Taxation Laws Amendment Bills, 2010: Response Document Highlights

3 August 2010
National Treasury & SARS

Committees On Finance

Ongoing TLAB Process

- Draft TLAB published on 10 May 2010
- Briefing SCOF on 18 May 2010
- SCOF Hearings held on 1 June
- Written comments due by 11 June
- 60 written submissions / comments received.
- Four NT/SARS workshops (late June & early July)
  - International and Business (Income Tax)
  - Individuals, Savings and Administration (Income Tax)
  - Mineral and Petroleum Royalty
  - Islamic Finance (Income Tax & Indirect)
- Schedule and rules relating to the Vehicle CO_2 emissions tax were published for comment on 2 July 2010. Four written comments were received.

Summary of Key Issues

- Individuals & Savings
  - Employer-provided motor vehicles
  - Narrowing of the interest exemption
  - Executive share schemes
  - Employer-provided professional fees
  - Key person insurance policies
- Business
  - Prevention of financial instrument mismatch schemes
  - Terminating residential entities
- International
  - Narrowing of the cross-border interest exemption
  - Foreign hybrid entities
- Royalties
  - Permissible rollovers
  - Specified condition for minerals
- Administration
  - Interest on underpayment of provisional tax raised on assessment

Individuals & Savings

Proposed Revisions

Employer-Provided Motor Vehicles: Main Initial Proposal

- New fringe benefit inclusion rate
  - Increased to a 4% monthly calculation for all vehicles provided (less business use and employee private costs)
- Monthly withholding
  - 3.2% included per month in respect of PAYE withholding

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Employer-Provided Motor Vehicles: Revised Proposal

- Revised inclusion rate
  - 3.5% monthly calculation for all vehicles (less business use and employee private costs)
- Vehicles purchased with maintenance plans
  - Rate reduced to a 3.25% monthly calculation for vehicles purchased with "full maintenance" plan included within the purchase price
- Reduced withholding for vehicles mainly dedicated to business use
  - Monthly PAYE withholding reduced to 20% of the above calculation if no more than 20% private use anticipated
  - Employer is jointly liable for errors in the private use assumption

Interest Threshold Exemption: Initial Proposal

- Revised domestic exemption thresholds
  - Individuals < 65 years = R22 300 (previously R21 000)
  - Individuals of 65 years+ = R32 000 (previously R30 000)
- Proposed narrowing (some permissible categories)
  - Interest bearing products listed on the JSE (e.g. listed bonds issued by private-sector companies & parastatals)
  - Interest paid by any one of the three spheres of government
  - Interest paid by any domestic bank
  - Interest paid by a registered medical scheme
  - Collective investment (money market) schemes and
  - Interest from dealer or brokerage accounts

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Interest Threshold Exemption: Revised Proposal

- Threshold increases to remain
- Proposed narrowing
  - The proposal to narrow the exemption will be completely withdrawn
  - Rationale #1 – Adversely impacts loans from family and friends
  - Rationale #2 – Will negatively impact less wealthy small business owners that have no interest from other sources

Revision of Executive Share Schemes: Main Initial Proposal

- Proposal #1: Company distributions
  - Holders of restricted instruments receiving distributions during the restriction period will be taxed at ordinary rates (i.e. no dividend exemption)
  - No deduction for employer and STC applies
- Proposal #2: Employee purchases
  - Employee acquisitions of shares are tainted under section 8C without regard to purpose (i.e. without regard to the "by virtue of employment" test)

Revision of Executive Share Schemes: Revised Proposal

- Proposal #1: Company distributions
  - Ordinary treatment for distributions will apply only in respect of restricted equity instruments that are not ordinary shares (e.g. restricted preference shares)
  - No deduction for employer and STC still applies
- Proposal #2: Employee purchases
  - Employee acquisitions of shares are still tainted without regard to purpose but this rule applies only to acquisitions of restricted shares

Employer-Provided Professional Fees

- Initial proposal
  - Employer-provided indemnity insurance is now an exempt fringe benefit
  - The rules relating to employer-provided professional subscriptions was to be changed so that:
    - Duties of employment must involve the practice of the profession to which the fee relates; and
    - Registration operates as a condition for that person to practice within the relevant profession
- Revision
  - Changes to the test for professional subscriptions will be dropped
  - Taxpayers will continue to rely on the current "condition of employment" test as requested

Key Person Insurance Plans

- Clarification
  Employers can deduct premiums if either:
  - Employees have a corresponding and simultaneous inclusion (e.g. are explicit plan beneficiaries); or
  - The premium is for a key person insurance plan that is genuinely for the benefit of the employer (e.g. to cover losses of employer profits)
- Odd and ends
  - Key employee plans must be pure risk plans without any surrender value
  - Taxpayers can cede the plan before maturity to creditors while continuing to pay on the policy while continuing to deduct the premiums
  - Taxpayers can also completely cede an "unmatured" plan to an employee upon the employee's departure (but matured plan payouts are impermissible)
  - Transitional relief: Illegitimate plans currently in existence receive rollover relief when transferred to employees (but no further deductions will be allowed going forward)

Business

Proposed Revisions

Financial Instrument Mismatches: Initial Proposal

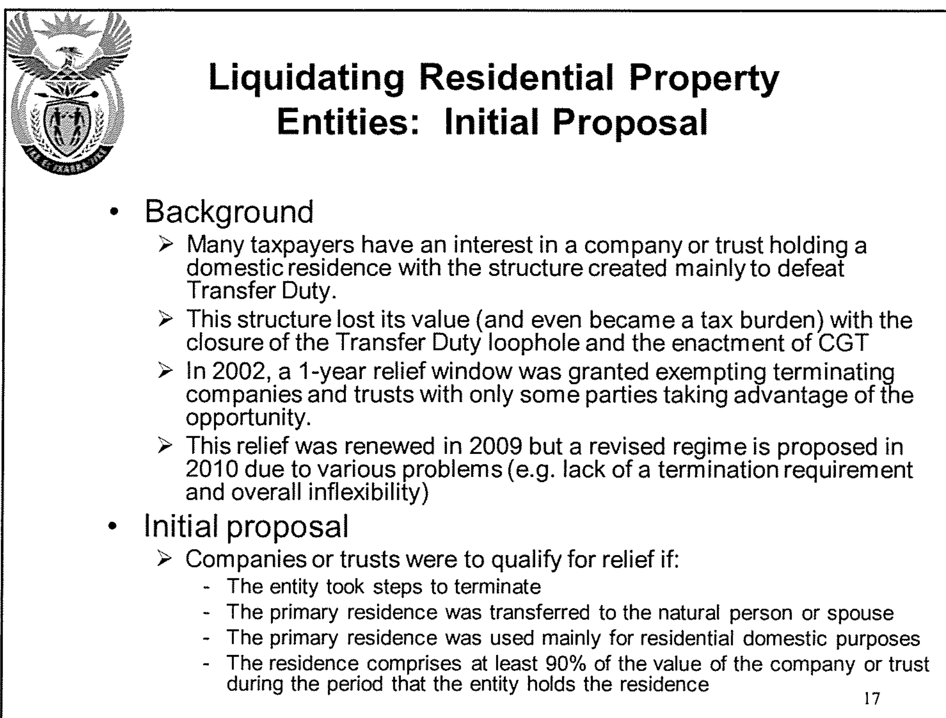
- In addition to common law tests relating to the general deduction formula, specific tracing was to be required to ensure exempt proceeds from financial instruments were not funded by debt (or other deductible financial instruments)
- Failure to apply specific tracing meant that financial instrument deductions in the current year were to be reduced equal to the exempt untraceable financial instrument receipts/accruals
- In terms of the new tracing rule, taxpayers ultimately were to look solely at "use" as opposed to "purpose"
- The anti-avoidance rule was to apply equally to newly issued and pre-existing financial instruments

Financial Instrument Mismatches: Revised Proposal

- Proposed anti-avoidance rule completely withdrawn
  - Rationale #1: The "purpose" element cannot be wholly removed as a practical matter
  - Rationale #2: The proposal could not be drafted without being either too broad or too narrow
- Notes of concern
  - Ongoing use of dividend cessions (and other exempt income shifts) to undermine the tax base
  - Difficulties of tracing under the section 11(a) formula where multiple fungible income streams are involved

Simple Example of Mismatch Problem

Assume no linkage possible	Interest Paid	Dividend Received
Economics (net zero)	- R100	- R100
Tax (negative R100)	-R100	Zero


Liquidating Residential Property Entities: Initial Proposal
• Background
➢ Many taxpayers have an interest in a company or trust holding a domestic residence with the structure created mainly to defeat Transfer Duty.
➢ This structure lost its value (and even became a tax burden) with the closure of the Transfer Duty loophole and the enactment of CGT
➢ In 2002, a 1-year relief window was granted exempting terminating companies and trusts with only some parties taking advantage of the opportunity.
➢ This relief was renewed in 2009 but a revised regime is proposed in 2010 due to various problems (e.g. lack of a termination requirement and overall inflexibility)
• Initial proposal
➢ Companies or trusts were to qualify for relief if:
- The entity took steps to terminate
- The primary residence was transferred to the natural person or spouse
- The primary residence was used mainly for residential domestic purposes
- The residence comprises at least 90% of the value of the company or trust during the period that the entity holds the residence
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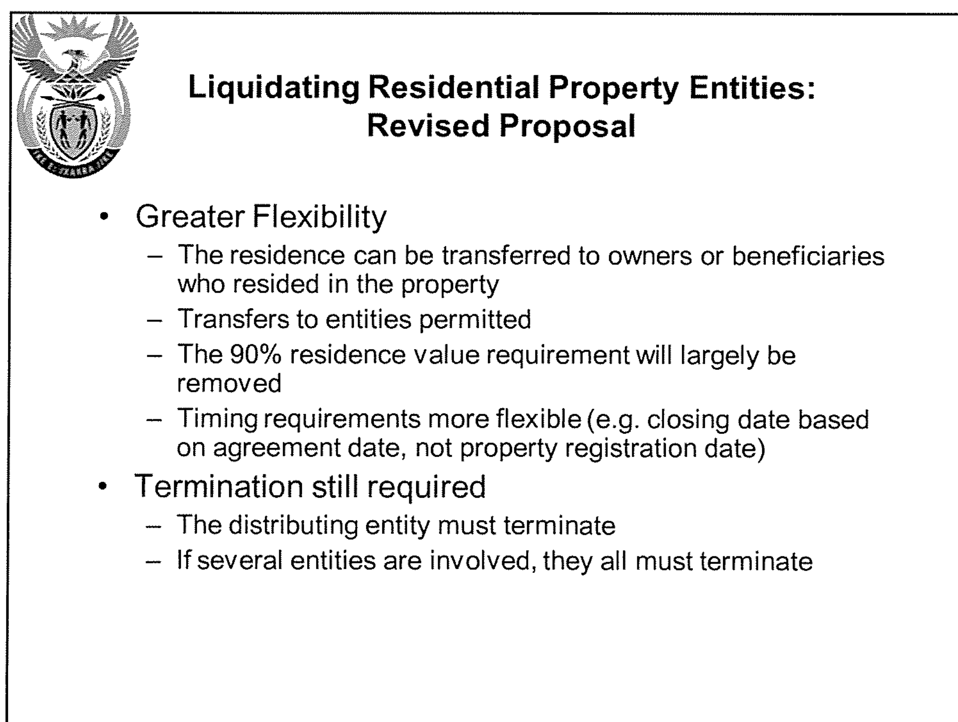
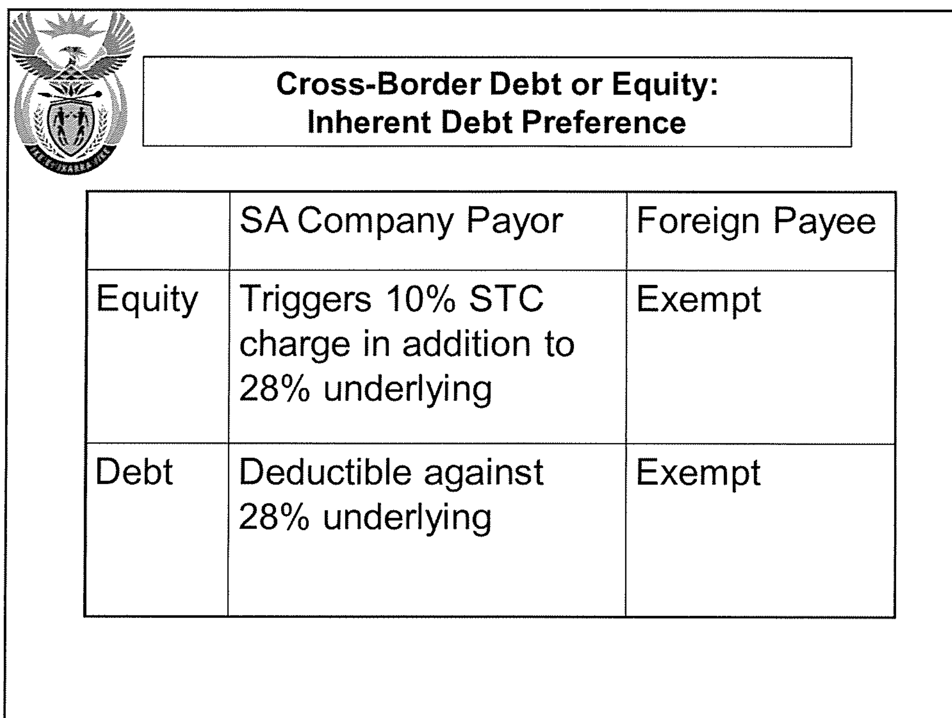

Liquidating Residential Property Entities: Revised Proposal
• Greater Flexibility
– The residence can be transferred to owners or beneficiaries who resided in the property
– Transfers to entities permitted
– The 90% residence value requirement will largely be removed
– Timing requirements more flexible (e.g. closing date based on agreement date, not property registration date)
• Termination still required
– The distributing entity must terminate
– If several entities are involved, they all must terminate

International

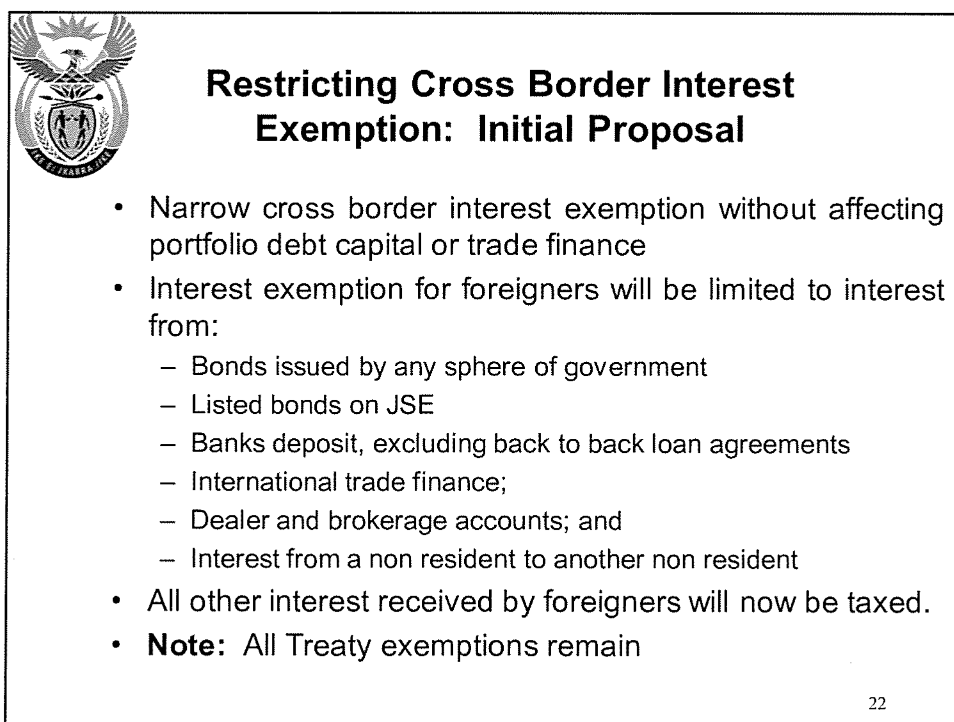
Proposed Revisions

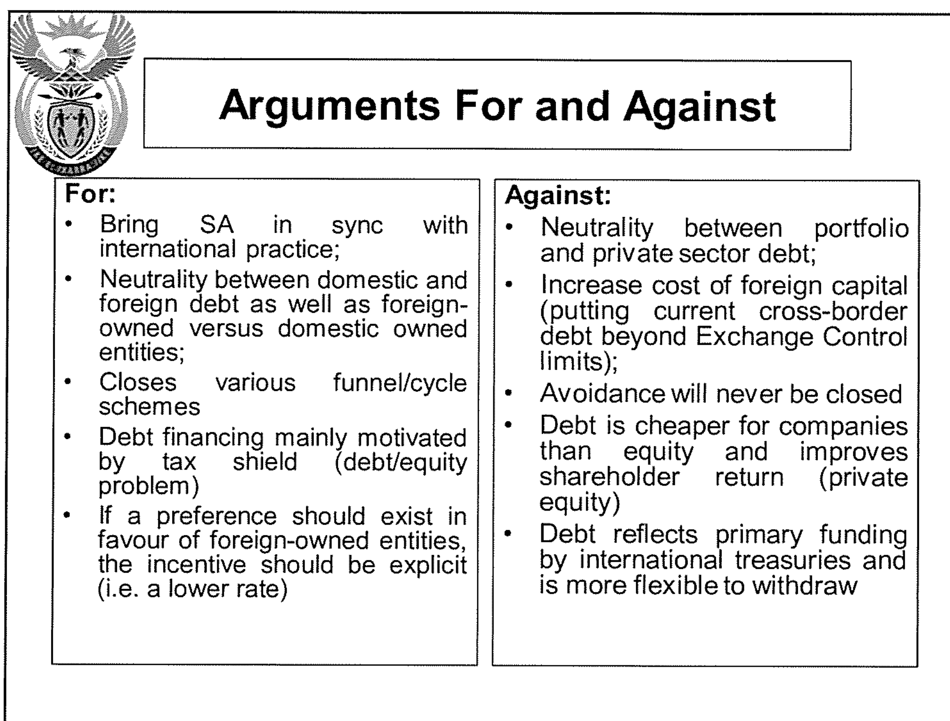
Restricting Cross Border Interest Exemption: Current Law

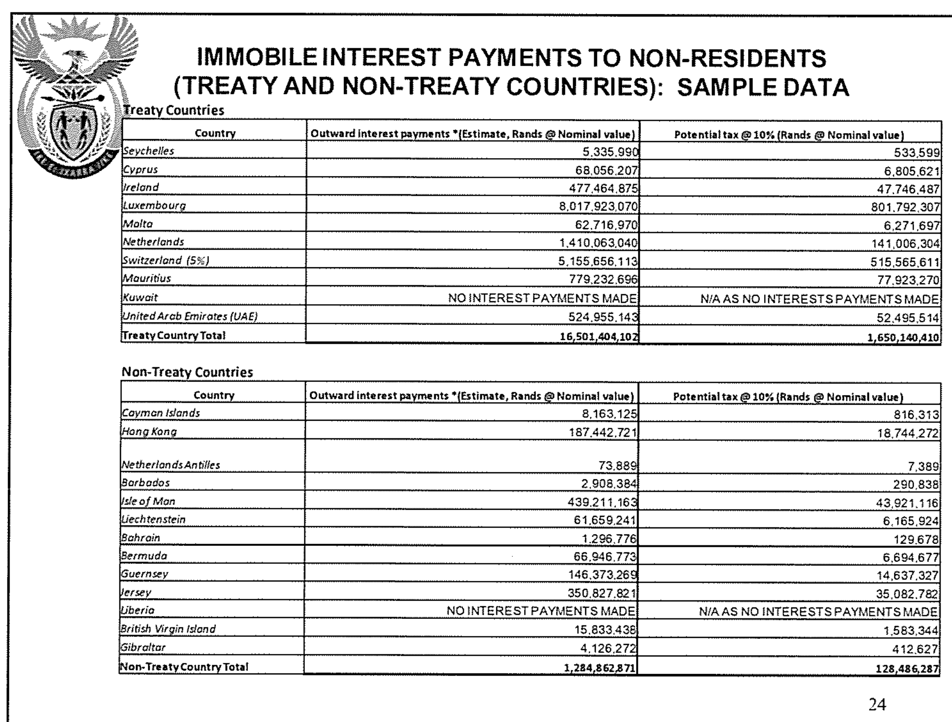
- Background
  - Current tax rules offer a blanket exemption to interest payable to foreigners
  - Exemption was intended to attract foreign portfolio investments
- Problem
  - The blanket interest exemption is not in line with international practice
  - Taxpayers collude so as to generate a deduction without corresponding taxable income
  - Taxpayers also have an incentive to claim excessive interest (despite thin capitalisation restrictions)



	SA Company Payor	Foreign Payee
Equity	Triggers 10% STC charge in addition to 28% underlying	Exempt
Debt	Deductible against 28% underlying	Exempt







IMMOBILE INTEREST PAYMENTS TO NON-RESIDENTS (TREATY AND NON-TREATY COUNTRIES): SAMPLE DATA

Treaty Countries

Country	Outward interest payments *(Estimate, Rands @ Nominal value)	Potential tax @ 10% (Rands @ Nominal value)
Seychelles	5,335,990	533,599
Cyprus	68,056,207	6,805,621
Ireland	477,464,875	47,746,487
Luxembourg	8,017,923,070	801,792,307
Malta	62,716,970	6,271,697
Netherlands	1,410,063,040	141,006,304
Switzerland (5%)	5,155,656,113	515,565,611
Mauritius	779,232,696	77,923,270
Kuwait	NO INTEREST PAYMENTS MADE	N/A AS NO INTERESTS PAYMENTS MADE
United Arab Emirates (UAE)	524,955,143	52,495,514
Treaty Country Total	**16,501,404,102**	**1,650,140,410**

Non-Treaty Countries

Country	Outward interest payments *(Estimate, Rands @ Nominal value)	Potential tax @ 10% (Rands @ Nominal value)
Cayman Islands	8,163,125	816,313
Hong Kong	187,442,721	18,744,272
Netherlands Antilles	73,889	7,389
Barbados	2,908,384	290,838
Isle of Man	439,211,163	43,921,116
Liechtenstein	61,659,241	6,165,924
Bahrain	1,296,776	129,678
Bermuda	66,946,773	6,694,677
Guernsey	146,373,269	14,637,327
Jersey	350,827,821	35,082,782
Liberia	NO INTEREST PAYMENTS MADE	N/A AS NO INTERESTS PAYMENTS MADE
British Virgin Island	15,833,438	1,583,344
Gibraltar	4,126,272	412,627
Non-Treaty Country Total	**1,284,862,871**	**128,486,287**

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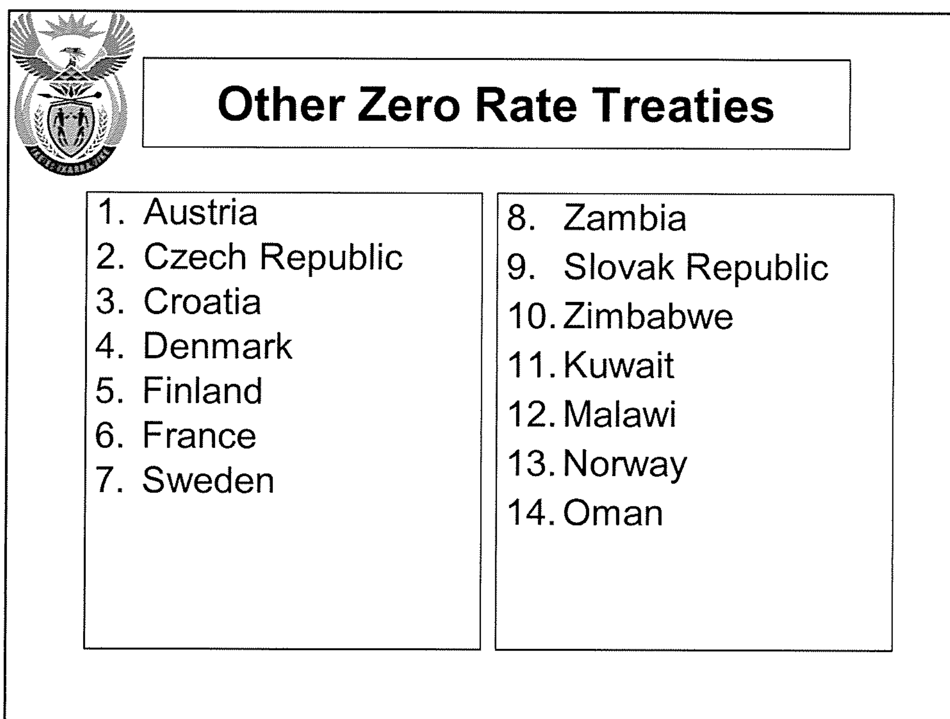
Treaty Problems

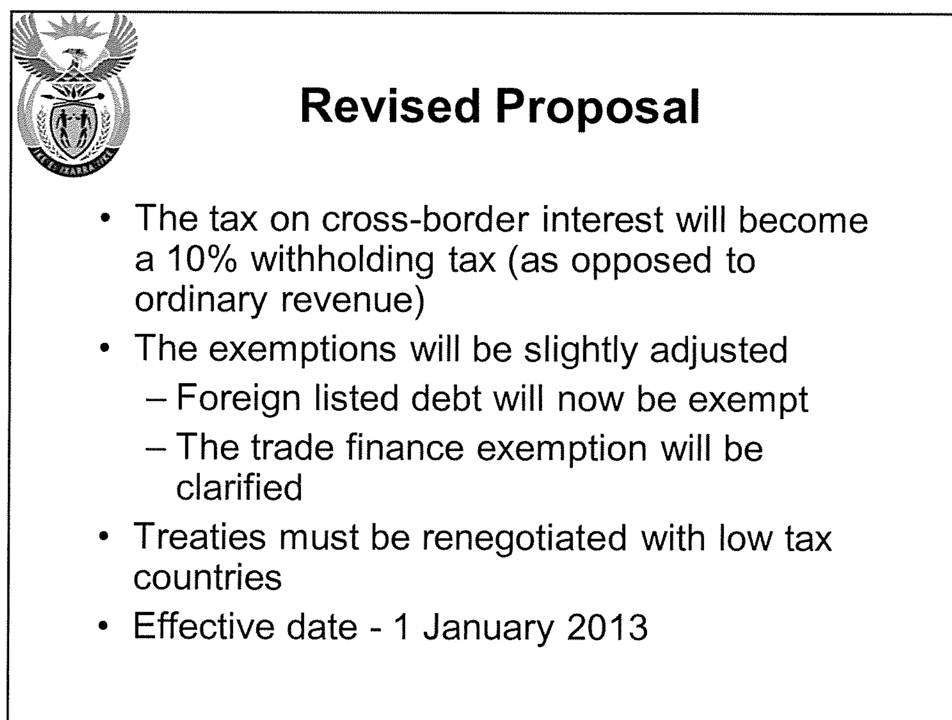
- 0% interest treaties will not be impacted by the proposal
- 0% interest treaties with low tax countries create an automatic problem
- 0% interest treaties with other countries may be a problem if taxpayers treaty shop
  - Note #1: Few SA tax treaties prevent treaty shopping
  - Note #2: General principles only mildly helpful (e.g. beneficial ownership concept)

Zero Rate Treaties (Low Tax Counties and Treaties with LOBs)

- **Zero rate treaties with low tax countries:**
  1. Cyprus
  2. Hungary
  3. Luxembourg
  4. Mauritius
  5. Netherlands
  6. Seychelles
  7. Singapore
  8. Switzerland (5%)

- **Zero rate treaties containing LOBs:**
  1. USA
  2. UK


Other Zero Rate Treaties
1. Austria
2. Czech Republic
3. Croatia
4. Denmark
5. Finland
6. France
7. Sweden
8. Zambia
9. Slovak Republic
10. Zimbabwe
11. Kuwait
12. Malawi
13. Norway
14. Oman


Revised Proposal
• The tax on cross-border interest will become a 10% withholding tax (as opposed to ordinary revenue)
• The exemptions will be slightly adjusted
– Foreign listed debt will now be exempt
– The trade finance exemption will be clarified
• Treaties must be renegotiated with low tax countries
• Effective date - 1 January 2013

Foreign Hybrid Entities: Nature of Vehicle

- Hybrid entities typically consist of:
  - Limited Liability Companies
  - Limited Liability Partnerships
- These entities mainly stem from the U.S. and the U.K.
- These entities offer limited liability like a company but are taxed in their home countries like a partnership (i.e. as a conduit)

Foreign Hybrid Entities: New Proposal

- Current Law: Not entirely clear but probably treated as a separate taxable company
- Proposal:
  - If the foreign entity is treated as a taxable conduit abroad, the South African tax system will treat the foreign entity as a conduit
  - Roughly follows the Australian approach
- Rationale for proposal
  - Clarity required in light of the new Companies Act and the pending Dividends Tax
  - Reduces offshore avoidance
  - Places foreign limited liability companies/partnerships on par with domestic *en commodite* partnerships, thereby providing equal tax relief for regional investment funds

Mineral and Petroleum Royalty

Proposed Revisions

Rollover Relief: Initial Proposal

- Background
  - Many smaller and medium sized extractors do not have sufficient resources to engage in the full gamut of refining activities – these extractors sell to other extractors who refine the mineral resources to a higher level
  - The sale triggers a royalty that is subject to a notional upliftment because many smaller and medium sized extractors lack the means to bring the mineral resource to the required minimum level
- Proposal
  - Elective roll-over relief was to be granted if both parties have mineral rights
  - This relief applies upon mutual agreement between extractors if the transferee refines the mineral resource within South Africa
  - In addition, a definition of "win nor recovers" was to be added that sought to create an automatic rollover for residue stock piles

Rollover Relief: Revised Proposal

- Rollover to be expanded
  - The transferee is no longer required to refine
  - Parties lacking mineral rights
    - can elect royalty registration so as to be eligible for rollover relief;
    - But cannot rollover mineral resources to other parties (to prevent artificial endless rollovers)
- The "win or recover" definition will be dropped as unworkable

Mineral Resources with Specified Condition Ranges: Initial Proposal

- Background
  - The Royalty Act seeks to ensure a minimum level of beneficiation for refined and unrefined mineral resources by specifying the condition at which mineral resources should be transferred
  - Confusion exists as to how the royalty applies if a range of acceptable conditions exist
- Initial proposal
  - It is proposed that mineral resources with ranges be treated as follows:
    - If within the range – utilise the actual value
    - If at a level above the range – adjust downward to the top end of range, and
    - If at a level below the range – adjust upwards to the bottom end of the range

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Mineral Resources with Specified Condition Ranges: Revised Generic Proposal

- If a specified range exists, the mineral resource must never fall below the range
- If the mineral is extracted above the minimum level, the higher extraction level applies
- If the mineral is beneficiated above the minimum level, the beneficiation does not adversely impact the parties (i.e. does not increase the specified level)

Iron and Coal

- Coal
  - Initially had a Grades A-D range
  - Now has a minimum level of 19MJ calorific content
- Iron Ore
  - Initially had a 61-64% range
  - Now has a 61.5% minimum level

Administration

Proposed Revisions

Interest on underpaid provisional tax raised on assessment

- Background
  - Current tax rules permit SARS to waive interest on underpaid provisional tax if a taxpayer had reasonable grounds for taking the position that led to the underpayment
- Problem
  - Interest relates to use of money
  - The question of whether reasonable grounds exist for a position taken is properly taken into account when setting any penalties due
- Revised proposal
  - Instead of completely deleting the discretion it will be narrowed to cater for circumstances outside a taxpayer's control, as is the case in the VAT Act

Item not in Bills

Vehicle CO_2 Emissions Tax

Vehicle CO_2 Emissions Tax

- *Comment:* The motor industry has raised an objection to the inclusion of double cabs and small bakkies as "passenger" vehicles.
- They are of the view that these vehicles are classified as light commercial vehicles and should at this stage be excluded from the CO_2 vehicle emissions tax.
- The industry also asserts that emissions data for light commercial vehicles are not available, the main reason why we originally agreed to refer to passengers vehicles only.

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Vehicle CO_2 Emissions Tax

- *Response:* Not Accepted. It was always the intention that double cab vehicles should be included in the group of vehicles that will be subject to the CO_2 vehicle emissions tax during the first phase of its implementation.
- The inclusion of double cabs as a passenger vehicle is also in line with the intent of the VAT Act, the practical reality being that double cabs are mainly used as passenger vehicles.
- The National Regulator for Compulsory Specifications (NRCS), a subsidiary of the SABS, has confirmed that CO_2 emissions expressed as g/km is available for all vehicles.
- Most small single cab bakkies and their double cab equivalents in relation to one another have similar engine sizes. These two categories of vehicles should be treated the same for the purpose of the vehicle CO_2 emissions tax.

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