national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Media Statement

Taxation Laws Amendment Bills 2010

National Treasury releases for public comment a draft of the 2010 Taxation Laws Amendment Bills which give effect to the 2010 Budget tax proposals. The draft legislation and explanatory memorandum can be found on the National Treasury (www.treasury.gov.za) and (www.sars.gov.za) websites.

The draft 2010 Taxation Laws Amendment Bills are published for public comment before formal introduction in Parliament. The Standing Committee on Finance convenes informal hearings on these draft Bills and considers public comments received. The Bills are then revised by the National Treasury to take account of the public comments and presented to the Committee in a response document before the revised bill is formally introduced by the Minister of Finance.

For technical reasons, the draft tax laws continue to be split into two bills – a money bill (section 77 of the Constitution) covering issues relating to rates and base and an ordinary bill covering administration (section 75 of the Constitution). Besides annual changes to personal income tax brackets and thresholds, the draft legislation deals with a number of matters, notably:

Individuals and Savings

1. *Employer-provided motor vehicles:* With effect from 1 March 2010, the deemed kilometre method for deducting expenses associated with the car allowance was repealed (leaving only the logbook method). The proposed legislation now seeks to tighten the rules relating to employer-provided motor vehicles so as to prevent tax arbitrage. These proposed changes increase the fringe benefit inclusion rate for "company cars" to 4 per cent per month (with only 3.2 per cent included per month in respect of Pay-As-You-Earn withholding). Relief against the 4 per cent fringe benefit will be granted on assessment and is based on actual business use (kilometres), proportional deductions for the private element of actual expenditure on license fees, insurance premiums and maintenance with private fuel costs based on a deemed rate per kilometre.

2. *Retrenchment Merger:* In 2008 and 2009, legislation was introduced in respect of retirement and pre-retirement withdrawal pension benefits that are now subject to a tax-preferred calculation that includes a tax free amount of R300 000 as well as a favourable marginal rate structure. In order to promote uniformity (and avoid duplication), employer-provided lump sum termination payouts will form part of the tax-preferred calculation.

3. *Key Person Insurance Plans:* Two types of key person insurance plans are commonly funded by employers. In legitimate cases, insurance plans offer payouts to employers so as to protect their businesses against the loss of profits if a key employee suffers from ill-health or disability or dies. In more suspect cases, these plans are used to provide low taxed, deferred compensation with all policy proceeds implicitly intended for the key employee as a form of deferred salary. The proposed legislation tightens the deduction criteria in order to eliminate this tax avoidance while expanding the deduction to allow for insurance policies that act as commercial collateral or payment to third party business creditors.

4. *Narrowing of the interest exemption threshold:* The interest exemption threshold for natural persons will be increased (to R22 300 for ages below 65 and R32 000 from ages 65 and above). Although the intended purpose is to promote savings by middle and lower income households, the exemption has increasingly become a planning tool to reduce the tax on otherwise existing investments (thereby representing a deadweight loss to the fiscus). The category of permissible instruments giving rise to the interest exemption will accordingly be narrowed. The effectiveness of this incentive will also be reviewed.

Business

5. *Islamic Finance:* The tax system does not currently cater for Islamic financing, thereby hindering the growth of South African financial service activities in this regard. The proposed amendments seek to place certain *Shari'a* compliant products (Mudarabah, Murabaha and Diminishing Musharaka) on an equal tax footing with conventional finance products. One benefit of the proposal is to provide Islamic savings products with the R22 300/R32 000 exemption for interest available to traditional savings products.

6. *Interest expense allocation*: Interest expenses allocable to revenue-generating assets are generally deductible while interest expenses allocable to non-revenue producing assets are not. A concern exists that financial institutions are deducting beyond what should be equitably allowed according to basic tax principles (leading to disparities that are also costly to the fiscus). The proposal seeks to close these loopholes by requiring specific tracing measures currently available in the case of legitimate non-tax motivated commercial transactions.

International

7. *South Africa as a regional financial centre:* South Africa is the economic powerhouse of Africa, has a developed infrastructure and an advanced financial services industry. These qualities (including its tax treaty network) make South Africa an ideal location for foreign investors to base the management of their regional operations. The proposal eliminates tax hurdles so that foreign investors can utilise South Africa as a launching point into the region. Tax hurdles are also being eliminated so that foreign investors can utilise South Africa as a central point for various regional equity fund investments.

8. *Cross-border interest:* The current blanket exemption for cross-border interest carries risks to the fiscus. The current exemption has often led to cross-border mismatch schemes resulting in deductions for interest paid offshore, without corresponding taxable income. The funds paid are often retained offshore or returned as tax-free dividends. The proposal seeks to tax interest flowing offshore whilst retaining significant exemptions so as to leave interest received by cross-border portfolio foreign investors unaffected. These exemptions include cross-border interest from bonds issued by any organs of state by any sphere of government, bonds listed on the JSE, interest paid by collective investment schemes, interest paid by banks and interest related to international trade finance.

Administration

9. *Voluntary disclosure programme:* To encourage taxpayers to come forward and avoid the future non-discretionary imposition of interest, a voluntary disclosure programme will be instituted from 1 November 2010 to 31 October 2011. Taxpayers may come forward during this period to disclose their defaults and regularise their tax affairs if disclosure is made before they are aware of a SARS audit or investigation. Although the full amount of tax will remain due, additional tax, penalties (other than administrative penalties) and interest relating to the default will be waived for qualifying taxpayers. SARS will also not pursue criminal prosecution in respect of the default. Under limited circumstances, disclosure may be made after taxpayers have become aware of an audit or investigation, in which case the above benefits will apply except that 50 per cent of the interest relating to the default will be waived. The voluntary disclosure programme will be supported by a simultaneous exchange control programme that will be brought into effect separately. More details on the programme will be forthcoming from SARS and SARB in the coming weeks.

10. *Discontinuation of standard income tax on employees (SITE) administrative provisions.* The standard income tax on employees' (SITE) was introduced in the late 1980s to limit the number of personal income tax returns filled annually, freeing up resources to deal with more complicated returns. Technological improvements have overtaken the need for the SITE system. The implementation of eFiling for individuals now allows for taxpayers earning up to R120 000 per annum with a single employer and no additional income or deductions not to file an income tax return, although they are liable to register as taxpayers. The discontinuation of SITE may potentially result in an increased tax liability for some low-income taxpayers with more than one source of income. SITE will be phased out over a three year period in order to limit any potential hardship to these taxpayers.

Public Comments and Parliamentary Hearings

The National Treasury and SARS are scheduled to brief the Parliament's Standing Committee on Finance regarding the draft legislation on 18 May 2010 (subject to confirmation by Parliament). Comments should be submitted to the National Treasury via Nomfanelo Mpotulo at Nomfanelo.mpotulo@treasury.gov.za and to SARS via Adele Collins at acollins@sars.gov.za by **11 June 2010**.

Comments should also be submitted to the Parliamentary Standing Committee on Finance with informal hearings currently scheduled for the 1st and 2nd of June 2010 (subject to confirmation by Parliament). For further details about the Parliamentary hearings and submission process, contact Bradley Viljoen at Parliament at bviljoen@parliament.gov.za or by telephone on 021 403 3759. To assist with the processing of comments in regard to all of the above submissions, comments should be given in the order listed as per the explanatory memorandum.

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