INTRODUCTORY SPEECH BY THE MINISTER OF FINANCE

REVENUE LAWS AMENDMENT BILL, 2006

02 November 2006

Introduction

Madame Speaker, it gives me great pleasure to introduce the "Revenue Laws Amendment Laws Bill, 2006." This Bill completes the tax amendment process initiated after my annual February 2006 Budget Address to the nation. The Bill mainly contains fiscal stimulus measures designed to accelerate economic growth as well as ongoing measures to broaden the tax base so that all our citizens pay their fair share. I will also close by covering other significant matters involving retirement savings, public benefit organisations and clubs.

Fiscal Stimulus Measures

2010 FIFA World Cup

As you are well aware, Government has recently earmarked R7,8 billion for the construction and upgrade of ten stadiums for the World Cup as well as a further R6,7 billion to upgrade the surrounding infrastructure, public transport and systems improvement. The Bill before you further adds to preparations for the FIFA 2010 World Cup. In particular, the Bill includes tax amendments that cover South Africa's commitments to FIFA.

These fiscal provisions cover Customs and other taxes (such as Income Tax and VAT).

In terms of taxes on imports, FIFA-related organisations will receive complete relief. These organisations can import inventory for sale at designated sites (e.g. stadiums), capital goods, consumables and promotional materials directly related to the World Cup, all of which will be free from import taxes. These temporary amendments to tax legislation should assist FIFA and their partners to host a successful Soccer World Cup.

In terms of the other taxes, the fiscal measures provide for three sets of relief:

1. FIFA, FIFA subsidiaries, and Participating National Associations (other than SAFA) will receive exemption from Income Tax. These entities will also generally be entitled to VAT refund credits.

2. Various FIFA sponsors will receive partial exemption. These sponsors will receive the same tax benefits as the first group, but only to the extent these sponsors operate within what is known as a “tax-free bubble” (perhaps used as a tax professional’s sad attempt to be humorous). This tax-free bubble essentially covers areas, such as the Stadiums and other key locations for hosting the World Cup.

3. FIFA-related foreign individuals will also receive partial exemption. This partial exemption will eliminate South African Income Tax associated with the event. This partial exemption will cover a host of foreign individuals associated with the event, such as the FIFA delegation as well as commercial and merchandising staff.

One item worthy of separate discussion is the VAT on ticket sales. Tickets and hospitality services (including hotel accommodations) will remain subject to VAT at the standard rate (14%). However, some of the VAT revenue collected from the sale of tickets will be made available via the budget of the Department of Sports to subsidise ticket prices for some local supporters

Small Business Relief

The Bill seeks to unlock ongoing tax hurdles for small business. One hurdle involves the anti-avoidance regime triggering "deemed employee" treatment, including monthly withholding at 34 per cent. While the initial legislation was necessary to stop ordinary employees from avoiding monthly PAYE withholding merely by incorporating themselves, the initial regime needs to be relaxed. A number of small companies have found themselves inadvertently subject to this regime, thereby disrupting their cash-flow. For instance, the mere receipt of "regular payments" could jeopardise the tax status of small business entities, even though many small businesses strive to obtain regular cash-flows for long-term sustainability. This and a few other less important anti-avoidance measures have accordingly been dropped.

Research and Development ("R&D")

Economic literature has placed a growing emphasis on knowledge economies and how R&D contributes to macro-economic growth. The Bill accordingly promotes R&D of a scientific and technical nature. Such current R&D expenditure will now be deductible at 150 per cent of actual expenses incurred, and R&D related capital investments can now be written off over three years at a 50:30:20 per cent rate.

Oil and Gas

Recent global events have again highlighted the importance of energy resources. South Africa has a long history of tax incentives to attract oil and gas exploration/extraction via private leasing agreements. These incentives (known as OP 26 agreements) have assisted in attracting oil and gas investment to the South African west and southern coast lines. However, the pending expiry of these agreements has deterred investments as of late. The Bill accordingly renews and modernises key features of the OP 26 regime in more transparent and user-friendly form. The new regime also guarantees that these incentives will remain in place over the life of these investments, thereby ensuring fiscal stability.

Base Broadening Measures

Government's ability to provide tax relief is only possible because of our previous base broadening efforts through sound tax administration and modernised tax legislation, such as the Capital Gains Tax.

This year's amendments contain some key changes with regard to compliance measures related to large corporate taxpayers. The Commissioner has spoken many times about the need for corporate accountability, not only to shareholders but the nation at large. While most corporations have taken heed of this corporate responsibility (especially in the post-Enron era), some overly aggressive taxpayers and their facilitators remain. Transactions of this nature frequently turn simple finance schemes into complex mountains or paper, filled with excessive legality, all for the purpose of reducing tax liabilities. At the end of the day, these schemes cost the fiscus billions in tax revenue – money which can be much better spent for society's benefit elsewhere.

In light of the above, Government announced its intent to close these schemes through what is known as a revised "General Anti-Avoidance Rule."

Development of this legislation is nearly two years in the making after several rounds of consultations. The new legislation seeks to target the most serious elements of all these schemes. This legislation is to be backed up by an enhanced system of required reporting (known as "reportable arrangements") so Government has an early detection system. The goal is to reach a state where these schemes can become “dead on arrival” when presented to any responsible board of directors.

The GAAR and reportable arrangements legislation is admittedly contentious (as was the Capital Gains Tax) in part because of its complexity. Unfortunately, complex tax avoidance schemes require complex responses. At the end of the day, Government has a choice it can sit back in the name of “legal tradition” and let some unscrupulous individuals deprive the fiscus of vast sums of tax revenue, or take action so that the tax burden is shared equitably and tax revenues are generated to cater for the needs of society at large. In this case, Government clearly must choose the latter.

Selected Issues

Retirement Savings

National Treasury has taken a twin approach towards promoting retirement savings. One the one hand, taxation of retirement savings is being gradually reduced with the current rate now sitting at 9 per cent (as opposed to the previous 25 per cent rate several years ago). On the other hand, National Treasury has sought to apply regulatory pressure in order to ensure that retirement savings will not be unduly consumed by industry fees. As part of this effort, I entered into a Statement of Intent with the long-term insurance industry in December 2005 to recover retirement savings lost in fees on both a retroactive and prospective basis.

As you may well be aware, individuals risk losing all moneys previously contributed to retirement funds under various penalty clauses if they stop making ongoing contributions. The Statement of Intent seeks to curb this unhealthy practice. The Bill before you seeks to ensure that recovery of these penalties is not unduly delayed by virtue of withholding taxes (though such payouts remain subject to tax and must be included in individual tax returns).

Public Benefit Organisations (“PBOs”)

Government has been engaged in a long-term effort to establish the appropriate tax regime for PBOs. PBOs should generally be free from income tax, except to the extent they engage in commercial businesses that compete with the private sector.

The Bill before you is designed to further assist PBOs. The Bill eliminates many ongoing restrictions on their investments. PBOs can now freely invest their funds as desired as long as these funds do not represent a disguised distribution of profits. Other changes eliminate hurdles facing foreign PBOs seeking to provide assistance to our communities and those within the Southern African region. Also addressed in this Bill are problems associated with the current dual registration process. Under present law, PBOs must register with the Non-Profit Organisation within the Department of Social Welfare as well as SARS as a precondition for tax-exemption. The Bill eliminates the Non-Profit Organisation registration requirement; except that the Non-Profit Organisation can request tax exemption to be overturned if a PBO is convicted of an offence in terms of the Non-Profit Organisation Act. Lastly, the higher tax rate of 40 per cent for PBOs registered as trusts has been remedied. Trading activities of PBOs will now be subject to the company tax rate, 29 per cent.

As I close on this subject, I would ask this Parliamentary body to be mindful of the valuable contributions of the late Eugene Saldana in this regard. We hope that our efforts in this area can be a lasting tribute to his hard work.

Clubs

Clubs were subject to partial taxation many years ago but the taxation of clubs was “temporarily” eliminated as Government transitioned its way towards the present system tax regime for PBOs. The current regime provides an unfair benefit for clubs, all of which are completely tax-free without any regulatory restriction. The Bill accordingly seeks to restore the appropriate parity.

Internationally, clubs are entitled to some level of tax exemption because members are merely sharing recreational expenses within a single fund. This sharing should not attract taxation. However, investment income is another matter; individuals are not entitled to tax-free investment income merely because that income is consumed for recreational activities – the same should hold true for clubs. Other areas of concern are club activities that compete with the private sector and are wholly unrelated to the club’s objects (such as fees from the rental of facilities for wedding parties for non-club members).

The Bill accordingly seeks to achieve this balance. Membership fees and other club member payments will generally remain free from income tax. Investment and unrelated business income will be taxable. However, investment and unrelated business income will be given some measure of tax relief in order to assist many smaller clubs linked to grass-root communities as well as to reduce unnecessary disputes over trivial amounts. The Bill exempts the trading and investment income of a club up to the greater of 5 per cent of its membership fees or R50 000. This exemption is similar to the current exemption for PBOs.

I would like to thank the Chairman Nhlanhla Nene for his leadership, and the members of the Portfolio Committee for their constructive role in the process. Our goal – as always – is economic growth that benefits all South Africans. That said, Madame Speaker, I hereby table the "Revenue Laws Amendment Bill, 2006."