
MEDIA STATEMENT

Draft Taxation Laws Amendment Bill and Tax Administration Laws Amendment Bill, 2013

National Treasury today publishes the 2013 draft Taxation Laws Amendment Bill and the Tax Administration Laws Amendment Bill for public comment. The draft legislation gives effect to most of the tax proposals announced in the 2013 Budget Review.

The Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2013 was published on the National Treasury website on 18 June 2013. Certain tax proposals requiring more consultation (amongst others, trust reforms, pre-retirement preservation proposals and the taxation of long-term insurers) will be dealt with later this year or as part of next year's process. Tax proposals that require specific legislation (e.g. employment tax incentive, gambling tax, waste discharge incentive charges bill) will be published later this year, whilst others (e.g. carbon tax) will be published for comment next year. The Merchant Shipping (International Oil Pollution Fund) Contribution & Administration Bills have already been published for comment.

The TLAB deals with some of the following issues:

- A beneficial tax regime for companies that locate in Special Economic Zones approved by the Minister of Finance.

- Proposals to revitalise the maritime sector in South Africa through implementation of an attractive tax regime.
- Containing tax base erosion in the form of profit-shifting through excessive interest deduction and the use of artificial debt through an objective set of rules and limitation rules.
- Taxing dividends received for services rendered under normal income tax rules (e.g. no Dividends Tax). The company paying the dividend will, subject to certain conditions, be entitled to an income tax deduction.
- As from 1 March 2015, enabling most individuals to qualify for a higher deduction in respect of contributions made to South African retirement funds. The new regime will be fair and excess contributions will not be deductible.
- Protecting the vested rights of current provident fund members in the proposals in respect of the annuitisation of provident funds.
- Proposals to ensure that employers will be able to assist their low-income employees to acquire houses at below market value without tax being payable by the employee.
- Requiring foreign e-commerce suppliers to register for VAT, in order to ensure that they compete on equal footing with local e-commerce suppliers.

The draft legislation and explanatory memorandum can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites.

Written comments are due at the close of business on Monday, 5 August 2013. Based on comments received, workshops or meetings will be held with stakeholders to ensure consistency between the policy and the wording of the Bills. Thereafter, National Treasury and the South African Revenue Service will revise the Bills, and introduce them in Parliament for the more formal parliamentary process.

More detail on some of the material amendments are provided below.

Draft Taxation Laws Amendment Bill, 2013

1. Disability (and income protection) policies: Premiums in respect of income protection insurance policies have been allowed as a tax deduction for individuals as those policies were intended to cover the individual against an actual loss of income. However, as a policy matter, premiums in respect of life cover and temporary or permanent disability are non-deductible, with the pay-outs being tax-free. It is proposed that these principles (non-deductibility of premiums and tax-free pay-outs) be extended to income protection policies to ensure that there is uniformity in the treatment of policies that relate to personal cover for individuals.
2. Removal of dividend character overlap and the employee share scheme dividends: The amendment seeks to address tax avoidance through the re-characterisation of income. This occurs when dividends are paid in respect of services rendered. Under this revised approach, the party receiving the dividend will be taxed on the dividend as ordinary income if the dividend is received or accrued by virtue of services rendered. The company paying the dividend will, subject to certain conditions, be entitled to an income tax deduction. This amendment addresses some of the concerns around employee share trusts.
3. Retirement reforms: The proposed reforms introduced in the Bill are based on some of the proposals made in various retirement reform papers published in 2012 and with the 2013 Budget. They encompass the tax treatment of contributions to retirement funds for the employer and the individual, as well as the alignment of provident funds to pension and retirement annuity funds. To ensure greater transparency and better data, employer contributions to any retirement fund will be taxed as a fringe benefit in the hands of the individual.

The sum of the contributions from employer and individual will be deductible in the hands of the individual taxpayer up to 27.5 per cent of the greater of taxable income or remuneration, or up to a monetary cap of R350 000, whichever is the lowest. Employer contributions towards a defined benefit fund will be valued through the application of a formula.

Although a few taxpayers might be negatively affected (those contributing in excess of the caps), the net after-tax position of the majority of taxpayers will remain unchanged and some will be marginally better off, given the higher 27.5 per cent deductions. The effect of the introduction of annuitisation to provident funds will be gradual through the protection of vested rights of current provident fund members. The annuitisation will only affect new contributions made by persons under the age of 55 as at 1 March 2015 and by those over the age of 55 to provident funds they joined after that date.

Consultations will continue to take place with interested parties, including trade unions, business, and public servants, to discuss the proposed reforms, including a reasonable period of notice to effect such proposals.

4. *Employer provided accommodation - low-cost housing:* Housing programmes initiated by employers for the benefit of their employees are hindered by the fringe benefit tax that an employee will pay on the difference between the market value of the property and the amount paid by the employee. In order to eliminate this obstacle, there will be no tax payable if an employee earning a total salary of not more than R200 000 acquires a property with a cost to the employer of not more than R350 000. The incentive is not limited to a certain sector; it should stimulate the provision of affordable housing in South Africa and help address some of the challenges in the mining sector in particular.

5. Restricting debt to prevent base erosion: Tax base erosion in the form of profit shifting through excessive interest deductions, with income being shifted to low-tax (or zero-tax) jurisdictions, or the conversion of interest income into a different type of income in another jurisdiction has been of global concern. It is proposed that permanent measures to address the concerns of tax base erosion be introduced. In respect of hybrid debt instruments, the proposals focus on two elements: (1) the debt instrument itself and (2) the yield. The proposal dealing with the instrument denies the interest deduction for the payor and treats the interest payments on the instruments as dividends if the debt satisfies one or more of the following characteristics: (i) it is unlikely to be redeemed within 30 years, (ii) it can be converted into shares, or (iii) payments in respect of the instrument are subject to the solvency of the issuer. The proposal dealing with the yield also denies the deduction and treats the interest as dividends if the interest payment is not determined with reference to a specified interest rate or the time value of money, or the payment obligation is conditional upon the solvency of the debtor.

The proposal dealing with connected person debt limits the interest deduction to 40 per cent of the debtor's taxable income (with certain adjustments) if the creditor (together with related parties) holds more than 70 per cent of the equity shares or voting rights in the creditor company. The proposal dealing with the limit for acquisition debt (taxable acquisitions) will be based on 40 per cent of the adjusted taxable income of the acquired company, while the limit for debt used in re-organisation transactions (tax-free acquisitions) will be based on 40 per cent of the adjusted taxable income of the acquiring company.

6. Collective investment schemes: Currently, hedge funds are operating in an unregulated arena. These funds will be regulated by housing them in the collective investment scheme framework. The proposed regulation is set for implementation in 2014.

Existing rules on the taxation of collective investment schemes (other than collective investment schemes in property) need to be adjusted to ensure a complete exemption from tax (income tax and capital gains tax) at a collective investment scheme level. Distributions by a collective investment scheme to unit holders will however be treated as normal income in the hands of the unit holder (investor), except where:

- the collective investment scheme makes the distribution as consideration for the buyback of units from the unit holder, or distributes units to the unit holder, upon which the distribution received by the unit holder will be treated as a capital receipt; and
- dividends are distributed within 12 months after receipt or accrual thereof by the collective investment scheme, in which case the dividend will be subject to dividends tax in the hands of the unit holder.

When the investor sells the units in a collective investment scheme in securities or in a retail hedge fund, the amount received will be deemed to be of a capital nature if the units were sold after a three year holding period. In the case of a restricted hedge fund, the amount received will always be deemed to be of an ordinary nature.

7. *Tax Incentives for Special Economic Zones*: The Department of Trade and Industry (DTI) has identified a lack of targeted tax incentives as one of the hindering factors to the success of Industrial Development Zones. In support of the DTI's broader initiative to improve governance, streamline procedures and provide more focused support for industry, it is proposed that companies operating within Special Economic Zones (SEZs) (and approved by the Minister of Finance after consultation with the Minister of Trade and Industry) will be eligible for a favourable tax dispensation. All businesses operating within approved SEZs will be eligible for accelerated depreciation allowances on capital structures and an employment incentive. Certain companies (carrying on qualifying activities within an approved SEZ) will be subject to a

reduced corporate tax rate (i.e. 15 per cent instead of 28 per cent). All SEZs will qualify for VAT and customs relief similar to that for the current IDZs.

8. Public benefit organisations: Donations to certain public benefit activities are deductible for income tax purposes up to a maximum of 10 per cent of taxable income. Where a taxpayer makes a donation in excess of 10 per cent of taxable income in any one tax year, the tax benefit of such excess donation is lost. The revised proposal will allow the tax deductibility of such excess donations to roll over to the next tax year so that the tax benefit is not foregone. This reform will also be beneficial to the biodiversity stewardship programme (BSP) of the Department of Environmental Affairs. A BSP is a partnership with private land owners to preserve biodiversity and is implemented through the creation and expansion of protected areas by means of bilateral agreements whereby private landowners voluntarily restrict and maintain the land on the government's behalf.

Where land has been owned for many years, the original cost of the land is generally much lower than its current market value. Presently, the incentive is calculated using the lower of cost or market value of the protected area for 99-year contracts. In addition to the above roll-over provision, the draft legislation provides that the value for the purpose of this incentive should be the lower of the municipal or market value. Capital gains will be triggered, but the taxable proportion of these gains will be set off against the deduction allowed over a period.

9. Streamlining the research and development (R&D) tax incentive: In moving from the previous to the current tax dispensation (whereby companies are required to obtain pre-approval for an additional deduction of 50 per cent of R&D related expenditure), some unintended anomalies have become apparent. The language in the current provision has led to uncertainties in the interpretation of the legislation and blockages have arisen in the adjudication process. The proposed amendments will streamline and

accelerate the adjudication process, particularly for projects in the pharmaceutical (generic medicines and clinical trials) and information and communication technology (ICT) related sectors.

10. Uniform cross-border withholding to prevent base erosion: Fees payable to foreign persons in respect of technical, management or consultancy services rendered in South Africa that fall outside normal tax are not subject to any withholding tax. Certain fees, like interest and royalties, generate local deductions that often lead to tax planning opportunities. Therefore, some form of protection in the form of withholding is needed to protect the tax base. It is proposed that cross-border consultancy, management and technical fees received by foreign residents be subject to withholding tax. This new withholding tax will be a final withholding tax that will be used to identify and collect revenue from non-resident taxpayers who provide certain services within a South African source that falls outside normal tax. This withholding tax will be levied at the rate of 15 per cent of the gross amount of fees paid to a foreign resident.

11. Exemption for international shipping transport entities: It is proposed that a new tax regime for shipping companies be introduced. In the main, the new shipping tax regime exempts qualifying shipping companies from income tax, capital gains tax, dividends tax, and withholding tax on interest. This tax relief would form part of the integral policy alignment by the Department of Transport to revive the maritime sector in South Africa. These complete exemptions are more favourable than the initially proposed tonnage tax for South Africa.

12. Gateway Subsidiary: The proposed domestic treasury management company regime encourages the establishment of group treasury management functions in South Africa. This is part of the ongoing strategy of leveraging South Africa's advantage as a gateway to Africa. In the main, any company listed on the Johannesburg Stock Exchange may establish an exchange

control-free subsidiary in South Africa to manage its group treasury functions without adverse currency tax implications.

13. VAT registration of E-commerce suppliers: Under current VAT law, foreign suppliers of e-commerce services to South African customers are not compelled to register as VAT vendors, owing to the fact that these foreign suppliers transact wholly over the internet and have no physical place of business in South Africa. Introducing a place of supply rule into the VAT Act will ensure that foreign suppliers of e-commerce services register for VAT in South Africa and will protect the VAT base. The local e-commerce service industry will benefit as the foreign suppliers will now be on equal footing with their local counterparts (i.e. VAT is levied on local sales of e-commerce services and will now be levied on e-commerce services electronically delivered by foreign suppliers to South African customers). E-commerce suppliers will be allowed to register for VAT on the payments basis in order to ease administration.

14. Streamlining VAT registration: The current provisions in the VAT Act regarding compulsory and voluntary registration are being streamlined. In the compulsory space, businesses that make taxable supplies in excess of R1 million over a continuous period of 12 months and businesses that will surpass this threshold in a future period of 12 months (owing to a contractual commitment in writing to make those supplies e.g. government tender work, etc.), will be obliged to register for VAT. The predictive element for compulsory VAT registration is eliminated and it is hoped that most of the disputes surrounding VAT registration in this area will be eliminated.

In the voluntary space, VAT registration is simplified with the ultimate objective of speeding up VAT registration for small and medium businesses, as well as large businesses that undertake huge capital investments (e.g. mining, forestry, warehousing, etc.). It is proposed that voluntary registration

follows a two-pronged approach: (i) traditional VAT registration, and (ii) fast-tracked VAT registration:

- Under the traditional approach, municipalities, welfare organisations, foreign donor-funded projects, etc. will be allowed to register – with no threshold test being applicable for supplies made, or to be made, by these entities. Further, other entities seeking registration under this traditional approach (e.g. mining, forestry, warehousing, etc.) must incur a minimum of R5 million in expenditures. Vendors registered under this approach can claim refunds for expenses incurred in respect of supplies received.
- Under the fast-tracked approach, persons/entities seeking registration will be registered – again with no threshold test being applicable for supplies made, or to be made, by these entities. A safeguard will be added to ensure that refunds are blocked until that person/entity makes R100 000 of taxable supplies in a continuous period of 12 months before becoming entitled to the refund.

15. Refinements to the mineral royalty regime: The proposed amendments to the Mineral and Petroleum Resources Royalty Act is to remove any anomalies that have arisen, and to refine and strengthen the current legislation. There are three main refinements:

- The current reporting requirements place an unnecessary compliance burden on taxpayers in that they must report to both SARS and National Treasury. In order to reduce this burden and streamline the data collection process, the proposed amendments will require the Commissioner for SARS to provide the Minister of Finance with detailed data on royalty calculations and payment information per taxpayer.
- The proposed amendments will alleviate the compliance burden on small business corporations (SBCs) – SBCs will no longer be required to register if their gross sales are below R10 million.
- The schedules have been reviewed due to some companies incorrectly interpreting the legislation or the legislation not being sufficiently clear. This appears to be prevalent in the case of coal. The value of total coal

sales constitutes a larger share than all other minerals in 2011 (second biggest in 2010), while royalty contributions from coal mining companies for 2011/12 are only 5.3 per cent (7.3 per cent in 2010/11) in relation to other minerals.

Draft Tax Administration Laws Amendment Bill, 2013

16. Search and Seizure provisions in terms of the Customs and Excise Act, 1964: Pursuant to the judgment by the Western Cape High Court in the *Patric Lorenz Martin Gaertner vs The South African Revenue Service (12632/12)* case and the finding that the search and seizure provisions in section 4 of the Customs and Excise Act, 1964, are unconstitutional, an amendment to section 4 is proposed in the draft Bill.

Currently the legislation affords very wide powers to officers to search any premises at any time, without the requirement of a warrant. The Court suspended the effect of the order to afford Parliament an opportunity to amend section 4 to correct the Constitutional defect. The proposed amendment aims to achieve this by establishing the broad principle that an officer may enter premises only on authority of a warrant. A warrantless search and seizure may occur in prescribed narrow circumstances. Certain categories of premises are excluded from the general rule and access to these premises is unrestricted and no warrant is required (e.g. premises managed or operated by the State or a public entity as part of a port, airport, railway station or land border post where customs activities are carried out).

17. Extension of prescription period in the event of delays by taxpayers: In complex matters, such as transfer pricing and GAAR audits, taxpayers often employ dilatory tactics in providing information to force a matter closer to the three year prescription period. The proposed amendment provides for an extension of prescription for the periods that taxpayers, without just cause, do not provide information or employ dilatory tactics.

18. Extension of prescription period for reduced assessment: The proposed amendment will enable SARS to issue a reduced assessment to address an error made by the taxpayer. However, a reduced assessment will only be issued if SARS was notified of the error in time, the error is not disputed, and SARS did not issue the reduced assessment before the expiry of the prescription period. Currently, SARS cannot accommodate the taxpayer.
19. Understatement penalty system: The proposed amendments to the Act seek to clarify that an understatement as a result of a *bona fide* inadvertent error will not result in a penalty. The applicable percentages of the penalty are also reduced in the case of substantial understatements, if reasonable care was not taken, or if no reasonable grounds exist for the tax position taken.
20. Regulation of tax practitioners: Under the current wording, employees who are under the *direct supervision* of a person who is a registered tax practitioner need not register as tax practitioners. Industry has made representations that this results in “intermediate managers” (between trainees or article clerks, for example) and a partner or director also having to register as tax practitioners. An amendment to replace direct supervision with the concept of acceptance of accountability is proposed.

Please forward written comments to nomfanelo.mpotulo@treasury.gov.za and acollins@sars.gov.za by the close of business on Monday, **5 August 2013.**

The following documents are attached:

- Draft Taxation Laws Amendment Bill (Annexure A);
- Draft Explanatory Memorandum (Annexure B);
- Draft Clause-by-Clause (Annexure C) to the draft Taxation Laws Amendment Bill;
- Draft Tax Administration Laws Amendment Bill (Annexure D); and

- Draft Memorandum of Objects (Annexure E) to the draft Tax Administration Laws Amendment Bill.