Standing Committee on Finance
Parliament of the Republic of South Africa
Plein Street
Cape Town
South Africa

By e-mail: awicomb@parliament.gov.za

1 March 2011

Chair, Members,

Budget 2011 Tax Proposals – Preliminary Comment

1. We present herewith PricewaterhouseCoopers' initial commentary on the Tax Proposals included in the 2010 Budget Speech.

2. As always, we remind members that tax legislation is notorious for having the proverbial "devil in the detail". As such, we may remain silent in respect of certain proposals that subsequently turn out to be objectionable or laudable, or we may commend ones that end up less favourable than initially anticipated, or we may oppose some that perhaps turn out to be less harsh than expected. We therefore eagerly await the actual text of draft amendment bills before submitting more comprehensive comment.

A. Overall

3. As with the 2010 proposals, we consider the 2011 tax proposals to be relatively neutral from a taxpayer and tax practitioner perspective. On balance, the combined effect of the proposals does not appear to be unduly harsh nor significantly generous.

4. The 2011 tax proposals appear to be well-balanced.

B. Proposals that are welcomed

Effective date for Dividends Tax ("DT")

5. Since the announcement in 2007 of the intention to scrap STC (the Secondary Tax on Companies) and replace it with a new withholding tax on dividends, companies and shareholders in SA and abroad have bemoaned the uncertainty around the actual implementation date.

PricewaterhouseCoopers Tax Services (Pty) Ltd, Reg. no. 1983/008289/07
No 1 Waterhouse Place, Century City 7441, P O Box 2799, Cape Town 8000
T: +27 (21) 529 2000, F: +27 (21) 529 3300, pwc.com/za

6. The certainty created by the Minister's announcement of the (expected) effective date of 1 April 2012 is thus welcomed.

Commitment to encouraging investment and capital flows

7. Several comments in this year's Budget signify an intention to support, clarify and strengthen existing initiatives aimed at encouraging investment.

8. Specifically:

   - The capital allowance regime for investments into Industrial Development Zones.
   - Further refinement of the so-called "Gateway into Africa" initiative (and, specifically, the rules around "*headquarter companies*"), aimed at encouraging foreign investors to use SA as an intermediate holding company location for investment into Africa.
   - The streamlining of the provisions aimed at incentivising expenditure on Research & Development in SA.
   - The review of the venture capital company (VCC) regime intended to facilitate investment in SMEs (small and medium-sized enterprises).
   - The suggestion that SA-based multinationals controlling foreign groups will be permitted to undertake internal re-organisation of those foreign sub-groups in a tax efficient manner.

9. We welcome the intention to further develop these aspects of SA's tax landscape.

Youth employment subsidy

10. Although the actual mechanics of this proposal are still somewhat uncertain, the subsidy initiative to encourage employers to employ inexperienced applicants is welcomed.

Extension of learnership allowances

11. The learnership allowance regime incentivises employers to up-skill their employees. The decision to review and extend this incentive (originally scheduled to terminate in 2011), is welcomed.

12. In fact, it is hoped that the review process will result in the retention of this incentive as a permanent aspect of SA's tax legislation.

C. Areas of Concern

National Health Insurance – How will this be funded?

13. The Minister's comments around how the proposed National Health Insurance will be funded, has raised a few eyebrows. Taxpayers are concerned that, in some way or another, this is simply another revenue-raiser without a corresponding improvement in health service delivery.

Retirement benefits

14. In the context of retirement funds, we await the detail on several aspects.

15. The proposal to treat employers' contribution as taxable fringe benefits is worrisome. This is likely to increase the taxable income of employees, although we are hopeful that the proposals around contribution-deductions (see next point) will mitigate this.

16. The simplification and increase of the deduction limits for retirement fund contributions is welcomed. We commend especially the decision to now allow the deduction of contributions to Provident Funds. The aggregation of all contributions into a single formula will also be a welcome simplification. However:

    - We are hopeful that employer contributions that will now become taxable (see above) will be deemed to be contributions by the employees themselves —failing which there will be a net increase in taxable income without any actual benefit or contribution profile having changed.

    - It is not clear why the aggregate deduction should be limited (to R200,000 per the Budget proposal). The capping sends a message that saving should be curtailed beyond a certain level. It may also result in punitive treatment of employees in the event that actuarial shortfalls require lump-sum contributions by employers to ensure fund solvency. This is of concern given SA's exceptionally low household savings rate (1.5% of GDP) and the outcome of research to the effect that only 9% of South Africans would have made adequate provision for retirement at age 65.

17. As regards the proposal to restrict lump sum payouts from Provident Funds to only one-third of the fund value, it is questioned whether the state should so expressly limit the savings choices of its citizens. Already, Retirement Annuity and Pension Funds permit only a restricted one-third payout, and the extension of this restriction to Provident Funds removes some degree of freedom of choice. However we note that this needs to be considered in conjunction with the deductibility of contributions.

18. The proposal to mandate preservation of retirement funds in the event of a change of job or divorce is welcomed as a step in the right direction to improve the household savings rate.

Youth employment subsidy – How will this work?

19. Details of the mechanics of the youth employment subsidy are also awaited. Specifically, the practical and administrative burden that will be placed on employers should not negate the incentive to employ inexperienced young employees.

Gambling withholding tax

20. From a principle perspective, taxpayers' find this objectionable since gambling losses are already being funded out of after-tax income, and no relief for losses is taken into account in taxing gambling winnings.

21. Furthermore, the National Lottery is already effectively a tax (albeit "voluntary") in the sense that it is a mechanism for the state to extract funds from its citizens in order to fund civic initiatives. The gambling tax therefore becomes a secondary layer of tax upon tax.

22. The practical policing of this measure, tax design issues —particularly related to defining winnings for different forms of gambling, the likelihood of a resurgence of non-compliance, and the creation of an incentive for illegal gambling operations, are also areas of concern.

Uniformity of taxing passive income and gains

23. There is uncertainty about how to interpret the suggestion that income and gains from capital should be uniformly taxed. For example, on the one hand dividends are currently fully exempt whilst, on the other hand, rental from fixed property is fully taxed. If National Treasury has some kind of convergence in mind, taxpayers will remain apprehensive of what final outcome is envisaged.

Medical expenses – Conversion into Tax Credits

24. The conversion of medical expenses (from deduction) into credits is an interesting and potentially equitable proposal. Details are awaited before further comment is made.

Dividend scheme anti-avoidance

25. There is no doubt that National Treasury and SARS are justified in targeting abusive tax avoidance schemes. However, the area of anti-avoidance provisions is notorious for a lack of precision. That is, there is always a concern that the anti-avoidance provisions are spread so widely that they end up attacking unintended transactions and structures —and thus end up being an impediment to normal commercial business operations.

26. The very same topic, as dealt with in the 2010 Budget and the subsequent 2010 Taxation Laws Amendment Act, is a case in point. The amendments that were written into the Income Tax Act last year remain so broad and vague that taxpayers are still making representations requesting clarity or raising objections. Some of these rules are so broad that they are considered unenforceable because they may technically/arguably be imposed in so many situations where it is glaringly obvious that they should not find application.

27. We therefore express the hope that this proposal refers simply to a correction and focusing of the existing rules —whilst still maintaining a commitment to attacking overly aggressive tax schemes— as opposed to introducing an entirely new and far reaching set of provisions.

Pre-2001 base cost (CGT)

28. The suggestion that the 1-Oct-01 value of certain older assets should be permanently fixed (as opposed to be dependent upon the eventual disposal proceeds) is also an interesting proposal. We await further details.

Carbon Tax

29. 28 February 2011 was the deadline for submissions in response to National Treasury's Discussion Paper on "*The Carbon Tax Option*". It is submitted that, based on analysis of the proposals in the Discussion Paper, SA is still some way off from implementing an effective carbon-pricing measure. Concern is expressed that the Carbon Tax may be seen as a revenue-raiser as opposed to a Pigouvian Tax and that several of the assumptions applied in the Paper are either fundamentally flawed or out of date. (PwC has already made separate submissions to National Treasury in this regard.)

D. National Treasury Tax Policy Unit

30. As a final matter, we take this opportunity to commend the Tax Policy team at National Treasury. Highly complex concepts are constantly addressed under stressful time pressure. However, it is also obvious (in our view) that the team is under-resourced with the result that inadvertent errors sometimes creep in but, more importantly, critical policy projects are delayed because the team is overburdened by the day-to-day workload.

31. A case in point is the Income Tax Act (ITA) re-write project. The current ITA was last consolidated and re-written 49 years ago, i.e. in 1962. Before that, there was a consolidation in 1945 —only 17 years earlier. There is little difference of opinion that the current ITA is desperately (and urgently) in need of consolidation. National Treasury's current re-write project appears to have commenced some 4 or 5 years ago, but progress seems to be slow. As mentioned, the main reason for this delay appears to be the resource constraints at National Treasury.

32. Apart from the re-write project, there are several other tax policy initiatives that taxpayers are calling on National Treasury to address (e.g. group taxation, the treatment of derivatives, and many others), but which are hampered by the resource problem.

33. Our request is that the resourcing of the Tax Policy unit be specifically reviewed.

We thank you for the opportunity to offer our opinion on the National Budget, and we trust that you find this to be of assistance in your deliberations. Please do not hesitate to call on us for further analysis.

Yours sincerely,

(Prof.) **Osman Mollagee**
Director: Tax Technical
osman.mollagee@za.pwc.com
+27 (21) 529 20 61

Kyle Mandy
National Head: Tax Technical
kyle.mandy@za.pwc.com
+27 (11) 797 49 77