national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

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Technical Corrections Website Release, 2012

Background

Annual taxation laws amendment bills regularly contain technical corrections that address various anomalies, such as ambiguities, unintended language, effective dates and the like. Most of these technical corrections stem from recent tax amendments but occasionally go back to earlier years. These annual technical corrections are envisioned by the yearly National Treasury Budget Review under Annexure C within the regular listing of tax amendments.

In order to facilitate the technical correction process, it was decided that an early website release of technical corrections would be beneficial so that these issues could be addressed before the formal release of the pending Taxation Laws Amendment Bill, 2012. Quick resolution of these technical issues also provides taxpayers with certainty, especially with regard to effective dates. Quick resolution of these issues also limits the need to raise trivial issues during the Parliamentary process.

National Treasury is accordingly releasing a website version of proposed technical corrections, along with a summary clause-by-clause explanation. It should also be noted that the Explanatory Memorandum associated with the Taxation Laws Amendment Bill, 2012 is now being released in light of the technical corrections uncovered and requests for clarification by taxpayers.

Highlights

While the attached draft legislation deals with a multitude of technical issues, the following items are worthy of note:

1. *Dividends Tax transitional rules:* The proposed amendments clarify the transition from the Secondary Tax on Companies to the new Dividends Tax (as well as related rules involving capital distributions and general definitions).

- The main points to note are newly added provisions to expressly prevent double taxation. More specifically, amounts subject to normal tax or the Secondary Tax on Companies will not be subject to tax again under the new Dividends Tax. The provisions also clarify that dividends subject to the Secondary Tax on Companies will generate credits against the new Dividends Tax even if timed shortly before the transition.

- In addition, as per the 2012 Budget Review, STC transitional credits will only be available three years into the new regime (as opposed to the initially proposed five year period). This reduced time period is in recognition of the fact that the new Dividends Tax has been long-delayed, thereby mitigating the need for transitional credits given the advanced warning for taxpayers to plan their affairs.

- Lastly, the rules relating to withholding certificates, exemption claims and refunds as well as collateral administrative issues may have to be revised to account for system implementation.

2. *Hybrid shares and third-party backed share guarantees:* The draft website legislation contains revisions to the hybrid share and third-party backed share guarantee provisions. The main purpose of the initial anti-avoidance provisions is to ensure that the holder of the shares directly or indirectly bears some form of equity risk associated with the issuer. Without this indirect risk, the shares should not be viewed as generating exempt dividends but taxable interest. Equity risk is usually eliminated one of two ways: either the risk is shifted to third parties via third party guarantees or *via* secured third-party financial instruments. That said, the initial 2011 legislation recognised that the use of preference share funding to acquire shares in operating companies was necessary to avoid indirect double taxation (because debt used to acquire shares generally does not allow for deductible interest). It is further recognised that black economic empowerment transactions largely follow this paradigm.

   The revised legislation essentially seeks to capture the original intent. However, intensive consultation with various key stakeholders suggests that the nature of the third party guarantees and security arrangements operate somewhat differently than initially believed when applied at a granular level. The revised legislation essentially adjusts both anti-avoidance provisions in light of these complexities. The details relating to the revised legislation are fully described in the draft explanatory memorandum attached. In closing, the other key points to note are as follows:

   - Given extensive granular nature of these adjustments, it has been decided that the effective date of both anti-avoidance provisions be deferred until 1 October 2012 (applying only in respect of years of assessment commencing from that date).

   - While it is understood that the rules closing down cession schemes should eliminate most collective investment schemes engaged in the practice of generating interest-like dividends via artificial preference share holdings, concerns exist that several schemes are trying to technically avoid the legislation through suspect means. Therefore, a second review of these schemes will be undertaken to ensure that the targeted schemes do not bypass the anti-avoidance legislation proposed.

- Requests were made to extend the exemption to include debt-like share financing in support of redemptions or in support of future dividends. However, it was decided that this extension raises significant policy issues and could become an easy avenue for renewed avoidance. It was accordingly decided that the exemptions retain their sole focus of supporting equity share acquisitions of operating companies.

- Concerns also exist that derivatives can be used to shift risk to wholly unrelated parties so as to bypass the proposed anti-avoidance rules. The proposed legislation may accordingly have to be tightened to address this concern.

3. *Minimum 45-day holding period before disposal:* The 2011 legislation was drafted with the intent of treating dividends as ordinary revenue (or additional capital gain) if the dividends arose 45 days before disposal. It is now proposed that this 45-day holding period be completely scrapped as impractical. Besides the burdensome reporting requirements associated with dividends received or accrued by various financial institutions (e.g. share dealers), it is questionable whether pre-sale dividends for regularly traded shares gives rise to the potential for avoidance initially believed. We also note that the main avoidance was terminated with the closure of cession schemes.

4. *Headquarter company regime:* The proposed amendments eliminate certain anomalies associated with the newly established Headquarter regime. For instance, the purchase of headquarter company shares will no longer be subject to the Securities Transfer Tax. Many of the requirements associated with the exemption for the disposal of shares by a headquarter company will also be dropped to allow for more flexible disposals as initially intended. More substantive aspects of the regime will be reviewed later in the year to further facilitate the regime's intended use.

5. *Delayed effective date for the revised research and development incentive:* It was initially intended that the revised incentive regime (i.e. the additional allowance system) for research and development was initially set to take effect as from 1 April 2012. This date has now been delayed until 1 October 2012 to facilitate enhanced implementation.

6. *Temporary Expanded Brokerage exemption from the Securities Transfer Tax:* In 2011, the brokerage exemption from the Securities Transaction Tax became the object of an interpretative challenge from SARS due to certain practices that shifted the economic risks and rewards to related parties. Without going into the merits of the issue, it was decided that the exemption be temporarily expanded so as not to disrupt the business of market making on the JSE nor the business of offering derivatives. It appears now that the technical language contained within that amendment may itself be suspect. Hence, it is proposed that the

language associated with the temporary expansion be adjusted to provide for full temporary protection from the Securities Transaction Tax (as initially intended).

7. *Deductible foreign dividends:* The 2011 legislation effectively treats foreign dividends as ordinary revenue if the dividend is deductible in the foreign home country. The purpose of this legislation was to prevent the use of hybrid instruments as a means of bringing exempt funds into the country (which often stem from local amounts paid offshore in deductible form). Nonetheless, several commentators contend that deductible foreign dividends are often not an indicator of avoidance and should be allowed. The proposed legislation remains silent on the matter. Further information will be required before any policy decision can be taken in this regard.

8. *Oil and gas incentive:* Oil and gas companies are eligible for special tax incentives within South Africa, including a fiscal stability clause against certain increased rates and other base broadening measures. Transition of these regimes in light of the new Dividends Tax will be conducted later in the year.