Draft Taxation Laws Amendment Bills, 2012

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Select Committee on Finance (20 November 2012)

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Overall 2012 Tax Process

- February 2012
  - Budget Speech
  - Release of Budget Review
- Monetary Rates and Threshold Bill (signed into law)
- Taxation Laws Amendment Bills, 2012
  - Informal briefings, hearings, response and National Assembly adoption (June through early November)
  - Select Committee on Finance/NCOP
  - Presidential signature
- Other significant items
  - National Gambling Tax Bill release
  - Retirement Discussion documents

Underlying Themes

- Economic Environment
  - Global trends are uncertain
  - Domestic economic growth and fiscal revenue are relatively flat
  - Political demands on the national budget are rising but discretionary household expenditure and savings are constrained
  - Local businesses are holding excess capital as a matter of risk-protection and see greater growth opportunities elsewhere
- Objectives
  - Preserve revenue by closing tax avoidance
  - Assist business by removing tax anomalies that hinder transactions without significant tax revenue implications
  - Find “win-wins” with the private sector where both tax enforcement and compliance costs are reduced

Individuals, Employment & Savings

Medical Credits (Section 6B)

Regime driver →	Taxpayer	Taxpayer, spouse, child	All others
Type of deduction ↓	65 years + older	Person with a disability	All others
Standard monthly medical scheme fees	- R230 monthly tax credit for taxpayer & first dependant - R154 monthly tax credit for each additional dependant		
Excess medical scheme fees	Deduct 33.3% of the amount by which medical scheme fees exceed 3 x the credit		Deduct 25% of the amount by which the aggregate of the medical scheme fees that exceed 4 x the credit and all qualifying medical expenses exceed 7,5% of taxpayer's taxable income
All qualifying medical expenses	Deduct 33.3% of all qualifying medical expenses		

- It is proposed that the new regime be effective in respect of years of assessment commencing on of after 1 March 2014.

Exemption for Compulsory Annuity Income Stemming from Non-Deductible Retirement Contributions (Sections 10C)

- Non-deductible contributions will be exempt from income tax in respect of retirement interests, regardless of whether these interests are withdrawn as part of a lump sum or by way of compulsory annuity.

- As a default rule, the proposed exemption will apply on a “first come, first serve” basis.

- Lastly, the exemption will apply regardless of whether the entire retirement interest or only two-thirds thereof was used to purchase the annuity.

Completion of the "Clean Break Principle" when dividing Retirement Interest in Divorce
(Definition of "formula C" in paragraph 1 of the Second Schedule)

Proposed tax regime: Accrual or receipt on or after 1 March 2012

SCENARIO	CURRENT DISPENSATION		RESULTS OF PROPOSED AMENDMENTS
	Election in time on/after 1 March 2009	**No election on/after 1 March 2009 or no clean break**	**Election or no election; whether the fund has incorporated clean break or not**
Divorce pre-13 September 2007	No tax	Member taxed	No tax
Divorce on/after 13 September 2007	Non-member taxed	Member taxed	Non-member taxed

Streamlined Timing for Variable Cash Remuneration (Sections 7B and 23E)

- The obligation to withhold PAYE arises when an employer has an unconditional liability to pay an employee (e.g. accrual).

- The current accrual/receipt determination for employers is often hard to track on a monthly basis (e.g. annual leave, bonuses and commissions); this problem often gives rise to unnecessary disputes and penalties

- It is proposed that in the case of variable remuneration, the timing of receipt of the listed items will be deemed to occur only when the underlying amount is <u>paid</u> by the employer to the employee.

- Employer deductions will also be moved to the same payment date so employer deductions match employee income so as to ensure a proper "push-pull" in the system.

Rented Employer–Provided Vehicles (Paragraph 7 of the Seventh Schedule)

- Employer-provided company-owned vehicles + **private use** in conjunction with business use = taxable fringe benefit

- However, the calculation of the value of the employee's fringe benefit in respect of any private use, assumes that the vehicle is owned or purchased (financed) via a finance lease by the employer.

- The calculation is excessive if the employer rents the vehicle pursuant to an operating lease.

- It is proposed that in instances where the vehicle provided via an operating lease from an unconnected third party at an arm's length price, the value of the benefit for the employee is the actual leasing cost to the employer.

Business (General)

Foreign Shareholder Dichotomy

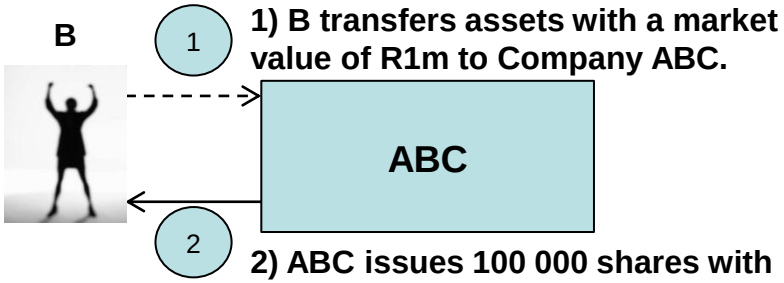
- Dividends received by foreign shareholders
  - 15% rate
  - Treaty relief (5% or 10%)
- Gains
  - Capital or ordinary gains for foreign persons are tax-free
- Hence, the sale of a share by a foreign person is tax-free versus a dividend, the latter of which is taxable. The incentive is to convert dividends into exempt gains
- Certain taxpayers are using this dichotomy to undermine the new Dividends Tax (costing 100s of millions in lost revenue)

Closure of Conversion Schemes (Section 64EB)

- Cessions schemes
  - Foreign shareholder sells the right to the dividend to an exempt person before receipt (but after announcement/declaration)
  - Proposal: Foreign shareholder is still deemed to receive a taxable dividend
- Share lending
  - The Foreign shareholder lends the share before dividend receipt (but after announcement/declaration)
  - Proposal: Foreign shareholder treats the “in lieu of” dividend as a taxable dividend
- Share repurchase agreements
  - The foreign shareholder sells the share before dividend receipt (but after announcement/declaration) and repurchases the share afterwards
  - Proposal: Foreign shareholder is still deemed to receive a taxable dividend
- Ongoing concerns
  - Share derivatives
  - New schemes (e.g. share dividends)

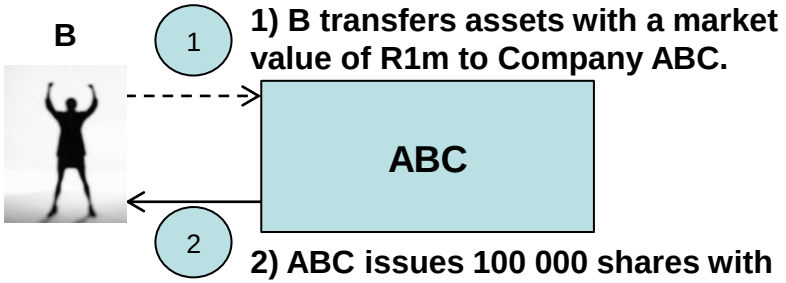
Value Mismatches (Section 24BA)

Current tax consequences



B and ABC are not connected persons and value shifting rules will not apply. Under the "barter" principle. The base cost of the shares in B's hands will be R1m (the market value of the assets transferred.

Proposed tax consequences



B will deemed to have received an in specie dividend of R500 000, representing the value shifted to him.

ABC would be liable for Dividends Tax as a dividend *in specie*.

Debt Reduction/Cancellations
(Section 19 and Paragraph 12A of the Eighth Schedule)

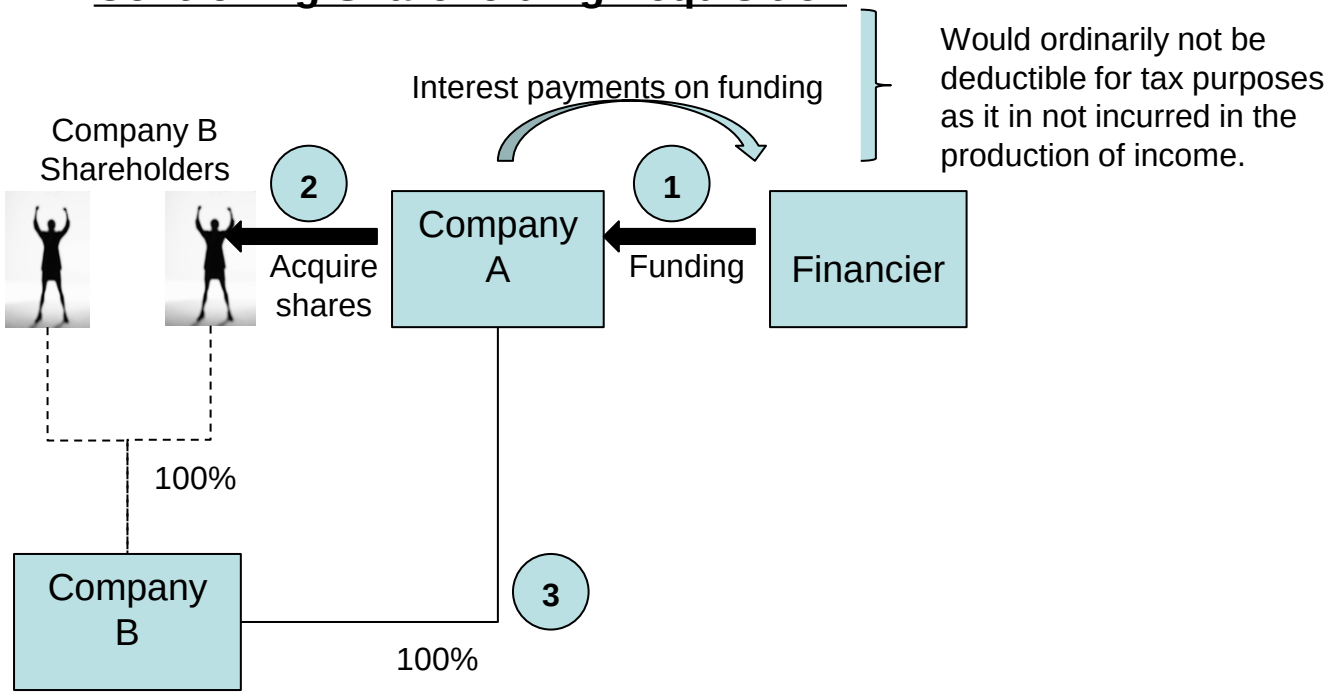
- Under current law,
  - Debt relief by creditors can give rise to ordinary revenue or capital gain, thereby triggering tax just when the debt is relieved
  - Even when SARS cancels a tax debt, taxable gain can arise
- Proposal,
  - Debt-purchased non-depreciable capital assets
    - Reduce base cost/then reduce capital losses/no capital gain
  - Debt-purchased trading stock
    - Reduce cost price/then trigger ordinary revenue
  - Debt-purchased allowance assets
    - Reduce base cost/then trigger ordinary revenue
  - Other
    - No gain/ordinary revenue from cancelling tax debts
    - Ordinary revenue arises if debt was used to fund deductible (non-trading stock) expenditure

Exemption for Government Grants (Section 12P and the 11th Schedule)

- **Background**
  - National funding (by way of a grant) is allocated to various governmental entities and to the private sector.
  - The Income Tax Act provides an exemption for certain grants but not all grants under tax legislation or that are approved by Ministerial notice.
- **Proposal**
  - Shift of presumption in favour of exempting rather than taxing genuine grants.
  - Exemption covers grants in a revised and extended legislative list
  - Exemption can also be achieved via approved by Ministerial notice
  - Exemption will now include provincial grants
  - The exemption will be subject to anti-double dipping rules (e.g. exempt government grants cannot be claimed as a deductible expenditure)

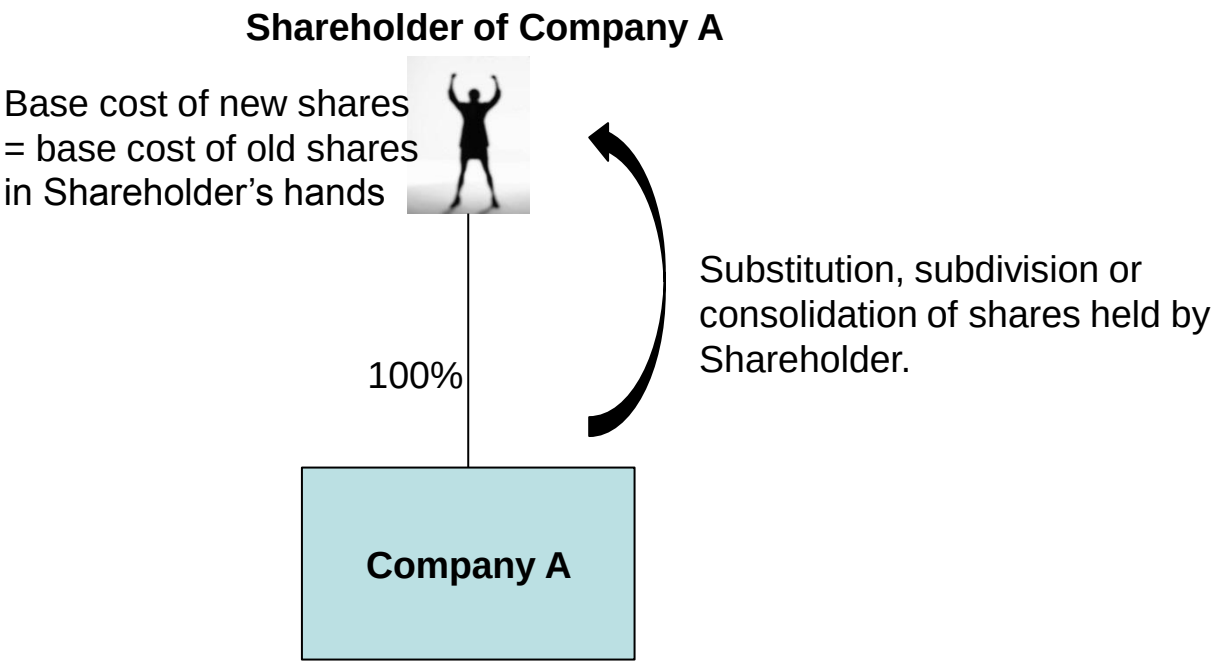
Debt Financed Acquisitions (Section 24O and 23K)

Controlling Shareholding Acquisition



It is proposed that the interest incurred on funding used to acquire a controlling interest in an operating entity. Such controlling interest is benchmarked at 70% (in line with the "controlling group company" definition). However, deductions will be subject to SARS discretion in the same fashion as indirect section 45 acquisitions

Substitutive share-for-share transactions (Section 43)



NOTE:

- It is proposed in the new section 43 that share recapitalisations should have roll-over relief
- This proposal should also be extended to apply to shares held as trading stock
- Non-equity shares can only be converted to other non-equity shares

Business (Financial Intermediaries and Vehicles)

Real Estate Investment Trust (REITs) (Sections 1 ("REIT" definition) and 25BB)

- Property investors directly invest in immovable properties for rental streams or indirectly through property investment entities
  - A steady rental stream acts as a substitute for interest income, and growth in the underlying property as relatively stable method of achieving appreciation.
  - Ownership in property investment schemes is highly liquid
- Two main types of property investment schemes exist that operate as international REIT – the Property Unit Trust (PUT) and Property Loan Stock (PLS)
  - Both the PUT and the PLS are subject to the same listing requirements for the purposes of the JSE.
  - Only the PUT is subject to FSB regulation
- Two different tax dispensations
  - PUTs have an explicit flow through of rentals and an exemption for capital gains
  - PLSs have a "homemade" flow-through via dual linked units with debenture interest
  - Debenture interest really operates as disguised "deductible" dividends that will violate the new debt equity rules (sections 8F and 8FA)

REIT Proposal

- It is proposed that a unified approach for the property investment schemes will be adopted for financial regulatory and tax purposes.
  - The new entity will be called a Real Estate Investment Trust (REIT) in line with the international norms.
  - The purpose of the proposed REIT regime is to treat investors roughly the same as investors holding immovable property directly (flow-through).
- New regime
  - All distributions will be deductible if the entity mostly (i.e. 75%) generates rental and similar income (or REIT dividends from subsidiaries)
  - Capital gains from immovable property will be exempt
  - Financial instruments will generate ordinary revenue (other than REIT interests)
  - REIT classification to be maintained by JSE rules
  - All REIT yields will be taxed as ordinary revenue (with foreign persons exempt from dividends tax until 1 January 2014)
  - Removal of dual-linked share set to begin from 2013
- Unlisted property funds will be the subject of review for 2013

Securities Transfer Tax (STT)
(Section 8 of the STT)

- General rule
  - STT applies at a rate of 0.25 per cent.
  - This tax generally applies when a person acquires beneficial ownership of a share (i.e. STT exemption exists if the broker acquires the share as principal)
- Role of brokers
  - All shares on the JSE must be traded through JSE members (i.e. stock brokers)
  - Brokers can act as agents or as principal
- Broker exemption has long existed for brokers acting as principal so as to promote liquidity but any transactions blur the agent/principal distinction with
  - the broker being the owner with the risk passed on via derivatives
  - Banks additionally have indirect control over shares in brokerage subsidiaries with indirect control over the ability to sell
- The new rules will allow for brokers as market-making in derivatives, thereby ensuring that the principal/agency principal is otherwise maintained

Mark-to-market of long term policyholder funds (Section 29B)

Background

- Insurers as “tax” trustees of policyholder investments must not only collect income tax but must also properly allocate tax to each policyholder investment.
- Insurers achieve this allocation amongst policyholders by applying continual mark-to-market approach (subtracting notional tax from the gain or loss policyholder investments on a continual basis)
- Any change in effective capital gains tax rates for policyholder funds creates complications for insurers as trustees (especially if higher rates apply only from a later date)

Proposal

- It is proposed that a deemed disposal and re-acquisition approach be applied to all policyholder fund assets that mimics mark-to-market taxation on 29 February 2012
  - Other than dual-linked funds
  - The gain or loss is spread over 4 years
- Annual mark-to-market system is pending larger review

New Deduction Formula for Long-term Policyholder Funds (Section 29A)

- Old Individual Policyholder formula
  - $\frac{I + R + F}{I + 2.5R + 4.75F + 4.75L}$
- Purpose
  - Deductions for indirect (and selling/administration expenses) should be limited to amounts dedicated to the production of gross income
  - The old formula took into account an implicit capital gain charge
- New formula
  - Taxable income; over
  - Taxable income plus dividends (less withholding taxes) plus capital gains without partial inclusion
  - Fully effective from 2013 onward
- Liability transfer formula moved from 50% down to 30% because new formula will produce a larger percentage deduction for insurers

Short-Term Insurance Reserves (Section 28; see also section 23L)

Background

- Short-term insurers are highly regulated by the FSB so that the public has certainty that actual funds are in reserve to pay claims. These deviations justify a deduction for reserves when most entities are not allowed to deduct reserves (section 23(e))
- The tax rules associated with short-term insurers are partially aligned with the system of regulatory reserves.
- It is proposed that the tax system will use the regulatory regime as a comprehensive starting point for all reserve calculations (especially since SAM no longer favours "over-reserving").

Proposal #1

- The new rules will basically follow FSB reserving, but for
  - Unapproved reinsurers
  - Formula cash-back cash reserves (but best estimates are ok)
- SARS discretion for denying deductible reserves will be removed

Proposal #2

- Payments in respect of short-term policies will no longer be deductible if the policy is viewed as an investment policy under IFRS

International
(Outbound and Inbound)

Tax Upon Cessation of Residence: Overturning the Tradehold Decision (Section 9H)

- **General principles:**
  - Ceasing to be a resident (migration) triggers CGT (exit charge) on deemed disposal of all assets at market value
  - The exit charge is triggered day before the cessation of residency
  - Exit charge cannot be neutralised by DTA
- **Reason for change:**
  - Tradehold case decision that the Luxembourg DTA applied to deemed disposal [no reference to timing of deemed disposal]
  - Align exit charge to international precedent
- **Proposed legislation:**
  - Year of assessment of migrant deemed to end day before migration. A new year of assessment commences on day of migration
  - Natural person emigrant deemed to dispose all assets at market value day before migration and reacquired at market value on day of migration
  - Corporate emigrant deemed to have distributed all its assets as a distribution in specie for market value on the day before migration

Rationalising Interest & Royalty Withholding Taxes (Parts IA and IVA)

- **Procedures and timing for interest withholding taxes:**
  - Non-residents are subject to withholding tax when receiving royalties, interest and dividends
  - Dividends tax was introduced on 1 April 2012;
  - Interest withholding tax will come into effect on 1 July 2013
  - Government and bank interest exemptions will be clarified
- **Proposed alignment of royalty and interest Withholding tax:**
  - Withholding tax rates (15%)
  - Liability to withhold
  - Timing of tax payments to SARS
  - Refund mechanisms and declarations
  - Currency translation rules

CROSS BORDER REORGANISATIONS
(Sections 41-47; Paragraph 64 of the Eighth Schedule)

- Purpose or reorganisation rules:
  - Rollover of gains and losses (potentially triggered at later stage) involving company restructurings/equity takeovers
- Reorganisation categories:
  - Domestic-to-domestic transactions
  - Inbound transactions (assets moved into South Africa)
  - Foreign to foreign transactions (if controlled by South African companies)
- Permissible offshore restructuring transactions:
  - Asset-for-share transactions (enhanced from 2011)
  - Amalgamation transactions (enhanced from 2011)
  - Intra-group transactions (new)
  - Unbundling transaction (enhanced from 2011)
  - Liquidation distributions (enhanced from 2011)

Comparable Country Tax Relief (Section 1 (resident definition) and 31)

- Many South African multinationals operate in countries that are subject to roughly the same or higher levels of tax than in South Africa but may be subject to anti-avoidance rules; the result is
  - Complex rules for little or no benefit to the fiscus (because tax credits offset most taxes due); or
  - Potential double taxation
- Local effective management
  - Local effective management may be used in African countries without infrastructure
  - Relief for local effective management in the case of controlled foreign companies with foreign business establishments and a 75% hypothetical South African rate
- Transfer pricing (low yielding loans/royalties)
  - Low yielding loans/royalties may be used to subsidies African subsidiaries operating without significant profit
  - Relief for transfer pricing in the case of controlled foreign companies with foreign business establishments and a 75% hypothetical South African rate

FURTHER REFINEMENTS TO HQ REGIME (Section 9I)

- Current tax qualifying criteria:
  - For all prior years, each shareholder satisfy minimum participation of 10%
  - For all prior years satisfy the 80/10 asset test (without taking into account money market deposits)
  - In current year, 50% passive receipts and accrual test (excluding R5 million de minimis receipts and currency gains and losses)
- Further refinements:
  - Exempt dormant companies (no trade + ≤R50 000 assets) from the "always qualification"
  - The always rule will be dropped for the 10% shareholder requirement
  - Relax transfer pricing rules in respect of back-to-back licenses of IP [with losses ring-fenced]

SOUTH AFRICAN FUND MANAGERS OF FOREIGN INVESTMENT FUNDS (Section 1)

- Background:
  - The use of SA based fund manager of a foreign fund potentially triggers SA world wide taxation of the fund [because of POEM test]
- Reason for change:
  - The triggering of the effective management test makes SA local managers potentially unattractive [as Gateway to Africa]
- Proposed legislation creates a carve-out from POEM test if:
  - Fund is incorporated, formed or established in a foreign country
  - Fund operates comparably similar to a local CIS
  - Sole assets of fund consist of cash or listed financial instruments
  - Fund has no full-time employees and directors, and
  - SA residents cannot participate more than 10% in fund
- Note: SA fund managers fees remain fully taxable in SA

ADMINISTRATION
(Taxation Laws Amendment Bill)

Administration: One stop border posts (Clause 1)

Background

- Bilateral agreement with Mozambique concluded in September 2007
- Bilateral agreement on annexures reached at officials' level in June 2011
- Agreement in principle on annexures after preliminary briefing to SCoF in June 2012

Proposal

- Enactment of a provision to give effect to agreement and its annexures in domestic law, once all requirements of section 231 of the Constitution have been complied with and the agreement binds South Africa

Administration: Dividends withholding tax refunds (Clauses 15 – 17)

Background

- Refund is available to beneficial owner if withholding tax is over-deducted due to late filing of required notification
- Refund may also arise from foreign tax credit in respect of dividends paid by a non-resident company on listed shares

Proposal

- Extend refund to foreign tax credit cases, within three year period of payment of dividend
- Adequate proof of payment of foreign tax must be obtained

Administration: Provisional tax estimates (Clauses 22 and 23)

Background

- Special tax table inserted for retirement fund lump sum benefits with effect from 1 October 2007, retirement fund lump sum withdrawal benefits with effect from 1 March 2009 and severance benefits with effect from 1 March 2011
- Provisional taxpayers' estimates of taxable income must include retirement and severance lump sum benefits, although taxed using a separate tax table and tax is withheld at source

Proposal

- Exclude retirement and severance lump sum benefits from provisional tax estimates to simplify process

Administration: Provisional tax penalties (Clause 23)

Background

- Imposition of understatement penalty discretionary for taxpayers with a taxable income of more than R1 million but compulsory, with a potential waiver based on circumstances, for those up to R1 million
- Taxpayers who underestimate their provisional tax at the end of a tax year (but have paid enough employees' tax and provisional tax) may be subject to an understatement penalty and have to seek a waiver

Proposal

- Bring imposition of penalty for higher income taxpayers in line with other taxpayers
- Make it clear that no penalty is due on an underestimate if enough employees' tax and provisional tax has been paid by the end of the tax year

Administration: Six monthly filing for micro businesses (Clauses 26 and 30)

Background

- A number of steps have been taken in the tax arena over the years to assist small and micro businesses

Proposal

- Allow micro businesses to elect to file returns and make payments for employees' tax and VAT every six months
- Micro businesses may remain on their current monthly payment schedule for employees' tax and two or four monthly payment schedule for VAT, e.g. if they are concerned about their ability to manage cash flows or are in a refund position for VAT

Administration: Regulation of tax practitioners

Background

- Regulation of tax practitioners is a long standing issue, first raised in 2002
- Registration required from June 2005, first round of draft legislation proposing a statutory regulator released in February 2007, followed by a second round in July 2008
- Minister raised question of personal non-compliance by registered tax practitioners and its implications for their clients in 2012 Budget Speech
- Meetings between Minister, Commissioner and tax practitioner associations thereafter to address question

Proposal

- Phase 1: Recognised controlling body in Bill
- Phase 2: Evaluate phase 1 and introduce statutory regulator

Administration: Recognised controlling body (Clauses 36 and 80 – 84)

Proposal

- Tax practitioners must register with or fall under the jurisdiction of a listed regulator or a recognised tax practitioner association from 1 July 2013
- SARS recognises tax practitioner associations based on:
  - Relevant and effective qualification and experience requirements, CPE, codes of ethics and conduct and disciplinary code and procedures
  - Tax exempt status as an association to promote the common interests of members carrying on a profession
  - Minimum membership (or likely membership in a year) of 1,000
- A recognised association must be given notice and opportunity to take corrective action if it no longer meets requirements
- Minister *may* appoint a panel of retired judges or similar persons to handle disciplinary matters on request or if disciplinary processes are ineffective
- Reportable misconduct expanded to cover additional tax specific misconduct

Administration: Tax clearance certificates (Clause 89)

Background

- Tax clearance requests have increased to more than 600 000 a year
- Delays and corruption occur from time to time in the process
- Maximum 21 day turnaround time may be inadequate in some cases

Proposal

- Create framework for providing real time, up-to-date and continuous tax status to authorised parties
- Maximum 21 day turnaround time modified to permit an exception if efficient and effective collection of revenue may be prejudiced, e.g. where request for tax clearance certificate to move funds offshore reveals wealth that appears inconsistent with prior tax returns