Standing Committee on Finance (SCOF): Report-Back Hearings

11 September 2012

DRAFT Taxation Laws Amendments Bill, 2012 and Tax Administration Amendment Bill, 2012

Draft Response Document from National Treasury and SARS, as presented to SCOF

(Final version of this document will be published by date of introduction of the Bills)

1. BACKGROUND

1.1 PROCESS

The Draft Taxation Laws Amendment Bill, 2012 and Tax Administration Amendment Bill, 2012 were publicly released on 6 July 2012. National Treasury and SARS conducted the initial briefing before the Standing Committee on Finance on 31 July 2012. Public responses to the Committee were presented at hearings held on 22 August 2012.

1.2 PUBLIC COMMENTS

The National Treasury/SARS deadline for public written responses was 31 July 2012 but comments were allowed until 2 August 2012. These responses amounted to over 511 pages provided by approximately 58 organisations. Pursuant to recent practice, a series of National Treasury/SARS workshops were conducted with interested stakeholders to review all comments. In total, three general workshops were held on 30 July, 1 August and 2 August (one for individual and savings issues, one for business issues and one for international issues). Separate meetings were also held to review specific issues (e.g. mark-to-market taxation for banks, brokers and long-term insurers, real estate investment trusts (REITs) and short-term insurers).

2. TEMPORARY DELAY OF DEBT/SHARE RULES

The proposed legislation contains three sets of debt/share rules (i.e. sections 1 (“debt” and “equity share” definitions), 8F, 8FA and 23L), the core of which has a 2014 effective date. The main purpose of the proposed legislation was to deny or defer the deduction of interest where the debt at issue has significant share-like features or where the debtor has the power to defer payment. Given the tight schedule of the current legislative cycle, it was determined that these legislative proposals be temporarily suspended (i.e. postponed for consideration in 2013). [see media statement]

3. DIVIDEND CONVERSION SCHEME ANNOUNCEMENT

On 31 August 2012, additional draft legislation was announced to close a series of related schemes designed to eliminate the dividends tax for foreign persons. While this sudden release of legislation is largely to be avoided after public hearings, the scale of the avoidance was so large is to place much of Government anticipated revenue from the Dividends Tax at risk. The scale of this loss required urgent action. The proposed comments below include taxpayer reactions to the proposed anti-avoidance legislation.

4. POLICY ISSUES AND RESPONSES

Provided below are the responses to the policy issues raised by the public comments received. Both policy and technical issues have been fully reviewed and included within the revised Bills as appropriate. Comments that fall wholly outside the scope of the Bills have not been taken into account for purposes of this response document. The references to the Bill provided below only link to the main references (i.e. the references are not exhaustive).

5. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

5.1 Additional medical expenses converted to medical tax credits

(Main references: Clauses 6, 7, 35 and 39; Amend section 6A, insert section 6B, amend section 12M, and delete section 18)

Comment: Between the proposals removing the unlimited medical deduction, and the static interest exemption, taxpayers age 65 years and older are being hit with a double blow. We propose that National Treasury reconsider the medical proposals particularly in view of ever-increasing medical costs and the fact that taxpayers at this late stage have no way to recover from the effect of these changes.

> *Response:* Not accepted. The vast majority of taxpayers and particularly those in income tax brackets below the 30 per cent bracket will be better off. Only taxpayers taxed at a tax rate exceeding 33.3% will receive less relief. More importantly the relief will be more equitable and the marginal benefit will no longer be linked to income.

Comment: Persons with disabilities and taxpayers aged 65 years and older are particularly vulnerable and have a less control than other individuals over medical costs, especially out-of-pocket expenses. Therefore, it is proposed that the rates of conversion for the medical credit be increased or that the current unlimited deduction be retained.

> *Response:* Not accepted. The proposed changes (regarding out of pocket expenses) will only take effect in the 2015 tax year. Only taxpayers taxed at a tax rate exceeding 33.3% will be negatively affected.

Comment: In order for an individual's qualifying medical expenses to exceed the 7.5 per cent ceiling, the circumstances have to be extraordinary. In essence, the current out-of-pocket regime is merely covering catastrophic medical events. A review of the proposed 25 per cent conversion rate is accordingly requested as too low. The conversion rate should be at least 33.33 per cent.

> *Response:* Not accepted. The intention has always been to provide tax relief (in addition to the tax relief provided for medical scheme contributions) for catastrophic medical events in particular. The 25 per cent conversion rate is most reasonable.

Comment: The proposed medical credit will not benefit taxpayers falling below the tax threshold because the credit is not refundable. It is proposed that a tax incentive be implemented to encourage medical scheme participation for low-income persons if that is the intention.

> *Response:* Comment misplaced. The public health system benefits those below the income tax threshold. The proposed NHI will hopefully expand and improve the health delivery system.

Comment: We propose that medical tax credits in excess of annual taxes payable be carried over to following tax years. This carryover would be similar to the carryover rules for non-deductible retirement annuity fund contributions.

> *Response:* Not accepted: This approach is administratively unfeasible. As a matter of course, roll-overs are generally limited to business taxation. Taxation of individuals should be kept as simple as possible.

Comment: The definition of "dependent" for medical scheme credits is narrower than for medical out-of-pocket expenses. No reason exists for this disparity.

> *Response:* Noted: There is arguably a difference between the definitions. Historical changes over the last 10 years have created some anomalies. The current wording ensures that the current and accepted language is kept in place until these anomalies are resolved without creating any unintended consequences.

Comments: It is proposed that the medical scheme tax credit apply monthly in the case of all taxpayers (regardless of age). Employers should be allowed to process the medical schemes credit on the payroll for employees who separately contribute in their own individual capacities.

> *Response:* Comment misplaced: The Income Tax Act already allows for scenarios where employees pay their own medical aid contributions and provide proof to the employer. There is no need for an additional amendment to cater for these scenarios in order to allow the employer to

take the credit into account for payroll purposes (see paragraph 9(6) of the Fourth Schedule to the Income Tax Act).

5.2 Exemption for compulsory annuity income stemming from non-deductible retirement contributions
(Main references: Clauses 24, 25(1)(c), 107(1)(c), and 108(1)(d); Insert section 10C; amend section 11(n), amend paragraphs 5(1) and 6(1)(b) of the Second Schedule)

Comment: The non-deductible contribution aspect of the compulsory annuity proposal does not refer to the correct funds. Contributions cannot be made to preservation funds. Preservation funds obtain funds only in respect of transfers from other funds (including the rollover of non-deductible contribution amounts). The fund references should be changed accordingly.

Response: <u>Accepted</u>. The references to preservation funds will be removed.

Comment: The new exemption does not apply to non-deductible contributions to provident funds to the extent that these funds may provide compulsory annuities to their members. It is proposed that the exemption be extended to include these types of funds to eliminate any prejudice.

Response: <u>Noted.</u> As National Treasury is in the process of considering broad changes to the provident fund regime as part of its overall retirement reforms, this issue will be deferred until these broad changes are made. However, it should be noted that the non-deductible contributions made to a provident fund would still be available to be set off against other compulsory annuities.

Comment: Many non-residents receive annuities and may have made non-deductible contributions. However, if these non-residents are not required to submit a tax return, there will be no opportunity to apply the exemption and provide these non-residents with a refund. It is requested that another alternative be considered to assist this class of annuity recipients.

Response: <u>Not accepted</u>. Withholding taxes apply irrespective of whether a taxpayer is registered or not. However, should a taxpayer wish to receive a refund it is required that the taxpayer register with SARS so that the refund can be processed. As such, non-residents will be required to register with SARS and submit a tax return in order to claim refunds. It is difficult to see how any other alternative would be less onerous.

Comment: This proposal will require significant system changes and sufficient time is required to update systems to take into account the proposed legislation. It is therefore proposed that this proposal only be effective as from 1 March 2014.

Response: <u>Accepted</u>. The effective date for this proposal will be 1 March 2014. This date will be aligned with other retirement reforms announced earlier this year.

5.3 Completion of the “clean break principle” when dividing retirement interest in divorce

(Main references: Clauses 100, 101,102,103 107(1)(a) and (e) and 108(c) and (d); delete the definition of “formula C” in paragraph 1, amend paragraphs 2(1)(b)(iA) and 2A, delete paragraph 2B, and amend paragraphs 5 and 6 of the Second Schedule)

Comment: The phrase “becomes payable” is confusing in the context of divorce. It is requested that the wording be clarified to differentiate whether the timing pertains to the date the divorce order is assigned against the fund or to the date that the election is made by the non-member spouse.

> *Response:* <u>Partially accepted:</u> The proposed wording will be amended to “due and payable” as this wording is an accepted and understood phrase as used in the Income Tax Act. The use of this wording means that neither the date of election nor date of payment is the deciding factor. Instead, the timing event is the day that the amount becomes “due and payable” in terms of the divorce order (i.e. is collectible by the non-member spouse).

Comment: It is proposed that the tax-free pre-1998 portion for government employees be available to a non-member spouse when pension funds are split pursuant to a divorce transfer. In other words, both spouses should benefit from the pre-1998 exemption period, not just the member spouse.

> *Response:* <u>Comment misplaced:</u> As with the member, the non-member spouse will retain the tax free portion for the first transfer to an approved fund. The overall policy is simply to divide the two pre-existing interests – tax-free allocations should be permitted as if the interests of both spouses were never divided.

5.4 Timing of certain forms of variable cash remuneration

(Main references: Clauses 8 and 50; Insert section 7B, delete section 23E)

Comment: Various other income streams besides those listed may be classified as “variable remuneration”, all of which create similar payroll timing issues in respect of employer-dealings with SARS. It is proposed that the definition of “variable remuneration” be extended to include these other sources of income so as to eliminate similar payroll issues.

> *Response:* <u>Noted:</u> The proposed amendment in respect of “variable remuneration” is intended to ease some of the difficulties that employers are experiencing in respect of employees tax. The income sources identified and included as part of variable remuneration have provided considerable difficulties for employers and the amendment should alleviate these difficulties. More information is required before the list should be extended (that said, National Treasury opposes a generic description that could extend the regime to unintended items).

5.5 Fringe benefit valuation of rented employer-provided vehicles

(Main reference: Clause 110; Amend paragraph 7 of the Seventh Schedule)

Comment: Reliance on the term "operating lease" to exclude financial leases from the rental employer-provided vehicle dispensation is too narrow. If the main concern is the implicit transfer of ownership, the definition of an "instalment credit agreement" under the Value-added Tax Act would be more appropriate. Alternatively, the requirement that the vehicle must be rented from a lessor who leases to the general public for time periods of less than a month should be dropped as overly restrictive.

> *Response:* <u>Not accepted:</u> The definition of an "operating lease" will remain as initially proposed. What is envisioned is a vehicle obtained from a standard rental-vehicle provider that offers vehicles for a period of a day, a week or a month. These situations are easy to value given the number of providers. However, it should be noted that the time requirement of "less than one month" does not preclude the providers of these vehicles from providing the vehicles for longer than one month. It merely serves to indicate that the providers must be in a position to provide these vehicles for periods of less than one month.

Comment: By inserting the requirement that the vehicle should be leased by the general public, certain lessor-provided vehicles are excluded, such as vehicles from a lessor with a majority of corporate entity clients. The term general public should include "corporate legal entities".

> *Response:* <u>Comment misplaced</u>: As a matter of interpretation, the definition of an "operating lease" does not exclude corporate lessees. The requirement merely clarifies that the "general public" should in fact be able to obtain these vehicles via these operating lease agreements.

Comment: The requirement that the "operating lease" must have been concluded at "arm's length with an unconnected third party" requirement is overstated. It is proposed that the requirement be changed so that the transaction instead must be concluded at a market related price.

> *Response:* <u>Not accepted:</u> The "arm's length" principle is firmly established in the Income Tax Act (see section 31). Taxpayers must set a price at arm's length in an open market. In addition, connected persons are to be excluded because of potential collusion in setting a price.

Comment: It is proposed that fuel costs be included as part of the fringe benefit calculation relating to rental vehicles. The total fringe benefit to be included will therefore be the cost of the rental, in line with the proposed legislation, as well as the fuel costs directly related to that vehicle. This change will ensure that the employer-owned and employer-rented company car regime will operate on a similar basis.

> *Response:* <u>Accepted:</u> The fuel costs that are directly associated with a rental vehicle used by an employee will be viewed as part of the fringe benefit to be included as part of the remuneration of the employee. The employee can, upon assessment, claim his or her business kilometers travelled in respect of this benefit.

5.6 Co-ordination of deduction and exemption rules in respect of employer-owned employee-related insurance policies

(Main reference: Clauses 22(1)(b), 25(1)(e)-(g) and 48; Amend paragraph (d)(ii) of the definition of "gross income" in section 1, and sections 10(1)(gH), 11(w), and 23B(5))

Comment: The proposed exclusion to section 11(w) in respect of a workplace-related policy seems to apply when the triggering event (death, disability, or severe illness of an employee) is a workplace-related event. The result is that it would be impossible to determine whether a policy premium should be deductible in terms of section 11(a) or section 11(w) until the actual event triggering the payout occurs. It is proposed that the coverage offered by the specific policy should be the deciding factor, i.e. if the policy only covers the death, disability, or severe illness of an employee if it occurs as a result of a workplace-related event, then the policy would fall outside the ambit of section 11(w).

> *Response:* <u>Accepted:</u> The wording will be amended so that the exclusion will apply if the policy only covers the death, disability, or severe illness of an employee if the death, disability, or severe illness occurs as a result of a workplace-related event.

Comment: In the area of insurance, employers can provide two types of fringe benefits. An employer can pay premiums in respect of a policy taken out by an employee, or an employer can take out a policy for the employee (and again pay the premiums). The first scenario results in a fringe benefit for the employee at a zero value if indemnity insurance is involved (e.g. to protect against negligence or malpractice) whilst the second scenario results in a fully taxable fringe benefit.

> *Response:* <u>Accepted:</u> Indemnity policies should not trigger a fringe benefit for employees if the employer funds the premiums regardless of whether the employer or the employee takes out the insurance.

Comment: The application of the "gross income" calculation under paragraph (d)(iii) is unclear when insurance funds are indirectly transferred to employees.

> *Response:* <u>Accepted:</u> This provision should apply if an employer receives an insurance payment and makes subsequent payment of that amount to the employee. The words "directly or indirectly" will be inserted to clarify the position.

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

(Main reference: Clause n/a; Paragraph (d)(iii)(cc) of the definition of "gross income" in section 1)

Comment: The explanatory memorandum states that a transfer of insurance policies by an employer to an approved retirement fund should not be taxable. However, the legislation continues to state otherwise.

Response: Accepted: The proposed amendment will be included in the amendment Bill.

6. INCOME TAX: BUSINESS TAX (GENERAL)

6.1 Revised "share" definition
(Main reference: Clause 2(x); section 1)

Comment: The definition of a "share" should cover a member's interest in a co-operative and a non-profit organisation. Without this coverage, the special rules relating to these entities will be rendered partially inoperative.

Response: Accepted. The current selective references to certain paragraphs of the company definition will be changed and reference will be made to all entities described in the "company" definition (thereby encompassing co-operatives and non-profit organisations).

Comment: The definition of "share" should encompass foreign co-operatives. South African companies often receive distributions from these entities via Netherlands and tax uncertainty could slow these repatriations.

Response: Accepted. The changes discussed in the response above should also address the concerns involving foreign co-operatives. Membership interests in these foreign co-operatives should accordingly be viewed as shares given the changes suggested.

6.2 Introduction of a definition of "debt"
(Main reference: Clause 2(e); section 1)

Comment: The proposed debt definition is too wide. The new definition seemingly includes non-credit arrangements (e.g. liabilities arising from lawsuits), which cannot be the intention.

Response: Accepted. Debt will not be defined in section 1. However, the terms relating to debt will be used consistently throughout the Income Tax Act bearing its ordinary meaning.

6.3 Revised version of the hybrid equity and third-party backed share proposals
(Main reference: Clauses 11 and 13; Sections 8E and 8EA)

Comment: As currently drafted, relief from both anti-avoidance provisions is too restrictive because the consideration applied may not be used for purposes other than "solely" for the acquisition of shares. This restriction is unrealistic because consideration of this nature is often applied to transaction costs.

Response: Accepted. The word "solely" will be removed. The exception will apply as long as the "share is issued" by the issuer for the appropriate purpose, which will include transaction costs attendant thereto.

Comment: Relief from both anti-avoidance provisions does not allow for the acquisition of shares in respect of pre-existing group companies, even if the shares are acquired from a wholly independent minority. While the prohibition of the use of funds to acquire shares already held within the group is understood (because intra-group acquisitions of this kind could render the purpose test meaningless), the prohibition against acquiring shares from an independent minority should be dropped.

> *Response*: Accepted. The language will be redrafted to ensure that purchases from independent minority shareholders is permissible. Only purchases of shares already held by group members should be excluded.

Comment: Third party guarantees should be permissible if made by any group company in relation to the issuer. No requirement should exist that the guarantee provided by the group company should bear some form of relationship in terms of ranking and quality in respect of another group company member.

> *Response*: Accepted. The ranking comparison will be removed as impractical. All group companies related to the issuer, the other issuer and operating companies will be allowed to provide guarantees regardless of ranking.

Comment: The 20 per cent ownership requirement for holders of the operating company, the issuer and the other issuer is too high. The level should be reduced. Natural persons, community trusts and employee trusts often own a much lower percentage.

> *Response*: Partially accepted. The 20 per cent per cent ownership requirement in the Special Purpose Vehicle will no longer apply to natural persons and community trusts.
>
> Employee trusts will, however, still be subject to the 20 per cent ownership requirement.

Comment: The relief for acceptable purposes under hybrid instrument and third-party backed share provisions appear to read contrary to the intended purpose due to the use of the word “or”. Taxpayers may have mixed purposes for the acquisition, each which is acceptable but not as an aggregate. A combination of good purposes should be allowed.

> *Response*: Accepted. The language will be clarified to state that acceptable purposes can be individually or in combination.

Comment: The third-party backed share rules appear to adversely impact standard hedging. Standard derivative hedges often impact both the share as well as any associated dividends.

> *Response*: Accepted. The anti-avoidance rules will be limited to preference shares. Ordinary shares will no longer fall within the anti-avoidance rules. The exclusion of ordinary shares should eliminate most of the concerns raised because standard hedging practice mainly relates to ordinary shares (i.e. shares that lack an interest-like yield).

Comment: The anti-avoidance rules for hybrid equity instruments and third-party backed shares do not cater for multiple redemption or serial transactions as intended.

> *Response:* Accepted. The allowable purposes in the hybrid equity instrument and third-party backed share provisions will make reference to each other, thereby allowing for serial allowable purpose transactions.

Comment: Earlier versions of the new hybrid equity instrument provisions provisions allow for restrictions upon distribution (e.g. restrictions prevent distributions to protect collateral or to prevent the distributions from undermining solvency or liquidity). However, the proposed provisions have removed this allowance. These types of restrictions should be permitted.

> *Response:* Not Accepted. The restriction relief requested is unnecessary because the allowable purpose test overrides all other purposes. In other words, if the purpose is valid (i.e. to acquire shares in an operating company), all of the various restrictions are irrelevant.

Comment: The part-year rules relating to hybrid equity instruments and third-party backed shares are too harsh. The "income" taint for impermissible features even applies in respect of portions of the year in which those features exist when the holder does not have ownership.

> *Response:* Not accepted. The problem seems to be more theoretical than real. No facts were provided to substantiate the request.

Comment: If the instruments contemplated in section 8E and 8EA are viewed as akin to debt, shouldn't these instruments be viewed as generating both deductible interest for the payor and interest that is received or accrued by the payee?

> *Response:* Noted. The comment represents legitimate concerns about creating an "interest deduction" as a matter of fairness / symmetry. However, the provision is an anti-avoidance provision and counter-concerns exist that the deemed interest deduction can be used for a new form of avoidance. If taxpayers want an interest deduction for interest, they have the power to obtain debt so as to ensure the deduction.

Comment: If the anti-avoidance rules for hybrid equity instruments and for third-party backed shares apply, the dividends tax should not apply. At present, the amounts appear to lead to double taxation.

> *Response:* Comment misplaced. The current proposal under clause 91 in respect of section 64F(l) exempts from Dividends Tax dividends that were not exempt from normal tax).

Comment: The exception to the hybrid equity instrument and third-party backed share anti-avoidance rules appear to allow for the acquisition of domestic shares of an operating company but not that of a foreign company. This distinction lacks any policy rationale.

> *Response:* Accepted. The acquisition of a foreign operating company will also be included as an allowable purpose. The inclusion of foreign operating companies should not represent any additional risk to the fiscus.

Comment: The permissible uses of preference shares should be expanded. Taxpayers should be allowed to use debt-like preference shares to fund dividend distributions and redemptions, amongst others.

> *Response:* Not accepted. The intention is to limit the use of preference shares solely to finance the acquisition of qualifying equity shares. If the other purposes are accepted, the anti-avoidance regime will be essentially meaningless.

Comment: The hybrid equity instrument and third-party backed share rules should allow for additional layers beyond the two layers of special purpose vehicles currently allowed. At present, the rules appear to solely allow for two sets of back-to-back issuers of preference shares. Certain structures are more complex, containing further chains even though the goals are essentially the same.

> *Response:* Comment misplaced. The current wording allows for multiple levels. (Note: legislative use of the singular and the plural are interchangeable in accordance with the Interpretation Act).

Comment: The hybrid equity instrument and third-party backed share rules should allow for syndicated security special purpose vehicles. These vehicles add to the level of funding security when a group of funders are involved.

> *Response:* Noted. We understand that these special purpose vehicles are shell entities solely to add legal strength to the guarantees involving group funders. However, further information is required from stakeholders at this stage before this matter can be addressed. This issue will be taken into account for possible inclusion within Annexure C proposals in the next budget cycle.

Comment: The rules allowing for the acquisition and redemption of preference shares (previously used for valid purposes) should include the settling of accrued dividends in respect of those shares.

> *Response:* Accepted. The payment of accrued dividends will be specifically included in the good purpose test.

Comment: Given the ongoing changes to the hybrid equity instrument and third-party backed share rules, the proposed effective date should be further delayed.

Response: Accepted. The proposed amendments to sections 8E and 8EA will come into operation on 1 January 2013 and apply in respect of dividends and foreign dividends received and accrued during years of assessment commencing on or after that date. However, in order to prevent the artificial acceleration of dividends before the effective date (i.e. amounts are declared before but only paid afterwards), dividends received after the effective date (but accrued before) will avoid the new regime only if subject to tax before the effective date.

6.4 Qualifying interests in asset-for-share reorganisations
(Main reference: Clause 80; Section 42)

Comment: Current law allows for foreign shareholders to hold up to 20 per cent of the unbundling company after the transaction. No reason exists for this threshold to be reduced to 10 per cent, especially if these shareholders are not part of the unbundling transaction.

Response: Accepted. The qualifying interest in respect of section 46(7) will remain at 20 per cent for the time being. The rules denying unbundlings in the case of foreign shareholders need to be revisited. The real issue is whether the unbundling distribution is to foreign shareholders, not whether foreign shareholders exist. Hence, this area must be re-examined as part of the proposed review associated with company tax reorganisations (as announced in the Budget Review).

Comment: The roll-over relief in respect of unbundling transactions under section 46 relief should also cover return of capital distributions.

Response: Not accepted. This amendment is not necessary as a company elects whether to distribute out of contributed tax capital. Therefore, taxpayers can simply avoid the issue by not electing to utilise contributed tax capital.

6.5 Share-for-share recapitalisations
(Main reference: Clauses 81 and 114; Section 43 and paragraph 78 of the Eighth Schedule)

Comment: The proposed rollover relief in respect of share-for-share recapitalisations of a single company should be allowed in the case of non-equity for non-equity shares exchanges. This form of share-for-share would merely leave the shareholders at issue in roughly the same position as before.

Response: Accepted. Relief will be provided under section 43 ("substitutive share-for-share transaction" definition) for non-equity swaps that do not change the nature of the interest (i.e. where a person disposes of a non-equity share for a non-equity share by means of a subdivision or consolidation).

Comment: The removal of the previously existing share-for-share relief under paragraph 78 of the Eighth Schedule is premature. Those rules also addressed share distributions (i.e. scrip dividends), and the new rules do not cover this aspect.

> *Response:* Accepted. Although paragraph 78 of the Eighth Schedule is being repealed, pre-existing section 40C should apply to deem a nil base cost for distributed equity instruments. Therefore, this aspect is fully covered.

6.6 Value mismatches involving share and debt issues
(Main reference: Clauses 57 and 58; Sections 24BA and 24BB)

Comment: The consequences of a share mismatch (taxable gains of value shifted) should be measured with reference to the arm's length price of the assets *vis-a-vis* the shares exchanged as opposed to the market value thereof.

> *Response:* Accepted. The section 24BA rules will apply if one or more assets are acquired by a company in exchange for the issue of shares and the transaction would not have been entered into between independent parties dealing at arm's length.

Comment: The proposed anti-avoidance rules undermine the reorganisation rules, especially within the context of group members (e.g. if assets are transferred to a wholly-owned subsidiary).

> *Response:* Accepted. These rules will not apply to transactions between companies that are part of the same group of companies. It should be noted that although the initial group rules assumed that most transactions would occur at book value (as opposed to market value) concerns exist in the group context.

Comment: The "value shifting" rules should not be completely removed because these rules cover transactions other than share or debt issues.

> *Response*: Accepted. The "value shifting" rules will be retained. However, where the "value shifting" rules apply, the proposed anti-avoidance rules in section 24BA will not apply.

6.7 Debt-financed acquisitions of controlling share interests
(Main reference: Clauses 54 and 63; Sections 23K and 24O)

Comment: The use of the word "solely" in the proposed section 24O(2) is overly restrictive. The debt may be applied to transaction costs and the acquisition may include shareholder loans.

> *Response:* Accepted. The words "solely" and "directly" will be removed. As a result, the funds may be applied for transaction costs and the settlement of shareholder loans.

Comment: Permissible deductible interest should include situations where the debt is used to acquire foreign shares. The rules at present allow only for the acquisition of domestic shares.

> *Response:* Noted. This issue will be considered for the next cycle of the Taxation Laws Amendment Bill. Concerns exist, that an interest deduction of this nature could give rise to local deductions without any direct or indirect corresponding income.

Comment: The percentage threshold for permissible debt-funded share acquisitions should require a lower threshold. At present, the acquiring company must acquire at least 70 per cent of the target company.

> *Response:* Not accepted. The rules are designed to mirror section 45, which is premised on a 70 per cent threshold.

Comment: The rules for permissible debt-funded share acquisitions should cover creeping acquisitions. At present, a 70 per cent percentage point increase in the target company is required.

> *Response:* Comment misplaced. If a taxpayer owns less than 70 per cent and acquires additional shares to reach the 70 per cent threshold, the new rules will apply. The parties at issue need not acquire the full 70 per cent amount in the transaction.

Comment: The rules for permissible debt-funded share acquisitions allow only for an interest deduction against the taxable income of the acquiring company. While this deduction is appreciated, the acquiring company is often a shell holding company that cannot use the deductions as a practical matter. Therefore, for this new rule to be fully effective, the associated interest deductions should be allowed against the target company's taxable income.

> *Response:* Not accepted. We note that what the comment really seeks is a form of group taxation in respect of losses. However, this request falls outside the scope of the current Bill. Transfer of losses will require a major policy review.

Comment: The proposed relief for debt-funded share acquisitions should be more closely linked to section 11(a) so that the deduction for interest is fully assured. At present, only the "production of income" test has been dropped. The parties at issue must still be engaged in a trade.

> *Response:* Not accepted. If a company acquires shares via debt financing, the only issue is the lack of productive income (because dividends generally do not constitute income). Indeed, if no trade is carried on there may simply be little or no income against which the interest may be deducted.

Comment: Persons other than companies should be allowed to utilise the permissible debt-funded share acquisition rules. Natural persons and trusts often engage in debt-funded share acquisitions.

Response: Not accepted. The regime mirrors section 45, which requires a company purchaser.

Comment: The rules for permissible debt-funded share acquisitions appear to limit the nature of the seller. Under the literal wording of the rule, the selling party can only be the target company itself.

Response: Accepted. The target company should not be required as a party to the deal. The seller should be allowed to be any person (i.e. a shareholder of a company) because no restriction exists of this nature in a section 45 acquisition. The requirement should be that the acquirer should be a company (as noted above). The definition of an "acquisition transaction" will be amended accordingly.

6.8 Debt reductions for less than full consideration
(Main reference: Clauses 9, 41, 42, 113, 117, 118, 119, 120, 124 and 129; Sections 8(4)(m), 19, proviso to 20(1)(a), paragraphs 3(b)(ii), 12A, 12(5), 13(1)(g), 20(3)(b), 40(2) and 56(2) of the Eighth Schedule.)

Comment: The base cost of assets acquired with borrowed funds that are later cancelled should not be reduced again under paragraph 20(3)(b) if reduced under the debt cancellation provisions (exclude section 19 directly). At present, the debtor appears to undergo a double reduction in base cost for the same debt cancellation.

Response: Accepted. No double reduction of base cost was ever intended. The base cost reduction provision in paragraph 20(3)(b) to the Eighth Schedule will only be applicable to the extent that the provisions of section 19(3) are not applicable to prevent double reduction of base cost. In addition, paragraph 20(3)(b) to the Eighth Schedule will also not be applicable to amounts applied to reduce the base cost of assets under 12P ("amounts received or accrued in respect of government grants") (see below).

Comment: The debt cancellation rules should be applied only to decrease the base cost of assets to nil. Reductions from debt cancellations should not create a negative base cost.

Response: Comment misplaced. The interpretation of the term "reduced" means "reduced" to nil (not below).

Comment: The proposed debt reduction rules for ordinary revenue overlap with section 24J(4A). Both provisions should not apply to the same debt cancellation.

Response: Accepted. Section 24J(4A)(b) will be amended so that this provision does not apply to the extent the ordinary debt reduction rules apply.

Comment: We understand that the proposed debt reduction rules are aimed at assisting financially distressed debtors. However, the rules do not deal with the issues associated with the longstanding "trade" requirement for maintaining a balance of assessed losses. The "trade" requirement should be eliminated (at least when the entity at issue is undergoing business rescue).

> *Response:* Noted. While the arguments raised seemed reasonable, this falls outside the current focus of the bill. This issue will be considered for an Annexure C amendment in the next budget cycle.

Comment: The ordinary debt reduction rules in section 19 will be easier to apply if there is a straight ordinary recoupment without any reference to the reduction of losses. If the taxpayer has ordinary losses, these losses can still be used to reduce any ordinary revenue that would otherwise arise.

> *Response:* Accepted. Ordinary debt reductions will be limited to cost price reductions and recoupments. The reduction of loss concept will be removed.

Comment: The impact on allowance (i.e. depreciable) assets differs in the proposed law from the draft Explanatory Memorandum. In the draft Explanatory Memorandum, base cost is reduced first, followed by potential recoupments. In the proposed legislation, recoupments are addressed first. The approach suggested by the draft explanatory memorandum is preferred because the method used in the proposed legislation provides no relief for debt cancellations.

> *Response:* Accepted. The draft Explanatory memorandum is correct. The base cost of assets should be reduced first. Once the base cost is zero, any further debt costs should give rise to potential recoupments. The proposed legislation will be amended accordingly.

Comment: The proposed debt cancellation rules require significant tracing. Unfortunately tracing is often difficult to undertake when debt is used for aggregate purposes (e.g. credit lines, working capital facilities, general banking facilitates, rolling credit facilities).

> *Response:* Not accepted. The current law also requires the tracing of cancelled debt. Tracing will always be required as long as there is a capital/ordinary distinction.

Comment: Despite the statement in the draft Explanatory Memorandum, no rule explicitly alleviates the tax impact of tax debt reductions provided by SARS. Possible ordinary revenue or debt cancellation could accordingly continue to arise when SARS agrees to reduce tax debt (one of the major shortcomings of current law).

> *Response:* Accepted. Tax debts will be specifically excluded from the capital gain debt cancellation rules. Taxing relief from SARS tax debt compromises essentially undermines the compromise agreed upon.

Comment: The tax rules do not provide any explicit coverage of how debt reductions impact pre-effective date assets of a capital nature. Special rules are required because these assets may have one of three base cost determinations

(2001 market value, time-based apportionment and the 20 per cent proceeds rule).

> *Response:* Accepted. All pre-effective date assets impacted by a base cost reduction will be treated as having a deemed disposal/reacquisition at base cost (similar to return of capital distributions).

Comment: The debt relief rules for connected persons and liquidations do not appear to be necessary. The general rule automatically eliminates capital gain arising from debt cancellations.

> *Response:* Comment misplaced. Relief is is still necessary to avoid base cost/capital loss reductions in respect of debts that are not linked to assets.

Comment: Under current law, relief for debt cancellations in the context of company liquidations and connected person cancellations exists so as to prevent capital gains tax. This form of relief should be extended for debt cancellations potentially giving rise to ordinary revenue.

> *Response:* Noted. The proposed rules for debt cancellation establish a new basic framework. Once this framework is established, the collateral rules (such as the relief mechanisms raised) will be addressed in 2013.

6.9 Conversion of share block interests to full title

(Main reference: Clauses1, 138 and 158; Paragraph 67B of the Eighth Schedule, section 9(19) of the Transfer Duty Act and section 8(19) of the Value-added Tax Act)

Comment: The rules for share block conversions are overly restrictive because these rules seemingly require the liquidation of the share block company. However, in many cases, the share block company continues to exist solely to govern (and hold title to) the common use areas (with the exclusive use areas now being in the hands of the shareholders in the form of full title).

> *Response:* Comment misplaced. The entry requirements for the relief under paragraph 67B of the Eighth schedule do not require a cancellation. However, if a cancellation arises (or a part disposal arises due to a return of capital distribution), relief is still provided under paragraph 67B(3)(b)(i).

Comment: Sometimes persons other than natural persons hold interests in the share block company undergoing the conversion. This form of ownership is permitted under the capital gains provisions but is seemingly absent from the transfer duty. Companies and trusts should also be exempted from transfer duty in the case of share block conversions.

> *Response:* Accepted. The capital gains provisions are correct. The transfer duty will be adjusted to allow for persons other than natural persons to be exempt in the case of share block conversions.

Comment: The share block conversion rules fail to provide relief from Dividends Tax. This omission leaves these conversions vulnerable because any form of share block conversion will otherwise generally be subject to the Dividends Tax (unless the shareholder is another company).

> *Response:* Accepted. A new exemption will be added so that share block conversions will be free from Dividends Tax.

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

7.1 Mark-to-market taxation of long-term insurers
(Main reference: Sections 29A and 29B; paragraph 32(3A) of the Eighth Schedule)

Comment: Introduction of an annual mark-to-market system is slightly premature in view of the four funds review. The market-to-market regime should be limited solely to 29 February 2012 – the item of sole concern stemming from the change in capital gains rates.

> *Response:* Accepted. The mark-to-market system will be limited to a deemed disposal and reacquisition on 29 February 2012. Introduction of an annual market-to-market system will be reconsidered going forward.

Comment: Assets (e.g. collective investment scheme interests) held by long-term insurers, conducting business as linked investment service providers, under linked policies in policyholder funds are more directly linked to each policyholder (unlike assets pursuant to a general long-term insurer license). For instance, a change in asset mix desired by the policyholder of a linked policy will result in a disposal by the long-term insurer (whereas, a change in asset mix initiated by other types of long-term policyholders may not trigger an actual disposal, only a reallocation or netting of assets by the long-term insurer). Therefore, the rationale for imposing the 29 February 2012 mark-to-market event does not apply in these cases and a deemed disposal should not apply.

> *Response:* Accepted. The mark-to-market regime will not apply to the extent the assets are held pursuant to a dual-linked policy (i.e. a policy held pursuant to business conducted under a category 3 licence granted in terms of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002).

Comment: The mark-to-market regime should not apply to debt and related-interest bearing products (including related derivatives). The gains in respect of these instruments is nominal and the mark-to-market regime creates more of a compliance burden than any potential revenue raised.

> *Response:* Accepted. Interest bearing arrangements and interest based derivatives will be removed from the mark-to-market 29 February 2012 event for the reasons stated.

Comment: The special rules relating to derivatives are unnecessary. For a variety of reasons, the capital gain or loss in respect of derivatives will be appropriately taken into account.

> *Response:* Accepted. The definitions of "derivative" and "derivative difference" will be deleted. There will be no special mark-to-market rules for derivatives.

Comment: Special rules are required for long-term insurers that hold reinsurance investment policies issued by local insurers. In these instances, the local reinsurer is subject to the deemed 29 February 2012 charge in respect of the underlying assets backing the policy. Therefore, the insurer holder of the reinsurer policy should not be subject to tax again on the value change in respect of the reinsurance policy.

> *Response:* Comment misplaced. Gain or loss on the policy will largely be exempt for the long-term insurer unless that policy constitutes a second hand policy (see paragraph 55 of the Eighth Schedule).

Comment: The market value rules for the 29 February 2012 event should differ from the standard definition used for long-term insurers. Value should be based on the value reported to policyholders.

> *Response:* Partially accepted. Listed instruments and associated derivatives will remain subject to the "market value" definition of section 29A (1). However, the value of assets outside this paradigm will be based on the amounts reported to policyholders.

Comment: The rules should apply to all policyholder funds (including the untaxed policyholder fund which is taxed at a rate of zero per cent). Insurers would prefer to have the same calculation for all policyholder funds.

> *Response:* Accepted. The mark-to-market regime will apply to all policyholder funds.

Comment: The lack of recoupment on 29 February 2012 in respect of immovable property assets creates an unfair advantage because taxpayers previously had the benefit of ordinary allowances. The increased cost could also be used as a starting point for future allowances.

> *Response:* Partially accepted. The non-recoupment rule for allowance assets will remain. However, assets of a capital nature will no longer be eligible for deductions or allowances from 1 March 2012.

Comment (paragraph 32(3B) of the Eighth Schedule): The weighted average system for calculating base cost should remain (as proposed) for all assets subject to the mark-to-market regime (thereby implicitly excluding debt and dual linked assets). In addition, long-term insurers should be freed from the loss denial rules for sales and repurchases occurring within 45 days (i.e. paragraph 42 of the Eighth Schedule) because the weighted average method eliminates the schemes of concern.

Response: Accepted. The weighted average method will be mandatory for all assets subject to the 29 February 2012 mark-to-market event. In addition, weighted average assets of this nature will not be subject to the 45-day rules.

Comment (paragraph 32(3B) of the Eighth Schedule): The weighted average method should apply to all policyholder funds, including untaxed policyholder funds (which are taxed at a rate of zero per cent). Insurers would prefer a single method for all assets to simplify compliance.

Response: Accepted. The weighted average method will apply to all policyholder funds, including the exempt policyholder fund and will be available for all types of assets deemed to have been re-acquired on 29 February 2012.

Comment (paragraph 19 of the Eighth Schedule): Although rare, taxpayers should not be subject to the anti-loss rules for extraordinary dividends preceding sale in the case of the 29 February 2012 deemed sale. The deemed sale was not anticipated by taxpayers and any extraordinary dividends before the date would have been coincidental.

Response: Accepted. The anti-loss rule for extra-ordinary dividends will not apply to the mark-to-market event that was deemed to occur on 29 February 2012.

Comment (section 29A(11)): The proposed four-fund indirect expense deduction formula is supported because the proposed formula is far more principled than the random nature of the current deduction formula, which is the cause of many anomalies. However, the 29 February deemed gain should not be taken into account in the new formula (even if spread over a few years).

Response: Not accepted. The built-in gain realised as a result of the 29 February 2012 deemed sale event must be taken into account; otherwise, the deduction-level under the formula will increase unrealistically. However, because the new formula is delayed until 2013, only three years of this built-in gain will be taken into account (25 per cent in each of 2013, 2014 and 2015).

Comment (section 29A(11)): The transfer deduction ratio will be too high once the new changes in the deduction formula are taken into account. The ratio should accordingly be reduced by adjusting the current 50 per cent factor.

Response: Accepted. The current 50 per cent factor will be reduced to 30 per cent. The net result will leave most long-term insurers in approximately the same position as before (with an effective threshold of roughly 15 per cent).

Comment (section 10B)): The new partial inclusion system for foreign dividends does not properly account for foreign dividends received or accrued in taxable policyholder funds. As a result, the rate for foreign dividends slightly exceeds the rate for other taxpayers.

> *Response:* Accepted. The partial inclusion ratio for individual policyholder funds should be 15/30 and the partial inclusion ratio for company policyholder funds should be 13/28. The net effect is a 15 per cent rate (the same rate as for other taxpayers).

7.2 Annual Fair Value Taxation of Financial Instruments in Respect of Financial Institutions
(Main reference: Clauses 60(1)(g) and 61; sections 24J(9) and 24JB)

Comment: The proposed mark-to-market taxation of banks/brokers in respect of financial instruments will effectively tax all dividends as ordinary revenue if held for trading. This treatment of dividends as ordinary revenue will place banks and brokers in a worse position than other shareholders, making the banks and brokers uncompetitive. In addition, the additional charge on these type of company shareholders will result in double taxation of corporate profits.

> *Response:* Noted. It is understood that taxation of all dividends in respect to shares held for trading will result in the consequences stated. On the other hand, the failure to tax dividends in a mark-to-market system will lead to readily available opportunities for tax arbitrage. The profit generated from dividend income will also be significantly reduced by related expenditure. Given the recent dividend conversions schemes (and the massive cost to the fiscus resulting from this avoidance), the potential loss of revenue of wholly exempting dividends in a mark-to-market context is too high to justify any changes without further consideration. Therefore, the effective date of the proposed mark-to-market regime will be deferred until 1 January 2014.

Comment: The "covered persons" eligible for the new regime are too narrow. The list of covered persons should either be extended or the current section 24J(9) election should be retained.

> *Response:* Noted. The current system of elections under section 24J(9) lacks control and creates opportunities for arbitrage. If the list needs to be extended, the list should be extended without regard to elections. That said, the deletion of section 24J(9) will be delayed until 1 January 2014 (like the postponement of the new mark-to-market regime).

Comment: The coverage of financial instruments needs to account for certain types of share interests that are accounted for on a market-to-market basis due to internal management reporting. However, strategic stakes in companies reported on a mark-to-market basis for these reasons should be outside the system so as to avoid liquidity issues.

> *Response:* Noted. The type of financial instruments within the regime still needs further refinements. For instance, the U.K. only takes into account instruments held for trading under tax law purposes; whereas,

the proposed system takes into account all instruments (even if held on capital account for tax purposes).

Comment: The rules seeking to close arbitrage between group companies – one of which is on the mark-to-market basis and the other of which is not, are overly broad. Given the number of intra-group transactions, the deviation from accounting will be significant, thereby undermining the proposed simplification.

> *Response:* Noted. The need for a narrower rule is understood. On the other hand, this area represents a significant risk for the fiscus. The appropriate balance still needs to be found.

Comment: The current rules do not create convergence between tax and accounting. For instance, loan impairments do not follow accounting (like the U.K. system) nor do other events follow mark-to-market accounting (like certain share incentive schemes). It would be simpler for the rules to move closer to accounting, thereby reducing arbitrage and promoting further simplification.

> *Response:* Noted. A more comprehensive regime represents an attractive solution for both taxpayers and the fiscus. However, these issues require further research.

Comment: The transitional rules are overly complex. Tax values should be ignored. Taxpayers should simply be subject to a charge based on their deferred tax account associated with unrealised financial assets.

> *Response:* Noted. The proposed regime is simply seeking to compare the tax and accounting deviations. The short-cut solution is worth examining but will require further investigation to determine viability.

7.3 Creation of a unified system for taxing REITs (property investment schemes)
(Main reference: clause 65; section 25BB)

Comment: The new system for immovable property entities (i.e. hereinafter referred to as REIT) should not be limited to listed entities. There are many other entities operating on a similar basis, including pension owned property funds, insurer owned property funds and various other forms of unlisted funds (sometimes referred to as incubator funds). No reason exists for these funds to be operating on a lesser basis (with the current listed vehicles effectively being given a permanent tax advantage).

> *Response:* Noted. The creation of a special tax regime for REITs is being enacted through a phased approach. Other forms of REITs will be addressed in 2013.

Comment: The proposed regime for immovable property entities should cater for mortgage bonds. This extension would lower overall mortgage costs for the banking industry by making these bonds more liquid.

> *Response:* Noted. Investment vehicles in mortgage bonds are a slightly different form of product. This type of investment vehicle may be aligned

with either the proposed REIT system or an adjusted tax dispensation associated with Collective Investment Schemes. This issue will be considered going forward.

Comment: The treatment of a "property subsidiary" as a REIT is too restrictive. Distributions by foreign subsidiaries should be included as rental income when received by a REIT (or another property subsidiary).

Response: Partially accepted. The receipt of qualifying distributions from a foreign subsidiary will be treated as rental income. Hence, these amounts can be relied upon for purposes of the more than 75 per cent rental income determination. However, no reason exists to grant a deduction for an offshore entity that mainly falls outside South African tax jurisdiction.

Comment: The treatment of a "property subsidiary" implies a more than 50 per cent ownership threshold. However, a number of property investment entities hold a lesser percentage (20 per cent or more) in unlisted property vehicles. The threshold should accordingly be reduced to a more practical level.

Response: Partially accepted. Distributions from a 20 per cent or greater associate can be treated as rental income for purposes of the more than 75 per cent test (if that entity generates more than 75 per cent of gross income in the form of rental). However, this 20 per cent or greater associate is not eligible for the distribution deduction.

Comment: The treatment of a "property subsidiary" as a qualifying vehicle is too narrow because the term implies that the entity must be a company. Controlled trusts should also be included.

Response: Accepted. A trust will be deemed to be a company if that trust is viewed as a subsidiary of a REIT for IFRS purposes. Distributions from this trust can then be relied upon as rental income for purposes of the more than 75 per cent gross rental test. The trust will also be treated like a company for all other purposes (including reliance on the 28 per cent company rate instead of the 40 per cent trust rate).

Comment: The receipt of earnings from a REIT should continue to qualify as interest (which is exempt foreign investors). Taxable income treatment is less favourable for foreign investors.

Response: Not accepted. Countries with real estate investment trust legislation do not grant exemption for yields distributed to foreign investors. The standard paradigm is to treat the yield as taxable dividends subject to tax treaty relief. It is accordingly proposed that distributions from a REIT similarly be treated as a taxable dividend. It should be remembered that primary taxing jurisdiction in respect of immovable property and immovable property companies is typically reserved for the source country under tax treaties).

Comment: The proposed system will create confusion for investors when receiving regular distributions because the nature of the yield may vary depending on the rental income generated by the REIT. Still worse, the level of rental income may not always be precisely known until after the distribution.

> *Response:* <u>Accepted</u>. Distributions from a REIT will be treated as taxable dividends without regard to the level of rental income produced by the REIT. The level of rental income will only have an impact on whether the distribution is deductible by the REIT (or whether the amount received by a REIT can be viewed as rental income).

Comment: The determination of whether a distribution qualifies as a deductible rental distribution is based on the prior year of assessment. While this one-year look-back is preferred for certainty, this one-year look-back is impossible to apply during the first year of operations.

> *Response:* <u>Accepted</u>. A special rule will be added for newly formed entities. The rental-to-gross income test for these entities will be measured prior to distribution during the current year for entities formed within that year.

Comment: It is unclear what types of income qualify as rental income for purposes of the 75 per cent threshold. Rental income should include all forms of income earned from the use of immovable property, not just pure rental.

> *Response:* <u>Accepted</u>. Rental income will include all amounts received or accrued in respect of the right of use or occupation of immovable property, including interest and penalties for failure to pay for that right. These amounts include income from basic rents, turnover rents and rent from collateral immovable assets, such as parking spaces and signs.

Comment: REITs should be allowed to generate net losses from rental distributions. Without this relief, timing issues could leave these entities in a double tax situation (with non-deductible distributions during a year even though the holders will treat the same distributions as ordinary revenue).

> *Response:* <u>Partially accepted</u>. The timing of the deduction will be based on the date of resolution to declare a dividend as opposed to the payment date. Basing the deduction on resolution date will effectively allow a REIT to better time the deduction against available taxable income.

Comment: Although it is understood that the yield from financial instruments should generate ordinary revenue so as to discourage the use of this entity as a collective investment in financial instruments having no relationship to immovable property, the rules fail to account of the receipts on disposal of property entities. Proceeds on disposal of other property entities (e.g. other REITs) should be excluded from this automatic ordinary revenue treatment.

> *Response:* <u>Accepted</u>. Proceeds on the disposal of interests in other qualifying property entities will not automatically qualify as ordinary revenue. Hence, a REIT can sell interests in a property subsidiary and

still potentially claim the disposal gives rise to an exempt capital gain or loss (as opposed to automatic ordinary revenue or loss).

Comment: While the relief from capital gains taxation is welcome, the sale of immovable property of a capital nature could still generate recoupments. Entity level taxation upon a REITs disposal of immovable property that qualifies as a capital asset should be completely eliminated (even if the capital asset generates depreciation allowance – i.e. the capital asset is an allowance asset).

> *Response:* <u>Accepted</u>. The disposal of immovable property of a capital nature will be completely excluded from taxable income (even recoupments). Tax will only arise from disposals of immovable property that qualify as trading stock. However, the price of this exemption for immovable property of a capital nature is the loss of all depreciation allowances associated with immovable property.

Comment: The deduction of rental distributions is largely unnecessary because taxpayers can still deduct the interest relating to the debenture portion under current law. This deduction for interest does not contain the same level of restrictions proposed for qualifying rental distributions.

> *Response:* <u>Comment misplaced</u>. The deduction of interest based on profits will soon be denied under proposed sections 8F and 8FA (to be revived next year). This pending denial should give these taxpayers an incentive to convert to the new system as soon as possible. REITs will also seek to invest in other entities qualifying as REITs so as to satisfy the more than 75 per cent rental threshold.

Comment (section 43): Taxpayers should be allowed to receive rollover treatment when converting current linked debentures to shares. However, current law only allows for share-for-share rollovers.

> *Response:* <u>Accepted</u>. Taxpayers will be allowed to convert the debenture interests in an entity qualifying as a REIT (including a property subsidiary) into shares via the newly enacted rollover provisions. Rollover relief in this instance will defer tax events acting a hindrance to the proposed debenture-share conversion.

Comment: Regulated intermediaries and other withholding agents for dividends tax will need additional time to prepare withholding systems for REIT dividends. Unlike most dividends, domestic dividends from a REIT are free from Dividends Tax with only foreign persons being subject to Dividends Tax. The JSE will also need additional time to set the REIT classification process in motion.

> *Response:* <u>Accepted</u>. The proposed effective date based on Ministerial notice will be removed. REIT taxation will generally commence from years of assessment commencing from 1 April 2013 for qualifying entities.

Comment: The proposed acceptance of cash-back bonuses as a permissible reserve if based on a best estimate is welcome. However, the relief is technically deficient because a best estimate reserve includes a risk margin.

Response: Accepted. The tax rules will explicitly recognise the margin element.

Comment: The short-term insurance reserve system contains special rules for recoverable amounts. However, premium refunds fall outside the system because these refunds are not recoverable amounts.

Response: Comment misplaced. Refunds are taken into account under the general provisions of the Income Tax Act (i.e. deductible) if previously included as income.

Comment: The references to short-term policies under the Short-term Insurance Act can be confusing if the reference is intended to cover both domestic and foreign policies of insurance (and reinsurance). While technically correct, these references seemingly cover only domestic policies. If both domestic and foreign policies are at issue (e.g. as reinsurance), reference to the Short-term Insurance Act should not be used.

Response: Accepted. The definition of short-term policy will be clarified by specifically stating that domestic and foreign policies are covered.

7.4 Investment contracts disguised as short-term insurance
(Main reference: clause 68; section 28A)

Comment: This system may result in double taxation in the case of employer-owned endowment policies for the direct or indirect benefit of employees. These policies already trigger a denial of deductions for the employer (or ordinary revenue for employees).

Response: Comment misplaced. The endowment policies described are largely in the form of long-term insurance. These policies should accordingly not be an issue because the proposed system only impacts short-term insurance viewed as an investment policy under IFRS.

8. INCOME TAX: BUSINESS TAX (INCENTIVES)

8.1 Depreciation of supporting structures for energy projects
(Main reference: Sections 11(e)(iiA), 12B(1)(h)-(i) and further proviso to section 12C(1))

Comment (sections 12B and 12N): The ownership requirement to qualify for the electricity generation allowance is restrictive because the allowance does not cover foundations or supporting structures on leased land. To be eligible for relief, assets and their foundations or supporting structures should not be deemed to be immovable property owned by the lessor. The lessee should retain the allowance because the lessee will be the party utilising the structure.

Response. Accepted: The policy in respect of improvements undertaken on a lessor's land needs to be reviewed in the light of Government's objective to increase the supply of electricity for economic growth via the procurement programme (i.e. the Independent Power Producer Procurement Programme). As an interim measure, lessees undertaking improvements on another person's property will be eligible for depreciation allowances in respect of electricity generating plant and machinery if associated with the programme. A more liberalized way of dealing with lessee improvements needs to be considered for legislative relief going forward.

Comment (section 12B): The depreciation relief proposed should be limited to the generation of electricity. The expansion of the relief to include all forms of energy is premature.

Response: Accepted. The depreciation relief at issue will remain solely applicable to electricity. Other forms of energy relief (such as biodiesel and biofuels) must be found under other pre-existing provisions.

Comment (section 12B): The depreciation relief proposed should be limited to smaller hydropower projects because trade-offs exist between electricity and water supplies.

Response: Accepted. The depreciation relief proposed will remain limited to a 30 megawatt. However, electricity generation will cover all forms of hydropower (not only hydropower related to gravitational forces) so that hydro power associated with sea currents can qualify. The 30 megawatt limitation will be re-examined in consultation with the Department of Energy.

8.2 Revision of the Learnership Allowance Incentive

(Main reference: Definition of "registered learnership agreement" in section 12H(1), 12H(2)(b) and 12H(6))

Comment: The time period allowed to register learnerships should be extended from 6 months to 12 months after the end of the year of assessment. Delays occasionally do occur beyond the six-month period due to factors outside the employer's control.

Response: Accepted. The time period for registration of learnership agreements will be extended from 6 months to 12 months after the end of the year of assessment.

8.3 Oil and Gas incentive and stability revisions

(Main reference: Sections 26B(2), 64B and paragraphs 2, 3 and 6 of the Tenth Schedule)

Comment: Taxpayers generating oil and gas income that have concluded a fiscal stability agreement should be allowed to re-enter into a new fiscal stability agreement if potential relief granted under the Tenth Schedule becomes more favourable.

Response: Comment misplaced. As a general matter, an oil and gas company that concludes a fiscal stability agreement under the Tenth Schedule may at any time unilaterally terminate the stability agreement with the Minister. The taxpayer is then free to enter into a new agreement. Fiscal stability agreements are designed to assist taxpayers, not to bind them.

8.4 Taxability of Government Transfers and Subsidies
(Main reference: Sections 10(1)(zA), 10(1)(zH), 10(1)(y), new section 12P, 23(n); paragraphs 20(3)(c) and 64A of the Eighth Schedule; Eleventh Schedule.)

Comment: The provisions regulating the tax treatment of in-kind government grants under the proposed regime appear to make these grants taxable. This result is contrary to what is intended because government grants awarded in-kind for the taxpayer's benefit should be exempt like all other grants under the same programme.

Response: Comment misplaced. The current rules are technically correct but complex. Exempt government grants awarded as in-kind benefits are proposed to be exempt with an effective tax cost of zero. In order to clarify the policy, the zero tax cost associated with the assets received via an exempt Government grant will be made explicit. (Note: These assets should have a zero tax cost because these assets are paid for directly by Government; no expense is incurred by the taxpayer).

Comment: The list of exempt grants in the proposed Eleventh Schedule should be broadened to include government transfers and subsidies for "on-grid" electrification (as opposed to only "off-grid" electrification).

Response: Accepted. The list of exempt grants under the Eleventh Schedule will be expanded. The list will specifically include government transfers and subsidies for "on-grid" electrification.

Comment: The base cost of assets acquired but later reimbursed by exempt government grants should not be reduced again under paragraph 20(3)(b) of the Eighth Schedule if reduced under the grant provisions. At present, these assets appear to undergo a double reduction in base cost.

Response: Accepted. The base cost reduction provisions in paragraph 20(3)(b) to the Eighth Schedule will not apply to assets funded by exempt Government grants (similar to the rules for debt reductions as discussed above).

9. INCOME TAX: INTERNATIONAL

9.1 Revised rollover regime for cross-border reorganisations
(Main reference: Clause 82, 84 and 85; Sections 41 through 47; paragraph 64B of the Eighth Schedule)

Comment: The exclusion of share consideration from the capital gains tax participation exemption narrows the exemption without providing corresponding rollover relief in the corporate reorganisation rules. Many companies enter into share-for-share transactions as an acquisition tool so the participation exemption must either continue to be allowed for share consideration or this form of transaction should be permitted as a rollover.

> *Response:* Accepted. The proposed exclusion of share consideration will be deleted. The revised participation exemption will provide an exemption if an interest in a foreign company is disposed of to an independent third party for any consideration, including shares. As a pre-condition for this relief however, the proposed value-for-value rule will be retained in order to prevent indirect corporate migration. More specifically, the consideration received or accrued must be equal to or exceed the value of the shares disposed.

Comment: Application of the proposed exit charge to disposals that qualify for the capital gains tax participation is not clear. In particular, if there is a disposal of a chain of controlled foreign companies (i.e. a parent controlled foreign company holding a chain of subsidiary controlled foreign companies), it is unclear whether the participation exemption applies to the disposal of the parent company as well as the chain of controlled foreign companies below (otherwise subject to the proposed exit charge). Failure to provide relief from the exit charge throughout the chain will greatly undermine the utility of the participation exemption.

> *Response:* Comment misplaced. The participation exemption should apply to a chain of CFCs if the top CFC is disposed of. The wording, however, will be reviewed to determine if there is any further clarity required on the matter.

Comment: The exclusion of loss assets from foreign rollover relief causes practical liquidity problems yet does not pose a risk to the tax base. The acceptance of loss assets in a foreign transferee does not pose a risk of those losses being imported into the domestic tax base. Differentiating gain and loss assets in a foreign context also adds significant complication to the use of the proposed rollovers.

> *Response:* Accepted. The exclusion of loss assets will be removed from rollover relief applicable to transfers to foreign entities. More specifically, the exclusion of loss assets will be limited to inbound restructurings in order to prevent the importation of losses into direct South African taxing jurisdiction.

Comment: In line with rollover relief for domestic and inbound share-for-share transactions, the foreign share for share rollover relief should allow for the transfer of target shares held as trading stock.

> *Response:* Not accepted. Rollover relief for foreign share for share transactions is not intended for the restructuring of portfolio shareholdings. The relief is limited to the restructuring of long term investments in line with the substituted capital gains tax participation exemption.

Comment: The current foreign share-for-share rules are too restrictive. The rules do not appear to permit the transfer of shares in a target foreign company if that foreign company is not a controlled foreign company (is not more than 50 per cent held). Taxpayers should be permitted to move around smaller equity stakes within an offshore group.

> *Response*: Accepted. Smaller stakes in a foreign company will be permitted if the transfer is to foreign transferee that is at least 70 per cent owned by a resident (or the same group). This adjustment will allow for greater flexibility to move target foreign companies around within a single group.

Comment: The current wording of the exclusion from rollover relief in the case of foreign asset-for-share transactions does not capture the intended purpose. In particular, the transfer of foreign equity shares by a foreign controlled company technically falls outside the regime because the rollover relief applies only if the disposal would be taken into account for the purposes of determining the net income of the 'transferor'. On the other hand, a transfer by a controlled foreign company can only be potentially taken into account as taxable income of a direct or indirect shareholder of the controlled foreign company transferor.

> *Response:* Accepted. Strictly speaking, it is true that the controlled foreign company rules only attribute net income in relation to a resident even if the transferor is a controlled foreign company. The reference to the 'transferor' should accordingly be changed to "any resident".

Comment: The definition of a foreign amalgamation transaction should not be premised on the "disposal" of assets of amalgamated company and the "termination" of that company because these concepts might not exist in foreign law. These concepts should be abandoned in favour of more general concepts of "amalgamation or merger".

> *Response:* Comment misplaced. The concerns appear resolvable through interpretation. In South African law, the concept of "disposal" is defined widely enough to include "operation of law' (especially in terms of capital gains). Similarly, the concept of "termination" has a wider meaning. The mere lack of ongoing existence should be viewed as a termination.

Comment: The current exclusion of amalgamation transaction rollover relief in the case of a subsidiary-parent combination is overly broad. The purpose of the exclusion is to prevent an overlap with the liquidation rules, but the exclusion also implicitly prevents the merger of a parent company into a subsidiary company (as opposed to a liquidation of a subsidiary into a parent company. The exclusion should accordingly be narrowed to the exclusion's true intention.

> *Response:* Accepted. In order to simplify the wording, the exclusion will apply solely to transactions that fall under the "liquidation distribution" definition.

Comment: The exit charge should not apply if a company ceases to be a controlled foreign company as a result of an amalgamation transaction. The exit rules are intended to apply only if assets leave taxing jurisdiction. In the case of rollover amalgamations, the assets will either be moving to a new controlled foreign company or to a domestic company.

> *Response:* Accepted. In line with the intended purpose of rollover relief, the amalgamation of a controlled foreign company will not give rise to an exit charge. A specific rule will be added to that effect.

Comment: The 50 per cent direct interest requirement in the "after test" is unduly restrictive. The requirement should be deleted as long as the distribution is in accordance with the effective interests of the shareholders and the unbundled company is a controlled foreign company.

> *Response:* Not accepted. The purpose of the unbundling rollover relief is to facilitate offshore group restructurings. This purpose is in line with the domestic unbundling rules in the context of unlisted shares.

Comment: The reduction of the current non-resident permissible threshold for unbundling rollovers from 20 per cent level down to a 10 per cent level will dramatically reduce the extent to which the unbundling rules can be used by entities with diverse shareholders. The 20 per cent threshold should be retained.

> *Response:* Accepted. The current 20 per cent exclusion will be retained on an all-or-nothing basis. However, this exclusion will be open to reconsideration in subsequent legislative cycles.

Comment: One of the qualifying requirements for inbound and foreign liquidation distributions is that at least 50 per cent of the holding company must be directly or indirectly held by residents immediately after the liquidation. This requirement is unduly restrictive and should be deleted as long as the holding company is a controlled foreign company immediately after the liquidation.

> *Response:* Not accepted. The purpose of the liquidation distribution rollover relief is to facilitate offshore group restructurings. This is in line with the domestic liquidation distribution rules. The entities must remain in the same overall group.

Comment: The exit charge should not apply if a company ceases to be a controlled foreign company as a result of a liquidation distribution transaction. The exit rules are intended apply only if the assets leave taxing jurisdiction. In the case of rollover liquidations, the assets will either be moving to a new controlled foreign company or to a domestic company.

> *Response:* Accepted. In line with the intended purpose of rollover relief, explicit rules will be added to ensure that the liquidation distribution of a controlled foreign company in a rollover context will not give rise to an exit charge.

Comment: The limitation of foreign intra-group relief to the transfer of equity shares held as capital assets is overly restrictive. In contrast, domestic intra-group rollover relief is allowed in respect of the transfer of any asset (both physical assets and shares) held as capital assets or trading stock. Foreign intra-group relief should accordingly be extended.

> *Response:* Not accepted. The rules are designed to facilitate offshore restructurings of long-terms investments. Moreover, the rules substitute the capital gains participation exemption for the disposal of foreign shares to a group controlled foreign company. This exemption was only available where shares are disposed of and held as capital assets.

9.2 Exit charge upon ceasing to be a resident in South Africa
(Main reference: Clause 20; Section 9H; paragraph 12 of the Eighth Schedule)

Comment: The proposed exit charge will result in double economic taxation. The new charge will apply not only to the existing company but also to the shareholders of the exiting company. This application of the exit charge at the shareholder-level will be especially harsh because the shareholders do not realise any cash-flows from the event nor do these shareholders have possession of any of the underlying assets exiting South African taxing jurisdiction.

> *Response:* Accepted. The deemed exit tax charge falling on the shareholders of the emigrating company will be removed. The exit charge will apply solely at the exiting entity level (including a deemed dividend *in specie*).

Comment: The proposed exit charge needs to be harmonised with the current capital gains tax exit charge. In particular, it appears that two sets of exit charges apply when a controlled foreign company becomes a resident.

> *Response:* Accepted. The rules will be clarified so that the capital gains change of residence rules apply when a controlled foreign company becomes a resident. If a controlled foreign company moves outside indirect South African jurisdiction, the exit charge is intended to apply.

Comment: The proposed exit charge should be deferred at the election of the taxpayer until the actual disposal of exiting company assets. This deferral could be made subject to the provision of appropriate security by the taxpayer. Similar provisions are found in other jurisdictions, such as Australia and Canada.

> *Response:* Not accepted. The enforcement of a tax claim after the emigration of the taxpayer is highly risky for the fiscus. Nor is there any policy benefit for Government to defer the exit charge (over any other charge arising from a deemed disposal).

Comment: The proposed exit charge makes the headquarter company (HQ) regime unattractive for existing local companies to use. As a result, South African multinationals will be forced to hold foreign investments in a foreign jurisdiction.

Response: Not accepted. Any transfer of assets to a foreign entity will trigger gain. The proposed gain on transfer to a headquarter company simply mimics this result.

Comment: The proposed exit charge is deemed to have come into operation on 8 May 2012 with the effect that certain taxpayers will be retrospectively liable for tax. This date is retroactive and will be difficult to enforce in respect of taxpayers that have already emigrated.

Response: Not accepted. The amendment is not retroactive in view of the 8 May media statement released by the National Treasury. Government is allowed to take action with immediate effect if necessary (as a matter of protecting the tax base).

Comment: The deemed dividends tax charge upon departure is overstated. In particular, the charge should apply solely to built-up profits within the exiting company. Stated differently, application of the Dividends Tax based on the market value of underlying assets should be reduced for contributed tax capital and for outstanding liabilities.

Response: Comment misplaced. The deemed dividends tax is already reduced for liabilities and contributed tax capital.

Comment: Application of the provisional tax system to an exiting taxpayer is uncertain. It must be clarified whether a second provisional tax payment is required by the exit date (which includes the deemed closure of the year of assessment), .

Response: Accepted. A provisional tax payment is required in accordance with the provisions of Part III of the Fourth Schedule by the end of the year of assessment. (See paragraph 21 of the Fourth Schedule.

9.3 Rationalisation of withholding taxes on payments to foreign persons
(Main reference: Clause 22, 72 and 75; Sections 35 and 37J through 37N)

Comment: The use of the word “payable” is unclear. The word “payable” can have two different meanings (either when the liability accrues or when the debt becomes due and payable). It is not clear which interpretation ought to be given.

Response: Accepted. In order to provide certainty, the phrase “due and payable” will be used. Hence, the amount must actually be available for payment to the non-resident.

Comment: Due to time constraints in relation to the effective implementation of withholding tax, the effective date of the interest and royalty withholding taxes need to be moved to a date later than 1 January 2013. It should also be noted that taxpayers are still coming to grips with the Dividends Tax.

Response: Accepted. The effective date of the revised royalty and interest withholding regimes will be moved to 1 July 2013.

Comment: The legislation should provide clarity on the withholding tax implications relating to repurchase arrangements. Stated differently, the exemption for banks appears limited to interest from debt instruments, which do not include repos. The exemption should apply to all forms of interest paid by banks.

> *Response:* Accepted. The reference to interest paid in respect of "debt" owed by a bank will be substituted for a reference to interest paid by a bank. Al forms of interest paid by the bank will be covered, regardless of whether a debt instrument is involved.

Comment: The withholding tax on interest will negatively impact foreign borrowings by the Development Bank of Southern Africa and the Industrial Development Corporation. The withholding tax will increase the cost of borrowing for these entities, which will naturally be passed on to clients. These government-owned entities should thus be exempt from withholding tax on interest in the same way as commercial banks.

> *Response:* Accepted. Interest paid by the Development Bank of Southern Africa and the Industrial Development Corporation will be exempt. This exemption is in line with general exemption for interest paid by commercial banks. Both entities are designed to exist as lenders where standard commercial bank lending is unavailable.

9.4 Removal of controlled foreign company (CFC) exemption from interest and royalty withholding
(Main reference: Clause 76 and 87; Sections 10(1)(h), 10(1)(l). 37J(1), 37K(3) and 37L(1))

Comment: Interest paid to foreign government-owned entities is generally exempt in terms of tax treaties. However, in order to claim this exemption, the holder of the debt instrument needs to provide a prescribed declaration to the issuer. From a practical point of view, questions arise on whether the issuer can simply rely on this declaration or whether the issuer still needs to verify the ownership of the holder from the foreign government involved.

> *Response:* Noted. The level of information required is an administrative issue. As a technical matter, a mere declaration from the exempt foreign entity is sufficient, unless further proof of status is specifically requested by SARS.

Comment: Intra-group funding between residents and controlled foreign companies is often provided on more favourable terms than third party funding. The proposed primary withholding tax on payments to controlled foreign companies and subsequent exemption of the relevant controlled foreign company net income will discourage the use of intra-group financing of this nature. This proposal should accordingly be deleted.

> *Response:* Not accepted. Offshore inter-group funding is merely being placed on par with other funding. The current exemption for payments to

a controlled foreign company creates a mechanism for avoiding withholding taxes.

9.5 Relief from effective management test in the case of high-taxed controlled foreign companies (CFCs)
(Main reference: Clause 2; Section 1 (paragraph (b) of the "resident" definition)

Comment: The proposed Bill provides a carve-out from the residency test via local effective management if a controlled foreign company is based in a high tax jurisdiction and has a business establishment in that jurisdiction. It is contended that the foreign business establishment requirement is administratively onerous and should be deleted as unnecessary. The only issue should be the tax level because no reason exists to extend South African taxing jurisdiction if little or no South African revenue is at stake (after tax credits are taken into account).

Response: Not accepted. The foreign business establishment requirement ensures that there is genuine separation of active operations versus management.

Comment: It is proposed that the highly-taxed controlled foreign company carve out from the residency test should be elective and not automatic because there may be companies that would prefer to be treated as residents. In particular, certain companies may wish to avoid foreign tax status to avoid the exit charge.

Response: Not accepted. Elections create unnecessary complexity and cannot be effectively administered.

Comment: The proposed residency carve-out for highly-taxed controlled foreign companies will trigger an exit charge when companies that previously qualified as residents cease to become residents.

Response: Partially accepted. The exit charge will be narrowed so that the exit charge does not apply due to the proposed carve-out coming into effect.

Comment: The high-tax test for effective management relief does not mirror the test set out in the controlled foreign company net income imputation rules. In particular, the provision is silent on the treatment of losses brought forward and in respect of group losses in determining whether the foreign taxes equate to at least 75 per cent of the South African taxes that would otherwise be payable.

Response: Accepted. The treatment of carryover losses and group losses will be taken into account for purposes of the high-tax calculation required for the proposed carve-out.

Comment: The effective management relief should not take into account the high tax status of the controlled foreign company. It is proposed that the high-tax requirement should be substituted for an enhanced foreign business establishment requirement. Stated differently, relief should exist if the entity is either high-taxed or contains a business establishment. Relief for business establishments should be allowed where the foreign company is benefiting from a tax holiday (such as an offshore manufacturing operation enjoying a tax holiday for being located in a development zone).

> Response: Not accepted. The foreign business establishment test and the effective management test operate differently. The effective management test is an all or nothing test; the foreign business establishment test exempts income on an allocable basis. Furthermore, the purpose of the proposed exemption is to ease administration where no significant South African tax is at stake.

9.6 Relief from transfer pricing in the case of high-taxed controlled foreign companies (CFCs)
(Main reference: Clause 71; Section 31)

Comment: The proposed legislation provides transfer pricing relief in respect of intra-group financing between a resident and a controlled foreign company. In order to qualify for this relief, the resident must own at least 10 per cent of the controlled foreign company, the controlled foreign company must be highly taxed (at least 75 per cent of the South African tax), and the controlled foreign company must have a foreign business establishment. It is proposed that the 10 per cent participation requirement is too narrow because the requirement caters solely for direct participation without taking into account indirect relationships.

> *Response:* Accepted. The wording for this transfer pricing relief will be adjusted to take into account equity shares and voting rights held by a resident taxpayer (alone or together with any other company forming part of the same group of companies as the taxpayer).

9.7 Foreign tax rebates (i.e. credits) for service fees improperly subject to foreign withholding taxes
(Main reference: Clause 4; Section 6quin)

Comment: Foreign tax credits for improperly imposed taxes are limited solely to foreign taxes imposed in respect of South African source income. However, foreign source income may also be improperly subject to foreign taxes (e.g. when a double tax agreement is not observed by the foreign jurisdiction and otherwise South African source income is deemed to be foreign source by virtue of tax treaty). A credit should also be allowed in these circumstances.

> Response: Accepted. The credit for improperly charged fees will be extended to cover foreign source income taxed in contravention of a double tax treaty.

9.8 Further refinements to the headquarter (HQ) company regime
(Main reference: Clause 21,44 and 71; Section 9I)

Comment: Since the tax rate applicable to headquarter companies cannot be reduced without the risk of South Africa being blacklisted as a tax haven, consider a tax credit system that applies only to headquarter companies that has the impact of reducing the effective tax rate. Reductions of this kind are the only way to make South Africa an investment holding company destination.

Response: Not accepted. The credit system proposed will be viewed in the same light (i.e. as a black-listed tax haven activity). The goal of the headquarter company regime is not to undermine the tax bases of other countries but merely to ensure that the flow of funds through South Africa does not create an added cost.

Comment: If a shelf company starts trading mid-way through the year, it appears that the shelf company may not qualify for the intended relief from the 10-per cent minimum shareholder test. This disqualification is problematic because shelf-companies are rarely acquired at the exact start or end of a year.

Response: Accepted. The 10 per cent ownership requirement should apply only once a trade begins during the current year of assessment. Periods before any trade begins should be ignored regardless of whether this pre-trade period ceases mid-year or lasts longer than a year.

9.9 South African fund managers of foreign investment funds
(Main reference: Clause 2; Section 1("foreign investment fund" and "resident" definitions)

Comment: The definitional rules pertaining to the structure of foreign investment funds are overly restrictive. Foreign investment funds may come in various forms, including, a company, trust or similar entity recognised under foreign law. Foreign funds may not necessarily come in the form of a collective investment scheme as suggested by the legislation.

Response: Accepted. The draft legislation will be adjusted to require that the entity "carry on activities of an investment scheme" and that the entity must hold a portfolio of financial instruments. The entity need not be in the form of collective investment scheme or similar arrangement.

Comment: While the proposal eliminates the possibility that a foreign investment funds can be a South African resident by virtue of a South African manager, there is still a possibility that fund managers may create permanent establishment status for the foreign investment entity.

Response: Noted. This issue was not raised by those close to the issue, and thus the surrounding fact patterns of concern are not clear. The issue will accordingly be deferred until the 2013 legislative cycle to determine if a problem truly does exist (or is more theoretical than real).

Comment: The exit charge should not apply merely because a foreign investment entity ceases to be a resident pursuant to the amendment coming into effect.

Response: Comment misplaced. The problem is more theoretical than real. The current rules have essentially prevented the activity from occurring locally so there is currently no entity that will be deemed to shift offshore.

Comment: The requirement for local investment managers to be a licensed financial services provider under the Financial Advisory and Intermediary Services Act should be removed.

> *Response:* Not accepted. This requirement ensures that the amendment is of limited scope and only available to managers that operate within a regulated environment. The goal is to assist local service providers so that they do not have to move offshore to perform their job functions.

Comment: The relief should be extended to private equity funds with South African or Southern African investments. Funds should not be limited solely to investments in listed and listed-type instruments.

> *Response:* Not accepted. Private equity represents a completely different class of investment than portfolio investment fund management, thereby raising different concerns. Further study will be required for this regime to be extended as requested.

Comment: The investment limitation is too narrow. Widely-traded over-the-counter investments should be permitted.

> Not accepted. Further consultation with practitioner closer to the issue is required in order to establish the nature of the instruments concerned. The issue will be considered in the 2013 legislative cycle.

9.10 Revised currency rules for intra-group exchange items
(Main reference: Clause 59; Section 24I(7A) and (10))

Comment: The adoption of International Financial Reporting Standard (IFRS) rules in respect of exchange differences on net investments in foreign subsidiaries is overly complex. It is proposed that the current deferral rules in respect of intra-group exchange items should be retained, subject to the exclusion of short-term items.

> *Response:* Accepted. The net investments in foreign subsidiary test will be replaced by a test based on unhedged non-current assets or liabilities between group members or connected persons. The meaning of current asset or current liability will follow the meaning in accordance with IFRS. The revised regime will trigger mark-to-market treatment for foreign currency debts hedged by derivatives and back-to-back loan funding stemming from parties outside the group.

9.11 Removal of foreign currency deferral for pre-production activities
(Main reference: Clause 59; Section 24I(7))

Comment: The current system of deferring the recognition of exchange differences in respect of pre-production assets should be retained. Imposition of mark-to-market taxation for loans used to acquire large assets (e.g. plant and machinery) will cause liquidity problems.

Response: Accepted. The proposed amendment will be deleted. Future consideration will be given to the possible alignment of the provision to the general tax treatment of pre-trade expenses.

9.12 Closure of dividend conversion schemes
(Main reference: Clause xx; section 64DA)

Comment: The proposed taxation of share derivatives is impractical. In the case of many share derivatives, the value attributable to dividends is estimated when the contract is entered into. Most notably, in the case of share derivatives traded on the JSE, the deemed dividend charge is often impossible to administer because the identity of the counter-party is generally unknown and because the current system does not allow for easy tracing of identities.

Response: Accepted. Imposition of the Dividends Tax in respect of share derivatives will be withdrawn for further consideration. However, deep concerns exist that this omission from dividend treatment creates a permanent bias in favour of share derivatives vis-a-vis shares. This issue will have to be revisited to protect the long-term viability of the Dividends Tax in respect of foreign shareholders.

Comment: Imposition of the charge as a dividend *in specie* is overly burdensome for the local payor because a direct charge on the payor will distort the pricing formula. It is unclear why the standard Dividend Tax withholding system cannot prevent the avoidance of concern, especially since the shareholder is the cause of the avoidance.

Response: Accepted. To address the issues raised, it is proposed that the anti-avoidance rule impose a withholding obligation on the payor on the amount deemed to be a dividend.

Comment: The deemed dividend charge is not directly tied to the amount associated with the dividend (the rules only limit the deemed dividend amount so that the deemed dividend amount may not exceed the actual dividend amount). The net result is that certain fees incurred by the payor could potentially be viewed as dividends. The deemed charge should accordingly be limited to amounts determined with direct or indirect reference to dividends.

Response: Not accepted. Concerns about fees implicitly being subject to tax only arises if the deemed dividend charge falls on the payor. Given that the regime will now be shifted to a pure withholding regime (with the payor as withholding agent), the payor will be paying a full dividend substitute plus a fee. .

Comment: The effective date is impractical given the short notice. The parties involved cannot stop a transaction mid-stream on day of Government announcement. Systems are also not in place to impose a deemed dividend charge with immediate effect. Taxpayers accordingly seek a little more time to properly manage the process.

Response: Accepted. The proposed amendments will no longer apply to amounts paid on or after 31 August 2012. Instead, the new regime will apply to transactions entered into on or after 31 August 2012 and to payments made on or after 1 October 2012 if the transaction was entered into before 31 August 2012.

10. INCOME TAX: TECHNICAL CORRECTIONS

10.1 Dividend Issues

Comment: *(Reference: Section 10B).* The foreign dividend exemption for listed shares does not apply if the dividend is deductible. However, these dividends are already subject to the Dividends Tax. The net result is unfair double taxation.

Response: Accepted. The denial of the exemption in respect of deductible foreign dividends should not apply to foreign dividends derived from JSE listed shares. These foreign dividends on listed shares are subject to the Dividends Tax in any event, thereby eliminating the arbitrage of concern (i.e. deduction for the payor with exemption for the payee).

Comment: *(Reference: Section 10B).* Foreign scrip distributions are now excluded from the foreign dividend definition (like the domestic dividend definition). However, this form of exclusion does not apply to foreign capital distributions even though domestic scrip distributions are fully excluded from the domestic return of capital definition. No reason exists for this deviation.

Response: Accepted. Foreign return of capital distributions should exclude scrip distributions. This exclusion will match the exclusion for domestic capital distributions.

Comment: *(Reference: Section 10B).* Section 10B(5) provides that the exemptions from tax provided by section 10B do not extend to any payments out of any foreign dividend received by or accrued to any person. On a strict reading of the wording, if a dividend is paid through a chain of foreign subsidiaries, and the dividends are funded by the foreign dividend, the foreign dividend received by the ultimate South African shareholder may possibly not qualify for the exemption. The net effect of this language is to undo the participation exemption when a South African company owns a chain of foreign subsidiaries. This result could not have been intended.

Response: Accepted. Section 10B(5) is merely intended to match section 10(3). The purpose of section 10(3) is to prevent exemption for annuities. Section 10B(5) will accordingly be reworded to have the same effect as section 10(3).

Comment: *(Reference: Clause 91; Sections 8C and 64F)*. An inclusion under Section 8C in respect of restricted (employee) equity instruments potentially overlaps with the Dividends Tax. Double tax relief should exist to prevent the Dividends Tax from applying to amounts already subject to section 8C.

Comment: *(Reference: Clauses 11 and 13; Sections 8E, 8EA and 64F)*. Income yields from hybrid equity instruments and third-party backed shares inclusions should not be taxed again under the Dividends Tax. Double tax relief should exist to prevent the Dividends Tax from applying to amounts already subject to the hybrid equity and third party backed share rules.

> *Response:* Comments misplaced. An exemption from Dividends Tax was proposed for amounts subject to normal tax.

Comment: *(Reference: Clause 92; Section 64FA)*. Clarity should be provided as to how to handle dividends paid to *en commandite* partnerships so that the partners can obtain the appropriate exemption/tax treaty relief as intended. The current tracing method of linking the beneficial owner of a dividend is complex and notification by the partnership of the owners forfeits en commandite status.

> *Response:* Not accepted. SARS requires information to determine whether a beneficiary is entitled to an exemption. SARS cannot be expected to exempt persons without having the ability to obtain proof of the exemption.

Comment: *(Reference: Clause 90; Section 64E)*. Under Dividends Tax certain interest-free loans give rise to Dividends Tax on an annual basis to the extent that the interest yield is too low. This charge exists even though the underlying loan corpus may have been subject to the Secondary tax on Companies under the former deemed dividend rules. This indirect double tax charge should be eliminated.

> *Response:* Comment misplaced. Proposed section 64E(4)(e) prevents duplication to the extent that the underlying loan was viewed as a deemed dividend subject to STC.

Comment: *(Reference: Clause 95; Section 64J)*. Under the law in existence as of 1 April, it appears that companies paying dividends can rely on STC credits in respect of intra-group dividends received even though those dividends were never subject to the STC. While the amendment correcting this mismatch is correct, the proposed legislation is retroactive. The timing of the correction should date back to the date the legislation was publicly released as of 6 July 2012 (not 1 April).

> *Response:* Not Accepted. While retroactivity is to be avoided, there is no constitutional bar against retroactivity in the context of tax legislation. Commonwealth norms of taxation do allow for retroactivity in particular instances. In this instance, the missing references were an obvious omission, especially given the clear indication of policy as stated in the explanatory memorandum. Moreover, almost all of the technical corrections proposed are seeking to assist taxpayers as requested. Taxpayers cannot expect retroactive technical corrections in their favour whilst the fiscus stands vulnerable for the same type of obvious errors working to the Government's detriment.

Comment: *(Reference: Clause 95; Section 64J).* If the Dividends Tax is understated because the company payor claims STC credits, the various recipients of these dividends with inflated STC credits should not be liable for any Dividends Tax ultimately due. These recipients (i.e. regulated intermediaries and beneficial owner of dividends) cannot be held responsible for tax understatements beyond their control.

> *Response:* Accepted. Any liability for the overstatement of STC credits should be the responsibility of the company payor because only the company payor has the information to make the calculation. Regulated intermediaries and beneficial owners of dividends should even be free from residual responsibility.

Comment: *(Reference: Clause 90; Section 64E and Clause 140; paragraph 75 to the Eighth Schedule)*. If a company distributes listed shares of another company in an unbundling, special valuation problems arise in respect of the listed unbundled shares subject to the Dividends Tax or taxable as a capital distribution. The value of the listed unbundling shares is often volatile (i.e. even changing on a daily basis). Under current law, the valuation date for determining the value of *in specie* assets is the date of payment, but this date is unrealistic because this date is simply too late. Taxpayers must be able to rely on a valuation date that reasonably precedes the dividend payment date in order to avoid under-valuations or over-valuations.

> *Response:* Accepted. In the case of a taxable unbundling of listed shares, the valuation date of the shares will be set at a date before payment. More specifically, the date will be the last date to register (i.e. the date of accrual).

Comment: (Reference: Clause 90; Section 64E and paragraph 2 of the Seventh Schedule). Company loans made to employers trigger fringe benefit tax to the extent the interest-yield falls below market value. A similar charge exists under the Dividends tax for below-market interest loans made to shareholders. This dual charge should be eliminated.

> *Response:* Comment misplaced. Section 64E(4) deems a dividend to exist in respect of low interest loans if the loan is granted by virtue of a share. The fringe benefit tax can only arise if the loan was granted by virtue of employment.

Comment: *(Reference: Clause 90; Section 64E)*. Profits derived from dividends paid by South African subsidiaries to JSE listed foreign companies are effectively double taxed when the listed company ultimately distributes the profits to South African shareholders. This form of dividend loop is quite common and merits double tax relief.

> *Response:* Not accepted. These tiered distributions are impossible to trace. In addition, loop structures are largely to be avoided as a matter of Exchange Control policy.

Comment: (Reference: Section 64K). Under current law, reporting under the Dividends Tax is limited to dates when Dividends Taxes are due. The proposal to extend reporting to all dividend payments (even when no potential Dividends Tax is ultimately due) is administratively burdensome.

> *Response:* Not accepted. SARS needs to be able to track all STC credits utilised, the utilisation of dividends tax exemptions and all other dividends paid to determine whether tax is fully or partially due. Hence, the potential tax base at stake must be reported in full, not just dividend amounts subject to tax as determined solely by the withholding agent.

Comment: *(Reference: Section 64N)*. Under current law, a company or regulated intermediary required to withhold Dividends Tax must obtain proof of any foreign tax paid for purposes of claiming foreign tax rebates. This requirement is very onerous, especially for regulated intermediaries who often make payment to thousands of foreign beneficiaries.

> *Response:* Not accepted. The need for proof of foreign tax paid has long been understood. SARS cannot be expected to allow relief merely on prime facie statements.

Comment: *(Reference: Section 64L)*. The JSE Derivatives Fund and the JSE Guarantee Fund are exempt from income tax. However, this same exemption does not apply in respect of the Dividends Tax. No reason exists for this disparity.

> *Response:* Accepted. It is agreed that the Dividend Tax exemption and the normal tax exemption should match in this instance. An exemption will accordingly be added for the Dividends Tax in respect of fidelity and indemnity funds.

Comment: *(Reference: Clause 22; Paragraph (ee) of the Proviso to Section 10(1)(k)(i))*. In 2011, dividend income was to be treated as (non-exempt) ordinary revenue if derived by way of cession or in consequence of cession. If read literally, this wording meant that all dividends would no longer enjoy any exemption because all shares are transferred by way of cession. The new wording to correct this concern gives rise to new problems by requiring a beneficial ownership interest in the underlying shares. In particular, the holder of the dividends does not always hold a beneficial interest in the underlying share. The shares may be held by way of a collective investment scheme or a discretionary trust. No reason exists to deny the dividend exemption in these circumstances.

> *Response:* Partially accepted. The denial of the exemption will be amended to deal with the areas of concern, namely dividends that are received by or accrue to or in favour of a company that does not hold and is not acquiring the full interest in the underlying shares. The rule will therefore apply to:
>
> - dividends that are ceded to a company; and
> - dividends that are vested in a company by a discretionary trust,

unless those dividends are received by or accrue to a company by reason of the holding or the acquisition, by that company, of the full interest in the underlying shares to which those dividends relate. However, the exemption will not apply where the acquisition of a share is subject to a fixed or conditional contractual undertaking to sell or an option to sell that share or a similar share. As such, this rule will also apply to share repurchase schemes where the dividend is passed between parties (i.e. where the share is sold cum-dividend and then repurchased ex-dividend). It should be noted that dividends in respect of borrowed shares already give rise to ordinary revenue under current law.

10.2 Miscellaneous Issues

Comment (section 9D(9A)): The current controlled foreign company rules tax rentals paid by a resident to the controlled foreign company unless the rental is paid in respect of an operating lease or a lease that constitutes a financial instrument. An operating lease is specifically defined to exclude finance leases. The current wording of this diversionary rule incorrectly assumes that a finance lease is a financial instrument.

Response: Comment misplaced. A finance lease is a financial instrument as defined. More specifically, a finance lease constitutes an interest bearing arrangement or a financial arrangement based on or determined with reference time value of money, cash flow or the exchange or the transfer of an asset. Hence, the term financial instrument covers financial leases (with the potential relief being the same applicable to other financial instruments).

Comment: *(Reference: Section 12E)*: Companies eligible for small business relief should be allowed to invest in a local portfolio of a collective investment scheme in securities because this type of investment is merely a passive form of investment and cannot be used as a form of income splitting.

Response: Accepted. The exclusion of local collective investment schemes represents an oversight. The exclusion previously applied to local investment schemes, but the reference to collective investment schemes was not updated when these schemes lost their status as a company under the section 1 tax definitions.

Comment: (Reference: Clause 46; Section 22B): The need for the current anti-avoidance rules designed to convert sales proceeds into pre-sale dividend funded by loans from a purchaser are understood. However, the wording is too wide. Under the literal terms of the anti-avoidance rules, any redemption funded by loans will now fall under the anti-avoidance rules even if no outside purchaser is involved.

Response: Noted. This issue will be considered in the next Budget cycle. Resolution of this issue will not be simple because pre-sale redemptions can be used as an acquisition tool.

Comment: (Reference: Section 45(3A)): The Taxation Laws Amendment Act of 2011 introduced new anti-avoidance rules applicable in respect of intra-group rollover transactions involving loans and preference shares. These rules prevented tax cost manipulation by limiting the tax cost of the newly issued debt (or preference shares) to zero. While the proposed amendment applies only to new transactions, certain transactions were unintentionally impacted because the agreement was concluded before the effective date with the suspensive conditions being fulfilled only afterwards. This application of the effective date is unfair given the potential determination of base cost after the fact, especially if the suspensive conditions are outside the control of the parties involved.

> *Response:* Accepted. Fully finalised transactions subject to suspensive conditions will be excluded. Stated differently, transactions entered into before the effective date will not be subject to the new anti-avoidance rules merely because the suspensive conditions were fulfilled afterwards.

Comment: (Reference: Section 45(3A)): The rule deeming a nil base cost for debt instruments and equity shares issued in an intra-group rollover needs to account for debt cancellations. This form of debt cancellation should not give rise to additional tax as long as the debt remained wholly within the group.

> *Response:* Comment misplaced. Section 45(3A) deals with the holder, not the issuer. The debt cancellation rules focus on the issuer. Also note the relief for debt cancellations between connected persons.

Comment: (Reference: Section 47(1)): The liquidation roll-over provisions should cover all disposals of assets of a company in the course of liquidation as opposed to only distributions. Assets in a liquidation are often being disposed of to cancel shareholder loans and this form of disposal is technically not a distribution.

> *Response:* Accepted. The definition of a “liquidation distribution” will be amended to cover disposals in the course of liquidation.

Comment: (Reference: Sections 44 and 47): The 18-month required liquidation period for amalgamation and liquidation rollovers is too short. The elimination of liabilities and the transfer of property registration often take longer due to factors outside the taxpayer’s control.

> *Response:* Accepted. The 18-month period will be extended to 36 months. This extended period should make the liquidation and amalgamation rollover provisions far more accessible.

11. VALUE-ADDED TAX

11.1 Amendment of section 12 – Relief for political parties
(Main reference: Clause 156(1)(b); section 12(1)(m))

Comment: The proposal to exempt from VAT the membership income of political parties and donations made to political parties raises the question of how these political parties will be treated in the period prior to the amendment becoming effective. The proposed relief for political parties must be on par with the relief previously given to fixed property developers in Taxation Laws Amendment Act 24 of 2011 (i.e. the relief given to developers was not retrospective and was applicable only as of the promulgation of that relief)

> *Response*: Accepted: The current relief proposed for political parties is prospective, coming into operation only from 1 January 2013. Political parties that are currently on register for VAT (insofar as VAT registration relates to the ambit of the proposed amendment), will be permitted to de-register with no exit charge. Further, political parties that have charged VAT on supplies made will not be refunded. These transition rules are consistent with the transition rules found elsewhere in the VAT Act.

11.2 Amendment of section 21 – Debit and credit notes
(Main reference: Clause 159; section 21(1)(f))

Comment: Although there is agreement that a credit note or debit note should be issued to correct a previously issued tax invoice, the proposed amendment is too lenient. More specifically, there must be a reasonable tax invoice to start with. A tax invoice should have at least a few particulars that make the invoice qualify as a valid tax invoice (i.e. the words “tax invoice”, the name, address and VAT registration number of the supplier, and an individual serialised number and the date of issue of the tax invoice). If a tax invoice is devoid of the stated bare minimum requirements, taxpayers should not be allowed to issue a correcting credit or debit note.

> *Response*: Accepted: The scenario under which a credit or debit note can be issued for information missing on a tax invoice will be narrowed. A credit or debit note is merely an extension of a tax invoice, the latter of which must satisfy a minimum standard (i.e. containing the word “tax invoice” as well as the name, address and VAT registration number of the supplier). It follows that a credit or a debit note cannot be issued to correct core deficiencies in respect of an invoice. Further, to assist SARS in VAT audits, a credit or debit note cannot be issued where the information pertaining to the individualised serial number and date of tax invoice is missing.

12. SECURITIES TRANSFER TAX

12.1 Temporary adjustment to the broker-member exemption
(Main reference: clause 163; section 8(1)(q))

Comment: While the proposed relief is welcome, the permissible stock accounts are too numerous. Brokers will not be able to constantly allocate (and reallocate) shares between the “unrestricted stock account”, “security restricted share loan stock account” and “security restricted cash loan stock account”. Brokers should be allowed to hold a single account but reflect the different levels of status within that single account.

Response: Accepted. Brokers will be allowed to hold a single restricted account for non-bank clients. Changes in status will be reflected as suggested.

Comment: In order to eliminate any further disputes on this matter in respect of prior years, the provisions clarifying the exemption for brokers should be dated back to 1995 when the exemption was initially added.

Response: Partially accepted. The revised exemption will be back-dated to 1 July 2008; the date when the Securities Transfer Tax became effective. Prior dates relate only to the now defunct Uncertificated Securities Tax.

12.2 Securities transfer tax on dividend cessions
(Clause 188; repeal of section 145 of Act 24 of 2011)

Comment: In 2011, imposition of the Securities Transfer Tax in respect of dividend cessions was repealed because dividend cessions became taxable as ordinary revenue. However, the proposed legislation reverses this repeal even though dividend cessions are still taxable as ordinary revenue. No seeming reason exists for this repeal.

Response: Accepted. Dividend cessions will remain free from Securities Transfer Tax. The proposed repeal of the relief will be withdrawn.

13 ADMINISTRATION

13.1 Penalty on inadequate estimate of second provisional tax payment for taxpayers with a taxable income in excess of R1 million
(Main reference: Clause 15; Amend paragraph 20)

Comment: The proposal is that these penalties will automatically be levied at a fixed percentage (20 per cent). It is also not clear why the penalty which was previously capped at a maximum of 20 per cent must now automatically be levied at the maximum. It is recommended that the 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 per cent).

Response: Not accepted. The proposal ensures that all provisional taxpayers are treated in the same way. As part of the proposal, paragraph 20(2) has been amended to permit SARS to waive part or all of the penalty imposed if satisfied that the estimate was seriously calculated and not deliberately or negligently understated.

13.2 Phase I of regulation of tax practitioners
(Main references: Clauses 63 and 64; Amend section 240 and insert section 240A)

Comment: The proposal provides that the Commissioner must recognise as "a statutory body" namely the Independent Regulatory Board for Auditors (IRBA), South African Legal Practice Council (SALPC) and certain other statutory bodies.

It is not clear if these bodies are intended to be the ultimate controlling bodies. The proposed section then provides that SARS "may" recognise other bodies, if such bodies meet the requirements as set out in section 240A(2). It is recommended that existing bodies that meet the requirements must also be approved by the Commissioner. If the Commissioner requires amendments to the existing bodies' constitutions, these amendments can be addressed before the approval is granted.

> *Response:* Comment misplaced. The statutory bodies listed have the same status as other recognised controlling bodies. The only difference being that they are automatically recognised. The use of the word "may" serves to indicate that it is the Commissioner who has the discretion to determine whether the requirements set out in section 240A(2) have been met. If amendments are required to meet the requirements, this will form part of the engagement between bodies seeking recognition and SARS.

Comment: There is a risk that there may be a period where there are no bodies that can specifically be recognised and that the statutory bodies mentioned in section 240A cannot allow persons who are only tax practitioners as members of their organisations, as these individuals would not meet the entrance requirements.

> *Response:* Accepted. Although bodies may begin engaging with SARS on an informal basis for recognition as soon as the legislation has been introduced, a window period after promulgation must be allowed for their formal recognition. Tax practitioners who do not fall under a recognised controlling body will also have to find a recognised controlling body with which to register. It is therefore proposed that the requirement to register with a recognised controlling body only come into effect on 1 April 2013.

Comment: With regard to the minimum qualification and experience requirements as well as the continuing professional education (CPE) requirement, it is recommended that it is specifically stated that these requirements must be within the field of taxation.

> *Response:* Comment misplaced. The opening requirement in the proposed section 240A(2)(*a*) is that the minimum qualification and experience requirements, as well as continuing professional education, be "relevant and effective". The question of relevance must be judged in the context of this provision appearing in the Tax Administration Act, 2011, and being administered by the Commissioner.

Comment: The Minister may appoint a panel of retired judges (or persons of similar stature and competence) to deal with disciplinary matters. There is some concern as to whether this will be appropriate as smaller bodies may not be able to afford their share of the costs of such a panel.

> *Response:* Accepted. It is proposed that it be made clear that the Minister will only appoint a panel at the request of the recognised controlling body or where the Minister is satisfied that the relevant recognised body's disciplinary process is ineffective. Furthermore, it is

proposed that the Minster be granted the discretion to appoint one of the panel members to hear complaints.

13.3 Privilege for advice by non-lawyers

Comment: There are a number of countries in which a limited statutory privilege is extended to tax advice provided by tax advisors who are not lawyers, including the UK, the USA, Germany and New Zealand. In view of the fact that tax practitioners are now being regulated by law, such a limited statutory privilege should be granted in the Tax Administration Amendment Bill, 2012.

Response: Not accepted. As was noted in the response to comments on the Tax Administration Bill, 2011, relating to this matter, the question of a limited privilege for tax advice by non-lawyers is a contentious one internationally. To update, two examples given in the response, the Australian discussion paper that set out the case for and against granting was released in April 2011, closed for comment in July 2011 and no decision has been taken to date. In the United Kingdom the appeal on extending the privilege, which is also referred to in the response is to be heard by the Supreme Court of Appeal in November 2012. In view of the above and the fact that Phase I of the regulation of tax practitioners still relies to a large extent on regulation by self-constituted professional bodies, the question should continue to be held over for consideration together with Phase II in a future Regulation of Tax Practitioners Bill.