MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

INTRODUCTORY SPEECH BY FINANCE MINISTER PRAVIN GORDHAN

TAXATION LAWS AMENDMENT BILLS, 2009

1 September 2009

Introduction

Mister Speaker, it gives me great pleasure to introduce the "Taxation Laws Amendment Laws Bills, 2009". These bills contain the tax proposals as announced in the February 2009 Budget Speech by the previous Minister of Finance and as elaborated on in the 2009 Budget Review.

For technical reasons, the amendments are split into two Bills - a money Bill (under section 77 of the Constitution) and an ordinary (or section 75) Bill. Given the 2009 general elections and the subsequent convening of the fourth democratically elected parliament, it was decided to introduce only one set of taxation amendments this year. There will therefore be no Revenue Laws Amendment Bills in 2009. It is my view that we should continue to strive towards having only one set of major taxation amendment Bills each year going forward, to allow for time to consult more widely and more effectively.

Impact of the global crisis

Mister Speaker, the global crisis continues to weigh heavily on economies around the world. Budget deficits have soared to unprecedented heights as tax revenue has fallen sharply. Employment is falling in almost every country.

The 2009 Taxation Laws Amendment Bill contains the tax measures announced in the 2009 Budget that, together with other aspects of the fiscal framework, provide support to the domestic economy through this extraordinary period in our history. We hoped at that time that South Africa would escape the economic crisis relatively unscathed. The economy continued to grow, although at a slower pace than during the boom. The first contraction in our economy was seen in the final quarter of 2008, but at 1.8%, it was still much less severe than the large contractions seen in other emerging markets, such as South Korea, Mexico and Thailand. We responded by choosing to sustain growth in infrastructure spending, to support well-targeted industrial development programmes, to broaden social security benefits, and to continue to invest in education, health and other public services. Our budget deficit estimate for 2009/10 was revised to 3.8% of GDP, a swing of nearly 5 percentage points, and the public sector borrowing requirement was sharply increased to reflect the policy intention to raise borrowing from domestic and foreign sources to support demand in the economy as a whole.

However, the global downturn has been worse than expected and South Africa is now in recession, the first in over 17 years. While there are indications that the South African economy might have reached the bottom of this sharp downturn, the road to recovery will be slow and gradual.

Fortunately, given the sound manner in which our fiscal framework has been managed over the years, and combined with sound tax policy reforms and tax administration, we can honour our spending commitments announced in February 2009. Our fiscal expansion is having a positive effect on our economic performance. In particular, the acceleration of infrastructure spending is contributing to both greater long term capacity and short term employment creation. These measures have not offset the full effect of the decline in global demand, but the situation would have been far worse had we firstly not anticipated the crisis, and secondly not acted as boldly as we have done and in the manner in which we have done.

The past year has shown us that capitalism is prone to periods of excess and exuberance. One of the roles of this administration going forward is to ensure that the poor and vulnerable are protected from the effects of these boom-bust cycles. It is in the rising numbers of unemployed that we observe the very real human costs of this economic crisis. In South Africa employment has fallen by 3.5% since the last quarter of 2008.

Additional measures like the proposed training layoff scheme provide a layer of protection for workers, giving firms an alternative to retrenchments during the recession. The expanded public works programme should help to provide additional job opportunities. For some economies, such as in Europe, wage moderation and firm-level flexibility have helped keep people in jobs

Going forward, our economic growth path has to be a more labour absorbing one. Reducing unemployment is our single biggest priority in the decade ahead. For us to succeed here, we need a radical departure from 'business as usual'. The public sector needs to create many more jobs, mainly through its infrastructure programme and through the delivery of labour intensive services, such as early childhood education and home-based care. The broader South African economy needs to become more competitive in its ability to grow exports to finance the consumption and investment needs of our domestic economy.

The world economy is on the cusp of recovery, but it may be a weak one. As South Africans, we need to find a sustainable path to renewal and economic development. There has been robust spending for many years by government, in support of the broader renewal of our economy, community, public services and infrastructure. We need to ensure that our economy is able to sustain that spending. A challenge is to ensure the effectiveness of the services we provide. Our health, education, transportation, and safety and security systems must help solve the tough challenges faced by ordinary South Africans every day. Over the next few years, we face the difficult challenge of doing more and better without additional resources. This will require a change in leadership style, in organisational culture and in structures of accountability in the public service. President Zuma has taken the lead in calling for more effective service delivery and better performance by government institutions. It is up to all of us to rise up to this challenge.

TLAB

The 2009 Taxation Laws Amendment Bills deal with wide-ranging amendments to various tax acts, including the Income Tax Act, the Value Added Tax Act, the Customs and Excise Duty Act and the Estate Duty Act. Some of the amendments that will be formally enacted in terms of these Bills have already taken effect, such as the increases in the excise duties, the fuel levies and the revised personal income tax tables for 2009/10.

Individuals

For individuals, the most important amendment was the adjustment to the personal income tax thresholds, which resulted in tax relief for individuals estimated at R13.5 billion. Other important amendments relate to the taxation of lump sum withdrawals from retirement savings before retirement and on retrenchment, especially in the current economic environment.

A significant simplification of the tax treatment of lump-sum payments from retirement savings upon retirement, and pre-retirement lump sum withdrawals, will be implemented as from this year. For pre-retirement lump sum withdrawals from retirement savings, the first R22 500 will be tax-free. The marginal tax rates on larger lump sums range from 18 per cent to 36 per cent for lump sums in excess of R900 000. In the case of a lump sum upon retirement, the first R300 000 is tax-free and the marginal tax rates also range from 18 per cent to 36 per cent for lump sums above R900 000. In an attempt to encourage individuals to preserve their retirement savings for the time they actually retire, the law provides for a more generous tax-free amount upon retirement. In addition, and to limit potential abuse, all lump-sum withdrawals and payments will be **aggregated** over the life of the taxpayer**,** meaning that once the tax-free portion has been used, it cannot be used again; subsequent lump-sums will be taxed at higher marginal rates.

Given concerns about the plight of workers that are losing jobs in the current economic climate, and as part of the measures agreed on through the NEDLAC process to help alleviate the impact of the current economic crisis, the draft Bills propose that withdrawal from retirement funds on retrenchment will qualify for the R300 000 exemption - the same as upon retirement. This concession will allow taxpayers significant tax relief in instances where circumstances beyond their control force them to make use of their retirement savings due to involuntary unemployment.

However, it should be noted that the principle of aggregation will still apply. Once a taxpayer has used all the benefits of the R300 000 tax free threshold, either as a result of one or a number of retrenchments, it will not be available for subsequent lump-sum payments. Employees should therefore, as far as possible be encouraged to preserve their retirement savings (and severance packages) for retirement.

Amendments to the Estate Duty Act seek to assist middle-income families and broaden the tax relief that some taxpayers could only access through advice from (expensive) tax planning experts. The amendments will allow the R3.5 million deduction for estate duty purposes to automatically rollover from the first deceased spouse to a surviving spouse or spouses. The surviving spouse or spouse will therefore have access to a deduction of up to R7 million on the second spouse's death.

In order to improve the equity of the income tax system and to broaden the tax base, the tax treatment of travel allowances will be reformed. The deemed kilometre method for deducting travel expenses will be repealed with effect from 1 March 2010. This amendment will eliminate an unintended subsidy for commuting by car (a personal expense). Individuals who use their private vehicles for businesses purposes and who receive a travel (car) allowance will still be able to claim these expenses by maintaining a logbook of business kilometres travelled. The PAYE system for travel (car) allowances will be adjusted so that 80 per cent of this allowance will be subject to PAYE. The 80 per cent rule will prevent under-withholding from taxpayers once the deemed kilometre method is repealed.

Business taxation

In terms of business taxation, the focus of the Bills are on further refinements to the proposed Dividends Tax that will replace the Secondary Tax on Companies, tax relief for certified emission reductions (CERs) and proposed tax incentives for energy efficiency savings by businesses. The Bills also refine the tax incentives for venture capital companies, and provide another opportunity for taxpayers to unwind legal entities that were set up to 'house' residential properties to minimise certain taxes – these loopholes have since been closed. The Bills provide for a more favourable depreciation regime for submarine telecommunication cables, to enhance efforts to improve our telecommunication networks and provide greater access to broadband. The learnership tax allowance is being streamlined and made more generous for longer-term apprenticeships. On the tax administrative side, the provisional tax payment system is being more closely tailored to taxpayer circumstances.

With respect to the proposed Dividends Tax, taxpayers will not be allowed to convert the taxable sale of shares into tax-exempt pre-sale dividends, and the new Dividends Tax will be imposed in respect of deemed dividends (e.g. loans to connected persons). The legislation also creates a level playing field for both domestic and foreign shares listed on the JSE. Hence, the 10 per cent tax on dividends will also apply to foreign shares listed on the JSE.

The learnership tax incentive to encourage employers to up-skill their employees through registered learnerships or apprenticeships is being streamlined and further enhanced. If an employee successfully completes a 12 month learnership, his or her employer will be able to claim an additional deduction of R60 000. This will result in tax relief of R16 800 per employee for an employer registered as a company. Where an employee successfully completes a three year apprenticeship, the employer will be able to claim an additional allowance of R180 000 at the end of the third year, resulting in a tax relief of R50 400 per employee. A more generous dispensation applies to employers who train employees with disabilities.

The sale of certified emission reductions (also known as carbon emission reductions credits) will be exempt from income tax. Businesses will obtain notional deductions for income tax purposes for energy efficiency savings, from certified baselines based on energy efficiency savings certificates. However, the implementation of the proposed energy efficiency savings tax incentives will only become effective after further consultation with the Departments of Trade and Industry, Energy, and other stakeholders.

The provisional tax system was tightened in 2008 to do away with the so-called "basic amount" and require 80 per cent accuracy in respect of the second provisional payment when compared to final assessed taxes due. Failure to meet this requirement would be subject to an automatic penalty of 20 per cent of the shortfall. Given concerns that meeting this 80 per cent requirement may not always be possible (especially for less sophisticated taxpayers), a two tier system is proposed: one for smaller taxpayers with annual taxable income of up to R1.0 million and one for larger taxpayers. Smaller taxpayers will have to adhere to the previous 90 per cent requirement, but the safe harbour of the basic amount will be reinstated. However, this amount will be increased by 8 per cent per year if it is more than a year out of date. Larger taxpayers will have to adhere to the 80 per cent requirement, but the imposition of the 20 per cent penalty will no longer be automatic.

The Bills also clarify provisions in respect of the principle of "pay now argue later". I must say there has been some misinformation on this issue. I hope the revised legislation provides for clarity and fairness in this regard, in accordance with existing case law and international experience.

Special circumstances

The Bills also contain a number of smaller policy and other technical amendments which are mostly of interest to the tax specialists, but which we should all take note of. I will not elaborate on these issues, unless you would like to be here for the next three hours. However, one of the amendments worth mentioning is the provision for the tax deductibility of contributions to the Consumer Education Foundation of the Financial Services Board that will facilitate the financial education of consumers. The need for more comprehensive efforts to improve the financial literacy of consumers has been highlighted during the current economic crisis, and is evident by the high debt levels of many consumers. The efforts of the Financial Services Board should complement other efforts in this regard, such as those provided for in the National Credit Act.

These difficult times have another impact. We have seen recognisable improvements in tax compliance and morality when times were good. Unfortunately, the peak of the economic cycle and now the downturn have tempted some to regard tax as just another expense to be minimised. It is not. Now, more than ever, it is a vital contribution to a strong and functioning democracy.

The results of this temptation have shown themselves across the board. In the large corporate space, international transactions and structures have been used to minimise income, maximise expenses or otherwise manufacture inappropriate tax benefits. More troublingly, the use of “structural fog”, limited disclosure or even non-disclosure seem to be a part of many attempts to secure these benefits. It is for this reason that South Africa supports international efforts to improve transparency and exchange of information in tax matters. Two senior SARS officials are participating in the Global Forum on this topic being held in Mexico as I speak. We will continue to co-operate with our existing treaty partners to identify structures. We will improve treaties in our existing network and expand the network.

Domestically VAT remains a concern. VAT refund levels are high, with a large number of vendors consistently claiming refunds. While this is understandable in some cases it requires investigation in others. Less understandable is the steady growth in the number of returns that have not been filed on time or that have been filed without payment. VAT that you and I have paid over on our purchases is being used by these vendors and not to address the challenges our country faces. Taken together with the incidence of fraudulent VAT refund claims, SARS has been forced to tighten its VAT registration requirements and give greater attention to other aspects of the VAT system.

In the personal income tax space, the growth in the number of taxpayers filing electronically and on time has been most encouraging. Yet even here we have seen a growth in the number of outstanding returns, especially amongst those who are likely to owe money on assessment. This is a situation that cannot be allowed to continue. SARS is far more willing to be sympathetic if you come to them before they come to you. And they will come.

I would like to thank the Chairman Mr. Mufamadi for his leadership, and the members of the Standing Committee on Finance for their constructive role in the process. Mister Speaker, I hereby table the “Taxation Laws Amendment Bills, 2009”.