national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

2014 Draft Taxation Laws Amendment Bill and draft Tax Administration Laws Amendment Bill

National Treasury today publishes for public comment the 2014 draft Taxation Laws Amendment Bill (TLAB), 2014 draft Tax Administration Laws Amendment Bill (TALAB) and specific draft regulations related to these bills. This follows on the 10 June 2014 publication of the Rates and Monetary Amounts and Amendment of Revenue Laws Bill ("Rates Bill") and the first batch of the 2014 draft TLAB. All the above bills give effect to the tax proposals announced in the 2014 Budget, including in the 2014 Budget Review.

Whilst the Rates Bill deals largely with the rate and threshold changes announced in the Budget, the 2014 draft TLAB deals with the more substantive changes to the law. The 2014 draft TALAB deals with changes to the administrative provisions of tax legislation currently administered by SARS, including the Tax Administration Act.

The 2014 draft TLAB and TALAB are published for public comment prior to formal introduction in Parliament. The Standing Committee of Finance normally convenes public hearings into these draft bills before their formal introduction in Parliament. As part of the process, the National Treasury and SARS hereby invite comments in writing, and will engage separately with key stakeholders, through workshops to be held in August 2014. Thereafter, a response document on comments received will be presented to the Standing Committee on Finance, after which the draft bills will be revised, taking into account public comments, and tabled formally in Parliament for its consideration.

The 2014 draft TLAB gives effect to the following key proposals announced in the 2014 Budget Review:

- the introduction of tax free saving accounts;
- amendments to the taxation of contributions to defined benefit funds;
- changes to the taxation of Small Business Corporations;
- adjustments to the tax treatment of the risk business of long term insurers;
- refinements to the employment tax incentive; and
- the repeal of the VAT zero rating in respect of goods for agricultural, pastoral or other farming purposes.

A summary of the main issues is provided below in this media statement, and a more comprehensive description of the draft amendments is provided in the draft Explanatory Memorandum.

Draft regulations dealing with specific amendments in the 2014 draft TLAB are also published for comment. These draft regulations relate to the taxation of contributions to defined benefit funds and tax incentive provisions relating to research and development and Special Economic Zones (SEZs).

It should be noted that comments were received on the first batch of the 2014 draft TLAB regarding the taxation of contributions to defined benefit funds and the tax treatment of the risk business of long term insurers. The draft legislation has been amended to take some of these comments into account. However, National Treasury and SARS will still engage with key stakeholders before revising the draft legislation for tabling.

For legal reasons, the draft tax amendments continue to be split into two bills, namely, a money bill (section 77 of the Constitution) dealing with issues relating to rates and the tax base and an ordinary bill (section 75 of the Constitution) dealing with issues relating to tax administration.

The 2014 draft TLAB, TALAB, Explanatory Memoranda and Regulations can be found on the National Treasury website (www.treasury.gov.za) and SARS website (www.sars.gov.za). Written comments on the TLAB, TALAB and Regulations should be submitted by close of business on **17 August 2014**.

The 2014 draft TLAB, TALAB and Regulations deal with the following amendments:

Taxation Laws Amendment Bill (TLAB)

1. *Income Tax: Individuals, employment and savings*

- Tax free savings accounts

Tax free savings accounts are proposed from 1 March 2015 as a measure to encourage household/individual savings. Individuals will be allowed to open multiple tax free savings accounts, however, they may only contribute up to a maximum of R30 000 into these accounts within any given year. A lifetime contribution limit of R500 000 will apply. The returns accruing to these accounts will not be subject to income or dividends tax. Amounts within the tax free savings accounts may be withdrawn at any time.

Where an individual contributes in excess of the prevailing annual or lifetime contribution limit in any year, a “penalty” (additional income tax) of 40 per cent on the amount of excess contribution will be levied by SARS on the individual.

- Taxation of contributions to defined benefit funds

Defined benefit funds offer retirement benefits that are calculated according to the rules of the pension fund, where the value of the contributions to the fund may not be an accurate reflection of the benefits that may be received by the retirement fund member. For example, if the pension fund is in financial difficulty and the employer needs to make additional contributions to meet the expected liabilities, it may be unfair to tax members of the fund on those contributions since there would be no associated increase in benefits.

A prescribed methodology is proposed to determine a notional employer contribution for members of defined benefit pension funds. The notional employer contribution will be a fringe benefit that is taxable in the hands of the employee and will be included in the total pension contribution amount to calculate whether the individual is still below the allowable annual and monthly deductible limits.

- Company car fringe benefit

A company car fringe benefit arises when an employer provides the employee with the right of use of a company owned car. In general, the monthly fringe benefit for the employee is deemed to be 3.5 per cent of the ‘determined value’ of the vehicle. The net outcome of the different procedures used to calculate the ‘determined value’ results in inequitable tax treatment. To align the tax treatment of company car fringe benefit in respect of all employees, it is proposed that actual retail market value be used in all cases for company cars that are purchased, acquired or manufactured after 1 March 2015.

2A Income Tax: Small businesses

The following two proposals follow from two of the recommendations made by the Davis Tax Committee's SME report, published on 14 July 2014, and available on the Tax Committee's website (www.taxcom.org.za) as well as the websites of the National Treasury and SARS. Whilst comments on the entire report can be submitted to the Davis Committee by 31 August 2014, the comments on these two proposals are regarded as more urgent. The Treasury and SARS will co-ordinate with the Davis Tax Committee on how to take account of the two processes when responding to the public comments.

- <u>Changes to the taxation of small business corporations (SBC): Replacing the current reduced tax rates regime with an annual refundable tax compliance rebate</u>

Currently, SBCs are taxed according to the reduced tax rates, instead of the flat corporate tax rate of 28 per cent. The Davis Tax Committee concluded in its report on SME taxation that the lower tax rates for SBCs are not effective, do little to support the objective of small business growth, and do not address compliance costs. The current regime provides tax relief to only 50 000 businesses and, in some instances to professions not originally intended as beneficiaries. In addition, businesses in a tax loss position do not benefit from the current SBC regime, despite having the same tax compliance burden as profit making businesses.

Based on the above, the Davis Tax Committee recommended that the SBC reduced rate regime be replaced with an annual refundable tax compliance rebate. The primary purpose of the rebate will be to assist SBCs with their tax compliance costs. As a result, if this proposal is adopted, SBCs will be taxed at a flat corporate tax rate of 28 per cent and not according to the reduced tax rates. In turn, SBCs will be entitled to receive an annual tax rebate of R15 000. The rebate will be refundable, meaning that SBCs in a tax loss position will also receive the rebate.

- <u>Tax treatment of grant funding to SME's by non-profit funding entities</u>

Most SME's find it difficult to access funding due to their inherent risk and lack of collateral together with the fact that they often lack the necessary training and commercial skills to manage and develop the businesses. Several non-profit entities are engaged in activities that support SME's. They provide developmental funding, including business support and training to SME's. In order to assist in the development of SME's, it is proposed that non-profit entities providing funding and support to SME's be exempt from income tax. This relief is similar to the relief provided to PBOs.

In turn, funding received by SME's from the above-mentioned non-profit funding entities will be exempt from tax in the hands of the SME's.

2B. Income Tax: Venture Capital and Public Benefit Organisations (PBOs)

- <u>Broadening the scope of the Venture Capital Company (VCC) regime</u>

The VCC regime was introduced in 2008 to encourage potential funders to invest equity into small businesses. Since its introduction, the VCC regime has seen limited uptake.

In order to get the VCC regime to gain more traction, and to achieve its objectives of growing SMME's and creating employment, it is proposed that the asset limits for qualifying investee companies be increased and that the normal tax deductions for investments in a VCC held for more than five years be made permanent.

- <u>PBOs: Lowering of the distribution requirement</u>

Individuals and businesses are encouraged through the tax system to make tax deductible donations to qualifying conduit PBOs. At least 75 per cent of funds received by a conduit PBO by way of tax deductible donations during a year of assessment should be distributed to other approved PBOs. The purpose of the 75 per cent distribution rule is to discourage conduit PBOs from locking in funds and to obtain a degree of matching between timing of the tax deduction claimed by the taxpayers and the distribution of such donations by the conduit PBO.

While Government is concerned that the funds required to support public benefit activities might be potentially locked in to accumulate reserves, several entities have indicated that the 75 per cent distribution rule is too restrictive, and affects their sustainability adversely. In order to enable conduit PBOs to have some flexibility to build up reserves over time so as to ensure some degree of financial sustainability, it is proposed that the 75 per cent distribution requirement of all funds received by way of tax deductible donations during a specific tax year be reduced to at least 50 per cent.

3. *Income Tax: Business*

- <u>The tax treatment of the risk business of long term insurers</u>

The current taxation of long term insurers does not distinguish between the investment and risk businesses. However, from a tax policy point of view the two types of businesses cannot be taxed by applying the same principles. From the perspective of a long-term insurer profits or losses arising in respect of a risk business should be fully taxed and should therefore not form part of the tax calculation of a policyholder fund that focuses on the taxation of the return on assets invested for the benefit of policyholders on the trustee basis.

It is proposed that as from 1 January 2016 a clear distinction be drawn in the taxation of investment and risk businesses conducted by long term insurers. Profits or losses that result from such new risk business will be taxed in the corporate fund.

- <u>Changes to the formula and rules relating to the limitation of interest deductions</u>

In 2013 amendments were made to the tax legislation to provide for measures to limit the deduction of excessive interest payments. A formula to determine the maximum amount of interest payments that may be deducted in any given tax year was also introduced. The maximum (expressed as a percentage of earnings before interest, taxation, depreciation and amortization-EBITDA) is currently set at 40 per cent. It is proposed that this formula be amended to allow for the maximum (percentage) to fluctuate, recognizing that interest rates (and thus cost of finance) can change. Using this formula, the percentage is 40 per cent of EBITDA at prevailing interest rates and will be capped at 60 per cent of EBITDA.

- Third party backed shares: Changes to the provisions relating to refinancing, limited pledges and definition of an operating company

The third party backed shares anti-avoidance rule concerns preference shares with dividend yields backed by third parties. The dividend yield of third party backed shares is treated as ordinary revenue unless the funds derived from the issue of the third party backed shares were used for a qualifying purpose, i.e., the acquisition of equity shares in an operating company.

Currently, an exception exists that allows for the refinancing of preference shares if the initial preference shares were used to finance the acquisition of equity shares in an operating company. Concerns have been raised that certain exception rules may not provide the relief originally envisaged for the refinancing of preference shares. As a result, it is proposed that refinancing of qualifying transactions be allowed. Also, with respect to asset backed preference shares, it is proposed that the scope of the exemption guarantees be broadened to allow for the pledging of the equity shares and associated debt claims in the issuer of preference shares.

In addition, it is proposed that the definition of an 'operating company' be extended to allow third party backed preference shares issued to acquire equity shares in an exploration company (usually by BEE parties).

- Refinements to the employment tax incentive

The employment tax incentive was introduced on 1 January 2014 to support employment growth amongst the youth by sharing the cost of employment between the government and the private sector. Employers have asked for clarification of the definition of a 'full time employee' when calculating the value of the incentive for employees who only work for part of a month. Further refinements are put forward for the reimbursement mechanism that is intended to be in place before the end of the year.

It is proposed that the calculation of the value of the incentive be simplified and linked to an hourly rate where the grossing up mechanism is linked to a baseline of 160 hours of work per month, rather than through the use of a discretionary 'full time' calculation. The effect of this is that the incentive can be claimed for qualifying employees who earn between R12.50 an hour (if there is no minimum wage) and R37.50 an hour (provided they work 160 hours or less per month).

With regard to the reimbursement mechanism, it is proposed that this should be simplified by 'ring fencing' the excess amount that is available to be rolled over at the end of the employer reporting period. Employers will be able to claim the value of the excess amount that has been ring fenced after SARS have determined whether they are tax compliant.

4. Value Added Tax (VAT)

- Repeal of the VAT zero-rating in respect of goods for agricultural, pastoral or other farming purposes

Currently, the supply of goods used or consumed for agricultural, pastoral or other farming purposes are charged with VAT at the rate of zero per cent. These goods may be supplied at the zero rate only if the recipient is a registered vendor carrying on agricultural, pastoral or other farming operations and is authorized by SARS to acquire those goods at the rate of zero per cent. This concession was intended to provide cash flow relief to the agricultural sector.

There is strong evidence that this provision is open to substantial abuse as various entities (i.e., those with and without endorsement from SARS to acquire goods at the zero rate) have entered into activities to fraudulently obtain a VAT input tax deduction. As a result, it is proposed that the zero rating of goods for agricultural, pastoral and other farming activities be repealed.

- Exclusion of second hand goods made from precious metal (gold) from claiming a notional input tax

Currently, a VAT vendor who acquires second hand goods, including goods made from precious metals, from a seller who is not a vendor, is entitled to claim a notional input tax deduction. This allows for the unlocking of part of the VAT on goods previously paid by final consumers as those goods re-enter the formal supply chain. While the acquisition of gold jewellery by VAT vendors from non-VAT vendors should allow for the deduction of notional input VAT, in practice, this provision significantly contributes to creating an enabling environment for fraudulent input tax deductions. In order to address this problem, it is proposed that second hand goods made from precious metals be excluded from obtaining the notional input tax.

Tax Administration Laws Amendment Bill (TALAB)

- Insertion of section 64MA in Income Tax Act

The amendment enables a company to claim a refund of dividends tax paid to SARS, in certain circumstances where the company had to pay the tax in respect of the distribution of dividends *in specie*.

- Alignment of exemptions from payment of provisional tax and increase of threshold

The amendment proposes to align the exemptions from payment of provisional tax for people 65 years or older with those of people under 65. The threshold for taxable income derived from interest, foreign dividends and fixed property rentals is raised from R20 000 (previously only applicable to under 65s) to R30 000 for all natural persons.

- Repeal of paragraph 20A of the Fourth Schedule to the Income Tax Act

The repeal addresses the issue that a single underestimation of provisional tax contemplated in paragraph 20 of the Fourth Schedule may result in a penalty under both paragraphs 20(1) and 20A(1). Also, paragraph 20 has been amended to allow a reduction of a penalty under paragraph 20(1) by the amount of any penalty under paragraph 27 for the late payment of provisional tax.

- Elimination of the four monthly VAT category

The four-monthly VAT category regime was introduced in 2005 to assist small businesses. Subsequently, other measures were introduced to assist small businesses and during 2012/13 fewer than 100 vendors, with only R44million output VAT and

R23million input VAT, were registered for this provision. It is therefore proposed to eliminate this category and bring the registered vendors into the bi-monthly VAT system.

- Preventing the unlawful use of SARS's names, trademarks and logos

Fraudulent use of SARS's names, trademarks and logos by, for example, bogus tax practitioners has become prevalent and has been aggravated by their improper and unauthorised use in domain names, the internet and social media. The purpose of a proposed amendment to the SARS Act is to broaden SARS's protection against unlawful use of its intellectual property and to protect the public from fraudulent schemes and misrepresentations of SARS's names and logos on the internet, in various media as false advertising and on goods.

- Automatic exchange of information

The new international standard for the exchange of information is automatic exchange of information. Amendments are proposed to improve the framework for automatic exchange of information and related due diligence obligations on third parties.

- Amendments to the reportable arrangement scheme

An amendment is proposed to include tax evasion under the term "tax benefit" to provide greater certainty as to what is meant by a "tax benefit" for purposes of the reportable arrangement system under the Tax Administration Act. Other proposed amendments clarify the reporting obligation of the promoter of an arrangement and all of the participants, that all participants to a reportable arrangement are responsible for reporting that arrangement and when the reporting obligation arises.

- Allowing temporary write-off of disputed tax debt

Currently, SARS cannot temporarily write off a debt while it is under dispute by a taxpayer. It is proposed that changes be made to the legislation to enable SARS to temporarily write-off a tax debt where it is evident that it is uneconomical to pursue and is thus akin to a "doubtful debt", despite the fact that the tax debt may still be disputed by the debtor.

Draft Regulations

Linked to the 2014 draft TLAB are draft regulations which will give effect to the following amendments. These draft regulations are also published for comment.

- Taxation of contributions to defined benefits

As stated above, in 2014, proposals were made regarding changes to the valuation of defined benefit contributions by an employer as a fringe benefit in the hands of the employee. In order to calculate the fringe benefit, the employer would need to multiply the pensionable salary by the 'fund member category factor' that is provided in the 'contribution certificate' and subtract the value of any contributions made by the employee. The pension fund would be required to calculate the 'fund member category factor'. The methodology for this calculation will be provided by way of regulation.

- Research & Development (R&D) Tax Incentive: Clinical Trials and Multisource Pharmaceutical Products (generics)

The current tax legislation still poses a barrier and prevents taxpayers conducting certain clinical trials and/or producing multisource pharmaceutical products from claiming the R&D tax incentive, despite amendments made in the tax legislation in 2013. In order to address these anomalies, it is proposed that changes be made to the R&D tax incentives to make certain clinical trials and/or multisource pharmaceutical products eligible for the R&D tax incentive. The criteria for eligible activities in this regard will be provided by way of regulation.

- Special Economic Zones (SEZs)

In 2013, additional tax incentives for SEZs that will include the current Industrial Development Zones (IDZs) were introduced in the Income Tax Act. The Department of Trade and Industry will be responsible for determining (and regulating) the qualifying criteria for the type of business that may locate in a special economic zone. The Income Tax Act provides certain tax concessions to businesses that locate in an SEZ approved by the Minister of Finance. The criteria for eligible business activities/sectors that do not qualify for the reduced corporate income tax rate will be provided by way of regulation.

Please forward written comments to Nombasa Nkumanda at Nombasa.nkumanda@treasury.gov.za and Adele Collins at acollins@sars.gov.za by the close of business on 17 August 2014.