national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

TAXATION LAWS AMENDMENT BILLS, 2010: DRAFT RESPONSE DOCUMENT ON PUBLIC COMMENTS RECEIVED

National Treasury and SARS have today (3 August 2010) released a response to public comments on the 2010 Taxation Laws Amendment Bills (available on www.treasury.gov.za). The response document was earlier today presented to the Standing Committee on Finance in Parliament.

The response document addresses the various comments received on the draft Taxation Taws Amendment Bills, 2010, which were published for public comment on 10 May 2010. The Standing Committee on Finance convened hearings on 1 June 2010 to review taxpayer comments. National Treasury and SARS also requested written comments by 11 June 2010, and held four public workshops in late June/early July to further facilitate resolution of issues. The workshops covered business and international issues; individual, savings and administration issues; royalty issues; and Islamic finance issues.

The response document covers a wide array of policy issues raised by commentators, but is not intended to be exhaustive. Significant issues are highlighted below. The final Bills are expected to be tabled before the end of this month. The current draft of the amendment Bills can be found on the National Treasury and SARS websites.

Individual Employment and Savings Tax Proposals

1. Employer-provided motor vehicles

- Under the initial proposal, all employer-provided motor vehicles would have in an initial year-end inclusion for employees based on a 4 per cent monthly calculation. However, this inclusion can be reduced by business use and certain private costs incurred by employees. For Pay-As-You-Earn purposes, the monthly inclusion rate was set at 3.2 per cent (80 per cent of the 4 per cent rate).

- Three significant policy changes will be made in response to public comment. Firstly, the rate will be reduced from 4 per cent down to 3.5 per cent. Secondly, the rate will be reduced by a further 0.25 per cent if the cost of the employer-provided vehicle includes a full maintenance plan. Thirdly, the monthly Pay-As-You-Earn rate will be reduced from 80 per cent to 20 per cent for vehicles intended to have no more than 20 per cent private use. Employers will be jointly liable in cases where the rate is incorrectly reduced.

2. *Narrowing of the interest exemption threshold*

- Under the initial proposal, the interest exemption threshold for natural persons was to be limited to interest received from certain sources (e.g. bank deposits, listed bonds and government paid interest). Other forms of interest were to fall outside the exemption.

- Due to concerns that the proposal may not have the impact intended, the proposal is withdrawn. However, it should be noted that questions exist whether the interest exemption actually promotes savings.

Business Tax Issues

3. *Interest expense allocation*

- A new anti-avoidance amendment had been proposed in response to the *Standard Bank* court decision. The proposal would have reduced the level of deductions relating to financial instruments if the taxpayer could not prove the source of funding of the financial instruments whose income is exempt from tax.

- The proposed anti-avoidance amendment will be withdrawn due to concerns that the amendment would cause more difficulties than it would cure. However, it should be noted that Government remains concerned about the number of dividend and other income from financial instruments that are acquired solely to reduce taxable income. It should also be noted, as a matter of interpretation, that the *Standard Bank* decision cannot be read as a blank ticket for deposit-taking institutions to acquire financial instruments whose income is except from tax without adhering to the rigors of the section 11(a) deduction formula.

4. *Terminating residential entities*

- In 2009, a window was granted allowing taxpayers to transfer residences out of pre-existing companies or trusts created to avoid the payment of transfer duty (an arrangement which is no longer allowed). After taking into account criticisms of the 2009 window, amendments were proposed in 2010 to provide a more flexible regime. The 2010 amendments also required in return for the exemption from transfer duty, the distributing company or trust be liquidated, wound up, or deregistered.

- It is now proposed that the 2010 regime be further widened to allow for a more complete array of distributions. Firstly, the distribution rules will no longer be restricted to the originating funders (and their spouses). Qualifying distributions can be made to a broader set of shareholders or beneficiaries. Secondly, the revised relief will accommodate multi-tier structures. Nonetheless, the requirement that the distributing company or trust (including structures with multiple tiers) is liquidated, wound-up, or deregistered in order to qualify for the relief on transfer duty remains unchanged.

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International Tax Issues

5. *Cross-border interest*

- Under the initial proposal, the cross-border interest exemption was to be limited to cross-border portfolio interest flows and to trade finance. Immobile interest flows other than trade finance would become taxable at ordinary rates.

- Despite strong opposition, the proposal will proceed, with some modifications. While it may be argued that the current open-ended exemption may act as an implicit incentive for foreign investment and offshore borrowing, the risks to the tax base are too high and any benefits are probably outweighed by the deadweight loss to the fiscus. That said, it is conceded that the proposed taxation of cross-border interest should come in the form of a 10 per cent final withholding tax so as to be more consistent with international practice. The effective date of the proposal will also be delayed until 1 January 2013 in order to renegotiate certain tax treaties with zero interest ceilings to the extent those treaties can lead to a continuing erosion of the tax base.

6. Hybrid entities

- The amended version of the Bill contains a new provision addressing the taxation of limited liability companies, limited liability partnerships and other hybrid entities. In essence, these entities will be treated as conduit entities (i.e. as domestic partnerships) if so treated abroad. The proposal stems from concerns about ongoing uncertainty in relation to these entities and will assist foreign investors who use foreign limited liability companies and partnerships as regional investment funds. This proposal will be effective from 1 October 2011 to allow time for comment should the proposal result in unintended anomalies.

Royalty Issues

7. *Minerals with specified ranges:*

- The royalty requires a minimum level of extraction and value addition for establishing the royalty base and rate. Many minerals currently have a specified range, most notably iron ore and coal. In these circumstances, the proposed legislation required minerals below the range to be charged at the minimum level, minerals within the range to be charged as transferred and minerals above the range to be charged at the top minimum level.

- It has been determined that the current range rule indirectly undermines beneficiation. Under the revised approach, minerals falling below the minimum range will still be charged at the minimum level. However, minerals above the minimum level will only be taxed at the higher level if the higher level was not reached due to a beneficiation process. Under this revised system, iron ore will have a 61.5 per cent minimum Fe content level and coal will have a 19 MJ (Grade D) ash content minimum level. It should also be noted that the specified levels relating to certain aggregate sands will be adjusted to better account for current practice.

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