2011 Draft Taxation Laws Amendment Bills

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National Treasury & SARS

Standing Committee on Finance

Ismail Momoniat
Keith Engel
Sharlin Hemraj
Franz Tomasek

Consultation Process for TLAB

- The Taxation Laws Amendment Bills give effect to the tax proposals announced in 2011 February (as contained in Chapter 5 and Annexure C of the Budget Review)
- The Bills are “money” bills.
- The Bills were published for public comment on 3 June 2011
  - Briefing before SCOF is 15 June
  - Hearings before SCOF are 21st and 22nd of June
  - Treasury deadline for public comments is 5 July 2011
  - Treasury workshops with the public to be held in mid-July
  - Response document to be presented before SCOF in August
  - Formal introduction of Bill in late August/September
- Treasury and SARS open to be persuaded by public comments and public consultations
- BUT we need to be vigilant about lobbying and special interest groups, and fact that individual interests often not represented

Pending or New Issues from the Budget

- Pending Issues (work in progress), to be dealt with in separate and later Bills
  - Medical credit (partial)
  - Retirement base (discussion document pending)
  - Provident fund (discussion document pending)
  - Gambling tax (pending)
  - Carbon tax discussion paper

- New Issues (focus anti-avoidance, eliminating anomalies):
  - Section 45 suspension
  - Dividends from share-based employee schemes
  - UIF exemption for office holders
  - Timing of foreign tax credits
  - VAT relief for temporary rentals by developers

Overview

Key Policy Objectives

Tax Policy Objectives for 2011/12

- Broadening the tax base in support of inclusive growth
- Raising sufficient revenue to finance government
- Tax relief for individuals, tax breaks to support job creation and skills development, including
  - Fiscal drag relief (changes in PIT brackets & rebates) and changes in some monetary thresholds
- Closure of tax loopholes to sustain a broad tax base
- Adjustments in specific excise taxes to address environmental and health concerns

Tax Proposal Highlights (1)

- **Individuals**
  - Personal income tax relief of R8.1 billion (fiscal drag)
  - Introduction of a third rebate of R2000 for individuals 75 years and older
  - Adjustments to medical scheme and tax free interest monetary thresholds
  - Conversion of living annuities into drawdown accounts
  - Uniform taxation of life insurance products
- **Business**
  - Dividends tax will take effect on 1 April 2012, replacing the secondary tax on companies
  - Foreign dividends to be taxed at an effective rate of 10%
  - Suspension of section 45 rollovers
  - Ordinary treatment for third-party backed shares and closure of various dividend schemes
  - Introduction of a government Sukuk
  - Modification of incentives, including industrial policy projects, research and development, venture capital companies and film production plus extension of the learnership incentive
  - Adjustments to the micro business turnover tax rates and exemption thresholds from R100 000 to R150 000 plus segregation from VAT

Tax Proposal Highlights (2)

- **International**
  - Gateway into Africa initiatives
  - Controlled foreign company reforms
  - Special taxation of offshore cell companies

- **Indirect taxes**
  - *VAT:* Notional inputs for developers purchasing property
  - *VAT:* Relief for developers temporarily engaged in rentals
  - *Transfer duty relief:* Increase in thresholds and equal exemptions for entities
  - *Securities Transfer Tax:* Temporary expansion of relief for brokers acting as principals
  - *Gambling tax:* Pending
- **Administration**
  - Voluntary disclosure programme remains open until 31 October 2011
  - Tax administration bill (formal introduction pending)
  - Customs modernisation progamme

Tax Proposal Highlights (3)

- Increase in the general fuel levy (10 c/l) and the road accident fund levy (8 c/l) effective as from 6 April 2011
- Increases in the excise duties on tobacco products and alcoholic beverages effective as from February 2011
- Electricity levy increase to 2.5c/kWh from 1 April 2011. Revenues to be used to finance rehabilitation of roads resulting from coal haulage
- Increase in the international air passenger departure tax effective from 1 October 2011
- Gambling tax legislation pending for later in the year

Revenue summary of main tax proposals

Impact of tax proposals on 2011/12 revenue

R million	Effect of tax proposals	
Tax revenue		745,735
Non-tax revenue		10,001
Less: SACU payments		-21,763
National budget revenue		**733,973**
Provinces, social security funds and selected public entities.		94,609
Budget revenue (before tax proposals)		**828,581**
Budget 2011/12 proposals:		**-4,115**
Taxes on individuals and companies	**-8,350**	
Personal income tax	-8,850	
Adjustment in personal tax rate structure	*-8,100*	
Adjustment in monetary thresholds	*-750*	
Business taxes	500	
Closure of dividend cession schemes	*500*	
Taxes on property	**-750**	
Adjustment in transfer duties	-750	
Indirect taxes	**4,985**	
Increase in general fuel levy	1,900	
Increase in excise duties on tobacco products	1,785	
Increase in Ad valorem excise duties	150	
Increase in electricity levy	1,150	
Budget revenue (after tax proposals)		**824,466**

Tax Revenue Trends 2006/07-2010/11

Tax Instruments	Actuals				Actual[2]	2010/11 vs 2009/10	
	2006/07	2007/08	2008/09	2009/10	2010/11 Revenue		
Personal Income Tax	140,578	168,379	195,115	205,145	226,916	21,771	11%
Corporate Income Tax	118,999	140,191	165,378	134,883	132,871	(2,012)	-1%
Value Added Tax	134,463	150,443	154,340	147,941	183,568	35,626	24%
Customs duties	24,036	26,470	22,654	19,577	26,587	7,010	36%
Transfer Duties	6,774	7,408	4,931	4,683	5,322	639	14%
STC	15,291	20,909	20,018	15,468	17,178	1,710	11%
General Fuel levy	21,845	23,741	24,884	28,833	34,417	5,585	19%
Specific Excise Duties	16,369	18,218	19,903	21,289	23,050	1,760	8%
Securities Transfer Tax	2,764	3,757	3,664	3,324	2,933	(391)	-12%
SDL	5,597	6,331	7,327	7,805	8,652	848	11%
Electricity levy	-	-	-	3,342	4,996	1,655	50%
Other[1]	8,832	6,967	6,881	6,415	7,710	1,295	20%
TOTAL TAX REVENUE	**495,548**	**572,815**	**625,095**	**598,705**	**674,202**	**75,497**	**13%**
NON-TAX REVENUE	**10,881**	**12,693**	**12,616**	**8,889**	**12,699**	**3,810**	**43%**
Of Which: Mineral and Petroleum Royalties					3,555	3,555	
GDP	**1,810,664**	**2,082,000**	**2,312,965**	**2,442,593**	**2,662,757**	**220,164**	**9%**
TOTAL TAX REVENUE/GDP RATIO	**27.4%**	**27.5%**	**27.0%**	**24.5%**	**25.3%**	**0.8%**	**3%**
SACU	**25,195**	**24,713**	**28,921**	**27,915**	**-17,906**	**-45,821**	**-164%**

1: Includes the sum of minor tax instruments such as plastic bag levy, diamond levy and air departure taxes.

2: Revenue Collected as of the 31st of March 2011

Tax Revenue Trends

- Total nominal tax collections recovered from the previous year by 13% driven by broad economic post recession recovery
- The performance of the four main revenue instruments are summarized:
  - PIT collections are 11% above that of 2009/10;
  - CIT collections are 1% below that in 2009/10, corporate profits continue to lag post recession growth;
  - VAT collections are 24% above 2009/10, this strong recovery was supported by consumption driven growth; and
  - Customs Duties are 36% above 2009/10, this strong growth was driven by strong post-recession recovery in vehicle imports

Revenue 2010/11: Estimates vs. Actual

Tax Instruments	2010 Budget	MTBPS	2011 Budget	Actual[2]	Actual vs 2010 Budget	Actual vs 2011 Budget
	2010/11 Revenue					
Personal Income Tax	224,676	230,000	228,000	226,916	2,241	(1,084)
Corporate Income Tax	133,650	138,000	132,500	132,871	(779)	371
Value Added Tax	164,000	181,000	181,335	183,568	19,568	2,233
Customs duties	20,500	26,000	26,400	26,587	6,087	187
Transfer Duties	5,000	5,700	5,500	5,322	322	(178)
STC	16,500	16,000	16,500	17,178	678	678
General Fuel levy	34,600	33,700	34,300	34,417	(183)	117
Specific Excise Duties	24,250	24,000	22,900	23,050	(1,200)	150
Securities Transfer Tax	4,100	3,400	3,000	2,933	(1,167)	(67)
SDL	8,424	8,700	8,420	8,652	228	232
Electricity levy	5,200	5,200	5,200	4,996	(204)	(204)
Other[1]	6,950	7,500	8,145	7,710	760	(435)
TOTAL TAX REVENUE	**647,850**	**679,200**	**672,200**	**674,202**	**26,352**	**2,002**
NON-TAX REVENUE	**10,380**	**12,265**	**12,254**	**12,699**	**2,318**	**445**
Of Which: Mineral and Petroleum Royalties	3,540	4,255	3,712	3,555	15	-157
GDP	**2,682,221**	**2,682,221**	**2,666,894**	**2,662,757**	**(19,464)**	**(4,137)**
TOTAL TAX REVENUE/GDP RATIO	**24.2%**	**25.3%**	**25.2%**	**25.3%**	**1.2%**	**0.1%**
SACU	**-14,991**	**-14,991**	**-14,991**	**-17,906**	**-2,914**	**-2,914**

1: Includes the sum of minor tax instruments such as plastic bag levy, diamond levy and air departure taxes.

2: Revenue Collected as of the 31st of March 2011

Rates and Thresholds

Income Tax

2010 rates & thresholds for individuals

TAXABLE INCOME	RATE OF TAX
R0 to R140K	18%
R140 001 to R221K	R25 200 + 25% of amount above R140K
R221 001 to R305K	R45 450 + 30% of amount above R221K
R305 001 to R431K	R70 650 + 35% of amount above R305K
R431 001 to R552 K	R114 750 + 38% of amount above R431K
R552 001 +	R160 730 + 40% of amount above R552K

Proposed 2011 rates & thresholds for individuals

TAXABLE INCOME	RATE OF TAX
R0 to R150K	18%
R150 001 to R235K	R27 000 + 25% of amount above R150K
R235 001 to R325K	R48 250 + 30% of amount above R235K
R325 001 to R455K	R75 250 + 35% of amount above R325K
R455 001 to R580 K	R120 750 + 38% of amount above R455K
R580 001 +	R168 230 + 40% of amount above R580K

Rebates for individuals

CURRENT REBATES		
Primary rebate	All naturals persons	R10 260
Secondary rebate	Natural persons 65 +	R 5 675

PROPOSED REBATES		
Primary rebate	All naturals persons	R10 755
Secondary rebate	Natural persons 65 +	R 6 012
Tertiary rebate	Natural persons 75 +	R 2 000

Proposed rebates effective as from 1 March 2011.

Current & proposed retirement lump sum & severance benefit tax table

TAXABLE INCOME	RATE OF TAX
R0 to R300 000	0%
R300 000 to R600000	18% of amount above R300 000
R600 000 to R900 000	R54 000 + 27% of amount above R600 000
R900 000	R135 000 + 36% of amount above R900 000

TAXABLE INCOME	PROPOSED RATE OF TAX
R0 to R315 000	0%
R315 000 to R630000	18% of amount above R315 000
R630 000 to R945 000	R56 700 + 27% of amount above R630 000
R945 000	R141 750 + 36% of amount above R945 000

Interest exemptions

EXEMPTION FOR INTEREST

- For natural persons below 65, the interest exemption for domestic interest is R22 800 (was R22 300).
- For natural persons 65 and older, the interest exemption for domestic interest is R33 000 (was R32 000).

FOREIGN SOURCE INTEREST

- The exemption for interest received from a foreign source is R3 700 (no change).

Capital gain exclusions

- The general annual capital gains exclusion for individuals and special trusts – R20 000 (was R17 500).
- Exclusion on death – R200 000 (was R120 000).
- Disposal of primary residence exclusion is
  - R1.5 million of gain; or
  - R2 million of proceeds

  (no change)

Individuals, Employment & Savings

Income Tax

Medical credits

(Sections 6A & 18(2)(c); Clauses 10 & 47)

- For equity purposes, it is proposed to move from a deduction system to a credit system as from 1 March 2012 for medical scheme contributions.
- A deduction allows taxpayers to reduce their taxable income by an amount calculated as the deduction at their marginal rate, whereas as a credit serves as a “rebate” to reduce the final amount of tax due to SARS.
- The credit system may also be extended to cover out of pocket expenses, including all expenses for the elderly and the disabled (see discussion document).

Medical credits

Current medical deduction 2011	Medical credit for 2012
@ individual's marginal tax rate	Value of credit as if at 30% marginal tax rate
Contribution deduction from income cap – R720p/m (from 670) for first 2 & R440p/m (from R410) for each additional member	Contribution credit cap – R216p/m for first 2 and R144p/m for each additional member, after tax Additional monthly credit of R216p/m for 65+ or with disability
Out of pocket expenses – can be claimed for amounts in excess of 7.5% of taxable income.	Out of pocket expenses – can be claimed for amounts in excess of 7.5% of taxable income.
Members aged 65 years and older and those with a disability – no limit on medical contributions or expenses	Members aged 65 years and older and those with a disability – no limit on medical contributions (monthly limited to credit) or expenses

Medical credits – Example

Taxpayer (under age 65)	A	B	C
Marginal tax rate	18%	30%	40%
Taxable Income – before medical deduction **(TI 1)**	150,000	320,000	640,000
Tax liability if no deduction or credit	16,245	62,995	181,495
Medical scheme contribution capped allowance			
Taxpayer plus 3 dependants (R720x2 + R440x2 / month)	27,840	27,840	27,840
Taxable Income – after medical scheme deduction **(TI 2)**	122,160	292,160	612,160
Tax liability if deduction taken into account	11,234	54,643	170,359
Tax benefit of medical scheme deduction	**5,011**	**8,352**	**11,136**
Medical scheme tax credit (fixed amounts)			
Taxpayer plus 3 dependants (R216x2 + R144x2 / month)	8,640	8,640	8,640
Tax liability on TI 1 – after medical scheme tax credit	7,605	54,355	172,855
Tax benefit of medical tax credit	**8,640**	**8,640**	**8,640**
Effect of tax credit vs tax deduction	**3,629**	**288**	**-2,496**

Medical Tax Credit: Discussion Document

- Discussion document to be released this week (www.treasury.gov.za)
- Two-pronged consultation process
- First prong relates to 2011 TLAB: One month consultation period for proposals relating to medical scheme contribution credits
- Second prong: Consultation on tax treatment relating to out of pocket expenses until 31 October 2011, for future proposals
  - Recognise individuals not as organised as business and other lobbies, require a longer period for consultation

Retirement reform: Living annuity background

(Section 1 definition; Clause 7(1)(zP))

- Upon retirement, members of a retirement annuity or pension fund must use 2/3^{rds} of their retirement interest to acquire a guaranteed annuity or a living annuity from the fund or from a long-term insurer.
- A guaranteed annuity provides for a guaranteed annuity series of payments over the life of the individual, regardless of the underlying assets. The risk falls on the provider.
- A living annuity is not a true annuity in that it does not provide guaranteed payments over the life of the individual. The risk falls on the individual with the payments based solely on underlying assets (like a savings account). In essence, this form of annuity lacks any insurance element.

Retirement reform: Conversion to drawdown account

- As from 1 March 2012, a living annuity will be re-named as a retirement income drawdown account (RIDDA).
- The RIDDA may be provided by collective investment schemes (including bank sponsored schemes) and government (in addition to long-term insurers or funds)
- Other than removing the minimum drawdown level, the old living annuity structure will remain for the RIDDA (the 17.5% maximum per annum withdrawal but not the 2.5% floor).
- The aim with the amendments is to allow natural competition in the market to drive down the costs of these products for retired individuals.

Long-term insurance: Employer contributions as a taxable fringe benefit

(Paragraph 12C of the 7th Schedule; Clause 113)

- Employers acquire life cover for the benefit of employees and their dependents and pay the contributions on their behalf. This benefit is typically offered through group plans

- The general rule is that any payment made for the benefit of an employee is treated as a taxable fringe benefit. This rule should equally apply to long-term insurance but questions exist as to how far this rule can be applied

- Under the proposed amendment, fringe benefit treatment will be made explicit. Employees will therefore be taxed on any premiums paid by an employer in respect of a risk policy (life cover) that is intended directly or indirectly for the benefit of the employees or their dependents.

Long-term insurance: Taxation of proceeds

(Section 1 - paragraph (m) of the definition of "gross income", sections 10(1)(gG) & 10(1)(gH); Clauses 7, 30 and 122)

- Long-term insurance policies provide risk cover for life, disability, etc. and can structured to provide pure risk, investment or a combination cover. Most payouts should be exempt (as capital in nature).

- Consistent with SARS practice, a two-fold system is proposed:
  - If the premiums were paid with after-tax money, the proceeds will be tax-free in the hands of the beneficiary. Examples: The policyholder could not deduct the premiums, or the employee paid tax on the premiums as a fringe benefit.
  - If the premiums were paid with pre-tax money, the proceeds will be taxable in the hands of the beneficiary. Examples: The policyholder or the employee deducted the premiums paid for tax purposes.

Long-term insurance: Employer key person plans

(Section 11(w)(ii); Clause 33)

- Employers take out key person policies to protect the business against the loss of profits (loss of clients, hiring replacement costs, etc.). Generally, employers prefer a tax-free payout and are willing to give up an upfront deduction for the premiums

- Based on consultation with industry, the legislation will allow the employer a one-off election per policy to choose the deduction (and receive taxable proceeds). If no election is made, no deduction may be claimed and the proceeds will be tax-free.

- Because the amendments seek to address the current practical difficulties, special transitional relief will exist for pre-existing policies.

Share incentive schemes

(Section 10(1)(k)(i)(dd); Clause 30)

- There is ongoing refinement of the anti-avoidance rules relating to key employee share-based schemes, which allow employees to own a share in the employing company
- In 2010, anti-avoidance measures were enacted to prevent high-taxed salary income from being converted into low-taxed or no-taxed dividends using share-based schemes
- However, the 2010 measures appear to be catching legitimate deals, including situations where companies use trusts to hold shares for the benefit of rank-and-file employees involved in empowerment deals (without the dividends being used as a mechanism to strip share value in the hands of the employees)
- To remedy this over-inclusiveness, it is proposed that Treasury be given the regulatory authority to relieve share trusts from the new anti-avoidance legislation under specified circumstances

Road accident fund payouts

(Section 10(1)(gB); Clause 30)

- Road accident fund compensates victims of accidents for damages sustained in motor vehicle accidents, usually in the form of a lump sum payment viewed as capital.
- However, the fund plans to create an option for this compensation to be paid annually in the form of an annuity. According to current tax principles, an annuity must be taxed as income in the hands of the recipient.
- The proposal is to exempt all payments from the fund, whether received as a lump sum or via annual payments.

Employee compensation fund entities

(Section 10(1)(t)(xvi) of the Income Tax Act and Section 1 of the VAT Act - proviso (xi) to the definition of "enterprise"; Clauses 30(1)(r) & 137)

- Compensation are paid to employees for death or injury suffered in course of employment, by the *Compensation Fund* regulated under the Compensation for Occupational Injuries and Diseases Act (COIDA)
  - The Compensation Fund is tax-exempt; and
  - Contributions to the Fund are free from VAT.
- The *Federated Employee Mutual (FEM)(construction)* and *Rand Mutual Assurance (RMA)(mining)* are licensed (like the *Compensation Fund*) to provide employee compensation
  - The Compensation Fund is taxable; and
  - Contributions to the Fund are subject to VAT.
- *FEM* provides the benefits under COIDA while *RMA* provides additional benefits over and above COIDA.
- Because FEM operates on par with COIDA, it is proposed that:
  - FEM be tax-exempt; and
  - Contributions to FEM will be free from VAT.

Judicial long-distance commuting

(Paragraph 7(8) of the Seventh Schedule; Clause 111)

- Employees using employer owned vehicles are subject to a taxable fringe benefit (excluding distances covered for business purposes).
- Distances travelled between an employee's place of residence and work are not regarded as business travel.
- Judges are unique in that they are required to travel long distances to serve various courts placed far and wide and cannot be expected to shift their homes to shorten their shifting work locations.
- It is proposed that judges treat their daily commute as business travel if they keep a log book to record the distances covered.

Parliamentarian contributions to UIF

(Section 4 of the UIF Act; Clause 150)

- Currently, like most formally employed individuals, parliamentarians are also required to contribute towards the Unemployment Insurance Fund (UIF).
- The benefit afforded to the contributing individual is that when he or she is unemployed, they have access to draw benefits from the fund in the form of monthly payments based on their prior contributions.
- Parliamentarians however do not have this option available to them and it is proposed that since they are not able to draw on the benefit of the UIF, they should therefore not be required to contribute to the fund.

Business

Income Tax

Dividends Tax: General Background

- The Secondary Tax on Companies ("STC") imposes tax at 10 per cent on dividend declared by domestic companies (at company level)
- STC is to be replaced with the Dividends Tax system
  - as of 1 April 2012
  - STC credits will continue for a transitional period
- Dividends Tax ("DT") imposes tax at 10 per cent on dividends paid by domestic companies (at shareholder level)
- DT uses a withholding system in terms of which the company paying the dividend must withhold the tax on behalf of the shareholders

Dividends Tax:
Technical refinements

Notable issues:

- Timing switched from accrual to cash/constructive cash payment (Section 64E; clause 82(1)(a))
- In specie dividend: shift from shareholder liability to domestic company payor liability (i.e. no withholding mechanism (Sections 64EA and 64FA; clauses 83 and 85)
- Collective investment schemes holding dividends beyond a 12-month period will be taxed as ordinary revenue (usually to be applied against management fees) (Section 25BA; clause 59)

Technical:

- Definitions:
  - Domestic dividends and return of capital: focus on distribution by domestic companies (with certain exclusions)
  - foreign dividends and return of capital: reliance on foreign law characterisation
  - Share and equity share: introduction of similar equity interest concept to clarify exclusion of debt
- Collateral changes to the reorganisation relief provisions

Dividends Tax: Removal of the VET

(Repeal of part 18; clause 91)

- Current STC:
  - The STC contains automatic deemed dividends, including loans to shareholders to be taxed upfront (with exceptions)
- Pending Value Extraction Tax (VET):
  - The pending VET contains similar automatic deeming rules including loans to shareholders
  - However, all loan capital not taxed upfront (only below market element)
- Proposal:
  - Remove the automatic deemed dividend rules (i.e. the VET)
  - Company provision of value for the benefit (or on behalf of) shareholders will trigger a dividend based on the facts and circumstances
  - However, if a valid shareholder loan falls below market, the below market element will trigger an annual charge

Foreign Dividends (Matching to Domestic Dividends)

(Section 10B; clause 32)

- New Charge:
  - Foreign dividends will no longer be fully included as gross income (i.e. potentially taxed at 28% or 40%)
  - The tax on foreign dividends will now be subject to tax at a maximum of 10% (like domestic dividends)
  - The new charge will not be subject to withholding (only provisional tax and a year-end assessment top-up)
- Collateral issues:
  - Removal of the de minimus exemption for individuals
  - No deduction to be allowed for interest expenditure incurred in relation to the acquisition of foreign shares
  - Foreign dividends will be subject to the same anti-avoidance rules as domestic dividends (e.g. cessions, short-sales)

Capital Distribution Revisions

(Paragraphs76, 76A and 76B of the eighth schedule; clause 12J - 12

General

- A distribution from a company can either be dividend or a return of capital (i.e. from profit/growth versus a return of the initial tax investment)
- It is proposed that the tax treatment of capital distributions follow international practice
  - Capital distributions to be allocated against full base cost of underlying shares (partial allocation of base cost to be removed)
- Pre-CGT assets (i.e. shares acquired before CGT effective date):
  - Valuation rules: share deemed to be fully acquired as of date of capital distribution (effect: creation of expenditure going forward)
  - No subsequent change of valuation method

Special deeming rule for 1 July deemed dispositions

- The new rule base cost rule will apply to deemed capital distributions triggered at 1 July 2011 (the 1 July 2011 deeming rule stems from prior avoidance transactions)

CONTRIBUTED TAX CAPITAL ("CTC") REFINEMENTS

(Section 1 and paragraph 19 of the nineth schedule; clauses 7(11) (c) and (d); 116)

- Avoidance concern:
  - Companies receive dividends tax-free but are subject to capital gains charges for return of capital distributions
  - As a result, companies may never remove CTC to avoid capital gains (because CTC extraction is wholly elective)
- Buy-backs and liquidations:
  - Companies reacquiring their shares are deemed to transfer CTC equal to proportionate share of CTC in relation to that class of shares
  - All CTC deemed to be transferred in the case of liquidations (on pro rata basis in respect of each impacted class)
  - No capital losses allowed if losses arise as a result of an exempt dividend being paid 2 years prior to buy-back, liquidation or similar transaction (i.e. shareholders retiring their own shares back to issuing company)
- Ordinary distributions:
  - CTC remains a class-by-class allocation (not share-by-share)
  - CTC per share may never exceed the pro rata allocation associated with that class

Debt Cancellation: Background Issues

- Debts may be cancelled for various reasons, for example:
  - In return for services rendered,
  - As consideration for acquisition of an asset,
  - Out of gratuity or disinterested benevolence, or
  - Due to debtor's inability to pay
- Impact of debt cancellation
  - Ordinary revenue impact: reduction of ordinary losses or recoupment (inclusion in debtor's gross income) if allocable to a prior deduction
  - Donations Tax: if cancelled out of gratuity, donations tax at a rate of 20 per cent of fair market value of debt so cancelled
  - Capital gains impact: proceeds received by or accrued to debtor, reduction of expenditure of asset and capital gain
- Issues
  - Ordinary revenue impact: no causal connection between impact and reasons for cancellation
  - Donations tax: inconsistency with debt reduction rules in respect of the normal tax due to focus on market value

Debt Cancellation: Facts and Circumstances Impact

(Sections 1 and 62; paragraph 35 (1) of the 9th schedule; clauses 7(i) (N); 79 and 118)

- Income Tax adjustment:
  - Debt reduction or cancellation to be treated as ordinary revenue (i.e. a receipt or accrual) equal to the face value of reduced/discharged debt
  - Contingent debt assumptions to be included at market value
- Capital gains adjustment:
  - Debt reduction or cancellation to be treated as capital gains (i.e. proceeds) equal to the face value of reduced/discharged debt
  - Contingent debt assumptions to be included at market value
- Donations Tax adjustments:
  - Amount taken into account at face value (not fair market value)
- Trigger will be based on the facts and circumstances for the cancellation or assumption (cancellation for services, assets, etc…)

Taxable Business Sales: Background

- Commercial background
  - Taxpayers selling a company may either sell the company shares or sell the underlying business assets
  - Buyers prefer assets to avoid business fixed and contingent liabilities (and to eliminate the company double tax)
  - Sellers prefer to sell the shares (to remove fixed and contingent liabilities and to eliminate the company double tax)
- Tax issues:
  - Who can deduct the expenses associated with the liabilities? Seller, buyer or both?

Contingent Liabilities: Business Assumption Proposal

(Sections 115 and 24(A); clauses 36 and 53)

- Seller
  - The seller increases the gain on the sale for liabilities assumed by the purchaser (at market value)
  - The seller can deduct the cost of the contingencies (with the lower sales price viewed as a cost incurred)
- Purchaser
  - The purchaser cannot generally deduct the contingent costs assumed (this result is accomplished through an allowance tracking mechanism)

Urgent Change: Section 45 Suspension (Section 45; Clause 75)

- The Bill suspends section 45 rollovers from 3 June 2011 until close of 2012
  - 3 June 2011 date is the date of publication of the draft TLAB
  - This date of suspension also subject to clause 75(1)(1)(b) in TLAB being enacted.
- Timing:
  - Not announced in February 2011
  - Urgent action due to rising tide of avoidance (reports coming through after February)
  - Each tax avoidance deal can wipe out a company's income for many years to come
- Related action: Preference share schemes (announced in February)

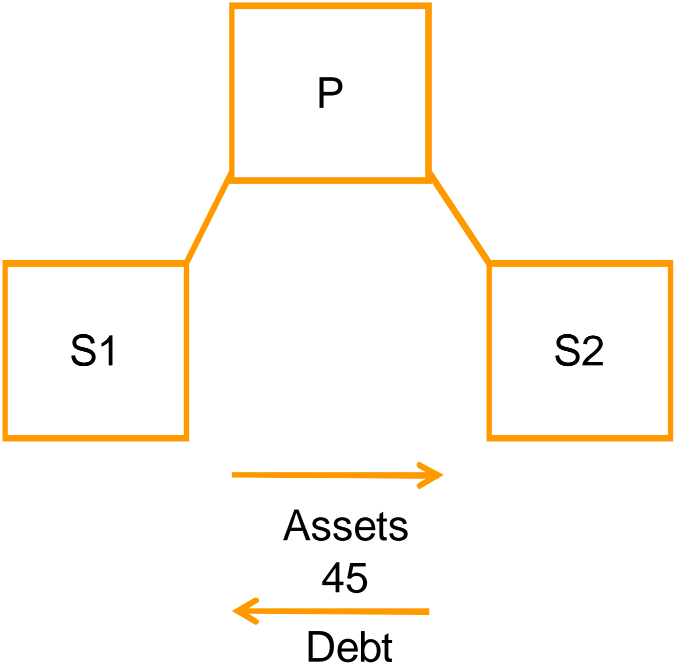
Section 45: Weighing Impact

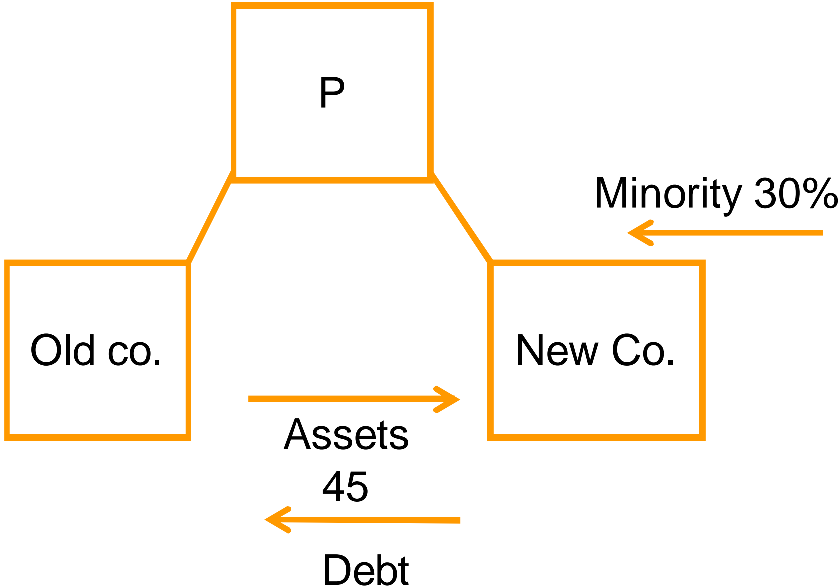
- Suspension decision not taken lightly
  - Treasury rarely takes action of this kind (last time was several years ago in relation to treaty avoidance)
  - While we understand the needs of commerce, the fiscus must be protected against unintended outflows
- Beware of labels
  - Some expensive avoidance deals are cloaked in BEE
  - LBOs can often be driven by financial engineering (including tax manipulation) as opposed to value addition
  - Many of those hardest hit are the dealers making the greatest revenues from the most aggressive deals

Need for Facts

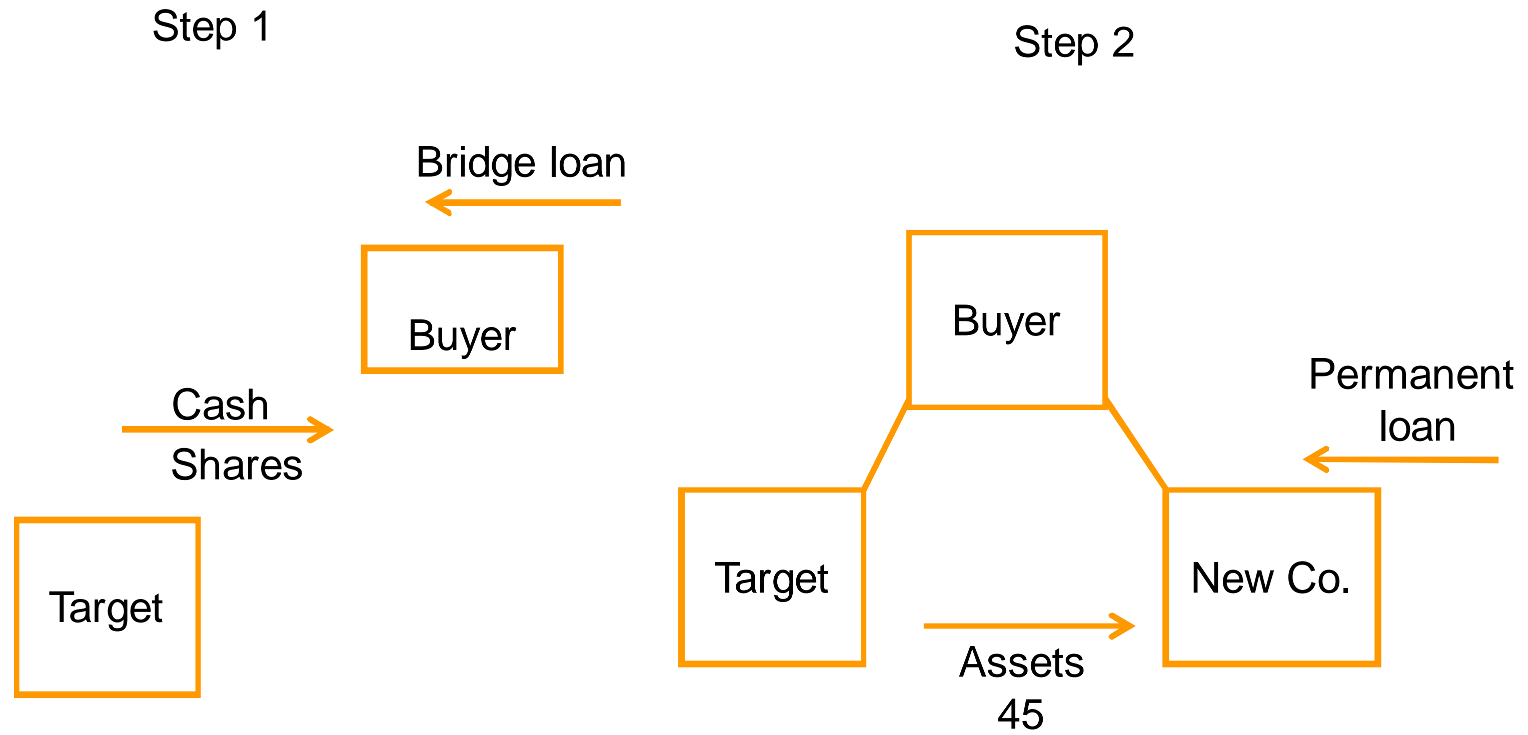
- While the suspension option is an option of last resort, the goal is to force open:
  - The facts of the good deals
  - The facts of the problematic deals
- Only with enhanced “factual” information, a better long-term (and possibly short-term) becomes possible
- Note:
  - Treasury has been concerned about the misuse of section 45 since 2006/7
  - The avoidance game is often one of “hide and seek” with taxpayers quick to complain about anti-avoidance efforts but slow to provide meaningful assistance

Initial Purpose of Section 45 Rollovers





Section 45 as an Acquisition Technique



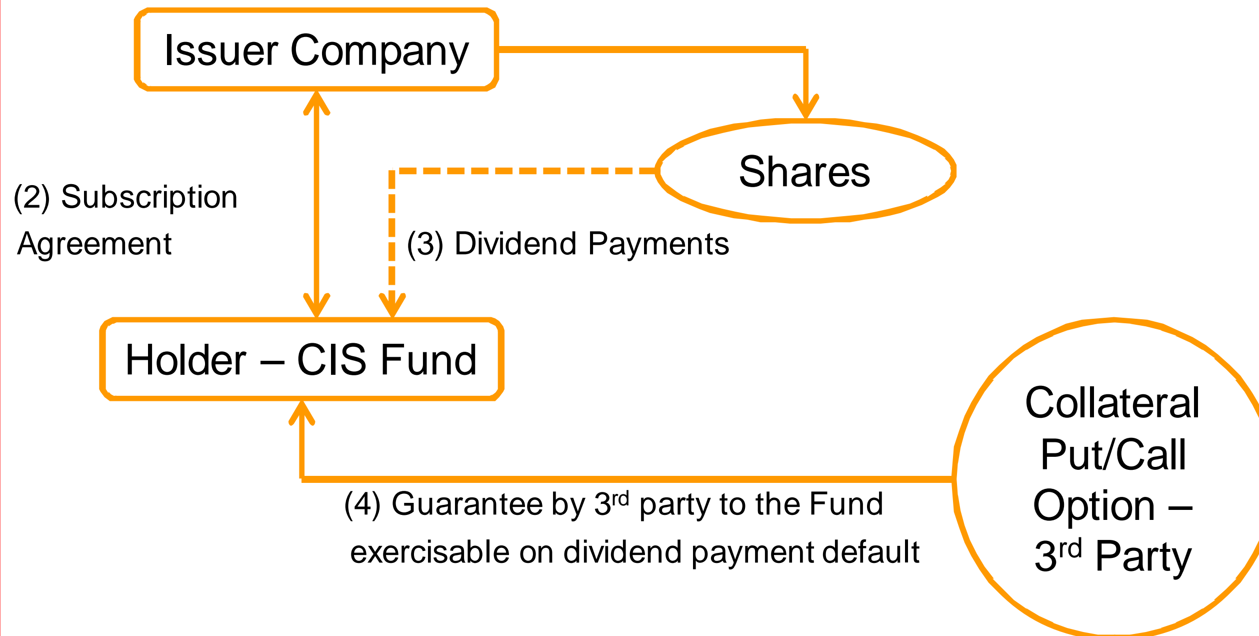
Section 45 as Switch

- Section 45 must be seen in context as part of a larger problem
- Debt/shares
  - Most taxpayers effectively view the label of “debt” or “share” as essentially elective regardless of the terms of the underlying instrument
  - A book/tax disparity often exists in term labels
  - The power to change labels at will (with the layering of entities) essentially allows taxpayers to freely move income as desired
- Section 45 acts as the switch to link debt to taxable assets or separate debt from exempt assets at a large scale (often with an alleged business purpose)

Minuses (-) and Pluses (+)

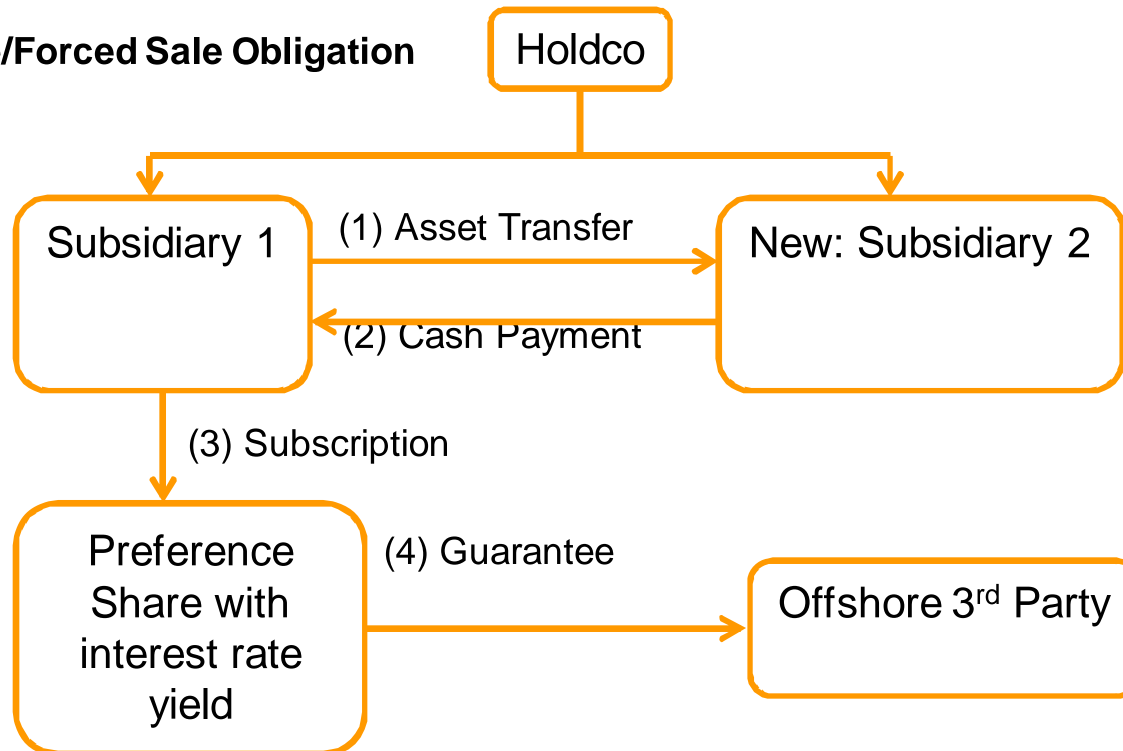
	Payor	Payee
Debt	(-)	(+)
Shares (equity)	0	0

Anti-Avoidance: Third Party Backed Dividends



Anti-Avoidance: Third Party Backed Dividends

2. Guarantee/Forced Sale Obligation



Anti-Avoidance: Third Party Backed Dividends (Sections 8E and 8EA; Clauses 20 and 21)

- **Background**
  - Debt and Equity instruments have different features and consequences
  - Specific rules deem (i) tainted dividends as interest and (ii) tainted interest on debt with equity features as not deductible; but these anti-avoidance rules do not if the instrument is exercisable only after 3 years (easy to avoid)
  - Dividends backed by 3rd parties raise similar concerns to dividend cessions since shareholder lacks meaningful stake in the share issuer
- **Proposals**
  - Dividends backed by third parties are treated as ordinary revenue
    - Without regard to the 3 year rule
  - Third party backing is present if
    - Holder can require a 3rd party to acquire the shares
    - Holder can facilitate disposition of the share
    - Holder can rely on 3rd party guarantee on the shares
    - The credit risk of the instrument is based on a 3rd party
  - The three year rule is extended to ten years for non-3rd party backed debt

Anti-Avoidance: Dividend Cessions

(Proviso (ee) to sector 10(1) (k) (i); clause 31 (I)(N))

- Problem:
  - Certain taxpayers (mainly financial institutions) purchase dividends after declaration
  - The sole purpose of the acquisition is to acquire tax-free amounts (that are usually indirectly linked to interest deductions)
  - But for tax, no meaningful commercial reason exists for these transactions
- Proposal:
  - Dividends will no longer be tax-free for companies if these companies do not hold the shares between dividend declaration and payment
  - A 45 day period is required for trading stock shares
  - The goal is to impose ordinary treatment if the recipient lacks any meaningful stake in the underlying shares

Anti-Avoidance: Dividends from Short Sales

(Provisors (FF) and (GG) to section 10(l) (i); clause 10(l)(N))

- Background
  - Taxpayers may borrow shares (by purchasing shares and promising resale to the lender at a set value)
  - Any dividends received by the borrower must be repaid to the lender (as a manufactured payment)
  - Schemes exist that create the possibility of tax-free dividends in respect of borrowed (or identical shares) with an obligation to pay deductible manufactured dividends (i.e. the result is economic neutrality with a tax-loss)
- Proposal
  - Dividends received from borrowed shares (or identical shares) will be fully taxable
  - Again, the taxpayers lack any meaningful risk in the underlying shares generating the dividend

Anti-Avoidance: Debt without maturity dates – Formula

(Section 8(31) and 24J definitions; clause 23; 57(l) (a) (b) and (e))

- Interest income/deductions are calculated according to a formula
- Formula
  - Taxpayers must know initial investment (i.e. amount lent)
  - Total payments to be repaid
  - Time period for repayment (requiring a maturity date)
  - Once, these factors are known, a deemed interest yield/charge is determined on a per annum basis
- Scheme – Create instruments without a maturity date, as follows:
  - Perpetual debt
  - Contingent dates
  - Repayment on demand

Debt without maturity dates: Proposal

- Perpetual debt
  - This form of debt (i.e. where the principle never has to be repaid) essentially is akin to shares
  - Payments are no longer deductible/receipts and accruals are treated as dividends
- Contingent debt
  - Look to the date that the debt is most likely to be discharged based on all the probabilities
- Debt repayable on demand
  - A deemed one-year maturity date applies

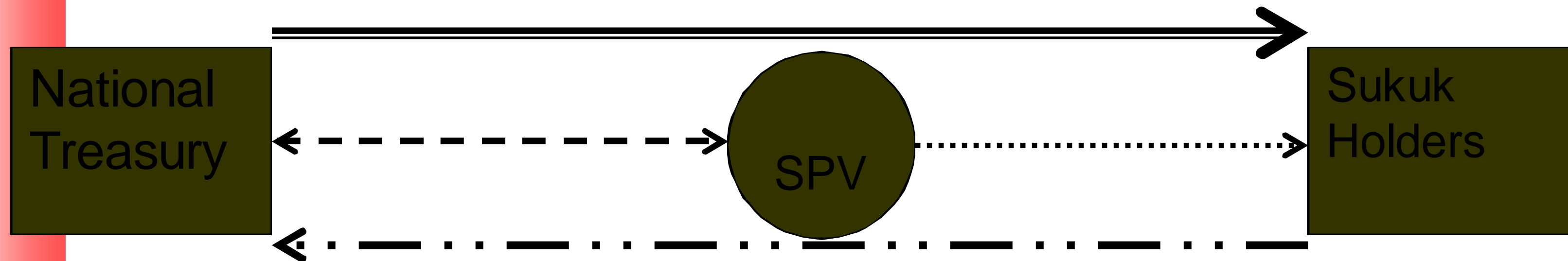
Islamic Finance: Government Sukuk

(Section 24JR; clause 58 (I)(e))

- Revised taxation of Shariá compliant arrangements were introduced in 2010 to provide parity of tax treatment with traditional products
- Islamic banks also require a risk-free standard (typically utilising interest-based Government bonds) for portfolio balancing and cash-flow regulation
- It is proposed that a Government Sukuk be introduced:
  - The yield will mimic the tax treatment of interest
  - Individuals will be entitled to the annual de minimis exception
  - Foreign persons will be entitled to the exemption (but the initial bond will only be available domestically)

Proposed Government Sukuk Structure

(Section 24JA; clause 58(I)(c))



- Step 1: identification of immovable property to pledge in market and establishment of SPV by National Treasury
- Step 2: transfer of usufruct in immovable property to SPV, issuance of Sukuk certificates by SPV to Sukuk Holders for cash and transfer of cash proceeds from Sukuk issuance to National Treasury by SPV
- Step 3: lease agreement entered into between SPV and National Treasury
- Step 4: payment of rental by National Treasury to SPV
- Step 5: payment of rental income received by SPV to Sukuk holders
- Step 6: redemption of Sukuk at end of lease term and return of asset or usufruct by SPV to National Treasury

Islamic Finance: Residuals

(Sections 18A (I) and 24JA(I);clause 49 and 58(I)(a))

- Murabaha:
  - Murabaha finance will be extended to cover all transactions with banks (either as financier or as client)
  - Rules associated with indirect taxes to be clarified
- Effective date:
  - Revised taxation for Islamic finance is still set for a date to be set by the Minister
  - This date will be aligned to the promulgation of the 2011 TLAB
- Collective Investment Schemes
  - Due to religious prohibitions, Islamic collective investment schemes donate impermissible income (interest and dividends derived from interest)
  - The tax law will be changed to allow for deductible contributions up to 0.5% of the weighted average of scheme value (as opposed to the 10% taxable income limit)

Incentive: Industrial Policy Project Revisions

(Section 12I(2); Clause 41)

Background:

- An additional tax allowance was introduced in 2008 in order to encourage large industrial projects
- The incentive offers special tax benefits (i.e. additional deductions) to new industrial projects and expansions/upgrades
- The DTI introduced the Industrial Development Zone (IDZ) regime to encourage industrial development within certain geographical areas, but the incentive has not reached its desired objectives

Proposal:

- The additional allowance for both new industrial projects (i.e. a 100% additional allowance) and expansions/upgrades (i.e. 75%) in IDZs
- The scoring criteria will also be changed to promote IDZs
- Other adjustments (for training allowances and deadweight losses) will be made to fix minor anomalies

Incentive: Venture Capital Company Revisions - Background

(Section 12J; Clause 42)

Problem:

The Venture capital company (VCC) regime was enacted in 2008 to act as an investment pool to encourage investment into small businesses and junior mining companies:

- The regime requires the VCC to use its shareholder funding (for 5-10 years) to fund small businesses and junior mining companies until they grow to a level when the VCC may sell them for a profit
- The VCC regime has been largely unsuccessful
  - Few applications have been made
  - No VCC has been successfully created to date

Overall Proposal:

- The VCC regime will be greatly liberalised
- This liberalisation will occurs at three levels: (i) at the investor-level, (ii) at the VCC level, and (iii) at the small business/junior mining company level

Incentive: Venture Capital Company Revisions – Proposals

1. Investor criteria
   - General ceilings and anti-entity prohibitions will be removed
   - At-risk criteria to be added to ensure meaningful economic investments
2. VCC criteria
   - VCCs will be allowed to list
   - VCCs will be permitted to form part of a group of companies with subsidiary company investments
   - VCCs will be allowed to hold more than 20% of their funds as passive income on an annual basis
3. Qualifying investee companies
   - The maximum book value thresholds that qualifying small businesses and junior mining companies are permitted to have will be increased (from R10million to R20million and from R100million to R300million respectively)
   - The restriction on the ownership by a VCC of a qualifying company will be decreased from 70% to more than 50%
   - VCCs will be able to invest in qualifying companies that operate as franchisees

Incentive: Research and Development Revisions – Background

- The income tax system contains an incentive to promote R&D in South Africa
- The incentive contains two main aspects:
  - A deduction for non-capital expenditure incurred by taxpayers (including funder-fundee arrangements) in respect of R&D activities
  - A accelerated write-off for assets that the taxpayers uses for R&D buildings, plant, etc…
- The definition of R&D has given rise to many problems
  - Many taxpayers are claiming relief for only peripheral R&D activities resulting in a large deadweight loss
  - SARS is challenging many claims on audit creating uncertainty for many taxpayers
- The incentive has also given rise to other anomalies
  - Funding of R&D by outside parties seemingly gives rise to a recoupment, thereby reversing the intended benefit

Incentive: Research and Development Revisions Proposal

(Section 11D; Clause 35)

- R&D definition
  - The definition will be changed to clarify inclusions and exclusions (thereby eliminating peripheral items such as overheads)
- Automatic deductions
  - Taxpayers will receive a full deduction (without pre-approval being required) for expenditure in respect of R&D activities if the expenditure meets specific criteria
  - R&D plant and machinery will automatically receive the same depreciation write-offs as manufacturing
- Additonal allowances
  - Taxpayers conducting R&D activities will qualify for an additional allowance (i.e. an additional 50%) with DS&T approval
  - Taxpayers funding R&D will also qualify for the additional allowance if funding:
    - Universities or certain Government-owned entities (e.g. CSIR); or
    - Group companies (with the funded entities forgoing the additional allowance)
  - Taxpayers will also receive an additional allowance (i.e. an additional 50%) for creating/building or improving an R&D facility

Incentive: Film Production Revisions - Background

(Section 12O; Clause 43)

Problem:

- As an incentive, the income tax system contains a 100% upfront deduction for domestic film production expenditure
- The incentive has been unsuccessful because the incentive primarily focuses on cost with taxpayers seeking to artificially inflate costs through various financing schemes
- Genuine investors have been discouraged from using the incentive because of the audit risk arising from SARS attempting to prevent ongoing abuse

Overall Proposal:

- The upfront deduction for film production expenditure will be removed and replaced by an exemption
- This proposal will contain a 5-year sunset clause (plus reporting requirements to monitor the success/risks of the incentive)

Incentive: Film Production Revisions - Proposal

1. Film requirement
   - Taxpayers will benefit from the incentive for films produced as a feature film, documentary or animation
2. Pre-approval required
   - All qualifying films must be approved by the National Film and Video Foundation (NFVF) for taxpayers to qualify for the exemption
     - Must be a South African production; or
     - Co-production
   - The NFVF will be responsible for the oversight of all film incentive applications
3. Initial investors
   - The exemption only applies to investors (holding exploitation rights) at the beginning of film production since these investors take initial risk
   - Broadcasters (and their connected persons) do not qualify for the exemption as these parties represent a deadweight loss
4. Exploitation rights
   - Investors will qualify for the exemption only in respect of exploitation rights associated with the film
   - The exemption will apply if the profits are wholly dependent on the success of the film (not disguised salary or interest)

Small business: Micro-business turnover tax relief – current & proposed rates

(Paragraph 7 of Appendix 1)

Taxable turnover	Rate of tax (current)
R0 to R100K	0% of taxable turnover
R100K to R300K	1% of amount above R100K
R300K to R500K	R 2 000 plus 3% of amount above R300K
R500K to R750K	R 8 000 plus 5% of amount above R500K
R750K +	R20 500 plus 7% of amount above R750K

Taxable turnover	Rate of tax (proposed)
R0 to R150K	0% of taxable turnover
R150K to R300K	1% of amount above R150K
R300K to R500K	R 1 500 plus 2% of amount above R300K
R500K to R750K	R 5 500 plus 4% of amount above R500K
R750K +	R15 500 plus 6% of amount above R750K

Small business: Micro-business turnover tax relief

(Sixth Schedule; Clauses 106, 108 & 109; VAT Clause 139, 141 & 148)

- Turnover tax (business with turnover up to R1 million) was introduced to assist small business and informal sector with lower tax rates and less administrative burdens like VAT returns when entering the tax system.

- Very few business opted for turnover tax due to its restrictions such as not being able to register for VAT if you are using this tax and most credible businesses require VAT registrations.

- More favorable tax rates are proposed and additional measures to encourage registration; for example, business may now be VAT registered and use this system and SARS will have the discretionary power to register businesses which do not voluntarily register for tax.

International

Income Tax

African Gateway: Unification of Source Rules – Background (Section 9; clause 24)

- The source of income is currently determined with reference to common law;
- The income Tax Act does not comprehensively define the term “source” but contains deeming rules that add some categories of income to domestic source
- Current rules give rise to uncertainty and additional costs with no benefit to the fiscus (often creating unintended double taxation)
- The source rules are based on the pre-2001 source plus system; whereas, the tax system is now based on residency (minus)

African gateway: Unification of source rules

- New uniform system of source rules uses OECD treaty principles as a starting point
- Dividends: Source based on residence of payor
- Interest: Source based on the residence of payor or a location of permanent establishment
- Royalties based on the residence of the payor or location of right of use
- Services: Location where services are rendered
- Gains from disposals:
  - Immovables – location of property
  - Movables – residence of party making disposal or location of permanent establishment
- The common law applies as a residual method for undefined categories of income

African gateway: Foreign rebates for management fees

(Section 6quin; Clause 12)

- **Background:**
  - South Africa residents taxed on world-wide income;
  - However, they are entitled to tax credit for taxes paid offshore; no foreign tax credits available in respect of South African sourced income
  - Many African countries impose withholding taxes on South African management services (despite treaties to the contrary); the result is double taxation
- **Proposal:**
  - Limited foreign tax credit will be introduced;
  - Foreign tax credit to be limited to foreign withholding taxes on services rendered in South Africa;
  - Excess foreign tax credit carry-forward not allowed

African gateway: Timing of foreign rebates

(Section 6quat; Clause 11)

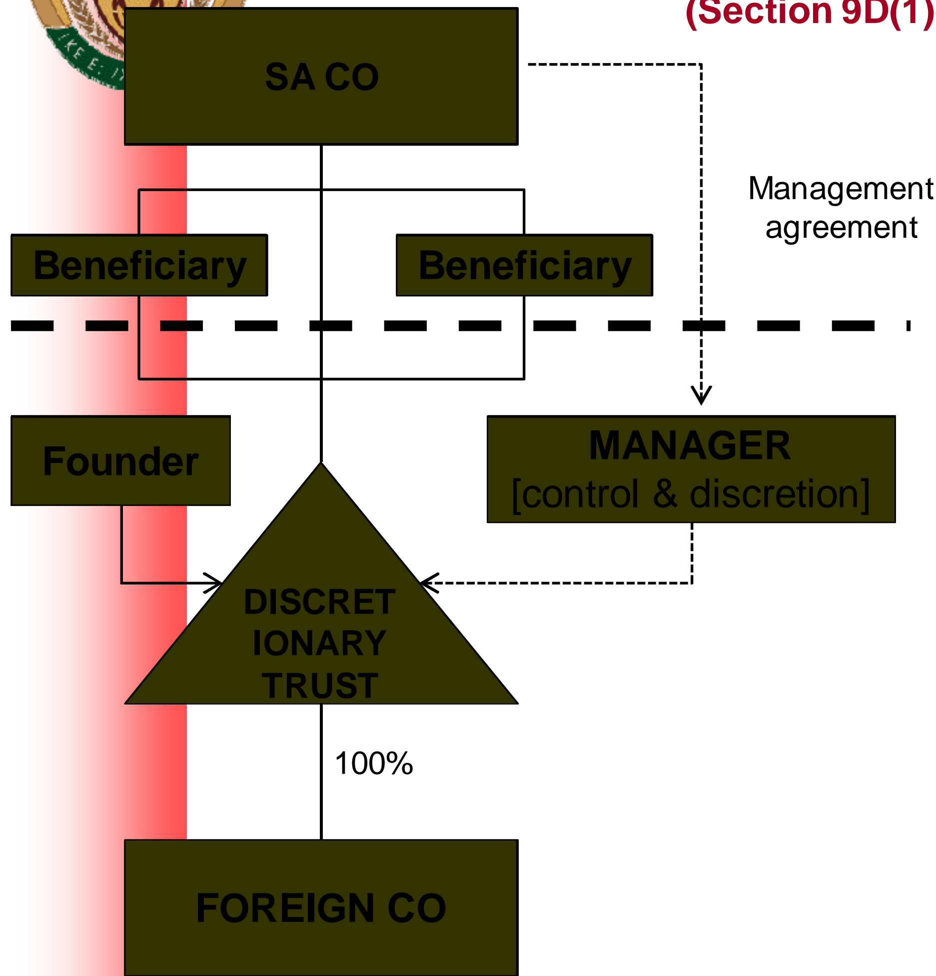
- **Background:**
  - Foreign tax credit system contains special rules to prevent timing mismatches between SA and foreign tax system;
  - However, these special rules are incomplete, mainly focusing on foreign tax deviations relating to disputes;
- **Proposal:**
  - Foreign tax rebate rules will be adjusted;
  - Rebates will be matched against the year in which the foreign taxable income is recognised (very important for withholding taxes imposed on a cash basis when South Africa taxes on an accrual basis)

African gateway: Headquarter company adjustments (section 9I; clause 29)

- The 80 per cent asset and receipts/accruals test will be relaxed;
- Pre-approval by either SARB or NT will be required for companies formed after 1 January 2011 (and will be given unless there is an erosion of the tax abse);
- Pre-existing companies will enter the regime upon approval by NT provided they meet certain conditions namely:
  - Enhancing SA as regional headquarter destination;
  - Creation of additional skills and
  - No erosion of the SA tax base;
- NT will require annual reporting in order to measure the success and risks of the regime

CFCs: Closure of de facto control schemes

(Section 9D(1)(cfc definition); Clause 27(1)(b))



Proposed use of de facto IFRS to create CFC status to create "control"; income attributed to a single controlling entity

CFCs: Tainted Income (business versus non-business) (Section 9D(9A)(a); clause 27(1)(o))

- Business Establishment Test:
  - Business establishment income remains exempt but the law clarifies that the income must be attributable to that establishment using section 31 arm's length principles
  - The section 31 "full inclusion" penalty will be removed
- Diversionary rules:
  - Focuses solely on the importation of goods and services; exports will no longer be subject to these anti-avoidance rules
  - CFCs associated with imported goods and services must satisfy a permanent establishment standard if within a low-taxed jurisdiction
  - Attribution to a permanent establishment must again be based on section 31 arm's length principles

CFCs: New paradigm for passive income

(Section 9D(9A)(a); clause 27(1)(o))

Principles

- Focus on the mobility of the relevant income stream
- Mobile income taxable unless specific exemptions apply

Specifics:

- Financial instruments: Taxable unless:
  - attributable to a bank or credit provider (other than a Treasury operation)
  - Part of working capital (using a 5% gross test)
- Insurance premiums: Taxable unless:
  - Attributable to an insurer (other than a captive)
- Rental of movables: Generally taxable unless an operating lease
- Intellectual property: Generally taxable unless: regularly engaged in intellectual property development

CFCs: Offshore cell companies

(Section 9D(1)("offshore cell company" definition); Clause 27(c) & (e))

- **Background:**
  - Offshore cell companies operate as multiple limited liability companies, separated into legally distinct cells
  - The cell companies are often found in low tax jurisdictions;
  - The cell company is a single legal; an entity that operates in two distinct parts, namely core and the other cells,
  - Cell companies normally issue two classes of shares namely ordinary voting shares and non-voting preference
- **Proposal:**
  - Each offshore cell will be tested as a separate foreign company for all section 9D purposes;
  - Stated differently, the more than 50 per cent control test will be measured cell-by-cell;

CFCs: Offshore restructuring

(Section 41-47, paragraph 64B of the 8th Schedule; Clauses 73,74, 76, 77 & 124)

- The proposed amendment extends the rollover reorganisation rules to cover the movement of controlled foreign companies within a group under the control of a South African parent:
  - The movement of foreign shares to CFCs
  - Amalgamations to CFCs (or onshore)
  - Liquidations to CFCs (or onshore)
  - Unbundlings to CFCs
- No section 45 intra-group relief
- The capital gains participation exemption will no longer apply to intra-group movements (only to disposals to independent foreign persons)

Foreign currency issues

(Section 24I and repeal of Part XIII of the 8th Schedule: Clauses 56 & 132)

- Acquisition of foreign shares:
  - Liberalise waiver of recognition for currency exchange differences in respect of hedges relating to the acquisition of foreign equity shares.
  - Remove the 20% acquisition and 50% control requirements in favour of overall 20% holding after acquisition requirement
- Monetary and non financial assets:
  - Unify the mark-to-market waivers for foreign currency monetary items associated with non-financial assets
  - i.e. Eliminate the recognition of exchange differences
- Repeal of current capital gains for individuals:
  - Repeal of recognition of currency gains and losses for individuals; compliance costs outweigh benefits to the fiscus
  - Revenue currency gains and losses of all trusts (other than special trusts) will now be fully recognised under the mark-to-market regime

Transfer Pricing Adjustments

(Section 31; Clause 62)

- **Background:**
  - The transfer pricing rules were modified in 2011 to be aligned with OECD principles
  - The revised regime looks at all parties to the arrangements and adjusts the overall pricing to reflect true substance
- **Proposals:**
  - The effective date will be moved from October 2011 to 1 April 2012
  - Correlative adjustments:
    - SARS is empowered to make secondary adjustments if circumstances so require
    - The automatic deemed dividend rules will be removed
  - The regime will be extended to explicitly cover all taxes within the Income Tax Act (not just the normal tax)

Taxpayer migration

(Section 9H; Clause 28)

- **Background:**
  - All taxpayers are subject to an exit capital gains charge if leaving South African taxing jurisdiction (with exemptions for assets remaining within South African taxing jurisdiction)
  - Companies are also subject to a deemed dividend charge
- **Proposal:**
  - The new exit charge will now also trigger an ordinary revenue charge for trading stock assets
  - The deemed dividend company charge will be eliminated (as overly inclusive)

Cross-Border Interest Withholding Adjustments

(Sections 37JA – 37N; Clauses 67 - 71)

- **Background:**
  - In 2010, Government introduced a withholding tax on interest at the rate of 10 per cent
  - The new withholding tax will take effect from 1 January 2013
  - Some issues relating to the administrative mechanisms are still outstanding, including: the nature of the liability, payment due dates and provision for refunds
- **Proposal:**
  - Beneficial owner will primarily be liable for the payment of the tax (but relieved by withholding)
  - Payment due date will be the close of the month following the month in which interest is paid to beneficial owner
  - Three-year limit for refunds from SARS is proposed

Value Added Tax

Delinking VAT from Transfer Duty – Background (Section 16(3) of VAT; Clause 145(1)(b))

- Vendors acquiring second hand fixed property from a non-vendor pay transfer duty, because the seller is not a vendor
- Vendors qualify for a notional input tax credit when acquiring property from non-vendors if the vendor uses the fixed property for enterprise purposes
- Tax credit is capped to the transfer duty paid and is only claimable when the transfer duty has been paid by the acquiring vendor.
- The notional input tax credit alleviates tax cascading, but was capped to prevent the inflating of fixed property prices to claim increased credits
- The cap may prevent the vendor (buyer) from being fully compensated for the VAT paid by previous owners (that is locked into the price)
- If the price of the fixed property is less than R600 000, no VAT input credits are allowed because the transfer duty is not applicable

Delinking VAT from Transfer Duty – Proposal

- Notional input tax credit will be based on fair market value and no longer capped by a Transfer Duty ceiling
- However, for this revised rules to apply, the fixed property must first be transferred into the vendor's name at the deeds office/registry.

Example: A vendor who buys fixed property for R1 million from a non-vendor would be liable for transfer duty of R30 000. The notional input tax credit would have been capped to the R30 000 transfer duty paid. In future the tax credit would be the tax fraction (14/114) of the fair market value. The notional input tax credit will therefore increase to R122 807 to release the full deemed VAT locked into the price.

Relief for temporary rentals by developers of residential fixed property

(Section 18B of VAT; Clause 146)

Background:

- Developers of residential fixed property prepared for sale are sometimes forced to temporarily rent the property to cover costs, especially if sales are slow
- The change to “exempt” residential rental use creates a deemed VAT charge at market value of the fixed property.
- This ‘forced’ deemed charge has placed some developers in a precarious financial situation.

Proposal: An interim short-term solution is granted to developers whereby fixed property may be temporarily rented for residential purposes for a maximum period of 36 months, provided the intention remains to sell the property (i.e. the developer does not permanently change his intention from selling to rental).

Note: This relief may have to be adjusted to ensure that the vender is a developer regularly engaged in development and sale as opposed to vendors engaged in occasional developments

Import-related issues

(Sections 13(2A), 13(2B) and Schedule 1(2) of VAT; Clauses 143, 144and 149)

1. **Synchronising VAT & customs for temporary import relief**
   - **Background**: VAT exempts goods temporarily imported into SA for manufacturing, processing, finishing, etc… as long as the goods are subsequently exported. Customs administers the VAT exemption but cannot clear the goods in terms of the Customs Act because the goods are duty free (only dutiable goods can be cleared).
   - **Proposal**: A provision will be put into the VAT and Customs Act to synchronise both regimes to effectuate the VAT exemption

2. **Minimum VAT exemption for imported services**
   - **Background**: Goods imported into SA that are less than R100 per parcel enjoy an exemption from import VAT – no comparable exemption exists for imported services.
   - **Proposal**: An exemption for services will apply at R500 per supply and the value of goods enjoying exemption is increased to R500 (per parcel).

3. **Intra-warehouse transfers of ownership**
   - **Background**: Customs duty applies to the initial value of goods imported and entered into a storage warehouse (when goods are entered for home consumption). *Risk* – goods may be sold whilst in storage for a higher value.
   - **Proposal**: If goods are sold intra-warehouse, VAT must apply on the higher of the initial value or the value of the goods sold to the buyer intra-warehouse.

Miscellaneous

(Section 11(n)(i), 16(3)(i) and 22; Clause 142, 145(1)(c), 147)

1. **Removal of the 12 month deemed charge in respect of unpaid debt between group members**
   – **Background**: A deemed charge exists for debts that remain unpaid after 12 months. After this point, the indebted vendor pays-back the input tax claimed to SARS in respect of supplies previously received
   – **Proposal**: Deemed charge is restrictive for a group of companies, and will be relaxed –*But*: the creditor/supplier cannot claim a bad debt write off of the unpaid debt owed by a group debtor until the debtor pays back the VAT to SARS.
2. **Input credits in respect of redeemed coupons**
   – **Background**: VAT input deductions for manufacturer/producer issued coupons are problematic. The manufacturer refunds the agent the discount allowed in respect of such token and claims a VAT input but should only do so if the underlying supply is taxable at 14 per cent (not zero per cent)
   – **Proposal**: The deduction of input VAT by the issuer (when a refund to the agent occurs) is now allowed when the underlying supply is taxable at 14 per cent
3. **Removal of superfluous zero rating for mining right renewal**
   – **Background**: Zero rated relief was granted for mining rights conversions or renewals to take into account the requirements of the Mineral and Petroleum Resources Development Act which required conversion of old order rights to new order rights. This led to abuse.
   – **Proposal**; The zero rating for conversions or continuation of rights will remain (but will be limited to where the rights do not change hands) but the renewal of the rights will no longer be allowed relief in order to forestall any abuse that may occur

Other indirect taxes

Transfer Duty, Securities Transfer
Tax and Gambling

Transfer Duty Relief

(Sections 2(1) and 9(1)(l); clauses 2(1)(b) and5(1)(a))

- Rates
  - Exemption is raised from R500 000 to R600 000
  - A 3% rate now applies from R600 000 to R1 million
- Entities
  - Companies and trusts are now subject to the same rates as natural persons
  - Transfer duty "asset-for-share" transfers for company shares are now permitted

Securities Transfer Tax: Expanded Broker Relief (Temporary)(Section 8(1)(q) of the STT; Clause 154(1)(b))

- Background
  - Brokers acting for their own benefit are exempt from STT in order to encourage brokers as market makers
  - Certain financial institutions utilised these brokers as "principals" with all risks/profits of the shares are located elsewhere
- Proposal
  - In order not to disrupt the market, the STT exemption is expanded to cover all broker actions as "principal"
  - Relief lasts until close of 2012 to examine whether the exemption needs to explicitly cover other forms of market making

Coming Attractions

Issues not covered in the TLAB
but coming in next tranch of bills
later this year or next year

Retirement reform:
Uniform retirement contribution base options

- It is proposed that the current retirement savings tax incentive be amended within the broader retirement reform framework in regards to the following:
  - The tax treatment of an employer's contribution on behalf of an employee (i.e. inclusion as a fringe benefit)
  - Uniform deduction limits for retirement savings (for employees and small business owners)
  - Limited deductions in respect of high income earners

- Different options (including the Budget Review option of 22.5%/R200 000) will be presented for public discussion (pending July 2011).

Retirement reform: Uniform retirement withdrawals (i.e. provident funds)

- Currently, pension and retirement annuity funds allow the retiring member to take 1/3rd as a lump sum and purchase an annuity with the rest.
- Provident funds however, allow the member to take the full amount as a lump sum upon withdrawal.
- Pending discussion document (July 2011) as require more consultations:
  - To create uniformity and to ensure that retired individuals have sustained sources of income during their retirement years, it is being considered that provident funds be subject to the same withdrawal rules as pension and retirement annuity funds.
  - Transitional measures will be provided to protect existing members.

Gambling Tax (NOT COVERED IN TLAB)

Background:

- Announcement in Budget 2010 that taxation of gambling will be reviewed to ensure efficient tax collection.
- National Treasury work in progress, particular emphasis on the role of taxation to address gambling externalities.
- dti paper on gambling to be made available
- Two-fold tax policy objective – To tax gambling winnings as compared to other forms of windfall income, plus internalisation of some of the social costs associated with problem gambling.

Initial proposal:

- All gambling winnings above R25 000, including from the National Lottery, will be subject to a final 15% withholding tax with effect from 1 April 2012.
- Details on the design and implementation of the gambling tax are being finalised through consultations with both government and gambling industry stakeholders to ensure the most administratively viable mechanism

Administration

- The Tax Administration Bill to be introduced later this month deals with the bulk of the administration related changes announced in this year's Budget
- Two issues relating to Customs are dealt with in the draft TL2AB:
  - Adjustments to the secrecy provisions relating to the enforcement of anti-money laundering legislation and of legislation regulating the movement of goods or persons into or out of South Africa
  - The continuation of rules made to underpin the SARS Customs modernisation process during the period 1 June 2010 to 31 July 2011. The only rule made in the period to date relates to the production to SARS of an exporter's clearing instructions to his/her customs broker
- An additional matter that has been the subject of industry consultation and may be included later, depending on procurement proceedings, relates to the replacement of the "diamond mark" on cigarette packages with a counterfeit-resistant digital system

Conclusion

- It should be remembered that these Bills are part of a larger package
  - Alleviating the burden for the middle class (PIT relief)
  - Incentivising savings (monetary thresholds retirement drawdown accounts, long-term insurance, etc…)
  - Promoting growth and jobs (industrial project, R&D, African Gateway, learnerships, etc..)
  - Promoting equity and fairness, and protecting the tax base (section 45, third party preference shares)
- It should also noted that this briefing (and publishing of draft TLAB) is only the start of the consultative process
  - Public comments, hearings, workshop and (where necessary) individual consultations lie ahead
  - Followed by adjustments based on public comment to be reported in the response document in late July/August