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Submission File

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Dear Sir/Madam

RE: CALL FOR COMMENTS ON DRAFT TAXATION LAWS AMENDMENT BILL, 2012, DRAFT EXPLANATORY MEMORANDUM AND DRAFT TAX ADMINISTRATION AMENDMENT BILL, 2012

We refer to the call for comments on the above-mentioned documents. Set out below please find the SAICA National Tax Committee's submission. As requested, the comments are arranged such that they follow the sequence of the Explanatory Memorandum.

DRAFT TAXATION LAWS AMENDMENT BILL, 2012 ("DTLAB") AND DRAFT EXPLANATORY MEMORANDUM ("EM")

General comment

The DTLAB contains a number of amendments with retrospective proposed dates of commencement, the effect of which is the back-dating of the proposed legislation. We submit that the back-dating of amendments to the legislation creates huge uncertainty and is considered unfair. An example is the proposed amendment to section 64K(1)(d) (clause 8 of the Tax Administration Amendment Bill).



Specific comments

1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

1.1 Additional medical expenses converted to medical tax credits

Comment

The formula expressed by the proposed wording of section 6B(3)(c) of the Income Tax Act for purposes of determining the additional medical expenses tax credit that is to be deducted from the normal tax payable by natural persons, under the age of 65, who are not entitled to disability benefits, does not agree with the formula used on page 4 of the EM dated 5 July 2012.

In the example in the EM the additional medical expenses tax credit available to Curwin was determined as follows:

$$\begin{aligned} & 25\% [(0 + 20\,000) - 7.5\% (200\,000)] \\ = & 25\% (20\,000 - 15\,000) \\ = & 25\% (5\,000) \\ = & 1\,250 \end{aligned}$$

Should the formula expressed by the proposed wording of the legislation be used, the additional medical expenses tax credit available to Curwin would be determined as follows:

$$\begin{aligned} & 25\%(0 + 20\,000) - 7.5\% (200\,000) \\ = & 5\,000 - 15\,000 \\ = & -10\,000 \end{aligned}$$

(Since this yields a negative answer no medical expenses tax credit will be available to Curwin)

Recommendation

The EM and the legislation need to be aligned, so as to give expression to the intention of the legislature.



Comment

The proposed changes for retirement savings currently anticipated as well as the changes for medical scheme credits are planned for implementation on 1 March 2014. This will create an immense burden on payroll software development and IT infrastructure. The prompt promulgation of the final legislation and distribution of the respective BRS documents is therefore vital otherwise all the changes will not be ready in time for 1 March 2014.

1. Definition of dependant

The definition of “dependant” under section 6A is narrower than the definition under section 6B.

The definition of ‘dependent’ under section 6B refers to ‘any other member of a person’s family in respect of whom he or she is liable for family care and support’. It is not clear whether this liability refers to legal liability or circumstantial liability. Please provide guidelines.

2. Medical expenses conversion – rates used

We would like to propose that the rates used (i.e. 33.3% and 25%) be increased for the following reasons:

With continued policy changes on dividends, interest and the current economic climate of low interest rates, the impact on pensioners is extreme. The stagnation of tax relief for the interest exemption and the low returns have all contributed to increased financial burden on individuals. As a result we feel that limiting the medical deduction to a 33.3% conversion rate is targeting an already vulnerable sector of the population.

Individuals under the 65 claiming for disability expenses are also impacted by the increasing cost of medical expense (which is an essential for them) will be severely impacted by the reduced deduction.



The 25% conversion for taxpayers under the age of 65 combined with the 7.5% of taxable income limitation is effecting making the deduction impossible for most taxpayers.

We would therefore suggest that the conversion rate for any tax payer over 65 be increased to 40% and that for tax payer under 65 be increased to 33.3% or the 7.5% limitation be removed.

3. Medical expenses conversion for individuals over 65

If an individual turns 65 during a year of assessment, would the 33,3% apply to their expenses for the entire year in a similar manner to the current secondary rebate? Please clarify.

4. Medical credits for individuals over 65

With the proposed repeal of section 18, individuals over 65 will now be entitled to the medical aid credit for contributions to a medical aid scheme on a monthly basis. Is it envisaged that this would be processed against their monthly annuity payments where applicable or claimed on assessment?

The proposed deletion of paragraph 2(4)(d) in the Fourth Schedule is a necessary deletion however it removes the provision whereby the employer can opt to allow the credit on payroll for employees that make contributions themselves.

We would suggest that a similar provision be inserted to allow employers to opt to allow the medical schemes credit on payroll where the employee makes the contributions personally as is envisaged by section 6A.

5. Medical scheme and expenses credit for retirees under the age of 65

For individuals who have retired due to superannuation, ill-health or other infirmity their medical scheme contributions remain at a NIL taxable value. Would these individuals remain entitled to the medical tax credits processed on a monthly basis against their monthly annuity or would they have to claim on assessment?



Would National Treasury consider expanding the 33.3% expense tax credit to those individuals forced to retire due to superannuation, ill-health or other infirmity (as per the Seventh Schedule) or is it anticipated that these individuals should where applicable fall into the disability provisions?

1.2 Exemption for compulsory annuity income stemming from non-deductible retirement contributions

Comment

The EM provides that the exemption will be applied on assessment.

Please confirm then that the long term insurers and retirement fund administrators may continue to deduct employees' tax from the monthly annuities paid to retirees who may be refunded on assessment where non-deductible retirement contributions are available?

A further consideration is for non-residents in receipt of annuities. In many instances, these individuals may not be required to render a tax return, however, should they have non-deductible contributions available to them from when they were residents they will be unable to benefit from these proposals unless they submit returns and claim the refund of tax deducted. The application of liability for tax in the Republic as well as the impact of double taxation agreements to these changes should be considered.

1.4 Streamlined timing for certain forms of variable cash remuneration

Comment

The amendment to section 7B refers to "paid". This concept is defined for purposes of the dividends tax and we suggest that the same principle applies to section 7B.

The comment in the draft EM "No direct linkage exists between most employer deductions and employee income" is true because the interpretation of accrued and incurred for Income Tax purposes follows different approaches, i.e. not necessarily the same timing. The proposal with regard to commission will mean that the employer's expense will not be allowed in the same year that the income that gave rise to the commission in the first place accrued to the employer.



The willingness of National Treasury to cater for these challenging payroll situations is appreciated. We would like to clarify that the payment method will continue to apply across tax years.

We would also like to recommend that back pay be included in this section as this creates similar timing issues on payroll.

The requirement that employers must wait for a tax directive from the South African Revenue Service ('SARS') prior to paying certain lump sums should also be considered in the above regime or this legislative requirement must be repealed. It is only used as a collection tool and SARS has sufficient other options to collect. This will alleviate the need to revise IRP5 certificates due to a directive received in another reporting period.

1.5 Fringe benefit valuation in respect of rented employer-provided vehicles

Comment

While we commend the move to acknowledge the rental of vehicles as a company provided vehicle and allow for the actual cost to be used to determine the fringe benefit to the employee, we have a number of concerns with the proposed legislation.

Definition of “operating lease”

The fact that National Treasury wants to limit this rule to rentals under an operating lease as opposed to a finance lease (which actually constitutes indirect ownership and which is already catered for in the current legislation) is understandable, but the definition of an “operating lease” as defined in section 23A of the Income Tax Act (ITA), is too narrow.

The definition of an “operating lease” in section 23A of the ITA requires that an operating lease must meet all 3 of the requirements:

- The property may be hired by members of the general public directly from that lessor in terms of such a lease, for a period of less than one month;
- The cost of maintaining such property and of carrying out repairs thereto required in consequence of normal wear and tear, is borne by the lessor; and



- Subject to any claim that the lessor may have against the lessee by reason of the lessee's failure to take proper care of the property, the risk of destruction or loss of or other disadvantage to such property is not assumed by the lessee;

In order to meet the first bullet point, it will only be rentals entered into in terms of an agreement with a very short lifespan (of less than one month) with short-term car rental companies that would qualify for this proposed amendment. In practice, employers would not normally rent vehicles on such a short term basis (for a period less than a month) for employees to provide as employer-provided vehicles. This means that very few employees would then be able to benefit from this new amendment.

SARS states in Interpretation Note (IN) number 53 on the limitation of allowances granted to lessors on affected assets, regarding this point that the definition requires that the asset in question "may" be hired by members of the general public for a period less than one month, that "Although an asset is not automatically excluded from the definition when it is let for a period of one month or longer, an asset which is let on a fixed basis for a period of, say six months, will be incapable of being let for a period of less than one month by reason of its extended lease period."

The following paragraph of this interpretation note states that "Furthermore, a lease entered into on the basis that the lessee is entitled to exercise options which will result in the asset being leased for consecutive terms continuously by the same lessee, will disqualify the lease as an operating lease. By implication, the property will not be available to the general public for a period of less than one month."

From a practical point of view that would then mean that an employer would have to rent a different vehicle every month for each employee in order for the lease to constitute an operating lease. The employer is not allowed to take out options to renew that lease every month as this will disqualify that lease as an operating lease. The employer is also not allowed to lease a specific vehicle for an employee for a six month period, as per IN 53 it does not constitute an operating lease. Even though the lease based on the remaining two criteria of the definition in section 23A would constitute an operating lease, the employer will not be entitled to tax the employee in terms of the proposed amendment to paragraph 7 of the Seventh Schedule and in these instances it could still lead to over taxation.



The fact that paragraph (a) that the property may be hired by members of the general public directly from that lessor in terms of such a lease, for a period of less than one month; is not met should not disqualify a lease from being an operating lease for purposes of this proposed amendment to paragraph 7.

The fact that that this specific requirement is not met does not result in the lease becoming a finance lease.

A very good definition of a finance lease can be found in paragraph (b) of the definition of an “instalment credit agreement“ in section 1 of the VAT Act which provides the following:

(b) are supplied under a lease under which—

- (i) the rent consists of a stated or determinable sum of money payable at a stated or determinable future date or periodically in whole or in part in instalments over a period in the future; and
- (ii) such sum of money includes finance charges stipulated in the lease; and
- (iii) the aggregate of the amounts payable under such lease by the lessee to the lessor for the period of such lease (disregarding the right of any party thereto to terminate the lease before the end of such period) and any residual value of the leased goods on termination of the lease, as stipulated in the lease, exceeds the cash value of the supply; and
- (iv) the lessee is entitled to the possession, use or enjoyment of those goods for a period of at least 12 months; and
- (v) the lessee accepts the full risk of destruction or loss of, or other disadvantage to, those goods and assumes all obligations of whatever nature arising in connection with the insurance, maintenance and repair of those goods while the agreement remains in force;

If one compares this finance lease definition to the definition of an operating lease one can clearly see that the main distinction between the two is that in the case of an operating lease the “risk of destruction or loss of the property” always remains with the lessor. The other



main consideration for an operating lease is that the cost of maintaining the property also remains with the lessor.

If these two requirements are met one would surely be dealing with an operating lease and not a finance lease. It is therefore suggested that in order not to prejudice those employees whose employers enter into an operating lease for a period of more than a month, the proposed amendment should be altered to state the following:

Paragraph 7(4)(b)(ii) “where such vehicle is acquired by the employer under an ‘operating lease’ as defined in paragraphs (b) and (c) of section 23A(1) or as defined in section 23A(1) excluding the requirement set out in subparagraph (a) concluded by parties transacting at arm’s length, be the actual cost to the employer incurred under that operating lease;”

This will widen the application of the proposed amendment, giving more employers and employees access to these provisions and assist in achieving the goal to limit the possible over-taxation of more employees.

In final support to this argument, please refer to what SARS states regarding the above (for VAT purposes) in its VAT 420 – Guide for Motor dealers:

ICA agreements are characterised by a condition that the passing of ownership of the goods or services supplied only takes place upon payment of the final instalment or once the residual amount has been settled (as the case may be).

A rental agreement (or operating lease) where the recipient does not become the owner of the goods is not an ICA.

The current requirements for the definition of an operating lease immediately preclude leasing arrangements with fleet management companies which do not constitute finance leases. Fleet management companies by their nature generally provide rental fleet to customers for periods ranging from a few months to up to 8 years, with the average rental term being 40 months.

We believe that the requirement for vehicles to be rented to the general public for periods of less than one month is counter-intuitive, in that in most cases a business wishing to rent rather



than buy its vehicle fleet will enter into a contract of at least 12 months with a rental fleet provider in order to avoid the administration involved in constantly rotating the vehicles. We thus recommend that this specific requirement for the definition of an operating lease be removed. In these cases the risk of loss and destruction of the vehicles always remains with the Fleet management company and the Fleet management company remains responsible for the costs of repairing and maintaining these vehicles.

Recommendation

Practically in order to give more employers and employees access to utilize the new proposed amendment to paragraph 7 of the Seventh Schedule of the ITA we suggest that the use of definition of an “operating lease” as defined in section 23A(1) of the ITA, should exclude requirement (a) of the definition which provides that “*(a) such property may be hired by members of the general public directly from that lessor in terms of such a lease, for a period of less than one month;*”

If the other 2 requirements set out in (b) and (c) are met, the lease would remain an operating lease.

Comment

1. Arms length price by independent parties

Throughout the Act, the words “at arm’s length” are used to ensure that the prices/values are reasonable whether between connected parties are not under- or overstated. This proposed provision is essentially a tautology as you are covering the same abuse twice. This restricts the options available to employers particularly in large groups where one company might be the owner of all the movable assets or have a fleet management company within its group. It would be sufficient to merely say that the price must be at arm’s length or market-related which could easily be established and proven to SARS if questioned.

2. “Related costs”

Clarity may need to be sought regarding what is envisaged by ‘related costs’ in the calculation below:



*“the monthly value of the rental vehicle will be based on the actual costs incurred by the employer (i.e. the rental contract and **related costs**)”*

Presumably the cost on which the employee would be taxed would be the monthly vehicle rental charge, including maintenance and service costs and the administration fee charged by the fleet management company. It would then not include unrelated services that the fleet management company may provide to the company, e.g. traffic fine management services or other ancillary services. Consideration should also be given to licensing fees, tracking fees, automobile association membership fees etc, which may form part of the monthly rental but in our view should be excluded, as these are not directly related to the monthly usage cost of the asset that the employee enjoys.

3. Fuel costs

The existing company car legislation incorporates the consideration of private use of fuel, vehicle, maintenance etc in determining the taxable fringe benefit under paragraph 7 of the 7th Schedule and the same process should apply where the vehicle is rented.

The EM, however, provides that the payment of fuel costs by the employer is an additional benefit to the employee and must be taxed as a travel allowance.

These vehicles are still employer provided, essentially company owned, and as a result all expenses relating thereto are for the account of the employer. The fuel expense is therefore a business expense and cannot be regarded as a travel allowance.

The employer would need to monitor the abuse of company vehicles and recover any private element from the employee. Further company petrol cards are always linked to specific vehicles and cannot be used with other vehicles; there is therefore no possibility that these can be abused.

The EM provides that the business over total travel method can be used to reduce the benefit to the employee. This is not carried forward in the legislation. The legislation seems to include the full value of the rental cost as a taxable fringe benefit, without adjustment. Would this be applied on assessment once the employee has inputted their business travel?



Further, the legislation prohibits the apportionment of costs where the employee may carry the cost of fuel if the vehicle is hired.

This is then subjecting the employee to excess tax on a monthly basis for pure business related expenses, essentially over-taxing the employee.

Recommendation

We would suggest that the rental value be increased by a fixed factor in order to account for any private use of the vehicle or fuel. Our proposal would be that for payroll purposes the value of the benefit be regarded as the rental cost plus 15% then at a 80% or 20% inclusion based on whether the vehicle is a tool of trade vehicle or not. The individual could then complete the tax return setting out the business over total kilometres and the tax paid would be corrected at that point.

1.7 Cession of employer-owned insurance policies (with investment values) to retirement funds

Comment

We cannot find the legislative changes in the definition of “gross income” to give effect to the comments in the EM.

Recommendation

We recommend that these be included in the next draft of the Bill.

1.8 Revision of learnership allowances

General

The amendments dealing with the “timing of registration” and “failed learnerships” addresses issues previously raised by SAICA via submissions to National Treasury and SARS. These amendments are welcomed.



Comment

Limiting the registration period for a learnership agreement to six months after the last day of the employer's year of assessment may still result in allowances being 'lost'.

Recommendation

It should be considered whether this period could be lengthened further, perhaps to one year.

2. INCOME TAX: BUSINESS

2.2 Equity share and hybrid equity instrument definitions

Comment

The draft Bill proposes that an "equity share" be defined in section 1 of the Income Tax Act as:

“any share in a company unless:

(a) the amount of any dividend or foreign dividends in respect of that share is based on or determined with reference to the time value of money:

(b) ...”

However, on page 21 the EM states that

“an 'equity share' will be defined as a 'share' (under section 1) unless the share has fixed dividend rights or is subject to a right of redemption:

- Fixed dividend rights: A fixed dividend right exists if the dividend is calculated wholly or partly with reference time value of money principles (e.g. specified rates of interest based on the issue price of the shares issued).

In our view, the introduction of the term “fixed dividend rights” in the EM in order to explain the clause “dividends in respect of that share is based on or determined with reference to the time value of money” is inaccurate and may lead to interpretational problems.

Recommendation

We therefore recommend that the use of the term “fixed dividend rights” be removed from the EM in order to align both the legislation and the EM with the intention of the legislature.



2.3 Revised version of the hybrid equity instrument definitions

Comment

Section 8E serves as an anti-avoidance measure against certain non-equity share financing schemes. The company paying the dividend needs to pay the dividend and withhold tax at a rate of 15% according to the new dividend tax rules. In the hands of the person receiving the dividend it is deemed to be interest received and that person is taxed on the "interest" received.

The effective rate for the lender is then up to 55%, using the marginal tax rate (40% + 15%) which is illustrated as follows:

Shares amounting to R1 000 is issued to Mr X. Section 8E is applicable. Dividend for the year amounts to R100. Thus when the R100 is paid, R15 dividend tax should be withheld from the amount and Mr X receives R85 (R100 less dividend tax withheld of R15). Because of the provisions of section 8E, Mr X is taxed on the full R100 and tax of R40 is payable. Total tax paid by Mr X is R55.

Recommendation

The dividend tax withheld should be given as a credit or no dividend tax should be withheld by the company - thus amendments to section 64 of the Income Tax Act are required.

Comment

The effective date of the changes to section 8E per clause 10(2) of the draft Bill is in respect of dividends received or accrued *on or after 1 April 2012*. The effective date per clause 11(2) is in respect of dividends received or accrued *during years of assessment commencing on or after 1 October 2012*. Finally, the effective date per clause 12(2) is in respect of dividends received or accrued *on or after 1 January 2013*.

Recommendation

Consideration should be given to wording the effective dates consistently

**Comment**

Reference is made in section 8E(1)(b)(ii)(aa) to “ordinary shares”. The term is however not defined elsewhere in the Act.

Recommendation

The term ‘ordinary shares’ should be defined in section 8E

Comment

Funding raised through the issue of preference shares may be applied to acquire shares in an operating company and to defray transaction costs associated with the acquisition. Where this is the case, the requirement that the consideration is applied “solely” to acquire shares in an operating company could preclude companies whose overall purpose is to acquire shares in the operating company from benefiting from the proviso to paragraph (c) of the definition of “hybrid equity instrument” of section 8E(1).

Recommendation

The proviso should be extended to cover the acquisition of shares in an operating company and related transaction costs.

Comment

Preference share funding may be used to acquire so-called productive assets i.e. assets which if funded through loan funding would entitle the purchaser to claim an interest deduction but which for commercial reasons cannot be funded through debt. Where these preference shares are secured, the dividends on the preference shares could be re-characterised as interest in the hands of the holder under the proviso to paragraph (c) of the definition of “hybrid equity instrument” of section 8E(1) read with section 8E(2), but not in the hands of the insurer.

Recommendation

We submit that where the preference shares have been used for a productive purpose, the return on the preference shares should be re-characterised in the hands of the both the issuer as well as the holder.



Comment

Reference is made in subparagraph (C) of the proviso to paragraph (c) of the definition of “hybrid equity instrument” in section 8E(1) to “*any preference share as defined in section 8EA(1)*”. The term preference share is defined in section 8EA(1) as “*a preference share as defined in section 8E(1)*”. The referencing appears to be circular.

Recommendation

The circular referencing should be removed if unintended.

Comment

Funding raised through the issue of preference shares may be applied to acquire shares in an operating company and to defray transaction costs associated with the acquisition. Where this is the case, the requirement that the consideration be applied “solely” to acquire shares in an operating company could preclude companies whose overall purpose is to acquire shares in the operating company from benefiting from the proviso contained in the definition of third party backed share in section 8EA.

Recommendation

The proviso should be extended to cover the acquisition of shares in an operating company and related transaction costs.

Comment

Preference share funding may be used to acquire so-called productive assets i.e. assets which if funded through loan funding would entitle the purchaser to claim an interest deduction but which for commercial reasons cannot be funded through debt. Where an enforcement right or obligation exists, the dividends on the preference shares could be re-characterised as interest in the hands of the holder under section 8EA.

Recommendation

We submit that where the preference shares have been used for a productive purpose, the return on the preference shares should be re-characterised in the hands of the both the issuer as well as the holder.



Comment

Proviso (a) to the definition of “third party backed share” jeopardises taxpayers who holds 70% or more in an operating company and wants to buy out the minorities.

Recommendation

The exclusion in respect of the shares in an operating company which forms part of the same group of companies should be revisited.

2.5 Anti-hybrid debt instrument re-characterisation rules

Comment

The classification of an instrument as hybrid debt which is linked to an obligation to repay the debt within a 30 year period is likely to result in similar misuse as the current 3 year rule in section 8E, as agreements will be manipulated to state that the debt must be repaid within 29 years.

At the end of year 29, the debt could be repaid and replaced via the advance of the same amount as a similar loan for the next 29 years.

Recommendation

The proposed criteria of “on a balance of probabilities, that debt will not be repaid in full within 30 years of the date of issue of that debt” could be replaced by “on a balance of probabilities, that debt will not be repaid prior to the liquidation, deregistration or termination of the corporate existence of the issuer”. This would capture any debt that was intended to be equity, irrespective of the stated repayment terms.

In addition, the proposed amendment should make provision for the original debt, as well as debt advanced to replace this original debt.

Comment

The proposed wording of sub-paragraph (c) of section 8F refers to a ‘balance of probabilities’. This wording is in our view unacceptably vague and will lead to high costs of compliance.



Recommendation

Sub paragraph (c) should be deleted.

Comment

It is not clear from the legislation what the effect on the 'contributed tax capital' of a company would be in the event that an instrument issued by it ceases to be a hybrid debt instrument otherwise than by way of redemption or repayment. For example, if the debt constitutes 'hybrid debt' due to the existence of a conversion option which lapses.

Recommendation

The definition of 'contributed tax capital' in section 1 of the Act should be reconsidered to take this into account.

Comment

The application section 8FA is overly broad. The proposed legislation will affect a number of pre-existing structures which were not set up for tax purposes (for e.g. unlisted REITs).

The 'dividend' definition in section 1 of the Act specifically excludes distributions made by a company which constitute shares in that company. The proposed reclassification of 'hybrid interest' paid in the form of scrip dividends from interest to dividend in terms of section 8FA is contrary to and overrides the dividend definition.

It is insufficient in order to prevent double taxation or a double deduction for section 8FA(2)(b) to state that an amount of hybrid interest which is reclassified as a dividend in terms of this section should not be taken into account for purposes of section 24J. The deeming of interest to be a dividend is only for purposes of part VIII of Chapter 2 and is not for purposes of the entire Act. It is therefore possible that the amount will also be taken into account in terms of the gross income definition or for purposes of section 11(a) thus resulting in double taxation or a double deduction.

Comment

This section, once effective, will affect pre-existing arrangements.



Recommendation

It is suggested that this section should only be effective for instruments issued on or after the effective date.

Comment

The definition of hybrid interest in section 8FA includes “*any interest paid by the issuer of a debt in respect of that debt if—*

- (a) the amount of that interest is not determined with reference to the time value of money”.*

It is submitted that any instrument that links its returns to a rate, would fall out of the definition of hybrid interest, even though this may not be sufficient to result in the amount paid really being interest.

Recommendation

It is recommended that the requirement be changed to “*means any interest paid by the issuer of a debt in respect of that debt if—*

- (a) the amount of that interest is not determined solely with reference to the time value of money and the credit risk of the issuer”.*

This will ensure that payments made in terms of any debt instrument that exposes the holder to risks other than those that a debt instrument would expose it to, would not be classified as interest.

Comment

The draft Bill proposes that the existing section 8F of the Income Tax Act be substituted with a new proposed section 8F.

Section 8F, as it currently reads, contains a definition of “date of issue” in relation to an instrument. The revised section 8F, as proposed by the draft Bill does not contain such a definition, regardless of the fact that the term “date of issue” is used repeatedly in the definition of “hybrid debt”.



Recommendation

The proposed section 8F should be amended so as to include a definition of the term “date of issue” in relation to debt.

Comment

Several South African companies have issued convertible bonds on the basis of the current version of section 8F, and in particular the leeway provided for listed instruments issued by a listed company in terms of paragraph (d) of the current definition of ‘hybrid debt instrument’. The proposed section 8F provides that a debt can constitute a ‘hybrid debt’ if it falls into one of four categories. By reason of the entitlement of the holders of many of these bonds to convert to shares, the bonds could fall into category (b) of the proposed new definition of ‘hybrid debt’. The proposals will have a severe impact on these existing debt instruments and the cost of early termination so as to issue debt in line with the tax legislation will be significant.

Recommendation

The application of category (b) should be reconsidered in relation to existing instruments.

2.6 Suspended deductions for interest/royalties paid to exempt persons

Comment

It will be difficult for taxpayers with listed interest-bearing debt in issue, such as bonds, to ascertain at year end the identity and status of the holders of the debt for purposes of adhering to section 23L.

Also, where the listed debt is for example transferred in the market from a foreigner to a South African taxpayer, how should the interest deduction be treated, taking into account that the interest will be paid in its entirety to the South African taxpayer, and this fact would have been factored into the price paid by the South African taxpayer for the listed debt?

Recommendation

The provisions should be reconsidered in light of the issue identified.



2.7 Qualifying interests in asset-for-share reorganisation

Comment

The content of part 2.7 of the EM appears to have been erroneously copied from section 2.4 instead of addressing the amendment to the “qualifying interest” definition as set out in section 42(1) of the Income Tax Act.

Recommendation

The EM needs to be amended so as to discuss the relevant amendments to section 42(1) of the Income Tax Act at part 2.7. (It is, however, noted that these amendment are discussed at part 5.2).

Comment

The proposed change to “qualifying interest”, as defined for purposes of the definition of “asset-for-share transaction”, is operational in respect of transactions entered into on or after 1 January 2013. Where an asset for share transaction is entered into before that date the required qualifying interest is 20%. It is not clear whether such shareholders who reduce their shareholding below 20% but hold more than 10% after 1 January 2013 will be deemed to have disposed of their remaining shares.

Recommendation

We recommend that it be clarified whether the transaction referred to in clause 80(4) refers to:

- an “asset-for-share transaction” as defined in section 42(1); or
- a transaction, subsequent to the “asset-for-share” transaction, in terms of which shares acquired under an “asset-for-share” transaction are subsequently sold, and to which the anti-avoidance provisions of section 42(6) apply

(i.e. it should be clarified whether the amended definition of “qualifying interest” applies for the purposes of section 42(6) to all “asset-for-share” transactions entered into on or after 1 January 2013, as well as “asset-for-share” transactions entered into before this date.)



2.8 Share-for-share recapitalisation

Comment

The foreign-to-foreign transaction provisions provided for in the corporate rules require that shares that are disposed of be held as capital assets only. It is not clear why the restriction against shares held as trading stock has been made. For example, in terms of the local rollover provisions of section 42 and section 45 it is possible to transfer shares held as trading stock in exchange for equity shares and non-equity shares, respectively.

Recommendation

The legislation relating to foreign-to-foreign transactions should be widened so as not restrict qualifying disposals to shares held as capital assets only.

2.9 Value mismatches involving share and debt issues

Comment

The creation of a deemed dividend *in specie* in the circumstance where the value of shares issued in exchange for an asset exceeds the market value of the asset is contrary to the section 1 definition of a ‘dividend’ which specifically excludes the distribution of shares in the issuing company.

Comment

From the EM it appears as if the intention behind the introduction of section 24BA is to tax a shift of a company’s value between shareholders without a disposal of the interest of the existing shareholders (thereby replacing the existing value shifting rules in the Eighth Schedule). If this is the intention, section 24BA should not be limited to assets transferred to a company in exchange for shares in the company, but also cash given for shares if the amount of cash and the value of the shares issued differ. If this is not done, then even value shifting arrangements within the current provisions of the Income Tax Act will not attract tax.

Recommendation

The reference in the proposed section 24BA to “*assets, as defined in paragraph 1 of the Eighth Schedule*” should be expanded to “*cash or assets, as defined in paragraph 1 of the Eighth Schedule*”.



The references to the “*market value of the asset*” should be expanded to the “*market value of the asset or the amount of cash received*”. It may however be very onerous to require taxpayers to consider the market value of the shares every time a company issues shares.

Comment

The interaction between the corporate rules as set out in sections 41 to 47 and the new section 24BA and 24BB is not clear.

Recommendation

There should be a *de minimus* ‘safe haven’ threshold of difference in market values below which the provision would not apply. For example the provision should not apply if the difference was less than 10 per cent of the difference in market values.

Comment

In terms of section 24BA, the market value of the shares must be determined immediately after the issue of the shares. Where the assets are acquired as consideration for the issue of shares as part of a broader transaction involving other inter related steps, the valuation of the shares immediately after the issue as opposed to at the end of the day on which the inter related transaction steps take place could be problematic.

Recommendation

The reference to immediately after the issue should be reconsidered.

Comment

With regard to the proposed section 24BA(1)(a) it is not clear why, if a company acquires an asset from any person as consideration for shares issued and the market value of the asset exceeds the market value of the shares, the company is automatically taxed on capital account in respect of the difference as the asset might have been acquired as trading stock. Provision is not made for the asset to be acquired as trading stock in the same way provision is made for the transferor of the asset.



Recommendation

The automatic capital treatment of these amounts should be reconsidered.

Comment

Is it the intention that section 24BA(1)(b) will override the dividend definition in section 64D such that foreign companies, whose shares are not listed on the JSE, could also be subjected to Dividends Tax? In other words, is it the intention that the relevant excess of the market value of shares issued by a foreign company, whose shares are not listed on the JSE, will be deemed to constitute a dividend, as defined for the purposes of section 64D, and to which the Dividends Tax applies? South Africa should in principle not subject foreign companies to Dividends Tax.

Recommendation

The application of the section in the above circumstances should be considered.

Comment

In terms of section 24BB(1)(a)(i) and (b)(i), the excess is deemed to be an amount received or accrued or expenditure incurred which is not of a capital nature. The clauses do not however confirm whether the amounts should be included in gross income / deducted under section 11(a).

Recommendation

The wording of the section should specifically provide for an inclusion in gross income or deduction under section 11(a).

Comment

Where the excess must be included in gross income in terms of section 24BB(1)(a)(i) the reduction of the tax cost of the debt in section 24BB(1)(a)(ii) would result in the holder of the debt being subject to tax twice on the same amount.



Recommendation

The intention of the legislature should be clarified in order to give expression to the intention of the legislature.

Comment

Where the excess must be deducted in terms of clause 58(1)(b)(i) the increase in the tax cost of the debt in section 24BB(1)(b)(ii) would result in the holder of the debt benefiting twice from the excess.

Recommendation

The intention of the legislature should be clarified to give expression to the intention of the legislature.

Comment

We note that unlike section 24B(1), section 40CA regulates the position of the person acquiring the asset and issuing the shares but is silent on the value at which the other party is regarded as having disposed of the asset.

Recommendation

We recommend that the position of party disposing of the asset is similarly regulated for purposes of section 40CA.

Comment

The reference to the amount of the debt in section 40CA could be problematic, where interest is rolled-up. Is the amount of the debt intended to refer to the original capital sum of the debt or the face value of the debt?

Recommendation

We recommend that the term 'amount of the debt' be defined for purposes of section 40CA.



2.10 Debt-financed acquisitions of controlling share interest

Comment

The proposed section 24O(2) reads as follows:

*“(2) Subject to subsection (3), where during any year of assessment an instrument is issued or used by a company **solely-***

(a) for the purpose of financing directly the acquisition by that company of an equity share in another group company in terms of an acquisition transaction; or

(b) ...” (our emphasis)

For the reasons stipulated below, the use of the word “solely” appears to have unnecessarily restrictive consequences.

In practice, in acquisition transactions, a company will not only acquire a controlling interest in the shares of the target company, it will also acquire the loan accounts owed to the selling shareholders of the target companies. The acquiring company will thus borrow an amount to fund both the acquisition of the shares and the shareholders’ loan accounts. Alternatively, the acquiring company could acquire another class of shares in addition to the equity shares.

While a deduction should only be available under section 24O in respect of the funds borrowed in order to acquire the shares, the use of the word “solely” in section 24O(2) suggest that no deduction will be available under section 24O in respect of the portion of the funds borrowed in order to acquire the shares, where the acquirer has this dual purpose for the borrowings.

Recommendation

We recommend that:

- the word “solely” be removed from section 24O(2); and
- the word “where” in section 24O(2) should be replaced with the words “to the extent that”.



This will make it clear that the deductibility conferred by section 24O(2) will apply to the interest to the extent that it relates to funds borrowed in order to acquire shares.

2.11 Debt reductions for less than full consideration

Comment

On page 49 the EM advises that under the proposed legislation, where the debt reduction is viewed as falling within a capital paradigm, the debt reduction or cancellation will firstly reduce the base cost of the capital assets so held by the debtor. However, this base cost reduction will apply only to the extent to which the borrowed funds were used to acquire those capital assets still held by the debtor and only to the extent that the capital assets have any remaining base cost.

However, the draft Bill has not proposed any amendments to paragraph 20(3)(b) of the Eighth Schedule to the Income Tax Act, to give effect to this stated intention.

Recommendation

We recommend that paragraph 20(3)(b) of the Eighth Schedule be amended accordingly.

Comment

Reducing the cost of closing stock in terms of section 22(1) will result in a lower tax charge unless it is matched by a reduction in opening stock in terms of section 22(2). The current wording of the provision seems to indicate a choice of which provision to apply which is not the intention.

The EM to the DTLAB suggests that in the scenario where a taxpayer purchases an allowance asset and a portion of the debt relating to the acquisition of the asset is waived for no consideration then the allocation of the portion waived between allowances already claimed on the asset and the remaining tax cost of the asset will be resolved in favour of the taxpayer (i.e. the waiver will first be allocated against the remaining tax cost). This intention indicated in the EM does not seem to be carried out in the proposed legislation.



Recommendation

The wording of subsection 19(3) should be set out more clearly so as to make it certain in which circumstances the cost of trading stock should be reduced in terms of section 11(a), section 22(1) or section 22(2).

Comment

These amendments provides for the costs allowable for deduction (insertion of section 19) as well as base costs of assets (insertion of paragraph 12A to the Eighth Schedule). However, there are no indication or amendments to the costs which should be used to determine the wear and tear or capital allowances of assets acquired where the debt associated with the acquisition of these assets were reduced or cancelled.

Recommendation

This needs to be dealt as the proposed amendments will cause the base cost of the assets to be reduced. However, as is, the base costs must also be reduced by the wear and tear allowances or capital allowances claimed when an asset is sold. This could potentially result in negative base costs of assets when they are disposed of.

Comment

The EM advises that the proposed regime will apply in respect of debts reduced or cancelled on or after 1 January 2013.

However, the draft Bill stipulates that proposed section 19 and proposed paragraph 12A to the Eighth Schedule are to come into operation on 1 January 2013 and *apply in respect of years of assessment commencing on or after 1 January 2013*. Thus, in terms of the Bill, should a taxpayer have (say) a June year end, these provisions would only apply to debts cancelled on or after 1 July 2013.

Recommendation

The EM and the legislation need to be aligned, so as to give expression to the intention of the legislature.



Comment

Where a debt is waived in its entirety, the waiver would result in a discharge of all amounts under the debt and would therefore give rise to redemption for purposes of section 24J. Where the amount waived includes interest, section 24J(4A) could result in a taxable adjusted gain on redemption.

Recommendation

The interaction between section 19 and section 24J(4A) should be clarified in the legislation.

Comment

The debt forgiveness rules for ordinary revenue do not cater for the situation where an insolvent company has forfeited an assessed loss brought forward owing to the cessation of trade. For example, assume a debt was incurred in a prior year of assessment when the company was still trading and the expenditure gave rise to an assessed loss which was carried forward, but the balance of the assessed loss brought forward fell away in a subsequent year after the company had ceased trading. The company should still be able to set off a debt reduction to the extent that there would have been an assessed loss had it continued to trade.

Recommendation

It is recommended that the ability of such company to access the assessed losses should be provided for. The following further proviso should be added to section 19(4):

“Provided further that for the purposes of the determination of the balance of the assessed loss against which such expenditure can be applied, the company will be deemed to have carried on a trade in each year of assessment subsequent to the year of assessment in which such expenditure was incurred.”

Comment

Paragraph 12A provides for relief where the company benefiting from the debt reduction is liquidated. No such provision is contained in section 19.

Recommendation

We submit that section 19 should contain similar relief provisions for liquidating companies.



3. INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)

3.1 Annual fair value taxation of financial instruments in respect of financial institutions

General

The effects and aftermath of the global financial crisis is still in the news. The role of mark-to-market accounting/fair value accounting in exasperating the crisis is being debated and researched. The consensus that is developing in the UK is that banks were overstating profits before the crisis and paid out remuneration and dividends from those overstatements. A quote from Martin Taylor, ex-Barclays CEO, illustrates the point:

“Observers of financial services saw unbelievable prosperity and apparently immense value added. Yet two years later the whole industry was bankrupt. A simple reason underlies this: any industry that pays out in cash colossal accounting profits that are largely imaginary will go bust quickly. Not only has the industry – and by extension societies that depend on it – been spending money that is no longer there, it has been giving away money that it only imagined it had in the first place.”

A very positive consequence of the proposed legislation could be that it provides a disincentive for banks to book optimistic profits or profits that are temporary. Unfortunately, this exact tax regime did not prevent bank failures in the UK during the crisis. Possible unintended consequences are, in my opinion, the main problem with the proposed legislation:

- Timing is wrong – Banking is already under pressure with immense changes coming from legislation that separates retail banking from commercial banking and changes compensation practices, Basel III and its liquidity requirements to be implemented from 2015 and IFRS 9 to be implemented only in 2015. A major change like this should be made together with the other major changes or after those other changes.
- IFRS itself is being questioned and might change – During the financial crisis the IASB changed the accounting standard on financial instruments, IAS 39, to soften the impact of fair value accounting write-downs. The Netherlands, Denmark and Sweden have already rejected fair value accounting for pension funds due to unintended consequences. The proposed legislation is thus anchored to a shifting base, IFRS.



- Liquidity pressure – Numerous financial instruments only give rise to cash flows at maturity. With this proposal SARS is demanding tax before any cash flow is produced, putting cash flow pressure on the institution. The implementation, even gradually implemented, of the new rules is significant enough to cause a liquidity shock to the SA system.
- Change is out of sync with remuneration practices – Compensation was identified as a factor that contributed to the global financial crisis and significant reforms were introduced. The deferral of bonuses was one such reform. According to the *FSB Principles for Sound Compensation Practices* 40 – 60% of variable compensation should be deferred for at least 3 years. For high earners the percentage should exceed 60%. More than 50% of variable compensation should be awarded in shares or share-linked instruments. Only the remainder of the deferred compensation should be paid as cash compensation vesting gradually. The payment of income tax on fair value accounting gains the moment they are booked would thus be completely out of sync with these practices.
- Increase on complexity – The SARS proposal greatly increases the complexity of the data requirements of the tax payer. SARS is not proposing the full implementation of fair value accounting but only a portion thereof. Thus, taxpayers would need to keep the necessary data for financial accounting purposes, for taxation purposes and for remuneration purposes.
- Increase in information opaqueness – IFRS accounting does not require the disclosure of the portion of net income that is unrealised. Analysts can deduce what portion of net income is unrealised by the evaluation of the relative size of a bank's deferred tax liability. By synchronising financial accounting and taxation this deferred tax liability will disappear and in that way analysts will lose a valuable tool with which to keep track of the unrealised portion of the net income of banks.

Recommendation

It is suggested that the implementation date of the proposed legislation is moved later than 2013 and more time and effort is invested in researching the potential consequences of the change. Case studies of the Australian and UK experience should also be considered.



Comment

The proposed legislation does not address the following, which appear to be prejudicial to taxpayers:

- Since all shareholdings (other than those out of the scope of IAS 39, such as investments in subsidiaries) are carried at fair value under IFRS, tax linked to fair value accounting will override any distinction between capital and revenue. It also seems that the proposed legislation will override any section 9C designation as capital after a three-year holding period.
- Gains in fair value will be taxable, but losses in fair value will only be deductible to the extent that there is other taxable income against which they may be utilised. Losses resulting in total assessed losses will not lead to a tax inflow for the taxpayer. The effect of the proposed provision therefore goes beyond one of tax timing, and may lead to a net tax outflow that may never have occurred under the existing regime.

Comment

Hedge instruments are excluded from the scope of the proposed legislation. However no reference is made to the definition of a hedge or how such instruments would be identified. The context suggests that ‘hedge’ might refer to instruments that meet the criteria of and for which the taxpayer has elected to apply hedge accounting under IFRS. However the EM indicates that the definition of hedging is intended to be broader than this.

Recommendation

A definition of ‘hedge/hedging’ needs to be included in the legislation.

Comment

Part (a) of the definition of ‘post-realisation year’ seems unduly complex in the way it is worded. It seems to mean the year following the realisation year.

Comment

The EM indicates that instruments falling within this provision should be excluded from gross income, sections 11(a), CGT and trading stock. However the provision itself makes no reference to section 22.



Specific comments

I. Background

A. Income taxation of financial instruments

Comment

The EM suggests that the reason that tax occurs at realisation rather than prior thereto is because of the difficulty in determining market values prior to realisation. However we would argue that realisation is used because it is consistent with the fundamental tax principle of accrual as arising at the point of unconditional entitlement to an amount.

Within the TOFA Rules, the reliance on financial reports method of taxation (which most closely approximates the proposed SA legislation) is elective, whereas the proposed SA legislation is mandatory. Taxpayers are therefore denied the opportunity of assessing whether the reduction in compliance costs outweighs the cost of accelerated tax payable.

The Australian legislation determines its scope through a combination of threshold financial instrument holdings and types of entities. The proposed SA legislation only lists types of entities within scope, as defined in cross-referenced legislation (The Banks Act). That it is envisaged there may be entities in and out of scope within the same group is evident from the examples in the EM. This creates the possibility that, through transferring the holdings of financial instruments within a group from in-scope to out-of-scope entities, it may be possible to move financial instruments out of the scope of the legislation.

The Australian legislation contains significant provisions dealing with the consequences of an entity moving into or out of its scope. The proposed SA legislation deals only with entities moving into scope. As it stands, an entity moving out-of-scope would have been taxed on fair value up to that point, and it is then unclear whether the final gain or loss on disposal would then be excluded from gross income or capital gains as a result of paragraph (3) (because ‘an amount’ had been included in income under these provisions) or whether it would become subject to tax on the disposal, and if so whether the portion already taxed would be taken into account.



Likewise the Australian legislation contains significant provisions dealing with the consequences of instruments moving into or out of scope. No such provisions are contained within the proposed SA legislation. It is unclear whether this could lead to a portion of a gain being untaxed or double-taxed.

The TOFA Rules prescribe tax on movements in balance sheet values rather than focusing on recognition in the statement of profit and loss or statement of other comprehensive income, which is the focus of the proposed SA legislation. There may be significance to this distinction that has not been addressed.

Comment

The argument contained in the background is considered wrong as the majority of SA bank financial assets and liabilities carried at fair value are not based on liquid market prices (level 1 valuation) but are carried at level 2 valuation. Level 2 is defined as “fair value is determined through valuation techniques based on observable inputs, either directly, such as quoted prices, or indirectly, such as derived from quoted prices. This category includes instruments valued using quoted market prices in active markets for similar instruments, quoted prices for identical or similar instruments in markets that are considered less than active or other valuation techniques where all significant inputs are directly or indirectly observable from market data” by Standard Bank in their 2012 financial statements.

		2007	2008	2009	2010	2011	2012
Assets at level 2 fair value	Investec	60%	62%	72%	64%	55%	59%
	Standard			83%	82%	81%	
Liabilities at level 2 fair value	Investec	90%	94%	84%	87%	78%	79%
	Standard			97%	95%	95%	

Percentage of assets and liabilities carried at fair value for The Standard Bank of SA and Investec Bank.

The implication of level 2 valuation is that the values are more prone to error in measurement; paying tax on a profit that might be temporary can only weaken the financial system. A conversation is taking place in Europe that even questions the recognition of profits by the banks when generated by the fair valuation of the most liquid instruments.



B. Accounting treatment of financial instruments

Comment

IAS 39 will be replaced by IFRS 9 in 2015. IFRS 9 collapses these 4 categories into 2 categories with a bias towards measuring financial instruments at fair value. Early adoption is allowed from 2009. The accounting treatment of financial instruments provided in the documents is thus outdated and refers to standards that have been replaced.

II. Reasons for change

Comment

The tracking of fair value accounting gains and its ultimate realisation for tax purposes is easily accomplished in a basic accounting system. The following example is based on an interview with a financial manager at one of the SA banks:

DR Financial Instruments – R100
 CR Bank and Cash – R100

Example purchase of R100 financial instrument

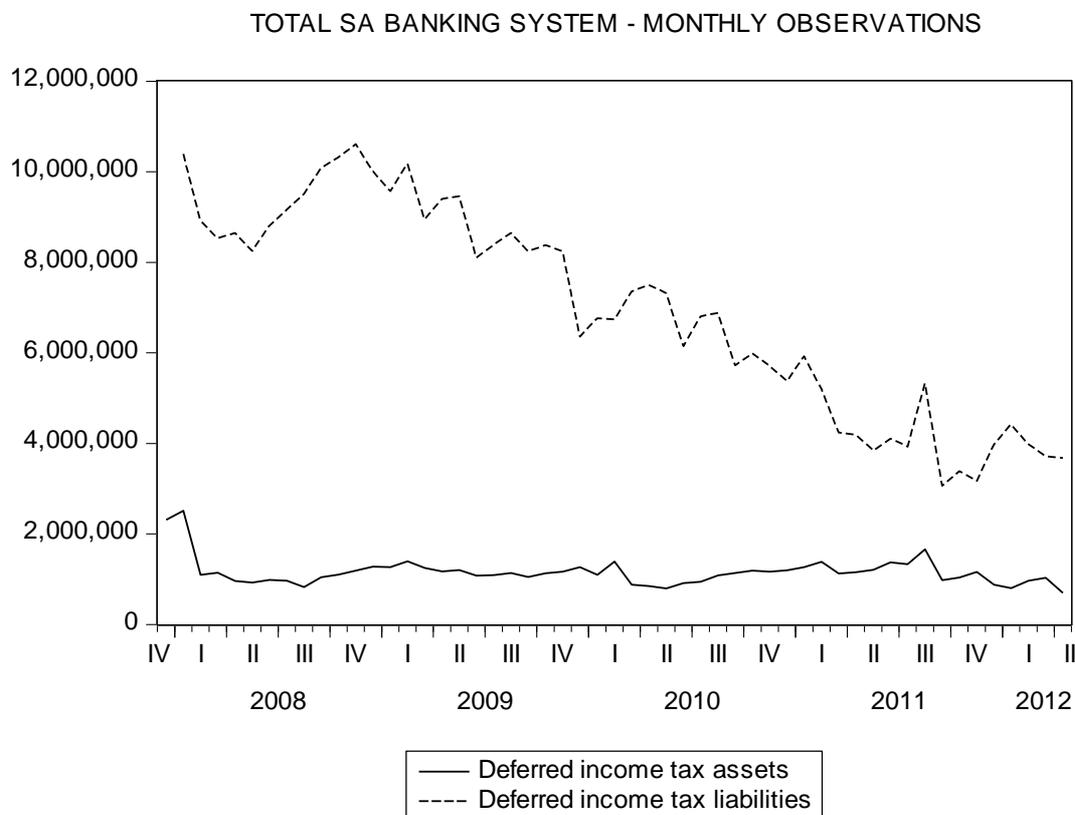
DR Financial Instrument – R10
 CR Gains on Financial Instruments (unrealised) – R10

R10 gain on instrument mark-to-market

DR Gains on Financial Instruments (unrealised) – R10
 CR Gains on Financial Instruments (realised) – R10

Realisation of previous gain

SARS's argument of an extreme divergence between taxation and financial accounting is also arguable. Since the global financial crisis numerous banking system changes have been implemented via bank supervisor intervention, local law changes and international banking regulations. The implication of these changes has been to close the gap between accounting profit results and taxation profit results as can be seen in the following graph based on data provided by the SARB:



The logic behind using the above graph of Deferred income tax liabilities to illustrate that the gap between accounting net income and tax net income is shrinking, is as follows. An analysis of Standard Bank and Investec disclosure had shown that most of the movement on Deferred tax liabilities was explained by transactions on the financial instruments line. These temporary tax differences arose because the accounting net income fair valued gains whilst the taxation system was realisation based.

The argument that current law allows mark-to-market on debt instruments should not be used to support the proposed changes as the current law provision provides the taxpayer with an option to use mark-to-market versus the proposed obligation.



III. Proposal

B. Covered persons

Comment

Hedge funds are notorious for investing in long-term instruments that do not generate consistent cash flows. Taxing gains, when cash flows might only realise much later, will provide further disincentives for the establishment of SA hedge funds. The result might be to drive hedge funds from the SA system leaving SARS in a worse position than before when they at least had sight of those hedge funds.

Comment

The covered persons exclude certain entities that have significant financial assets and liabilities accounted for at fair value by recognising changes in profit or loss. The use of financial instruments that are accounted for at fair value forms an integral part of the business of these entities.

For example, commodity brokers make extensive use of financial instruments in their main business. The gains or losses on the hedging instruments (SAFEX forward contracts) are included in taxable income on a fair value basis (as settlement takes place on a daily basis), while the other leg is only recognised when the hedged transaction takes place. This results in a timing mismatch from a tax and tax cash flow perspective.

Recommendation

Consider allowing entities other than those included in the ‘covered persons’ definition to elect to use the fair value tax model. This may entail that these entities should apply to the Commissioner in order to determine that the election is not made for purposes that will abuse the tax regime (similar to section 23K).

Alternatively, the definition of “covered persons” should be broadened to, at the very least, include companies, who in the past had received approval from SARS to apply the provisions of section 24J(9) of the Income Tax Act. Another alternative is the provisions of section 24J(9) should continue to apply to these taxpayers.



Comment

The effective date of section 24JB does not allow covered persons who do not currently apply to market to market taxation sufficient time to implement systems to cater for the treatment.

Recommendation

The effective date of the proposed section should be extended.

C. Annual fair value taxation

Comment

A major issue with the proposed changes are that not all fair value accounting transactions will be included. A possible argument is that any IFRS fair value transactions included in profit and loss should also be included for tax purposes. If that was the case only cash flow hedge instruments and available-for-sale instruments should have been excluded from the proposed legislation. But the current proposal also excludes substantial “designated at fair value categories”:

The “designated at fair value” option is available when:

- It reduces or eliminate an accounting mismatch – this is allowed to be fair valued by the proposed legislation;
- A portfolio of assets or liabilities is managed on a fair value basis – this is not allowed to be fair value according to the proposed legislation and
- A financial instrument contains embedded derivatives - not mentioned by the proposed legislation.

The “portfolio of assets or liabilities is managed on a fair value basis” is used by banks for so called macro-hedging purposes. An example is a portfolio of fixed interest rate loans advanced by an SA bank financed by a portfolio of fixed interest rate deposits. IFRS “hedging” does not allow for a portfolio hedge which is accomplished by designating both portfolios at fair value.



The implication of this is that economic activities are bound to be skewed by the tax legislation, generating a tax externality cost as well as additional cost of compliance by tax payers due to the additional information that must be collected and stored.

D. Instruments between consolidated group members

Comment

This section is inconsistent with the previous section in that the previous section did not recognise macro-hedging whilst this section recognises macro-hedging.

Comment

(Example 2)

The facts contained in Example 2 are considered unrealistic in the South African (SA) context. SA banking groups have listed group companies with a subsidiary bank. The stock brokerage company typically will be owned by the group company.

E. Transactional year

Comment

The proposed legislation places an additional cash flow burden on the SA banking system when Basel 3 already requires banks to hold more cash with the new Liquidity Coverage Ratio to be implemented from 2015. Estimates are that the SA banking system as a whole would be unable to meet this requirement, necessitating the SARB to make available a new liquidity facility.

In April 2012 the SA banking system had R3 676 564 000 of deferred taxation liabilities; this is a good estimate of the liquidity need if the proposed legislation was implemented at that date.

Comment

The categories of financial instruments listed in the proposed section 24JB(2) exclude any derivatives that form part of a designated hedge relationship (these instruments are excluded by the IFRS definitions of the categories). The EM makes clear mention of the intention to exclude instruments that form part of a cash flow hedge relationship from the scope of the



proposed section. The proposed wording however also excludes instruments that form part of a fair value hedge relationship. At present the lack of fair value hedge accounting adjustments for tax purposes result in a tax mismatch in respect of transactions in terms of which a commodity broker agrees to purchase commodities in future, and enters into a derivative to hedge itself against price risk on its future purchase, in the hands of commodity brokers.

For example, an agreement/commitment to purchase commodities in future (commodity purchase agreement) is entered into by the broker, who at the same time hedges itself by entering into a forward sales contract on SAFEX. The gains or losses on the SAFEX contract are included in taxable income on a daily basis (as settlement takes place on a daily basis), while the gains or losses of the commodity purchase agreement that are hedged by the SAFEX contract are only taken into account when the purchase takes place. This could result in the entity being taxed on gains on the hedging instrument, without an adjustment to taxable income for the losses on the item being hedged, resulting in tax payable in one year, only to be reversed (by a deduction) in the next.

To illustrate: Broker enters into a contract with a producer to purchase a commodity at R1500 per unit. At the same time it enters into a SAFEX forward contract to sell the commodity at R1550 per unit. The broker's profit from the transaction is intended to only be the R50 differential. If the commodity price drops to R1 000, the broker realises a R550 gain on the forward contract, which is included in its taxable income as it accrues (due to the daily settlement of mark-to-market differences on SAFEX). The hedged loss will only be shown in taxable income when the commodity is purchased for R1 500 and can thereafter only be sold in the market for R1 000 (resulting in a R500 loss). This tax treatment does not reflect the nature of the hedge that the broker had put in place. The move towards taxing the fair value movements on certain financial instruments indicates that the focus in respect of these instruments from a tax perspective should not be on the cash flow, but rather on the accrual basis. If this argument is followed, the broker should be allowed a deduction in respect of the accrued losses on the commodity purchase agreement that forms part of the hedging relationship or is otherwise accounted for as a derivative in terms of IAS 39.5 to 7.

Recommendation

Consider including financial assets and liabilities that form part of a fair value hedge relationship into the scope of the proposed provision.



Comment

IAS 39 and IFRS 9 result in entities recognising gains/income in respect of financial liabilities accounted for at fair value when the issuer/debtor's own credit risk deteriorates. Currently it is proposed in section 24JB that all gains or losses recognised in profit or loss or other comprehensive income should be included or deducted from the covered person's taxable income (thus including these gains arising from the deterioration of the issuer's credit risk).

The gain on a financial liability as a result of the deterioration of a taxpayer's own credit risk may however ultimately result in the financial liability/obligation being written off. In order to establish whether the benefit from this write-off would be taxed, the proposed section 19 and paragraph 12A of the Eighth Schedule should be applied. The application of these provisions may result in the benefit arising from write-off not being taxed, while it would automatically be taxed if the fair value gain is included in taxable income. It is therefore submitted that the proposed fair value accounting treatment of financial liabilities is not completely aligned with the proposed debt relief provisions. Taxing such a gain arising from the deterioration of a taxpayer's own credit risk and financial position would not be in line with the policy to provide relief from the tax burden which arises in cases where debtors are unable to fulfil their obligations (as it is stated in the EM in respect of section 19 and paragraph 12A of the Eighth Schedule).

Given the requirements that a financial asset or liability has to meet for the fair value tax regime to apply (held for trading and accounted for at fair value to prevent mismatches), it is unlikely that other capital/revenue or taxability issues should arise.

For example, Debtor owes Creditor R1 million and accounts for this liability at fair value. As Debtor's own credit risk and financial position deteriorates, the fair value of the instrument decreases to R400 000. If the amount owing in terms of the instrument becomes irrecoverable, the fair value would drop to R Nil. If fair value accounting is applied, the Debtor will be taxed on a gain of R600 000 (R1m – R400 000) because its own financial position worsened. If however the loan is written off, the Debtor may or may not be taxed on the gain, depending on the situation.



Recommendation

IAS 39 requires that fair value movements in a financial liability that stem from changes in the debtor's credit risk should be recognised separately in other comprehensive income. A possible suggestion as to how the above concern may be addressed, would be that all gains or losses recognised in profit or losses by a covered person should be included or deducted from the person's taxable income, except those amounts recognised other comprehensive income in respect of changes in the issuer's own credit risk.

Comment

The proposed amendment uses the terminology of IAS 39. Despite IFRS 9 only being compulsory for financial years commencing on or after 1 January 2015, entities may choose to adopt this standard early. IFRS 9 uses a different classification system – for example, no reference to financial assets held for trading. In addition, in terms of IFRS 9 financial assets will automatically be measured at fair value through profit or loss, unless they fall into the amortised cost category. The proposed amendment should make provision for entities that chose to adopt IFRS 9 early.

Recommendation

The provisions of the proposed section should make provision for entities that adopted IFRS 9 early. This could be done by including the IFRS 9 classifications and terminology into the proposed section or by stating that an entity had to meet the requirements of the section had it applied IAS 39, without early adoption of IFRS 9.

3.2 Mark-to-market taxation of long-term policy holder funds

Comment

In terms of the proposed section 29B of the Income Tax Act, there will be a deemed disposal of policyholder assets on an annual basis (i.e. at the close of each policyholder fund's year of assessment). The EM states that such deemed disposal will not trigger certain loss-limitation rules, such as those contained in paragraphs 39 and 42 of the Eighth Schedule to the Income Tax Act.



It is further proposed that paragraph 42 of the Eighth Schedule to the Income Tax Act be amended to disregard capital losses that arise as a consequence of the application of section 29B of the Income Tax Act. However, no similar amendment has been proposed in respect of paragraph 39 of the Eighth Schedule to the Income Tax Act. In our view, this is an oversight.

Recommendation

We recommend that this oversight be corrected and that paragraph 39 of Eighth Schedule to the Income Tax Act be amended so that it does not apply to capital losses that arise as a consequence of the application of section 29B of the Income Tax Act.

3.3 Creation of unified system of taxing real estate investment trusts for property investment schemes

Comment

The EM states that the reason for the proposed introduction of section 25BB of the Income Tax Act is to adopt a unified approach for property investments schemes for financial regulatory and tax purposes.

It is proposed that a Real Estate Investment Trust (REIT) be defined in section 1 of the Income Tax Act so as to mean a company:

- whose shares are listed on an exchange as shares of a real estate investment trust, as defined in the JSE Limited Listing Requirements; or
- a company whose shares are not so listed and that company is a property subsidiary, as defined in the JSE Limited Listing Requirements, of a company whose shares are listed as above.

The proposed definition presupposes that the property loan stock (PLS) and property unit trust (PUT) entities that the legislature wishes to consolidate under the REIT umbrella are listed companies (or are subsidiaries of listed companies). In our experience, this is not the case in all instances and, consequently the proposed definition of a REIT is too narrow.



Recommendation

We recommend that the definition of a REIT be expanded to include both listed and unlisted property investment schemes.

4. INCOME TAX: BUSINESS (INCENTIVES)

4.1 Depreciation of supporting structures for energy projects

Comment

In terms of the proposed amendments foundations and supporting structures used in the production of renewable energy are to be included in the accelerated capital allowances provided by this section.

Recommendation

It is submitted that the effective date of this section should be backdated so as to apply to pre-existing foundations and supporting structures. In our view there has never been a valid reason to exclude foundations and supporting structures from benefitting from the allowance under the circumstances listed in the provision.

4.3 Oil and gas incentive and stability revisions

Comment

Paragraph 8(1)(a) of the Tenth Schedule to the Income Tax Act states that the Minister of Finance may enter into a binding fiscal stability agreement with an oil and gas company, in respect of an oil and gas right, that guarantees that the provisions of the Tenth Schedule as at the date on which the agreement was entered into will apply in respect of the income of the oil and gas company, which is derived from that right.

Consequently, oil and gas companies that have already entered into binding fiscal stability agreements may not be able to benefit from the proposed amendments to the Tenth Schedule.



Recommendation

It is suggested that that the Tenth Schedule be amended in order to allow an oil and gas company to benefit from beneficial changes to the Tenth Schedule, subsequent to entering into a binding fiscal stability agreement.

Comment

The draft Bill states the following regarding the effective date of paragraph 2 of the Tenth Schedule:

“Subsection (1) comes into operation on 31 March 2013 and applies in respect of–

(a) years of assessment ending during the period of 12 months ending on that date; and

(b) (all years of assessment subsequent to any year of assessment contemplated in paragraph (a).”

However, the EM states that:

“The rate limitations to the Tenth Schedule will apply with effect for years of assessment commencing from 1 March [April?] 2012.”

This is confusing.

Recommendation

The EM and the legislation must be aligned, so as to give expression to the intention of the legislature.

5. INCOME TAX: INTERNATIONAL

5.2 Revised rollover regime for cross-border reorganisations

Comment

The term “qualifying interest” is defined in section 42(1) of the Income tax Act for the purposes of:

- paragraph (a) of the definition of “asset-for-share transaction”; and



- paragraph (b) of the definition of “asset-for-share transaction”.

Clause 80(1)(d) of the draft Bill proposes that the definition of the term “qualifying interest” for the purposes of paragraph (b) of the definition of “asset-for-share transaction” be amended.

It is submitted that the definition of the term “qualifying interest” for the purposes of paragraph (b) of the definition of “asset-for-share transaction” (and consequently the amendment proposed in clause 80(1)(d) of the draft Bill) has become superfluous, since the draft Bill also proposes amendments to:

- paragraph (b) of the definition of “asset-for-share transaction”; and
- section 42(6) of the Income Tax Act,

which, in effect removes the references to “qualifying interest” in these sections.

Recommendation

Since the definition of the term “qualifying interest” for the purposes of paragraph (b) of the definition of “asset-for-share transaction” has become superfluous it is recommended that this definition be removed and the amendments proposed in clause 80(1)(d) of the draft Bill not be enacted.

Comment

The EM states that cross-border asset-for-share transactions may now need to satisfy the post-transaction requirement that *all* of the equity shares of the transferee company must be directly or indirectly held by a resident (see page 95, last bullet and illustrated by Example 4 on page 97).

However, proposed paragraph (b) of the definition of “asset-for-share transaction requires that:

“(ii) at the close of the day on which the asset is disposed of in terms of that transaction:

(aa)..; or



*(bb) that person is a resident and directly or indirectly (...) holds **the equity share** in the other foreign company that is acquired in exchange for the equity share disposed of by that person in terms of that transaction;” (our emphasis).*

Therefore, this drafting appears to be inconsistent to the apparent intention of the Legislature, as stipulated in the EM.

Recommendation

The EM and the legislation need to be aligned, so as to give expression to the intention of the legislature.

5.3 Rollover relief for controlled foreign company (CFC) intra-group transactions

Comment

The word “instrument” has not been deleted in all instances in accordance with the proposed amendments to section 45.

5.4 Narrowing of the participation exemption in respect of foreign equity share disposals

Comment

Clause 133 of the draft bill replaced the current paragraph 64B and proposed that paragraph 64B(1)(b) should read as follows:

- “(b) that interest is disposed of to any person that is not a resident (other than a controlled foreign company) for an amount that—
- (i) is equal to or exceeds the market value of the interest; and
 - (ii) does not include an amount that does not constitute a share in any company”

The current wording and layout can be interpreted to mean that the amount should be equal to or exceed the market value of the interest and should consist solely of shares. This is not in line with the EM, which clearly states that “for this requirement the receipt of shares will not be taken into account”



Recommendation

Presumably, the proposed amendment should read as follows:

“(b) that interest is disposed of to any person that is not a resident (other than a controlled foreign company) for an amount that is equal to or exceeds the market value of the interest; provided that in determining whether such amount is equal to or exceeds the market value of the interest any part of that amount that constitute a share in any company will be disregarded.

5.6 Rationalisation of withholding taxes on payments to foreign persons

Comment

The draft Bill proposes that section 35 of the Income Tax Act be repealed. It is further proposed that Part IVA of chapter II, which pertains to the withholding tax on royalties, be introduced as sections 49A to 49G of the Income Tax Act. The positioning of these provisions as sections 49A to 49G does not appear to follow the lay-out of the Income Tax Act.

Recommendation

It is proposed that the provisions pertaining to the withholding tax on royalties be positioned close to the other sections dealing with withholding taxes such as section 35A (withholding of amounts from payments to non-resident sellers of immovable property) and sections 37I -37N (withholding tax on interest), perhaps as a new section 35.

Comment

At clause 86 the draft Bill proposes the introduction of sections 49A to 49G of the Income Tax Act. This includes the introduction of section 49D. However, at clause 87 the draft Bill proposes amendments to section 49D. The reason for the introduction and amendment of section 49D in the same Bill is unclear and confusing, in particular, considering that the proposed respective effective dates of these proposed amendments overlap. (Additional concerns regarding the provisions of the proposed section 49D and their interaction with the provisions of sections 10(1)(l) and 9D, as amended by the proposals in the draft Bill are discussed at part 5.7 below).



Recommendation

It is therefore proposed that the above be clarified and that section 49D be introduced in a form and effective date that gives expression to the intention of the legislature and that the effective dates of the amendments to sections 9D, 49D and 10(1)(l) be aligned accordingly.

5.7 Removal of the controlled foreign company (CFC) exemption from interest and royalties

Comment

Part 5.7 of the EM explains that it is proposed that:

- The CFC exemptions from cross border withholding tax in respect of interest and royalties be removed. Thus, CFCs will be fully subjected to these respective withholding taxes, subject to the application of the provisions of agreements for the prevention of double taxation.
- Further, the exemption from normal tax will be aligned and foreign persons will be fully exempt from normal tax on interest and royalties unless that person
 - is a natural person who is physically present in South Africa for more than 183 days;
or
 - has a permanent establishment in South Africa during the relevant year of assessment
- Interest and royalties received by a CFC will thus be subject to the attribution rules of section 9D, unless such amounts have been subjected to South African cross border withholding tax.

A review of the proposed amendments to sections 9D, 10(1)(h), 10(1)(l), 37J(1), 37K(3), 37L(1) and 49D raises the question as to whether this is achieved. Furthermore, the sections make it very difficult to follow what the actual position is.

Taking interest as the example (royalties are treated the same): The proposed section 10(1)(h) exempts from tax:



“any amount of interest as defined in s37I [s37I, in turn, refers to s24J(1) and it is therefore not clear why this section is being changed to refer the reader to s37I first and not straight to s24I] which is received or accrued during any year of assessment by or to any person who 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” (our comments in square brackets).

Thus, if the amount is exempt from withholding tax in terms of s 37K the exemption from normal tax does not apply.

Clause 75 of the Amendment Bill indicates that the proposed section 37K(3) exempts a person that is a CFC, as defined in s9D, from the withholding tax on interest. This clause becomes effective on 1 January 2013 in respect of interest that accrues or is paid or becomes payable after that date.

Thus, in terms of these two proposed clauses the interest paid to a CFC is subject to normal tax in the CFCs hand's if received from 1 January 2013. A tax return would need to be submitted to SARS to reflect this interest.

The question that then arises is, whether the interest income received by the CFC must also be attributed back to its South African shareholders in terms of s9D. In this regard, section 9D(9)(e) provides an exemption from attribution for income (including interest) that has already been taxed in SA in the CFC's hands. Thus, no double taxation results.

Oddly, a new paragraph (d) is being inserted into section 9D(9), which exempts from attribution any amount that has been subject to the withholding tax on interest or royalties. Based on the above this is superfluous.

However, a further review of the draft Bill reveals that clause 76 also becomes effective on 1 January 2013 and applies in respect of interest paid or that becomes payable during years of assessment commencing on or after that date. Clause, 76 proposes that section 37K be amended so as to remove the exemption from the withholding tax on interest for CFCs. This will result in the interest paid to CFC's being exempt from normal tax in terms of s10(1)(h) (and no SA tax return needing to be submitted), but subject to the withholding tax in terms of section 37K, and exempt from the attribution rules in terms of s9D(9)(c).



This is very confusing and the treatment is completely different under each scenario. Since the proposed respective effective dates of these proposed amendments overlap it is also not clear which should prevail. If both apply then there may be a period from 1 January 2013 to the beginning of the paying company's tax year (which company is referred to is also not clear) when a tax return must be submitted for the CFC. Thereafter only WHT must apply. This is surely not the intention, and if it is it is counterproductive.

Recommendation

We recommend that the two amendments (Clause 75 and 76) be merged and the removal of the CFC from the withholding tax exemptions should be made effective for interest paid or payable on or after 1 January 2013, along with the rest of s37K. This will make sense of the other related amendments and make it clear what is intended.

The reference to s37I in section 10(1)(h) should be changed back to section 24J(1) to remove the need to refer to two sections to get to s24I(1).

5.8 Relief from the effective management test in the case of high-taxed controlled foreign companies (CFCs)

Comment

We welcome the proposed amendment to the definition of "resident" as it relates to persons other than natural persons.

We are concerned however that the 75% rule included in this definition may be problematic. For example, say a Namibian incorporated company meets the 75% rule. However in one year, it disposes of land and buildings for a significant capital gain. As Namibia, which is a high tax jurisdiction, does not impose capital gains tax, the Namibian company will suddenly be a SA resident for the year in which the land and buildings are disposed of. The very next year, it meets the 75% rule again and now ceases to be a resident, resulting in the exits charges contained in the Act coming into play.



Recommendation

Consideration should be given to removing the 75% rule. It is submitted that the requirement for the company to have a foreign business establishment together with the diversionary rules contained in section 9D(A) should be sufficient to ensure that the company is located outside South Africa for commercial as opposed to tax reasons.

5.11 Further refinements to the headquarter company regime

Comment

While the introduction of the headquarter company tax regime was welcomed, it is still not as tax efficient as other jurisdictions (mainly Mauritius' GBC company regime) if the headquarter company continues to be taxed at a corporate tax rate of 28%.

There is limited tax relief for the receipt of interest and royalties, but not for other income, such as management fees. The headquarter company will thus be taxed at 28% on management fee income (and even interest and royalties) to the extent that it does not have a corresponding expense, which is much higher than the effective rate of 3% which a GBC1 company is taxed at.

Recommendation

Since, the tax rate applicable to headquarter companies cannot simply be reduced, without the risk of South Africa being blacklisted as a tax haven, a tax credit system specifically applicable to headquarter companies, which reduces the effective tax rate paid by such company, should be considered.

5.13 Revised currency rules for intra-group exchange items

Comment

The current wording to section 24I(7A) provides a 10 percent spreading rule which applies to pre-2005 exchange items. The EM indicates that the proposed changes to section 24I which aligns the section more closely with IFRS will result in any residual amounts carried forward



in terms of the existing section 24I(7A) to be immediately recognized. This proposed treatment per the EM does not appear to be given any effect in the DTLAB.

The EM further advises, at part 5.13 (III – paragraph C), that the spreading provision in relation to pre-close 8 November 2005 loans will be completely abandoned. This is not supported in the wording of the proposed legislation. Section 24I(10) is subject to subsection 24I(7A) and this provision has not been removed.

If a debt fell into the provisions of sub-section 7A and that debt is still in existence, subsection 7A requires that the unrealised exchange difference must be deferred until the debt is realised. This is due to the fact that every year the debt is restated and every year the foreign exchange balance is adjusted with the current year's foreign exchange amount. Thus, the proposed wording of the legislation does not stop this process.

Recommendation

We recommend that wording similar to that as being proposed in subsection 10 is included in subsection 7A to correct this. This can be added as the following proposed proviso at the end of subsection 24I(7A)(b):

“Provided further that any exchange item as contemplated in paragraph (a) that is held and not realised before the last day of any year of assessment of a person (that is the holder of that exchange item) ending before the year of assessment of that person commencing on or after 1 January 2014 shall be deemed to have been realised on that last day.”

Comment

Paragraph (b)(i) of the proposed insertion refers to “the group”. Should that not be to “the same group” as per paragraph (a)(i) of the same subsection?

Comment

The proposed wording to the final proviso to section 24(10) indicates that unrealized exchange differences that are carried forward on the last day of the year of assessment that ending immediately before 1 January 2014 will be deemed to have been realized on that date.



This date is misaligned with the effective dates of the other proposed changes to the section of 1 January 2013.

6. MISCELLANEOUS AMENDMENTS

CLAUSE 23 – Section 10B(2)(b)

Comment

The definition of foreign dividend in section 1 of the Act is (in its most basic form) an amount paid or payable by a foreign company.

The definition of a foreign company in section 1 of the Act is any company which is not a resident, i.e. a company that is not incorporated nor effectively managed in SA.

A foreign company, as a non-resident, is taxable in South Africa on South African source income. The source of dividends, according to section 9(2)(a), is South Africa if the amount constitutes a dividend (i.e. paid by a resident company). The source of dividends, according to section 9(4)(a) is not South Africa if the amount constitutes a foreign dividend.

In order for a foreign company to be entitled to the exemption contained within section 10B(2)(a) an inherent requirement is that the amount should have been included in the foreign company's gross income (from a South African source). The issue is, however, how can a foreign company include a foreign dividend in its gross income if it is not from a South African source?

The EM to the Taxation Laws Amendment Bill of 2011 states that a controlled foreign company (CFC) will be allowed to claim a participation exemption (i.e. the section 10B(2)(b) exemption) if a foreign dividend is paid by a foreign company which is situated within the same country as the CFC to which the foreign dividend is paid. If this exemption should apply to a CFC (however, the proposed legislation simply refers to a foreign company, not a CFC), should it not rather be contained within section 9D and not section 10B?



For example, A PLC is a company with its place of effective management in Botswana (i.e. a foreign company). The company's shareholders are B Ltd (a South African resident) that owns 60% of its shares and C PLC (a non-resident) that owns the remaining 40% of its shares. A PLC has two types of income: Interest from a South African source of the equivalent of R100 000 and a dividend from a company in Botswana (D PLC) the equivalent of R200 000.

A PLC will be taxed in South Africa on the R100 000 South African interest as it is from a South African source. However, A PLC will not be taxed in South Africa on the dividend received from D PLC as it constitutes a foreign dividend (dividend paid by a foreign company). If the foreign dividend is therefore not included in A PLC's gross income, how can the company qualify for the section 10B(2)(b) country-to-country exemption?

Recommendation

If the purpose of the section 10B(2)(b) exemption is to exempt foreign dividends received by a CFC from a company located in the same country as the CFC, it is recommended that the section 10B(2)(b) exemption be deleted and moved to section 9D – possibly section 9D(2A) or section 9D(9)?

Comment

The draft Bill proposes to exempt from Dividends Tax dividends “to the extent that the *dividend* is not *exempt from normal tax*”. In terms of the EM the aim is to prevent double taxation. The concern is that:

- Section 8C does not tax the dividend, but triggers taxation of a “gain”, which is either determined as (i) the market value of the equity instrument less consideration paid or (ii) the amount received / accrued less consideration paid. Section 8C does not tax the dividend *per se*.

Dividends are exempt from tax in terms of section 10(1)(k). The section 8C taxation is independent from the section 10(1)(k) exemption (i.e. the dividend is still exempt, but there is a section 8C taxing event).

Recommendation

The interaction between the above sections should be reviewed.



Comment

The legislation does not cater for the situation when dividends are distributed by a company to partnership which includes non-residents. We refer primarily to the situation where funds are structured as limited partnerships with the general partner in South Africa but the other partners including a number of foreign investors. The question that arises is whether the dividends tax must be withheld from the portion of the dividends that goes to each non-resident partner. This is administratively complex. Furthermore, since these partnerships are generally limited partnership where the identity of some partners is protected, by completing the notifications (i.e. the declaration and undertaking form) to underlying investees, these partners' identities would be revealed which defeats the purposes of the limited partnership.

Recommendation

We submit that the legislation should be amended so that the general partner can provide the notifications without revealing the identities of the *en commandite* partners. Alternatively, we submit that the general partner could be designated as the relevant withholding agent.

Comment

A company's dividend cycle is deemed to end on 31 March 2013 (proviso to the definition of "dividend cycle" in 64B). However, the legislation does not state that a dividend (of nil) is deemed as being declared on that date. The suggested amendment to Section 64J(2)(a) states that the STC credit will be the amount by which the dividends accrued during that last dividend cycle *exceed the dividends*, as contemplated in section 64B(2), *declared on that day*. If no dividend was declared on 31 March, or deemed to be declared (because deeming the dividend cycle to end on that date is not the same as deeming a dividend to be declared then), will 64J(2)(a) even apply? Very conservatively speaking, an argument could be made that if no dividend was declared on 31 March, the subsection finds no application. Of course this argument will mean that no STC credit will arise in respect of dividends accrued and those carried forward prior to 31 March, UNLESS the company actually declared a dividend on 31 March, which is clearly nonsense and not at all the intention. This appears to be a mistake.



Recommendation

The legislation needs to be amended to provide that where no dividend was declared during that final dividend cycle, the STC credit will simply be the amount of dividends that had accrued on that date.

CLAUSE 34 – Section 12L

Comment

The proposed amendment substitutes the formula for calculating the amount of the allowance under section 12L with an amount per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.

Prior to 2012 amendment:

Prior to this amendment, section 12L was a notional allowance expressed as the average of the energy savings multiplied by an applied rate. Therefore, if less energy was used it could have lead to a larger allowance in terms of section 12L and in turn result in a reduced tax liability.

Post 2012 amendment

The amendment states that *“The amount of the allowance contemplated in subsection (2) must be calculated at 45 cent per kilowatt hours or kilowatt hours equivalent of energy efficiency savings”*.

This means the allowance is calculated at a fixed rate of 45% of energy savings incurred, which may/may not be to the benefit of taxpayers - see difference between scenario 1 and 2 below.

Subsection (1) comes into operation on the date on which section 27(1) of the Taxation Laws Amendment Act, 2009 (Act No. 17 of 2009), comes into operation. Section 12L comes into operation on the date on which section 27(1) of the Taxation Laws Amendment Act, 2009, comes into operation. Since this deduction is allowed only in any year of assessment ending before 1 January 2020, it is imperative that section 12L is enacted as soon as possible.

For example

Facts: Scenario 1



B: 100kWh Energy saving in a particular YOA
C: R4/kWh Assumed lowest feed-in-tariff rate at the beginning of the year of assessment in R/kWh. It is unsure what this rate would have been and therefore we have created 2 scenarios

Prior to 2012 amendment:

$$\begin{aligned} A &= B * C / D \\ &= 100 * 4 / 2 \\ &= R200 \text{ allowance} \end{aligned}$$

Post 2012 amendment:

A = 45 cent per kilowatt hours or kilowatt hours equivalent of energy efficiency savings.

$$\begin{aligned} A &= 100 \text{kWh} * 0.45 \\ &= R45 \text{ allowance} \end{aligned}$$

The old regime therefore appears as a much larger tax incentive to taxpayers.

Facts: Scenario 2

B: 100kWh Saving in a particular YOA
C: R0.75/kWh Lowest feed-in-tariff rate at the beginning of the year of assessment in R/kWh

Prior to 2012 amendment:

$$\begin{aligned} A &= B * C / D \\ &= 100 * 0.75 / 2 \\ &= R37.50 \text{ allowance} \end{aligned}$$

Post 2012 amendment:

A = 45 cent per kilowatt hours or kilowatt hours equivalent of energy efficiency savings.

$$\begin{aligned} A &= 100 \text{kWh} * 0.45 \\ &= R45 \text{ allowance} \end{aligned}$$



Even though there might have been technical complications prior to this amendment, this amendment is now reducing the benefit of investing in new "green" technology. This however depends on what the Lowest feed-in-tariff rate at the beginning of the year of assessment in R/kWh would have been as determined by the Regulatory Guidelines of the National Energy Regulator of South Africa issued in terms of sections 4(a)(ii) and 47(1) of the National Energy Regulator Act, 2004 (Act No. 40 of 2004);

Recommendation

1. The incentive to invest in new green technology should be made more worthwhile. For example, in the UK, a taxpayer may claim a ECA (Enhanced capital allowance) at 100% and UK taxpayers merely have to purchase the prescribed energy saving products to qualify. The ECA is more incentivising because 100% of the cost of this investment is deductible for tax purposes. Compared to SA, only the average of the energy savings multiplied by an applied rate would have been allowed as a deduction in the past. Now it is proposed that only 45% of savings are allowed as a deduction.

2. The deadline or window period to qualify for the allowance in terms of section 12L(2), should either be extended or section 12L should be enacted as soon as possible to allow taxpayers adequate time to benefit from this allowance.

CLAUSE 91 – Section 64F(1)

Comment

The wording in the proposed insertion in section 64F(1) reads: *“any person to the extent that the dividend is not exempt from normal tax”*. Section 8E deems certain dividends to be interest (or income in terms of the proposed amendments) in the hands of the recipient, while it remains dividends in the hands of the company declaring the dividend. This may place an obligation on the company paying the dividend (in whose hands the amount remains a dividend) to withhold dividends tax, while the amount no longer constitutes a dividend in the hands of the recipient (the person referred to in section 64F(1)). It is submitted that the proposed wording of section 64F(1) is only wide enough to include amounts that remain dividends in the hands of the recipient (i.e. amounts intended in section 10(1)(k)(i)). The wording of this proposed exemption is not wide enough to cover dividends that are deemed to



no longer be a dividend in the hands of the recipient, while these amounts should arguably also qualify for the exemption.

Recommendation

The wording of section 64F(1) should be changed to *“any person to the extent that the dividend or the dividend which is deemed to be another form of income in the hands of the recipient is not exempt from normal tax”*

CLAUSE 95(1)(b)(a) read with CLAUSE 90(1)(b)

Comment

The retrospective amendment to section 64E would mean that listed companies did not notify their shareholders as required by section 64J.

Recommendation

The effective date of the amendment to section 64E should be the date of promulgation.

CLAUSE 95(1)(e)

Comment

Companies created for the purpose of facilitating BEE shareholding (BEE companies) in other companies often receive significant amounts of dividends from the shares they hold in the other company in order to enable them to make repayments on loans and other funding instruments used to acquire these shares. Until the BEE company has settled its funding obligations, these companies are placed under restrictions as to what they may do with their available resources (one such restriction would be that the BEE company will not be allowed to declare dividends until the funding obligations have been settled). A BEE company that has accumulated significant STC credits prior to 1 April 2012, may not have the ability to utilise this STC credit within 3 years from 1 April 2012 due to the restrictions imposed by funders.

This will result in an impoverishment of the shareholders of the BEE company, as the dividends they ultimately receive from the BEE company will be fully subject to dividends tax (assuming that the shareholders are not companies). This impoverishment of such



shareholders would be in conflict with the overall objective of BEE to uplift the individuals who own the shares of the BEE company.

Recommendation

An exception to the three year period should be contemplated for BEE companies. The criteria to qualify for this exception could, among others, include whether the shareholding of the BEE company in any other company could result in BEE points in terms of the DTI scorecards, to ensure that only the intended group benefits from this.

The alternative suggested would be to provide a window period for these companies to use their accumulated STC credits within a certain period after the restrictions of the company's ability to declare dividends have been lifted.

Miscellaneous errors

1. The example on page four of the EM is incorrect. The facts state R 50,000 qualifying medical expenses, but the solution is based on R 20,000 qualifying medical expenses.
2. Clause-by- clause EM's ("EM") comments in relation to clause 17 is not aligned to the draft bill. The EM does not comment on clause 17(b) and as a result the comments to clauses 17(c) to 17(f) does not correspond with the relevant clause in the draft bill.
3. Section 37K(1)(a): numbering of subparagraphs is (1),(ii)(iii)(iv) and (vi), i.e. number (v) is skipped (page 94 of Bill).
4. Section 42 (clause 80 of the draft Bill, top of page 99) should read: "...issue of an equity share or shares"
5. The layout of the definition of "conversion transaction appears to be incorrect: **'conversion transaction'** means any transaction in terms of which a close corporation is converted to a company
(b) a co-operative is converted to a company as contemplated in section 40B'

Presumably it should be:



‘conversion transaction’ means any transaction in terms of which

(a) a close corporation is converted to a company , or

(b) a co-operative is converted to a company as contemplated in section 40B’

6. Clause 115 to amend paragraph 10 of the Eight Schedule refers to Act XX of 2012.

DRAFT TAX ADMINISTRATION AMENDMENT BILL, 2012 (“DTAAB”)

CLAUSE 58

Comment

The DTAAB provides that the Commissioner must recognise as “a statutory body...” the IRBA, SALPC and other statutory bodies. It is not clear if these bodies are intended to be the ultimate controlling bodies – IRBA is a regulatory body. The proposed section then proposes that SARS “may” recognise the other bodies.

Recommendation

It is recommended that the controlling bodies are in fact the bodies envisaged in section 240A(2) and that existing bodies, like SAICA, that meet the requirements, must also be approved by the Commissioner. If the Commissioner requires amendments to the existing bodies’ constitutions, this can be addressed before the approval is granted.

There is a risk that there may otherwise be a period where there are no bodies that can specifically be recognised and that the abovementioned bodies cannot allow persons who are only tax practitioners as members of their organisations, as these individuals would not meet the entrance requirements.

Comment

It is unclear as to whether there is an expectation that the continuing professional education (‘CPE’) requirement includes specific tax CPE. If so, this will have implications for CPE policies which may not specify in what area the person should gain their CPE.



Recommendation

With regard to the minimum qualification and experience requirements as well as the CPE requirements it is recommended that it is specifically stated that these are in the field of taxation. The tax practitioner must not only be competent and maintain an up to date skill, but must be a person who specialises in tax. The DTAAB should emphasise this.

It is also suggested that the SARS staff meet the same minimum requirements regarding training and CPE.

Comment

The fact that the body must set minimum qualifications *etcetera* is very vague. This could lead to a wide discrepancy in skill and knowledge areas.

Recommendation

We recommend that the wording be expanded to provide some clarity and specifics in this regard. We also suggest that as part of the code of conduct, there is a requirement that a person cannot take on the role of tax practitioner unless they have the necessary competence to carry out the work and that due professional care be exercised when undertaking such assignments.

Comment

The DTAAB states that the Minister may appoint a panel of judges to deal with disciplinary matters. There is some concern as to whether this will be appropriate as it may result in the cost being shared by SARS and the body and many of the smaller bodies may not be able to afford this.

Recommendation

We recommend that the DTAAB specifically address the concerns above.

CLAUSES 14 to 18

Comment



The DTAAB proposes to change the principal of levying a penalty for provisional taxpayers whose taxable income exceeds R1 million. The proposal is that these penalties will automatically be levied and at a fixed percentage (20%). It is also not clear why the penalty which was previously capped at maximum of 20% must now automatically be levied at the maximum.

Recommendation

It is recommend that existing system be retained, i.e. the penalty may be levied if SARS is not satisfied that it was seriously calculated and will not automatically be levied at 20%.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

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