COMMENTS ON THE 2012 DRAFT TAXATION LAWS AMENDMENT BILL

1. **Inequality regarding the application of the dividends tax (Section 64E and double tax agreements)**

We note that the current dividends tax provisions discriminate between resident companies and branches of non-resident companies. The former will be exempt from dividends tax and the latter would suffer dividends tax at 15%. In this regard we note that double taxation agreements ("DTA's") typically contain non-discrimination provisions. By way of example, Article 23(2) of the DTA entered into with the United Kingdom provides that:

> *"the taxation on a permanent establishment which an enterprise of a Contracting State* (UK) *has in the other Contracting State* (SA) *shall not be less favourably levied in that other State* (SA) *than the taxation levied on enterprises of that other State carrying on the same activities."*

In addition, we note that a non-resident company which is resident in a jurisdiction that has entered into a DTA with South Africa may suffer a higher withholding tax rate (ie 15%) if it carries on business in South Africa through a permanent establishment than it would have had it not carried on business in South Africa through a permanent establishment (ie the DTA may reduce the rate to 5/10%).

We question whether it is intended that companies resident in DTA partner countries should be discouraged from having a presence in South Africa.

Although it does not address the discriminatory impact, in our view the domestic legislation should at least contain a reduction of the dividends tax rate where the foreign company is resident in a DTA jurisdiction equal to the reduced rate contained in the dividends tax article of the DTA in instances where the non-resident operates through a permanent establishment in South Africa.

2. **Section 64J(2) of the Income Tax Act– proposed amendment**

Background

Section 64J(2) of the draft Taxation Laws Amendment Bill, 2012 ("the TLAB") published on 5 July 2012 proposes to amend section 64J(2) of the Income Tax Act, No. 58 of 1962 ("the Act") to exclude any dividends in respect of which the intra-group exemption from secondary tax on companies ("STC") applies. Prior to the publication of the TLAB, section 64J(2) of the Act provided that the STC credit of a company is equal to the sum of, *inter alia*, the amount by which the dividends accrued to that company during the dividend cycle ending on the day

immediately before the effective date and the dividends which are deemed in terms of section 64B to have accrued to that company during that dividend cycle exceed the dividends declared on that day by that company (section 64J(2)(a) of the Act).

The TLAB proposes to amend section 64J(2)(a) to state that the amount by which the dividends accrued to that company during the relevant dividend cycle must be determined "without regard to any dividend contemplated in section 64B(3A)". Section 64B(3A) of the Act refers to*, inter alia*, dividends contemplated in section 64B(5)(f), namely intra-group dividends.

The amendment is deemed to have come into operation on 1 April 2012.

Comment

The proposed amendment to section 64J(2)(a) of the Act intends that the section should apply with retrospective effect.

It has been a long-established rule, not only in South African law, but in other legal systems, that no statute is to be construed as having retrospective effect unless the Legislature clearly intended the statute to have that effect.

The basis of presumption against retrospectivity is what has been described as *"elementary considerations of fairness [which] dictate individuals should have an opportunity to know what the law is and to conform their conduct accordingly"* (*National Director of Public Prosecutions v Carolus and Others*, 2000 (1) SA 1127 (SCA) at 1139.

The presumption against retrospectivity is so strong that the Appellate Division has stated that *"even where a statutory provision is expressly stated to be retrospective in its operation it is an accepted rule that**, in the absence of contrary intention appearing from the statute, it is not treated as affecting completed transactions**"* (*Bellairs v Hodnett*, 1978 (1) SA 1109 (A) at 1148. Moreover, the presumption against retrospectivity operates so as to protect not only completed transactions, but also those that are nearing completion (*Bell v Voorsitter van die Rasklassifikasieraad*, 1968 (2) SA 678 (A).

The rule of law is specifically stated in the 1996 Constitution, No. 108 of 1996 ("the Constitution") to be one of the foundational values of the South African constitutional order. To this effect, section 1(c) of the Constitution provides that the Republic of South Africa is one, sovereign, democratic state founded on, *inter alia*, the supremacy of the constitution and the rule of law.

In the case of *Pharmaceutical Manufacturers Association of SA and another: In re ex parte President of the Republic of South Africa and others*, 2000 (2) SA 674 (CC), Chaskalson P

quoted with approval the following passage from De Smith, Woolf & Jowell Judicial Review of Administrative Action (5ed), making it clear that the rule of law does not embrace legislation that is retrospective in its operation:

"The scope of the rule of law is broad… [it] embraces some internal qualities of all public law: that it should be certain, that it is ***ascertainable in advance so as to be predictable and not retrospective in its operation****; and that it can be applied equally without unjustifiable differentiation."* (emphasis added)

Similarly in the case of *President of the Republic of South Africa and another v Hugo*, 1997 (4) SA 1 (CC), it was suggested that in the new constitutional order all law, including statutes enacted by Parliament, must satisfy the requirements of the rule of law. The court held as follows:

> *"The need for accessibility, precision and general application flow from the concept of the rule of law. A person should be able to know of the law, and be able to conform his or her conduct to the law."*

One of the fundamental principles of the rule of law is thus that it should not operate with retrospective effect, because such retrospectivity can have an unfairly detrimental impact on the vested rights and obligations of persons who organised their affairs and arranged their transactions in accordance with what the law required at the time of such conduct. The rule of law requires that persons should be able to know what the law requires at the time transactions are entered into in order for them to ensure that their conduct conforms to the requirements of the relevant law.

As regards the proposed amendment to section 64J(2)(a) of the Act, taxpayers may have declared dividends prior to the publication or promulgation of the TLAB on the basis of the law as it read at the time of declaration, taking dividends in respect of which the intra-group exemption was claimed into account in the determination of the STC credit. In the case of a listed company, where available STC credits were sufficient to absorb the dividends declared, payment of such dividends would have been correctly made by the regulated intermediary to the shareholders without withholding dividends tax.

Should the TLAB be promulgated in its current form, the provisions of section 64(1) of the Act will not be met in respect of dividends declared by a listed company since the dividend may, in terms of the proposed retrospective amendments, exceed the STC credits of such company.

Although the company would not have the liability to withhold dividends tax since the payment is to a regulated intermediary, the regulated intermediary should have withheld dividends tax on the basis that it did not receive any specified declarations from the beneficial owners.

In terms of section 64K(1)(a) the beneficial owner must pay the amount of dividends tax by the last day of the month following the month during which that dividend is paid by the company that declared the dividend unless the tax is being paid by any other person.

In addition, in terms of section 64K(3) on the basis that the regulated intermediary failed to withhold dividends tax as required, it is liable for the payment of the dividends tax as if it were tax due by that regulated intermediary unless the tax is paid by any other person.

In terms of section 64K(1)(c) the regulated intermediary should have paid over the dividends tax to SARS by the last day of the month following the month during which the dividend was paid.

In conclusion, in terms of section 64K(3) of the Act, SARS could claim the dividends tax from the regulated intermediary. Alternatively SARS could claim the dividends tax from the beneficial owners in terms of sections 64EA(a) and 64K(1)(a). SARS cannot approach the declaring company for the dividends tax. Seeking to claim the withholding tax from the regulated intermediary would, in our view, be inequitable since the intermediary acts on instruction from the company in withholding or not withholding dividends tax, and has no control over the position.

In light of the proposed amendment, it is firstly not possible for either the regulated intermediary or the beneficial owners to make the payments of dividends tax within the time period specified in section 64K(1) of the Act on the basis that no dividends tax is payable in respect of such dividends until the promulgation of the TLAB.

The retrospective provisions would therefore give rise to an impossibility to comply with existing statutory provisions from a practical perspective.

Based on the above, we urge the relevant authorities to make the proposed amendment prospective from the date of publication of the TLAB.

3. **Tax on rental company cars**

The proposed amendment to paragraph 7 of the Seventh Schedule, which is contained in the TLAB, provides that where the vehicle is “acquired” by the employer under an arm’s length “operating lease” (as defined), the taxable value will be the actual cost to the employer incurred under that operating lease.

The definition of an operating lease in section 23A restricts the ambit of this provision to very limited circumstances. In our experience, most employers acquire their company vehicles by means of full maintenance leases from vehicle financing companies. Typically, the vehicles would be returned to the lessor company upon termination of the lease. It appears that such rental vehicles acquired under a finance lease would not fall within the proposed amendment. It was the stated intention to exclude finance leases (i.e. indirect ownership) from the ambit of the provision, as indicated in the Explanatory Memorandum.

However, there seems no equitable reason to distinguish between an operating lease and a finance lease in determining the fringe benefit taxable value of company cars. Even in the case where the lease is a finance lease, the actual rental costs incurred by the employer under an arm's length lease agreement should constitute the taxable value of the fringe benefit.

4. **Proposed amendments to section 10(1)(h)**

Background

In terms of the current law non-residents earning South African sourced interest income is exempt from income tax in terms of section 10(1)(h) unless:

(i) is a natural person who was physically present in the Republic for a period exceeding 183 days in aggregate during that year; or

(ii) at any time during that year carried on business through a permanent establishment in the Republic."

From 1 January 2013 withholding tax on interest will be introduced and section 22(1)(c) of the TLAB proposes to amend 10(1)(h) of the Act to provide as follows:

"*There shall be exempt from normal tax-*

…

(h) any amount of interest as defined in section 37I which is received or accrued during any year of assessment by or to any person who is not a resident, unless that amount is attributable to an amount that is exempt from the withholding tax on interest in terms of section 37K."

Comment

We note that the effect of the amendment proposed in section 22(1)(c) of the TLAB is that section 10(1)(h) of the Act will provide an exemption from income tax in respect of South African sourced interest income received by or accrued to a non-resident only to the extent that the amount is not exempt from the withholding tax on interest in terms of section 37K.

As a result a non-resident without a permanent establishment in South Africa may be subject to Income Tax if it invests in, for example, South African listed debt instruments. This seems to be an unintended consequence of the proposed amendments. In particular, in page 115 of the Explanatory Memorandum it is stated that:

> *"Both interest and royalties received or accrued by foreign persons will be fully exempt from normal tax unless: (i) that person is a natural person who is physically present within South Africa during the relevant year of assessment for more than 183 days, or (ii) that person has a permanent establishment within South Africa at any time during the relevant year of assessment."*

It is therefore proposed that the suggested change to section 10(1)(h) in the TLAB be deleted and that section 10(1)(h) of the Act be retained in its current form as this will ensure that non-residents with permanent establishments in South Africa are subject to tax on interest income which is exempt from the withholding tax in line with the intention of the legislation.

5. **Effective date and scope of the amendments to the section 10(1)(h) exemption**

Section 22(4) of the TLAB proposes that the amendment to section 10(1)(h) contained in section 22(1)(c) of the TLAB comes into operation on 1 January 2013 and applies in respect of—

(a) amounts received or accrued before that date; and
(b) amounts paid or that become payable on or after that date.

It is submitted that reference to "receipt" in paragraph (a) above be removed, as it cannot be intended that the provisions of the amended legislation apply to amounts of interest which have already been received before 1 January 2013.

6. **Conclusion**

We wish to thank you for the opportunity to submit comments on the TLAB.

Edward Nathan Sonnenbergs Inc.