension of tax payments when an assessment is under appeal. The survey concluded that, two-thirds of the countries surveyed, allowed for postponing tax due, pending the hearing of an appeal.

   We recommend that the "pay-now-argue-later" principle only be applicable once the objection process is finalised.

2. The discretionary powers conferred to the Commissioner in the proposed section 88 is not expressly made subject to objection and appeal, which mean that it is an absolute or administrative discretion. The taxpayer is therefore effectively prohibited from using the simpler and more effective objection and appeal process in Part III of the Act as well as the Dispute Resolution procedures in Part IIIA of the Act and forced to take the case to court on review. In addition, such absolute discretions may also be challenged as unconstitutional *vis-à-vis* the Constitution.

   Research undertaken by Professor Linda van Schalkwyk, and published in *Meditari* (2001:286), found that–

   "The prevailing low tax morality of taxpayers in South Africa, coupled with the high incidence of tax evasion in South Africa, would be exacerbated if the constitutional protection of the rights of taxpayers were not evident, or if such constitutional protection proved not to be a real aid by eliminating unconstitutional tax provisions".

   It is therefore strongly recommend that the proposed section 88 be amended and expressly made subject to objection and appeal.

3. The proposed amendment to list the factors the Commissioner will consider when exercising his discretionary power to suspend the "pay-now-argue-later" rule is welcomed as this will instill confidence in taxpayers. We are, however, concerned that the Commissioner, a party to the dispute, will be provided with the discretionary power to consider whether the taxpayer has an "arguable case". It proposed that the decision whether the taxpayer has an "arguable case" be decided by the National Director of Public Prosecutions, or other independent body.

- The proposed amendment of section 88 does not stipulate a timeframe within which the taxpayer and the Commissioner must act. For example, the providing of information concerning the taxpayer's financial position. We recommend that section 88 be amended to provide timeframes which must be adhered to by the Commissioner and taxpayers.

Clause 18: Amendment to section 105 of the Income Tax Act No. 58 of 1962

- This clause refers to section 105 whereas it should refer to section 105A.

Clause 22: Amendment of paragraph 20 of the Fourth Schedule of the Income Tax Act No. 58 of 1962

- Allowing SARS to prescribe the basis for determining the provisional tax payments by notice in the Government *Gazette* may result in the situation where taxpayer's do not know what their potential liability is until shortly before the due date for payment. This is obviously undesirable and is at odds with the fundamental requirement of certainty. If SARS goes this route is essential that any such notice must be published well in advance of (i.e. more than 1 year before) the payment date.

- Clause 22 proposes an amendment to paragraph 20 of the Fourth Schedule to the Income Tax Act No. 58 of 1962 which may assist some taxpayers in complying with the extremely onerous rules regulating the second provisional tax payment. It is unfortunate that the relief is not contained in the Bill but will be prescribed by the Commissioner. It is unclear how the Commissioner is required to prescribe the basis envisaged in clause 22. As a minimum, we recommend that the Commissioner should be required to prescribe the basis in the Government *Gazette*.

  Unfortunately, clause 22 does not afford any relief to for example long-term insurance companies which must determine taxable income under section 29A of the Act which relies on actuarial calculations which are only finalized some time after the close of the long-term insurers year end.

- The fact that provisional taxpayers must submit a second provisional tax payment based on 80% of taxable income is extremely onerous and will no doubt give rise to a significant number of disputes on the additional tax of 20% envisaged in paragraph 20 of the Fourth Schedule to the Act that will unduly increase the administration for SARS and taxpayers alike.

Clauses 33, 34 and 36: section 1, section 6(6) and section 23 of the Value-Added Tax Act No. 89 of 1991

- The new VAT registration verification procedures that have been implemented from November 2008 caused significant delays in VAT registrations, increased the cost of registering for VAT significantly, and resulted in a number of practical difficulties. It is expected that the requirement to provide biometrical information will cause further delays in VAT registrations, and will increase the cost of VAT registration even further.

  It is premature to introduce legislation requiring biometrical information for VAT registration whilst SARS is still in discussion with tax practitioners and other stakeholders to seek alternative solutions to combat "the exceptionally high levels of fictitious persons applying for VAT registration" and to overcome the current practical difficulties that are being experienced with existing verification procedures.

  Foreign entities with no presence in South Africa will not be able to comply with the biometrical information requirements even though they may be obliged to register for VAT in South Africa.

  If biometrical information is considered to be the only alternative to combat "the exceptionally high levels of fictitious persons applying for VAT registration" then the such information should only be required in exceptional circumstances, and then only be made applicable in instances where persons apply for voluntary registration in terms of section 23(3)(c) of the VAT Act.

  We therefore recommend that the amendments in clauses 33, 34 and 36 of the VAT Act not be implemented at this stage.

Clause 35: section 20 of the Value-Added Tax Act No. 89 of 1991

- We would give preference to the first proposed amendment.

  The new proposed section 20(5A) should not only be made applicable to section 44, but its application should be extended to section 42 and 45 as well, and to supplies made in terms of section 11(1)(e) of the VAT Act, as similar practical problems with regard to the issue of tax invoices are being encountered in respect of supplies made in terms of these provisions of the VAT Act, as what is anticipated with transactions in terms of section 44 of the VAT Act.

  The proposed amendment should not be limited to tax invoices, but should be extended to debit and credit notes (section 21 of the VAT Act) as well.

Clause 37: Section 36 of the Value-Added Tax Act No. 89 of 1991

- The proposed section 36(4)(c) and 36(5)(d) is too subjective and should be deleted. The mere fact that the case is under objection or appeal means in principle that the Commissioner believes that the vendor does not have an arguable case.

  The amount of the tax under dispute should not influence the Commissioner's decision whether or not to suspend payment. The proposed section 36(4)(b) should therefore be deleted.

  Section 36(6) makes the payment of interest subject to the provisions of section 45(1), i.e. the Commissioner may refuse to pay interest if any VAT return, income tax return or any other tax return is outstanding. The Commissioner is liable to pay interest on the basis that a payment was made to SARS which was not so due and payable in the first instance, whilst section 45(1) applies to interest payable on delayed VAT refunds. Accordingly, the payment of interest by the Commissioner in terms of section 36(6) should not be made subject to section 45(1) of the VAT Act.

Clause 38: Section 39 of the Value-Added Tax Act No. 89 of 1991

- Interest is not intended to be a penalty or additional tax payable by the vendor for non-compliance with the VAT Act, but payable to compensate the *fiscus* for a financial loss incurred, or a cash flow cost incurred by the *fiscus*. If the *fiscus* did not suffer any financial loss, there is in principle no reason to pay interest.

  The principal test for the payment of interest should therefore be whether or not the *fiscus* suffered financial loss as a result of the non-payment of the delayed payment. Whether or not the non-payment or delayed payment was due to circumstances beyond the control of the vendor is very subjective. We recommend that no amendment be made to section 39(7)(b) of the VAT Act.

  The implementation of the new section 39(8) of the VAT Act should be delayed until the regulations have been published and have been made subject to public comment.

2 CONCLUSION

Thank you for the opportunity to comment. We look forward to meeting with National Treasury during the round table meeting.

Please do not hesitate to contact us should you have any queries regarding the submission.

Yours sincerely,

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Chief Executive

Professor Jackie Arendse
Chair: National Technical Committee