

Standing Committee on Finance (“SCoF”)
Parliament of the Republic of South Africa
90 Plein Street
Cape Town

By email: awicomb@parliament.gov.za

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Dear Members

Draft Taxation Laws Amendment Bills 2011

Introduction and overall remarks

- 1 We refer to the draft Taxation Laws Amendment Bills, 2011 (“**the Bills**”) and the accompanying Explanatory Memoranda (“**EM**”) and Media Statement published by National Treasury (hereinafter “**Treasury**”) on 2 June for public comment.
- 2 Attached for your consideration as Appendix A are our comments in respect of the detailed proposals contained in the draft Bills. As requested in the Media Statement accompanying the draft Bills, these have been arranged in the same order as the related matters have been set out in the EM.
- 3 However, prior to commenting on the specific proposals there are certain aspects that we wish to highlight to the SCoF on the basis they are overarching matters of key importance. Other matters are included in this introductory section for purposes of brevity as they are points which are applicable to a number of the specific proposals discussed later.

The dangers of sudden announcements

- 4 As has been seen through the various press articles and was acknowledged by Treasury in its presentation to the SCoF of 15th June the hiatus of the section 45 relief was a sudden shock to the business community (in one instance cited in the press the withdrawal of the relief has caused the proposed BEE transaction of a listed company to be halted, with 11% of the share price and value wiped out and the SCoF has heard from PMC that in its case the equivalent figure was 20%).
- 5 Whilst we acknowledge that Treasury have indicated the revocation was a matter of last resort and that their hope is that the final legislation will contain a more targeted measure against the mischiefs they have identified, the potential harm caused from the way in which this matter has been handled must not be underestimated.
- 6 Aside from the legitimate transactions impacted (more on this aspect later) we would bring to the attention of the SCoF experience elsewhere in this regard.

- 7 When Australia sought to introduce a mining 'super tax' it similarly did so without warning and with no prior consultation with, in that case, the specific industry.
- 8 The lack of certainty and stability (both from a tax system and political risk perspective) resulting from this has been attributed to giving rise to an additional cost to the Australian economy through an increase in the perceived sovereign risk. This cost is not just on government debt but on debt that the corporate market borrows from offshore.
- 9 In this regard we include as Appendix B for the SCoF's attention copies of certain articles and reports concerning such sovereign risk. It is important to note that these risks result from the uncertainties that dramatic legislation without forewarning may bring about, it is not necessarily the tax itself that results in the increased risk, though that of course can also be the case.
- 10 It is suggested that such risks are something that South Africa cannot afford, particularly not in a time of increasing government debt.
- 11 In addition the Media Statement accompanying the draft Bills refers to 'excessive debt' which can be by reference either to the level of debt or the rate at which such debt is raised. It is, to say the very least, wholly incongruous that as Treasury is raising a concern as to excessive debt it has opted to amend legislation in a manner that can negatively impact on the very matter on which it is seeking to legislate.
- 12 In short the concern is that the manner in which such radical legislation has been put forward without warning may lead to a lack of investor confidence in South Africa as an investment jurisdiction with the attendant risk of scaring off long term capital investment needed to stimulate the economy and assist in job creation.

The need for an internationally competitive tax system

- 13 South Africa remains heavily dependent upon its mining resources industry. The mining resources industry however is an increasingly global one with fresh markets continuing to open up and the fight for development capital increasing. In this regard we refer again to the Ernst & Young report included within Appendix B which highlights that in 2009 Africa as a whole accounted for only 15% of the global mining spend (no break-down is provided for how much of this related to South Africa).
- 14 Although the above point is in relation to the mining industry, many industries are highly mobile and certain aspects relating to countries (amongst which the tax system and its stability certainly rank highly) are relevant in determining where investments are made.
- 15 Whilst South Africa has for many years now had many of the fiscal protections common to sophisticated tax systems (such as anti-avoidance mechanisms in the form of controlled foreign company legislation, a general anti-avoidance rule, thin capitalization provisions) certain of the balancing key fundamentals in the taxpayer's favour found in other jurisdictions remain lacking, such as the interest deductibility on the acquisition of shares (more on this later) and any form of group taxation (be it consolidated tax filings or loss surrender).
- 16 It is imperative that South Africa not drag its heels on these aspects any longer, aside from bringing the country in line with its international peers and the countries to which Treasury regularly compares us in bringing forward new legislation (UK, US, Australia, Canada) the introduction of such measures would mitigate against certain of the root causes of the section 45 debate now raging (in particular its use in leveraged buyouts – discussed in greater detail below). In addition, in like vein, it is essential that section 45 (with such safeguards as are necessary) be retained.

The need for equitable treatment

- 17 Whilst it has been said that there is no equity in tax (and in certain cases this is so) this does not mean that this is not something that each tax system should strive for. Indeed, National Treasury's presentation to the SCoF on 15th June (slide 56 "Minuses (-) and Pluses (+)") is on this very basis, as are certain of the proposed amendments this year (eg interest on perpetual debt treated as dividends for both payor and recipient, treatment of assumption of contingent liabilities ensures one deduction only, employer deduction for insurance contributions only where included as taxable benefit for employee).
- 18 Even in the context of tax avoidance arrangements, where SARS adjusts the tax outcome in one taxpayer the legislation obliges SARS to effect compensating adjustments in counterparties so as to ensure consistent treatment.
- 19 All of the above is in our view good for the promotion of an equitable system which, combined with other aspects such as a transparent legislative process and an impartial Revenue Service applying the law as it stands, encourages, amongst other, taxpayer morality.
- 20 Although certain non-neutralities do exist in any tax system (a basic example in South Africa's case being where a bank is taxed on the receipt of bond interest whereas the borrower using the funds to acquire their residential home obtains no deduction) others, some of which are identified below, are, it is submitted, so unjust that they prejudice the very moral fibre of the tax system itself.
- 21 Whilst a number of the instances summarized below are not new they perhaps give an indication as to possible reasons why certain taxpayers may feel justified in looking for the "net minus" when the fiscus on the other side is legislating for "net pluses".
- 22 Examples of legislation perceived as unfair;
- Section 1 – the proposal that dividends (being the distribution of income which has already been subject to tax) be again subject to tax should they be paid to a beneficiary of a trust who is not an individual (and in some cases also where the beneficiary is an individual) even in the absence of any tax avoidance;
 - Section 8E and proposed section 8EA – treats dividends on certain shares as taxable interest in the hands of the recipient whilst remaining a dividend (non-deductible) and subject to secondary tax on companies in the payor;
 - Section 8F – treats interest as non-deductible in the hands of the payor whilst retaining its taxable interest character in the hands of the recipient;
 - Section 9E (not yet enacted)
 - unlike the proposed dividends withholding tax regime which grants a transitional credit for STC credits existing at the date the new regime comes in the proposed regime for passive holding companies contains no such provisions with the result that double tax is likely to arise;
 - double tax will also arise as dividends flow up a multi-tiered chain of companies as no exemption is provided for dividends from profits which have already been subject to tax under section 9E;

- Section 10(1)(k)(i)(dd) – treats dividend income (paid from post tax profits in the declarer) as taxable in the hands of the recipient on the basis it is hidden salary whilst remaining a dividend (non-deductible) and subject to secondary tax on companies in the payor;
- Section 42 – a provision aimed at facilitating reorganizations on a tax neutral manner in fact doubles up the CGT cost (this in the context of promoting business restructures);
- Whilst South Africans have been taxed on a world-wide basis since 2001 restrictions still apply to the offset of foreign trading losses which, in the context of individuals cannot even be offset against foreign capital gains, let alone South African sourced income;
- When Securities Transfer Tax replaced Stamp Duty (the latter being payable on issue but not cancellation of shares) no duty was charged on issue but a charge was introduced for cancellation with no credit being given for Stamp Duty having been paid on the issue of the same share;

23 The above list is by no means an exhaustive one and has been included for illustrative purposes, though each of the matters summarized above is also discussed in greater detail in this submission.

Timeframes and process

- 24 The draft Bills, accompanying EMs and Media Statement, totaling some 376 pages, were released on National Treasury's website on the evening of 2nd June.
- 25 Although the comment period to SARS and Treasury is open until 4 July public submissions to the SCoF are scheduled for 21st and 22nd of June with advance copies of submissions and presentations having been requested for the attention of the SCoF by 3pm on Monday 20th June.
- 26 This affords the public less than 11 business days to review and comment on the documents.
- 27 The SCoF are placed in the even more insidious position of having to review and consider not only the documentation prepared by Treasury and SARS but also the public comment from multiple interested parties.
- 28 This position has been highlighted repeatedly by a number of commentators over the last few years yet the issue remains. It is respectfully submitted that the SCoF must enforce that suitable time, for both the public and the SCoF, is granted in order that due consideration can be given by all involved.
- 29 In addition, whilst Treasury each year also gives feedback to the SCoF post further consultation with the public as to which comments have been accepted and which not, the public is not afforded the opportunity to state its case again in order that the SCoF can understand where real remaining issues arise. This issue has also been raised for a number of years but the timetable set out for the parliamentary process surrounding the bills for 2011 again does not appear to make any provision for such a session.

- 30 This point is even more pertinent in a year that, in our view, represents some of the most wide ranging and radical reforms since the introduction of capital gains and controlled foreign company legislation in 2001.
- 31 Notwithstanding the concerns detailed above it is only fair to note that the interaction between National Treasury and SARS with the public around this time and throughout the year by way of various workshops is extremely good and useful and we commend them both for this.

Labels

- 32 Treasury has made much of the danger of transactions being presented under a 'label' whereby a flag of convenience is attached to a transaction in an attempt to motivate the tax treatment sought ('BEE' is one such transaction often cited by Treasury). Whilst we agree that the fiscus must be cognisant of this risk we are concerned that there is a very real risk (as is evident from the legislation) that legitimate transactions are prejudiced. The reality in South Africa is that BEE transactions are a required part of the economic landscape and the continued suggestion that BEE is being merely used as a label is unacceptable.
- 33 Many businesses in South Africa are incurring substantial cost to implement broad based BEE in a spirit of reconciliation. To suggest that these transactions are nothing other than tax motivated transactions ignores the real and substantial value being created for the historically disadvantaged part of our community.
- 34 Whilst in certain instances the alignment of tax policy with other government policies is evident, in the current instance, with the proposed removal of section 45 and its attendant risks to the policy of empowerment it is not evident that due consideration has been given in consultation with other government departments affected.

Particular aspects

- 35 Whilst, as noted above, Appendix A contains our comments to date on the detailed proposals put forward by Treasury in the draft Bill, as has been the case in previous years we have no doubt that additional comments will be made prior to the close of the comment period.
- 36 For purposes of our presentation to the SCoF we have focused on only two of the detailed issues we perceive as being of critical importance, being the proposed revocation of section 45 and the insertion of section 8EA. In this regard we refer to our powerpoint presentation, a copy of which is attached as Appendix C.

As always we thank each of the committee, Treasury and SARS for the opportunity afforded the public to the development of the country's legislation.

Yours faithfully

James Aitchison

Appendices

- A Comments on detailed proposals
- B Selection of articles and reports on impact on Australia's sovereign risk from introduction of super tax on mining
- C Powerpoint presentation on key points

cc nomfanelo.mpotulo@treasury.gov.za
keith.engel@treasury.gov.za
acollins@sars.gov.za
ftomasek@sars.gov.za