18 September 2019

Draft Response Document on the 2019 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2019 Draft Income Tax Amendment Bill, 2019 Draft Taxation Laws Amendment Bill and 2019 Draft Tax Administration Laws Amendment Bill.

(Based on hearings by the Standing Committee on Finance and Select Committee on Finance in Parliament on 10 September 2019)

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1. BACKGROUND

1.1. PROCESS

Subsequent to the tax pronouncements made by the Minister of Finance (the Minister) as part of the 2019 Budget announcements on 20 February 2019, the 2019 annual draft tax bills were published to give effect to the tax proposals announced in the Budget. These 2019 annual draft tax bills include the following, the 2019 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (Rates Bill), the 2019 Draft Income Tax Amendment Bill, the 2019 Draft Taxation Laws Amendment Bill (TLAB), and the 2019 Draft Tax Administration Laws Amendment Bill (TALAB).

The 2019 Draft Rates Bill was first published on the same day as the Budget (20 February 2019), and published for the second time on 21 July 2019 in order to solicit comments on the tax proposals contained therein. The 2019 Draft Rates Bill contains tax announcements made in the 2019 Budget, dealing with changes in rates and monetary thresholds, changes to personal income tax tables, increases of the excise duties on alcohol and tobacco and adjustments to the eligible income bands that qualify for the employment tax incentive.

The 2019 Draft TLAB and 2019 Draft TALAB were published on 21 July 2019 and contain more complex, technical and administrative tax proposals announced in the 2019 Budget.

This year, a separate 2019 Draft Income Tax Amendment Bill was published on 30 July 2019, which contains environmental incentive announcements made in the 2019 Budget that deal with the repeal of the exemption for certified emissions reductions as well as the extension of the of the energy efficiency savings incentives. These changes provide the necessary legislative amendments required to implement the carbon tax, which came into effect on 1 June 2019.

Due to constitutional requirements, the draft tax bills are divided into two separate categories, i.e., money bills in terms of section 77 of the Constitution dealing with national taxes, levies, duties and surcharges (for example the 2019 Draft Rates Bill, 2019 Draft TLAB and 2019 Draft Income Tax Amendment Bill) and an ordinary bill in terms of section 75 of the Constitution, dealing with tax administration issues (for example, 2019 Draft TALAB).

1.2. PUBLIC COMMENTS

The 2019 Draft Rates Bill, 2019 Draft TLAB and 2019 Draft TALAB were published for public comments on 21 July 2019 and the 2019 Draft Income Tax Amendment Bill was published for public comments 30 July 2019. The closing date for public comments on the above-mentioned 2019 draft tax bills was 23 August 2019. National Treasury and SARS received written comments from 77 organisations and 600 individuals (see Annexure A and B attached). National Treasury and SARS also

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engaged stakeholders that submitted comments in more detail through workshops that were held in Pretoria on 5 and 6 September 2019.

National Treasury and SARS briefed both the Standing Committee on Finance (SCoF) and Select Committee on Finance (SECoF) on the 2019 draft tax bills on 3 September 2019. Subsequently, on 10 September 2019, the SCoF and SECoF convened public hearings on these 2019 draft tax bills. There were about 14 organisations that were present at the public hearings held by the joint SCoF and SECoF meeting.

Today, on 18 September 2019, National Treasury and SARS present to both the SCoF and SECoF the 2019 Draft Response Document on the 2019 Draft Rates Bill, 2019 Draft Income Tax Amendment Bill, 2019 Draft TLAB and the 2019 Draft TALAB. The 2019 Draft Response Document contains a summary of draft responses to the public comments received and proposed steps to be taken in addressing the key issues raised during the consultation process.

After the SCoF and SECoF have considered the draft Response Document, it will be presented to the Minister for approval, including approving consequential amendments to the 2019 draft tax bills, prior to the formal introduction/tabling in Parliament in October 2019.

1.3. POLICY ISSUES AND RESPONSES

Provided below are the responses to the key issues raised during the public consultation process in respect of the 2019 Draft Rates Bill, 2019 Draft Income Tax Amendment Bill, 2019 Draft TLAB and 2019 Draft TALAB. These comments will be taken into account in finalising the draft tax bills to be formally introduced/tabled in Parliament. Comments that are outside the scope of the draft tax bills are not taken into account for purposes of this response document.

1.4. SUMMARY

This response document includes a summary of the key written comments received on the 2019 Draft Rates Bill, 2019 Draft Income Tax Amendment Bill, 2019 Draft TLAB and 2019 Draft TALAB released for public comment as well as other key issues raised during the public hearings held by both the SCoF and SECoF on 10 September 2019.

2019 Draft Rates Bill

The main comments are the following:

- Increase of excise duty on tobacco

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Carbon Tax Amendments
The main comments are the following:

2019 Draft Income Tax Amendment Bill
- Repeal of the tax exemption for Certified Emission Reductions
- Extension of the Energy Efficiency Savings Tax Incentive

Technical carbon tax amendments in the 2019 Draft TLAB

2019 Draft TLAB

The main comments are the following:

A. Individuals, Savings and Employment
- Reviewing the tax treatment of surviving spouse pensions
- Tax treatment of bulk payments to former members of closed funds
- Exemption relating to annuities from a provident or provident preservation fund
- Aligning the effective date of tax neutral transfers between retirement funds with the effective date of all retirement reforms
- Reviewing measures aimed at avoiding Estate Duty
- Extending the scope of amounts constituting variable remuneration

B. Business Tax (General)
- Addressing abusive arrangements aimed at avoiding the anti-dividend stripping provisions
- Correcting anomalies arising from applying anti-value shifting rules
- Refining provisions around the special interest deduction for debt funded share acquisitions
    - Clarifying the exclusion from interest deductions for debt financed acquisitions of start-up businesses
    - Amending the special interest deduction rules in respect of share acquisitions funded by debt to allow for deductions after unbundling transactions
- Clarifying the interaction between corporate reorganisation rules and other provisions in the Income Tax Act
    - Clarifying corporate reorganisations rules relating to exchange items and interest-bearing instruments
    - Refining the interaction between the anti-avoidance provisions for intra-group transactions

C. Business Tax (Financial Institutions and Products)
- Clarifying inconsistencies in the current Real Estate Investment Trust (REIT) tax regime
    - Amendment of the definition of rental income in the REITs tax regime in respect of foreign exchange differences

- Clarification of the interaction between corporate reorganisation rules and REITs tax regime
- Taxation of long-term insurers
  - Refinement to taxation of risk policy funds of long-term insurers
  - Alignment of the tax treatment of "deferred revenue" between long-term and short-term insurers
- Consequential amendments to tax treatment of doubtful debts for banks in terms of section 11(jA)

D. Business Tax (Incentives)

- Refining the Special Economic Zone (SEZ) tax incentive regime
  - Aligning the tax provisions of SEZ with the overall objectives of the SEZ regime
  - Reviewing the SEZ anti-profit shifting measures
- Reviewing the venture capital company tax incentive regime
- Employment Tax Incentive (ETI)
  - Updating the employment tax incentive to align with the national minimum wage
  - Clarifying the interaction between the employment tax incentive and the special economic zone provisions
- Repeal of the retrospective approval of tax exempt status for Public Benefit Organisations (PBOs) and recreational clubs

E. Business Tax (International)

- Reviewing the comparable tax exemption of controlled foreign companies
- Considering the "affected transaction" concept in the arm's length transfer pricing rules
- Reviewing the definition of "permanent establishment"

F. Value Added Tax

- Reviewing section 72 of the VAT Act
- Refining the VAT treatment of foreign donor funded projects

G. Customs and Excise Act

- Ad-valorem excise duty on motor vehicles

2019 Draft TALAB

The main comments are the following:

H. Income Tax Act

- Removal of per payment declaration that royalties and interest are exempt or subject to a reduced rate in terms of a double taxation agreement
- Removal of requirements to submit a declaration to a regulated intermediary in respect of tax free investments

I. Customs and Excise Act

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- Authorisation for the Commissioner to prescribe rules relating to the making of advance foreign currency payments

J. Tax Administration Act

- Extension of notice period to institute legal proceedings against the Commissioner
- Common Reporting Standard mandatory disclosure rules and non-compliance penalties
- Completing move from tax compliance certificate to tax compliance status

2019 DRAFT RATES BILL

2. INCREASE ON EXCISE DUTY ON TOBACCO

2.1. Increase in excise duty on Tobacco:

(Mail reference: Section 65 of the Customs and Excise Act: clause 63 of the Draft TLAB:)

In the 2019 Draft Rates Bill, changes were made to increase the excise duties on tobacco products in Schedule II (Section 4), Amendment of Part 2A of Schedule No.1 of Customs and Excise Act.

Comment: An increase in taxes, and therefore an increase in the price to consumers of legal tobacco products, drives consumers to cheaper, illegal products. If the current situation continues, where the excise framework remains unbalanced, excise increases are roughly 8 per cent per year, and enforcement action against illicit trade remains limited. It is our forecast that the illicit market will outgrow the legal market, within 5 years. This will have a devastating impact on the total legal tobacco value chain, including commercial and emerging farmers in deep rural areas of our country. Tobacco farmers have already experienced a 15 per cent decrease in the demand for tobacco leaves over the past two years as a direct result of the illegal trade.

Response: Not accepted. Increases in excise rates are not responsible for the growth of illicit trade in tobacco products, but rather due to a lack of legal enforcement and the criminal nature of the activities. There have been problems with enforcement over the last couple of years which has led to the surge in illicit trade. SARS is however rebuilding capacity and strengthening enforcement to address problems of illicit economy (especially in tobacco).

"The tobacco industry and others often argue that high tobacco product taxes lead to tax evasion. However, the evidence shows that non-tax factors including weak governance, high levels of corruption, poor government commitment to tackling illicit tobacco trade, ineffective customs and tax administration, and informal distribution channels for tobacco products are often of equal or greater importance." - *WHO Tobacco Fact Sheet 26 July 2019.*

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Comment: It is requested that excise rates on cigarettes are held at current levels for at least three years or until the illicit trade has been drastically reduced. An excise freeze (R833/1000 sticks) on cigarettes for 3 years is needed to allow consumers to afford legal cigarettes.

Response: Not accepted. There is an excise tax policy in place to increase the excise rates by at least inflation or targeted incidence, whichever is higher, on an annual basis. Addressing the concerns regarding illicit trade in tobacco products will happen concurrently with the implementation of the excise tax policy on tobacco products.

Comment: It is recommended that less harmful tobacco products be given subcategory role, and an excise rate that reflects the harm associated with the product. As these categories are new in the tobacco category, affording consumers options to migrate to these new products as harm reduced products must outweigh the need to tax them on the same level as cigarettes. Using the Risk Continuum Model, as a guiding tool for excise structuring, tobacco heated products, for example, must carry an excise rate equivalent to their harm and the premium price position they currently occupy. On the other hand, nicotine containing chemical preparations have 95 per cent less harmful health effects and should be encouraged as a substitute product to cigarettes.

Response: Accepted. Government had already indicated in the 2019 February Budget that the use of electronic cigarettes and tobacco heating products has increased in recent years, and it intends to start taxing these products. The process will be completed in consultation with the National Department of Health, who have already started a process of amending the current tobacco legislation through the "Control of Tobacco Products and Electronic Delivery Systems Bill". The excise policy work in this regard is currently underway.

Comment: The current fiscal framework for the tobacco category reveals that cigarettes carry the highest excise rate within the tobacco products category. Pipe tobacco (a semi-finished tobacco product) and water pipe tobacco, which carry similar harmful effects as cigarettes are given reprieve, indexing 21 per cent of cigarettes excise rate. The current excise framework is unbalanced, and can no longer deliver revenues as expected without a policy review that internalises harm and captures the revenue opportunity from the non-cigarette tobacco subcategories.

Response: Not accepted. The tobacco excise policy uses the targeted incidence approach that is set at 40 per cent of the retail selling price of the most popular brand within each product category. Also, cigarettes make up the majority of the tobacco market.

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CARBON TAX AMENDMENTS

3. 2019 DRAFT INCOME TAX AMENDMENT BILL

3.1. Repeal of the tax exemption for Certified Emission Reductions

(Main reference: Section 12K of the Income Tax Act: clause 1 of the Draft Income Tax Amendment Bill)

In 2009, government introduced the tax exemption for income generated from the sale of certified emission reduction credits arising from projects developed under the Clean Development Mechanism (CDM) of the Kyoto Protocol. The main aim of the incentive was to promote investments in eligible low carbon initiatives. Under the Carbon Tax Act, No 15 of 2019 ("Carbon Tax Act"), which became effective on 1 June 2019, taxpayers will now qualify for a carbon offset allowance of up to a maximum of 10 per cent of its total greenhouse gas emissions under the Carbon Tax Act. To avoid a double benefit scenario, where the same emissions reductions lead to both an income tax exemption under section 12K of the Act and a lower carbon tax liability for a taxpayer under the Carbon Tax Act, it is proposed that the tax exemption for certified emission reduction units from CDM projects is repealed to become effective from the date of introduction of the carbon tax.

Comment: Stakeholders acknowledged the potential for double benefits to project developers including taxpayers undertaking CDM projects. There were suggestions from stakeholders that the exemption should continue but is limited to those credits from projects that will not be used as offsets under the carbon tax.

Response: Not accepted. The carbon tax creates the economic incentives for the uptake of carbon offset projects in South Africa by helping to improve the financial viability of low carbon projects and making these projects more cost competitive with high carbon emitting initiatives. The offset allowance provides an additional incentive for taxpayers to invest in low carbon projects and to help reduce their tax liability. To date, since the introduction of the tax exemption for CERs, there has also been a limited uptake of CDM projects in South Africa with only 15 projects issued with carbon credits. In light of this, the primary instrument that will drive investments in carbon offset projects over the short, medium and long term will be the carbon tax.

Credits generated from projects developed under the CDM, Gold Standard (GS) and Verified Carbon Standard (VCS) can be used as offsets under the carbon tax. Maintaining the tax exemption for CERs could create further distortions in the market where credits from CDM projects qualify for preferential tax treatment compared to credits generated under the GS and VCS. The repeal of the tax exemption will ensure a more equitable tax regime where offsets generated under the different carbon standards will be subject to similar tax treatment.

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3.2. Extension of the Energy Efficiency Savings Tax Incentive

(Main reference: Section 12L of the Income Tax Act: clause 2 of the Draft Income Tax Amendment Bill)

In 2013, Government introduced the energy efficiency savings tax incentive to encourage investments in energy efficiency measures to help reduce emissions of greenhouse gases, address climate change, and promote efficient energy use. To date, the incentive has helped to promote significant investments in energy intensive sectors such as mining as well manufacturing amounting to about R 3 billion in total. The energy efficiency savings tax incentive has a sunset provision where only energy efficiency savings generated prior to the year of assessment ending before 1 January 2020 will be eligible to qualify for the incentive. During stakeholder consultations on the carbon tax, there were views that the energy efficiency savings tax incentive should be extended beyond 2020 to ensure that there is long term policy certainty on revenue recycling commitments made under the carbon tax. It was therefore proposed to extend the duration of the incentive to be aligned with the first phase of the carbon tax, ending 31 December 2022.

Comment: There was broad support by stakeholders for the extension of the duration of the incentive. Some stakeholders were of the view that the incentive should be extended beyond 2022.

Response: <u>Noted.</u> As part of the holistic review of the Section 12L incentive, government will consider the overall design, administration and economic feasibility of the incentive.

4. Technical Carbon Tax Amendments in 2019 Draft TLAB

(Main references: Sections 1, 3, 4, 5, 7, 8, 9, 13 & Schedules 1 & 2 of the Carbon Tax Act: clauses 83 to 92 of the Draft TLAB)

The President signed into law the Carbon Tax Act No 15 of 2019 on 22 May 2019 giving effect to the carbon tax from 1 June 2019. Technical amendments were proposed in the 2019 Draft TLAB including clarifications of definitions, applicable thresholds, the tax base, units in the formula, and tax free allowances.

4.1. Thresholds applied for taxpayers to be liable for carbon tax

To ensure alignment with the Department of Environment Forestry and Fisheries (DEFF) requirements for reporting of GHG emissions, it is proposed that those subject to the carbon tax would undertake activities that are not only above the thresholds provided but also meet the thresholds for reporting GHG emissions to DEFF.

Comment: Taxpayers suggest that the DEFF documents are aligned with the Carbon Tax Act and refer only to those activities above the threshold.

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Response: Not accepted. The Carbon Tax Act is aligned with the requirements of the DEFF for GHG emissions reporting.

4.2. Clarification of the carbon tax base

The proposed amendments in section 4 seek to clarify the different types of emissions methodologies that can be utilised by a taxpayer to calculate its emissions of greenhouse gases from energy and industrial processes, and fugitive emissions. Proposed amendments to Section 4(1) clarify that taxpayers may use a company specific emissions methodology or tier 3 methodology approved by the Department of Environment, Forestry and Fisheries (DEFF) to calculate its total greenhouse gas emissions. If a company specific emissions methodology has not been developed and approved by the DEFF, the proposed amendments to Section 4(2) taxpayers clarifies that taxpayers will be required to use emission factors defined in the 2006 Intergovernmental Panel on Climate Change (IPCC) Guidelines or country specific emissions factors to determine their total greenhouse gas emissions.

Comment: Some stakeholders were of the view that this section should be deleted. It is noted that GHG emissions are reported to the DEFF therefore there is no need for the Carbon Tax Act to provide for the calculation of emissions.

Response: Not accepted. On several occasions stakeholders were informed that Section 75 / 77 of the Constitution for money bills requires that the tax rate and tax base is defined. The Carbon Tax Act similar to other tax legislation therefore defines the tax base in sections 4(1) and (2) of the Act.

Comment: Stakeholders were of the view that the calculation of GHG emissions under the carbon tax and GHG emissions reported to the DEFF could produce different results due to the use of different Net Calorific Values (NCV). The methodology included in s4(2) of the Carbon Tax Act provides for a single NCV value for each activity. One of the suggestions is that the NCV values in Schedule 1 of the Carbon Tax Act are based on Annexure A of the Technical Guidelines and that the proposed country specific NCV values of the South African Petroleum Industry Association (SAPIA) in Annexure D of the Technical Guidelines should be considered.

*Response.*Partially accepted. Based on discussions with the DEFF, the National Treasury proposes that the NCV values for the fuels defined in Schedule 1 of the Carbon Tax Act should also include IPCC expected NCV values range. This will ensure alignment with GHG Emissions Reporting requirements of the DEFF and cater for scenarios for taxpayers may use an NCV value other than the Default IPCC NCV reflected in the schedule 1 currently.

Although National Treasury notes the importance of achieving the highest level of accuracy in the GHG emissions calculated, from a tax perspective, NT is concerned about the potential risk of tax avoidance that could arise through adjustments in the final emission factors which would result in lower levels of emissions disclosed and therefore undermine the carbon tax base.

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The case of motor vehicle manufacturers Volkswagen should, for example, be taken into account where mechanisms were developed to inaccurately measure and disclose emissions from vehicles. To minimise possible tax avoidance, it is proposed that where NCVs used by taxpayers differ from the Tier 1 IPCC default NCV factors, a scientific report which is assessed and verified by the DEFF should accompany taxpayer returns.

4.3. Clarification of Formulas for determining the total emissions of a taxpayer

The formulas to be used by taxpayers to determine the total GHG emissions are reflected in different units including the energy content and volume of fuels. It is proposed that these units are amended to allow for a conversion of units from kg to tonnes, and to specify density factors in the calculation for converting from volume to mass of fuel.

Comment: The clarification of the units was welcomed. Some stakeholders suggested that a density factor is also provided for CO_2 emissions from coal mining and handling.

Response: Noted. Further engagements between stakeholders and the DEFF will be required on an appropriate density factor.

2019 DRAFT TAXATION LAWS AMENDMENT BILL

5. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

5.1. Reviewing the tax treatment of surviving spouse pensions

(Main Reference: Paragraph 2 of the Fourth Schedule to the Act: clause 48 of the Draft TLAB)

Members of retirement funds can deduct contributions to their retirement funds from their taxable income when determining their monthly employees' tax and annual income tax payable. Upon the death of a member, the surviving spouse may be entitled to receive a monthly spousal pension from the retirement fund. This spousal pension is taxable in the surviving spouse's hands by the retirement fund. If the surviving spouse also receives a salary or other income, that salary or other income is added to the "surviving spouse's pension" to determine his or her correct tax liability on assessment. The result of the assessment is that the surviving spouse has a tax liability that exceeds the employees' tax withheld by the employer and retirement fund(s) during the year of assessment, since both the retirement fund and the employer apply the rebates when estimating the tax liability (but the rebates can only be used once) and the aggregation of income pushes them into a higher tax bracket. It has come to Government's attention that in most cases, the surviving spouse does not foresee the additional tax liability, and this creates a cash flow burden and tax debt for the surviving spouse. In

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order to alleviate the financial burden, it is proposed that the tax rebates should not be taken into account when calculating taxes to be withheld by the retirement funds on the spousal pension.

Comment: There is no clarity with regard to whom the proposed amendment is meant to apply to, as the draft legislation seems to imply that it would apply to taxpayers other than surviving spouses.

Response: Noted. The policy rationale regarding the proposed amendment was to assist surviving spouses. Based on the comments received, it is clear that taxpayers other than surviving spouses are also impacted. In order to cater for this, it is proposed that the amendment should be extended to apply to any taxpayer receiving two or more sources of remuneration, provided that one of those sources is from a retirement fund or an insurer.

Comment: The proposed amendment would be administratively burdensome for both SARS and retirement funds, and can therefore not come into effect on 1 March 2020.

Response: Accepted. In order to provide both SARS and taxpayers more time to ready their systems for the changes and implementation required as a result of the proposed amendment, it is proposed that the effective date for the proposed amendment be postponed from 1 March 2020 to 1 March 2021.

5.2. Tax treatment of bulk payments to former members of closed funds

(Main reference: new paragraph 2D of the Second Schedule to the Act: clause 46 of the Draft TLAB)

In 2009, the Minister of Finance published a notice in Government Gazette No. 32005 approving retirement funds to make tax free payments of "undisclosed secret profits" based on certain criteria. When the notice was published, some retirement funds were no longer registered and these deregistered retirement funds had already paid amounts to the fund administrators but the amounts were not yet paid to the affected members and/or beneficiaries. In order to ensure consistent tax treatment, it is proposed that changes be made in the Act to make provision for the payment of amounts currently held by fund administrators on behalf of deregistered funds to qualify for tax exemption, provided that they meet the criteria to be determined by the Minister in a notice in Government Gazette.

Comment: The current wording of the proposed amendment, specifically "*held by or under the control of an administrator*" creates the impression that the money held by the funds is an asset belonging to the funds as opposed to the rightful beneficiaries.

Response: Not Accepted. The proposed words "*held by or under the control of*" make it clear that this refers to money or assets held in possession. Possession does not imply ownership thereof.

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5.3. Exemption relating to annuities from a provident or provident preservation fund

(Main references: section 10C of the Act: clause 14 of the Draft TLAB)

In 2016, Government introduced some of the broader objectives of the retirement reforms. As a result, contributions by both employers and employees to pension, provident and retirement annuity funds qualify for a tax deduction from employees' taxable income, subject to caps. On the other hand, contributions by employers to pension, provident and retirement annuity funds on behalf of employees are taxable fringe benefits in the hands of employees. Consequently, members of provident funds receiving an annuity found themselves in a position where any non-deductible contributions could only be off-set against the lump sum received and the balance of the non-deductible contributions in excess of the lump sum received is forfeited or lost. In order to promote uniform tax treatment of all retirement funds, it is proposed that provident fund members who receive annuities qualify for the same tax exemption status that would be applicable to other retirement fund members.

Comment: The proposed amendment should be applicable to provident and provident preservation fund members irrespective of how much of their retirement benefit is taken as a lump sum upon retirement. Further to the above, the effective date should apply retrospectively with effect from 1 March 2019 instead of 1 March 2020.

Response: Noted. The requirement for provident and provident preservation fund members to annuitize at least two-thirds of their retirement benefit in order to receive the section 10C exemption shall be delayed until the effective date of the annuitisation provisions, i.e. 1 March 2021. With regard to the comment that the effective date should apply retrospectively with effect from 1 March 2019, this is not accepted. It is proposed that the effective date remain unchanged, i.e. will apply with effect from 1 March 2020, in line with the start of the next tax year for individuals, to allow for the necessary system and process changes.

Comment: The current structure of the provision limits the effectiveness of the relief provided under section 10C, as the allowable deduction is rarely exceeded. The relief measure should be amended, and an additional R500 000 exemption should apply in instances where a taxpayer has not previously received a lump sum in their lifetime and the annuity received is below the tax threshold.

Response: Not Accepted. Changing the structure of the provision will require further amendments to this section once the annuitisation provisions come into effect, this could result in avoidable complications to the tax system.

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5.4. Aligning the effective date of tax neutral transfers between retirement funds with the effective date of all retirement reforms

(Main reference: Paragraph 6(1)(a) of the Second Schedule to the Act: clause 47 of the Draft TLAB)

In 2013, retirement fund reform amendments were effected to the Act regarding the annuitisation requirements for provident funds. The main objective of these amendments was to enhance preservation of retirement fund interests during retirement and to have uniform tax treatment across the various retirement funds, thus resulting in provident funds being treated similar to pension and retirement annuity funds with regard to the requirement to annuitize retirement benefits. These retirement fund reform amendments were supposed to come into effect on 1 March 2015. However, the annuitisation requirements for provident funds have repeatedly been postponed due to discussions that are currently taking place at NEDLAC concerning comprehensive social security.

Each postponement of the effective date requires several consequential amendments to various provisions of the Act. In making changes to the effective dates in relation to the several consequential amendments required, an oversight occurred with regard to paragraph 6(1)(a) of the Second Schedule to the Act. Failure to change the effective date in the above-mentioned provision resulted in non-taxable treatment of transfers from pension funds to provident or provident preservation funds with effect from 1 March 2019. In order to include the required consequential amendment that was inadvertently left out, it is proposed that changes be made in the Act to align the effective date of the tax neutral transfers from pension to provident or provident preservation funds with the current effective date of annuitisation related reforms, which is 1 March 2021.

Comment: A retrospective effective date places taxpayers who made such transfers in good faith in a “non-compliance” position. Further to the above, the ability to make tax neutral transfers from a more restrictive retirement fund to a less restrictive fund should not be linked to the annuitisation requirements.

Response: Not Accepted. The proposed amendment intends to rectify an oversight made during the 2018 legislative cycle. The policy intention remains that tax neutral transfers from a more restrictive retirement fund to a less restrictive fund only become possible once the annuitisation provisions come into effect. Any such transfers made between 1 March 2019 and date of promulgation of the 2019 TLAA would have been treated as taxable transfers by SARS.

5.5. Reviewing measures aimed at avoiding Estate duty

(Main Reference: Section 3 of the Estate Duty Act: clause 1 of the Draft TLAB)

In 2015, changes were made to section 3(2) of the Estate Duty Act to prevent individuals from avoiding estate duty by making a large contribution into a retirement annuity fund in the year the individual dies. Consequently, this paragraph makes provision for inclusion in the estate any amounts that have not been allowed as a deduction in terms of sections 11(k), 11(n) or 11F of the Income Tax Act (essentially the excess non-deductible contributions created by the large contributions made to the retirement annuity fund). However, section 3(2)(bA) erroneously includes not only excess contributions in terms of sections 11(k), 11(n) or 11F, but also amounts which are not taken into consideration in terms of the Second Schedule of the Income Tax Act. In order to close this loophole, it is proposed that retrospective changes be made to section 3(2)(bA) of the Estate Duty Act.

Comment: The inclusion of non-deductible contributions in a person's deceased estate is inequitable as contributions used to reduce annuities and lumpsums received at retirement should not be included in estate duty. Further to the above, the effective dates proposed do not have a desirable impact on tax collection.

Response: Accepted. Legislative changes will be made in the 2019 Draft TLAB to take into account the provisions of section 10C of the Income Tax Act when determining the deceased's tax liability for estate duty purposes. In addition, it is proposed that the effective dates for the proposed amendments be changed as follows:

- The proposed amendments shall be deemed to apply to contributions made on or after 1 March 2016
- The proposed amendments will come into effect in respect of the estate of a person who dies on or after the date of promulgation of the 2019 TLAA.

5.6. Extending the scope of amounts constituting variable remuneration

(Main reference: Section 7B of the Act: clause 3 of the Draft TLAB)

The Income Tax Act contains section 7B, aimed at matching the timing between accrual and payment of various forms of variable remuneration and deems certain amounts to accrue to the employee when they are actually paid. It has come to Government's attention that the scope of this section is very limited as it does not cater for certain amounts, such as night shift allowance and stand by allowance. In order to address this anomaly, changes are proposed in section 7B so that this section does not apply to specific amounts but applies to amounts bearing certain generic characteristics listed in the Act.

Comment: The proposed amendment makes it difficult for employers to ascertain which payments qualify as variable remuneration. Further, amounts that previously qualified as variable remuneration are as a result of the proposal no longer taxable as variable remuneration.

Response: Accepted. Due to the confusion caused by the application of generic qualification criteria, it is proposed that changes be made in the 2019 Draft TLAB so that the specific list that was available in the Act before the proposed changes be reinstated, and updated to cater for certain amounts that are not currently included in the list.

6. INCOME TAX: BUSINESS (GENERAL)

6.1. Addressing abusive arrangements aimed at avoiding the anti-dividend stripping provisions

(Main references: section 22B and paragraph 43A of the Eighth Schedule of the Act; clauses 23 and 59 of the Draft TLAB)

A. Background of the anti-dividend stripping rules

The anti-avoidance rules dealing with dividend stripping were first introduced in the Income Tax Act in 2009. Dividend stripping is achieved when a shareholder company extracts value of a target company through tax-exempt dividends prior to the sale of shares in that target company to a prospective purchaser. These pre-sale dividends, decreases the value of shares in the target company and the shareholder company can sell the shares at a lower amount, thereby avoiding tax in respect of the sale of shares. In 2017, amendments were made in order to strengthen the anti-avoidance rules dealing with dividend stripping to curb such transactions. As a result of the 2017 changes, excessive exempt dividends (extra-ordinary dividends) that are received by a shareholder company are treated as proceeds or income and are subject to tax in the hands of that shareholder company, provided that the shares in respect of which extra-ordinary dividends are received, are disposed of within a period of 18 months after that extra-ordinary dividend. In 2018, further amendments that were made to the anti-avoidance rules dealing with dividend stripping rules do not hinder legitimate reorganisation transactions.

B. 2019 legislative amendments

The 2019 Budget Review included a legislative proposal under Annexure C to further strengthen the anti-avoidance rules dealing with dividend stripping in order to curb the use of new arrangements being used by taxpayers to undermine the 2017 rules. These arrangements also involve a substantial dividend (extraordinary dividend) being declared by the target company to its shareholder company but is then combined with the issuance, by that target company, of shares to a third party or parties. This results in a decrease of the shareholder company's effective interest in the shares of the target company that does not involve a disposal of those shares by the shareholder company. This results in a situation where these 2017 anti-avoidance rules not being triggered as they are triggered only when the shareholder disposes of the shares it holds in the target company. To curb the use of these new arrangements, proposed amendments were included in the 2019 Draft TLAB and it was further proposed that these further strengthened rules would apply with effect from Budget Day (20 February 2019).

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Publication of the initial batch of the 2019 Draft TLAB: 10 June 2019

On 10 June 2019, National Treasury and SARS published the proposed amendments to the anti-avoidance rules dealing with dividend stripping as part of an initial batch of the 2019 Draft TLAB (the initial batch). The proposed amendments in the initial batch introduced a deemed disposal that will trigger the application of the anti-avoidance rules dealing with dividend stripping. The result of this was that, in addition to the anti-avoidance rules dealing with dividend stripping being triggered when a shareholder disposes of their shares in the target company after receiving an extraordinary dividend, the anti-avoidance rules will also be triggered when a deemed disposal occurs. The rules provided that a deemed disposal occurs when a target company issued shares and as a result of that issue of shares, the market value of the shares held by a shareholder company decreases. In such an instance, tax will be triggered only to the extent that 18 months prior to such an issue of shares the shareholder company received an extraordinary dividend from the target company. As was indicated in Annexure C of the 2019 Budget Review, it was proposed that these measures will be deemed to have come into effect from 20 February 2019.

Taxpayers were requested to make written submissions of their comments on the abovementioned proposals contained in the initial batch no later than 25 June 2019. On 4 July 2019, National Treasury and SARS held a meeting with all the stakeholders who submitted comments to provide them with an opportunity to expand on their written submissions. Based on that meeting, revised changes were made to the proposed anti-avoidance rules dealing with dividend stripping and were contained in the 2019 Draft TLAB that was published for public comment on 21 July 2019.

Comment: From the proposed legislative changes contained in the initial batch the scenario envisaged is where a shareholder company that holds a qualifying interest receives an extraordinary dividend which will result in a decrease in the market value of the shares held by that shareholder company in the target company and the target company subsequently issues shares to another party other than that shareholder company. However, the trigger for the application of the anti-avoidance is when the target company issues shares to a party other than the shareholder company and as a result of that issue of shares, the market value of the shares the shareholder company holds in the target company decreases. This abovementioned trigger that focusses on the reduction in the market value held by the shareholder company as a result of the issue of shares by the target company is ineffective as the reduction in value of the shares held by the shareholder company takes place as a result of the payment of the dividend (which is the mechanism for the extraction of value from the company) and not as a result of the issue of shares.

> *Response:* Accepted. The proposal in the initial batch is not effective in curbing the abuse that it was intended to curb. As such the proposed rules are changed to rather focus on instances where the effective interest of the shareholder company is reduced as a result of a share issue by the target

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company of a party other than that shareholder company. These changes were reflected in the full version of the 2019 Draft TLAB that was published for public comment.

Publication of the full version of the 2019 Draft TLAB: 21 July 2019

The 2019 Draft TLAB that was published on 21 July 2019 contained the revised proposed amendments to the anti-avoidance rules dealing with dividend stripping. The revised proposed amendments contained changes to the version published as part of the initial batch. In this respect, the version contained in the full version of the Draft TLAB provides that a shareholder company will be deemed to have disposed of its shares in the target company, if the target company issues shares to another party and the effective interest held by the shareholder company in the target company is reduced by reason of the shares issued by the target company. The focus on the reduction of the effective interest differs from the proposal contained in the initial batch that focused on the reduction of the market value of the shares. The focus on the effective interest is in line with the proposal that was contained in the 2019 Budget Review and ensures that the right transactions are made subject to the proposed deemed disposal rule.

Furthermore, the revised version also clarifies that this deemed disposal will be imposed solely for purposes of the dividend stripping rules and will result in an income inclusion or capital gain (and not proceeds arising from disposal) in the hands of the shareholder company. This will have the effect that the shareholder company will have to account for an immediate additional tax but will still be able to apply their original cost of the shares (i.e. base cost) against the consideration they receive in the event that the shares they hold are actually disposed of after the deemed disposal. In this regard, the following issues were raised in written submission and discussed in more detail at a workshop that were held in Pretoria on 5 September 2019.

Comment: The proposed rules are overly broad in their application. These rules have moved away from the original policy at the time that they were first inserted. This has resulted in a situation where any new share issue, no matter how small, would reduce the effective interest of an existing shareholder in the target company, potentially triggering the rules even where there is no link between the share issue and the relevant extraordinary dividend. Consideration must be given to introduce a link between the extraordinary dividend and the issue of shares.

Response: Not Accepted. The 2017 Budget Review proposed legislative amendments in respect of the anti-avoidance rules dealing with dividend stripping under the heading "Addressing circumvention of dividend-stripping rules". The 2017 legislative amendments were necessary because the pre-2017 anti-avoidance rules were limited in their scope and were, as a result, being undermined by taxpayers. The pre-2017 anti-avoidance rules only applied where the shareholder company held more than 50 per cent of the shares in in the target company. This threshold was too high and did not focus on the ability of a

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shareholder company that wishes to dispose of shares in another company to significantly influence the decisions of whether a dividend will be distributed in respect of those shares to achieve the desired reduction of the value of those shares and its effective interest in the shares of the target company. Secondly, anti-avoidance rules applied if there was a link between the funding of the subscription amount and the dividend declared. In this respect, the anti-avoidance rules applied where such funding was provided for or guaranteed by the prospective purchaser of shares or a connected person in relation to a prospective purchaser. The link between the subscription price and the dividend made the pre-2017 anti-avoidance rules easy to circumvent as taxpayers broke the link by using funders other than the prospective purchaser or connected persons in relation to the prospective purchaser. Even more worrying were cases where the target company had sufficient distributable reserves to fund the dividend.

However, the following refinements are proposed to limit the application of the 2019 proposed anti-avoidance rules regarding dividend stripping to scenarios that pose the most risk to the fiscus:

Providing certainty regarding the use of the term "effective interest"

Taxpayers have indicated in both their written submissions and during public hearings that the term "effective interest" needs to be clarified. More specifically, clarity is required as to whether taxpayers are required to assess changes in effective interest held by the shareholder company in a target company in the class of shares that the target company issues. Secondly, if the effective interest of a shareholder company must be calculated across all classes of shares of the target company, it is not clear how this effective interest should be calculated.

As a starting point, Government is aware that taxpayers are already developing tax structures that will manipulate the use of different classes of shares to avoid the currently proposed rules. In the instance that there are different classes of shares of a target company, taxpayers can extract value by ensuring that an extraordinary dividend is declared in respect of one class of shares while the target company issues shares of a different class with similar rights attached to it or shares of a different class that are convertible into another class of shares after a period of time. Effectively, taxpayers can use different classes of shares to achieve dividend stripping and the request to limit the effective interest test opens the fiscus to abuse using new tax structures.

It is Government's position that the current proposed rules require taxpayers to do a "facts and circumstances" analysis when determining whether a shareholder company's effective interest in a target company has been reduced. In the first instance, where an extraordinary dividend is paid and shares of the same class are issued, the effective interest test is applied by considering the effective percentage held before the share issue to that held after the shares issue. In the instance that an extraordinary dividend is paid in respect of a one class of shares and shares of a different class are issued by the target company, the reduction in the effective interest of the shareholder company must be considered with reference to the reduction of the value of that shareholder company's interest in the target company across the different classes of shares.

That being said, where possible and with regard to instances that Government considers the risk of using different classes of shares to avoid the 2019 proposed changes, limitations will be proposed.

Base cost in respect of deemed disposal

In the instance that the proposed rules are triggered, the shareholder company must include the amount of extraordinary dividends received in its income, where the shares are held as trading stock, or as a capital gain, where the shares are held as a capital asset. However, taxpayers have submitted that, there is no provision that permits the shareholder to claim a proportional amount of the cost of the shares as a deduction against the income or capital gain which is in contrast with an actual disposal of shares where the shareholder company can claim a tax deduction of the cost of the shares disposed of. In this respect, taxpayers have requested that a proportional amount of the cost of the shares should be allowed as a deduction against the income or capital gain. In addition, interaction of the proposed rules with paragraph 19 of the Eighth Schedule results in a situation that when the shareholder company is subject to the inclusions as a result of the proposed rules, paragraph 19 also denies that shareholder company the cost of the shares if those shares are subsequently disposed of.

In this regard, it should be noted that the anti-avoidance rules dealing with dividend stripping are meant to curb the use of arrangements to avoid tax that ordinarily arises on the disposal of shares. As such, the anti-avoidance rules should achieve this by triggering a tax event (i.e. the inclusion of income or a capital gain) and encourage taxpayers to rather enter into actual share disposal transactions. As such, parity of the treatment of the cost of the shares between instances of actual share disposal and instances of deemed disposal will not be provided for. However, in the instance that a shareholder company disposed of its shares in a target company subsequent to being subject to the anti-avoidance rules dealing with dividend stripping in respect of a deemed disposal, changes are proposed to clarify that the cost of the shares may be deducted against the proceeds arising from that actual share disposal.

Extraordinary dividends arising in the course of or as part of a corporate reorganisation transaction

Taxpayers have indicated that it is not entirely clear whether the proposed rules will apply in respect of extraordinary dividends that are paid in the course or as part of reorganisation transactions. In this regard, various corporate reorganisation transactions will be considered and where there is no risk associated with their potential use by taxpayers to avoid the application of the anti-avoidance rules dealing with dividend stripping, exclusions will be provided.

6.2. Correcting anomalies arising from applying anti-value shifting rules

(Main reference: section 24BA of the Act; clause 28 of the Draft TLAB)

The Income Tax Act contains anti-value shifting rules aimed at ensuring that all asset for share transactions are entered into by taxpayers on a value for value basis (i.e. assets are exchanged for shares of equal value). In 2019, a proposal was included in the Budget to clarify the effect of deferred tax liability on the market value of issued shares. As a result, proposed amendments were included in the 2019 Draft TLAB that was published for public comment on 21 July 2019 to exclude transactions from the application of the anti-value shifting rules where the market value of an asset transferred is different from the market value of the shares received in return only due to deferred tax. This issue may for example arise because the depreciation write off period for accounting purposes may be different from the write off period for tax purposes.

Comment: Various taxpayers submitted written comment requesting that an exclusion should also be made in the instance that the difference in market value is attributable to a deferred tax asset arising. In addition, it was also requested that references to IFRS should be removed as SMMEs do use IFRS for SMMEs for reporting purposes.

Response: <u>Not Accepted.</u> During the public workshops held in Pretoria on 5 September 2019, it came to Government's attention that that given the use of different reporting standards for accounting reporting (and in some instances not disclosing deferred tax), a blanket exclusion will not be possible to include in the draft legislation. In addition, taxpayers indicated that it is not necessary to have an exclusion for market value differences attributable to deferred tax as it is well understood, in practice, that the anti-value shifting rules are meant to apply only where the difference in market value is attributable to value shifting. As a result, it is proposed that this provision be withdrawn from the 2019 Draft TLAB.

6.3. Refining provisions around special interest deduction for debt funded share acquisitions

6.3.1 Clarifying the exclusion from interest deduction for debt financed acquisitions for start-up companies

(Main reference: section 24O of the Act; clause 30 of the Draft TLAB)

The Act contains special interest deduction rules in section 24O that make provision for companies to deduct interest in respect of interest-bearing debt used to acquire a direct or indirect controlling share interest in an operating company.

An operating company is defined as a company of which at least 80 per cent of the company's receipts and accruals should constitute income and that income must have been generated from its business of providing goods and services. Some taxpayers have attempted to abuse these rules by using them to get an interest deduction in respect of interest-bearing debt raised to capitalise a shelf company. In turn, the shelf company uses the funding from its new shareholder to acquire income producing assets and embarks on its trade. The view of some taxpayers is that the shareholder can claim a special interest deduction in respect of the interest-bearing debt used to capitalise the shelf company that subsequently generates income and subsequently meets the definition of an operating company. This goes against the policy rationale for the introduction of the special interest deduction and amendments are proposed in the 2019 Draft TLAB to further clarify this.

Comment: The proposed amendments in respect of start-up companies which are contained in the definition of "acquisition transaction" refer to "an operating company that is continuously carrying on a business on the date of acquisition". However, the definition of an "operating company" requires a company to derive income from a business carried on continuously. The repetition of this requirement in the definition of an "acquisition transaction" is therefore superfluous and may lead to confusion.

Response: Accepted. Changes will be made to the 2019 Draft TLAB to the definition of an "acquisition transaction" so that it rather refers to a company that is an operating company prior to the date of acquisition as that will mean that it must have traded for at least one year prior to the date of acquisition.

6.3.2 Amending the special interest deduction in respect of share acquisitions funded by debt to allow for deductions after an unbundling transaction

(Main reference: section 24O of the Act; clause 30 of the Draft TLAB)

The Act contains special interest deduction rules in section 24O that make provision for companies to deduct interest in respect of interest-bearing debt used to acquire a direct or indirect controlling share interest in an operating company. In some instances, a company may be unable to acquire a direct controlling interest in an operating company, but instead may acquire an indirect controlling interest by acquiring the shares in a controlling holding company in relation to that operating company. It is uncertain whether a company may continue to claim this special interest deduction if the controlling group company unbundles the shares it holds in the operating company to that company (if the indirect controlling interest acquired by that company in the operating company is in effect converted to a direct controlling interest in the operating company). Legislative amendments were included in the 2019 Draft TLAB to allow taxpayers to continue deducting interest in instances where an unbundling transaction involving a company (that previously held an indirect controlling share interest in a holding company) results in a direct controlling share interest in an operating company.

Comment: It may happen that an indirect shareholding in an operating company is transferred to the acquiring company rather than a direct shareholding. Continuation of the deduction should also be provided for in such instances.

Response: Not Accepted. The policy rationale for the introduction of the special interest deduction in 2012 was to discourage the use of multiple step debt push down structures where taxpayers used temporary funding to acquire shares of productive companies and then raised permanent funding to fund the acquisition of the productive assets in order to qualify for an interest deduction. The decision to allow taxpayers to be able to carry on claiming the special interest deduction after acquiring a direct shareholding of a company with productive assets by way of an unbundling was to encourage the acquisition of the shares of a productive company rather than a holding company in relation to a productive company, thus have a more direct interest in the productive assets. As such, no concession is being considered to further encourage indirect shareholdings.

Comment: Clarity must be provided as to whether taxpayers can continue to claim the special interest deduction after unbundling transactions in respect of which the provisions of section 46 were applied or all unbundling transactions.

Response: Noted. The unbundling transactions envisaged are local unbundling transactions (i.e. unbundling transaction as defined in paragraph (a) of the definition of “unbundling transaction” in section 46) in respect of which the provisions of section 46 apply. Changes will be made to the proposed amendments that were contained the 2019 Draft TLAB to reflect this position

Comment: The proposal should not be limited to changes from indirect to direct shareholding as a result of unbundling transactions, and the interest deduction should continue to be allowed irrespective of how the change from an indirect to a direct shareholding takes place. This is particularly an issue in respect to liquidation transactions.

Response: Accepted. Changes will be made to the 2019 Draft TLAB to extend the proposal to instances where a direct shareholding is acquired as result of a local “liquidation distribution” (i.e. liquidation distribution as defined in paragraph (a) of the definition of “liquidation distribution” in section 47) in respect of which section 47 has applied.

6.4. Clarifying the interaction between corporate reorganisation rules and other provisions in the Act

6.4.1 Clarifying corporate reorganisation rules relating to exchange items and interest-bearing instruments

(Main reference: Section 41 of the Act: clause 38 of the Draft TLAB)

The Act contains corporate reorganisation rules that make provision for the tax neutral transfer of assets between companies that are part of the same group.

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However, these rules do not specifically address how exchange items and interest-bearing instruments should be treated during corporate restructuring. This anomaly arises due to the fact that the Act contains specific rules dealing with the tax treatment of interest-bearing instruments (section 24J) and the tax treatment of exchange items (section 24I). At issue is which rules should take precedence during corporate restructurings. Interest-bearing instrument and exchange items are different from other assets because they are taxed on unrealised interest and exchange differences and their value is also dependent on changes in interest rates and exchange rates. In order to provide clarity, it is provided that changes be made in the corporate reorganisation rules to provide that the corporate reorganisation rules should not override the application of sections 24J and 24I of the Act.

Comment: It is unclear why the instruments identified in terms of section 24I or section 24J should be specifically excluded from the inter-group relief because there is no mischief that may arise. In addition, it is uncertain as to why unrealised gains on interest-bearing assets and foreign exchange assets should be excluded as they are no different to any other trading stock or capital asset.

Response: Not Accepted. The proposed amendment was intended to clarify the tax effect in the application of corporate rules regarding the transfer of exchange items and interest-bearing instruments and to give effect to the principle that exchange gains and losses arising until the effective date of the corporate restructuring transaction should be reflected in the taxable income of the transferor. In addition, interest-bearing assets and foreign exchange assets are different from trading stock or capital assets as their value are influenced by changes in interest rates and exchange rates.

6.4.2 Refining the interaction between the anti-avoidance provisions for intra-group transactions

(Main reference: section 45: New clause in the Draft TLAB)

Section 45 provides for tax deferral (i.e. roll-over relief) when companies transfer assets between group companies. However, section 45 also contains multiple anti-avoidance rules to ensure that they are not abused by taxpayers. In Annexure C of the 2019 Budget Review, Government proposed that it would make legislative changes in the Income Tax Act to clarify how the multiple anti-avoidance rules applicable to intra-group transactions should interact with each other in order to ensure that they do not give rise to double taxation in the event that more than one of them apply in respect of one intra-group transaction. In particular, at issue are the anti-avoidance rules around the reversal of the tax deferral in instances where a seller and acquirer of assets under an intra-group transaction cease to form part of the same group of companies within six years of the intra-group transaction (i.e. the de-grouping charge).

During internal consultative meetings on the drafting of the 2019 Draft TLAB, the potential for double taxation was regarded as an interpretation issue. As a result, it

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was decided that legislative intervention is not required as the interaction of these multiple anti-avoidance measures could be clarified by way of interpretation guidelines. As a result, no changes were proposed in the 2019 Draft TLAB.

Comment: It is understood that a de-grouping should only be accounted for once and cannot be triggered again by the operation of another anti-avoidance rule. However, the anti-avoidance rule applicable where assets are transferred on loan account between connected person which provides that the loan receivable has a zero base cost does not interact well with the de-grouping charge. This is because if an asset is transferred on loan account and the loan receivable of the seller is deemed to have a zero base cost, should the de-grouping charge subsequently be triggered and the tax deferral be reversed, there is no need for the zero base cost rule to still apply. The de-grouping charge should be the final charge as it reverses the tax deferral.

Response: Accepted. Legislative changes will be proposed in the 2019 Draft TLAB to ensure that the zero base cost rule is not triggered subsequent to a de-grouping charge.

7. INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)

7.1. Addressing inconsistencies in the current REIT tax regime

7.1.1 Amendment of the definition of rental income in a REIT tax regime in respect of foreign exchange differences

(Main reference: Section 25BB of the Act: clause 31 of the Draft TLAB)

The special tax dispensation for regulated and listed property companies (REITs) allows these companies not to be taxed on distributed profits from rental income and gains relating to immovable property. However, the dividends received by shareholders in these REITs are taxed. REITs may claim distributions to investors as a deduction against its income. This deduction may only be claimed if the distribution is a “qualifying distribution”, that is, if more than 75 per cent of the gross income of the REIT consists of “rental income”. At issue is the fact that the definition of “rental income” does not include unrealised exchange gains or losses arising from the forward exchange contracts entered into by REITs to hedge their exposure to future cash flows relating to rental income. In order to address this, it is proposed that a REIT or controlled company include foreign exchange gains and deduct foreign exchange losses on exchange items relating to other elements of rental income in the definition of “rental income”.

Comment: The proposed amendment is welcomed however inclusion of exchange differences in rental income should be extended to all exchange differences of a REIT or controlled company which directly or indirectly relate to REIT activities.

Response: Not Accepted. The proposed amendment is intended to assist taxpayers and only caters for foreign exchange differences relating to "exchange items" that hedge amounts defined as "rental income". Exchange differences relating to the financing of immovable property are not viewed as rental income.

Comment: The proposed amendment should be changed to include foreign exchange gains only and disregard foreign exchange losses because reducing the "rental income" by foreign exchange losses will make it harder for a REIT or controlled company to reach the 75 per cent of "gross income" target needed to make a "qualifying distribution".

Response: Accepted. Changes will be made to the 2019 Draft TLAB to exclude foreign exchange losses when determining a "qualifying distribution" for the purposes of section 25BB.

7.1.2 Clarification of the interaction between corporate reorganisation rules and REITs tax regime

(Main references: Sections 42, 22 and 45 of the Act: clauses 39, 40 and 45 of the Draft TLAB)

A REIT or a controlled company is granted capital gains tax exemption in respect of the disposal by a REIT or a controlled property company of:

- immovable property of a company that is a REIT or controlled company at the time of disposal;
- a share or a linked unit in a company that is a REIT at the time of that disposal; or
- a share or a linked unit in a company that is a property company at the time of that disposal.

However, corporate re-organisation rules allow taxpayers to transfer assets to a company free of immediate tax consequences provided certain requirements are met. But, certain anti-avoidance provisions may be triggered if the company that acquired the assets, disposes of the assets within 18 months of acquisition by requiring that the rolled over capital gain be treated as a taxable capital gain of the REIT for the year of assessment in which the disposal takes place. This creates a discrepancy because section 25BB(5) of the Act states that disposals of immovable property by a REIT do not give rise to capital gains tax. In order to ensure that the rules for the taxation of REITs are aligned with the corporate re-organisation rules, it is proposed that corporate re-organisation rules do not give rise to capital gains tax on disposal of assets within 18 months after their acquisition by a REIT or controlled company under a corporate re-organisation rule

Comment: The proposed amendment is welcomed on sections 42, 44 and 45. However, section 47 also contains the 18 months ring-fencing rule but no amendments were made to exclude the application of this rule to section 25BB assets.

Response: Accepted. Legislative changes will be will be made in the 2019 Draft TLAB to take into account section 47 of the Act.

Comment: Section 45(4) contains a de-grouping charge which deems there to be a capital gain without a corresponding deemed disposal of the asset and this may result in section 25BB(5) not to apply to such de-grouping charge.

Response: Accepted. Legislative changes will be made in the 2019 Draft TLAB on section 45(4) to deem the capital gain to arise from a disposal of the asset to ensure that section 25BB(5) applies in this regard.

7.2. Taxation of long-term insurers

7.2.1 Refinement to taxation of risk policy funds for long-term insurers

(Main reference: Section 29A of the Act: clause 33 of the Draft TLAB)

Section 29A(1) of the Act defines a "risk policy" as a policy under which the benefits payable (i) cannot exceed the amount of premiums receivable, except where all or substantially the whole of the policy benefits are payable due to death, disablement, illness or unemployment; or (ii) excluding benefits due to death, disablement, illness or unemployment cannot exceed the amount of premiums receivable. However, policies under which annuities are being paid are specifically excluded from being classified as a risk policy. In the case where a policy is initially allocated to the risk policy fund and the risk policy commence to pay out annuities on the happening of risk event, section 29A(6) of the Act requires the transfer of assets and liabilities pertaining to that risk policy to the untaxed policyholder fund. This transfer of assets and liabilities from the risk policy fund to the untaxed policyholder fund was said to be administratively burdensome and arguably may not result in a different tax consequence if it remained in the risk policy fund as opposed to being transferred to the untaxed policyholder fund. It was proposed that the exclusion of a "contract of insurance in terms of which annuities are being paid" be removed from the risk policy definition to ensure that the risk policy remains allocated to the risk policy fund even when policy proceeds are paid in a form of an annuity.

Comment: The proposed amendment may cause an additional administrative burden since it may result in establishing two sets of risk policy annuity reserves and therefore the industry request an election continue the practice of transferring policies paying annuities to the untaxed policy fund if the insurer has only one pool of policies from which annuities are paid and not to transfer all policies with annuities in payment from the untaxed policyholder fund to the risk policy fund.

Response: Not Accepted. Firstly, the proposed amendment was intended to assist insurers with the administrative burden pointed out by them and not to create an additional administrative burden. Secondly, it became evident during the public workshops held on 5 September 2019 that this issue is not crucial for some of the insurers. Lastly, as general matter, an election in the Act should be

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avoided as this may be administratively burdensome to SARS. Therefore, is proposed that this amendment be withdrawn from the 2019 Draft TLAB.

7.2.2 Alignment of the tax treatment of "deferred revenue" between long-term and short-term insurers

(Main reference: Section 28(3) of the Act: new clause in the Draft TLAB)

Section 28(3) was revised in 2015 such that a short-term insurer may claim deductions for certain liabilities that are recognised as liabilities for purposes of IFRS relating to premiums and claims reduced by the amounts recognised in accordance with IFRS in respect of amounts 'recoverable under policies of reinsurance' and further reduced by 'deferred acquisition costs'.

Comment: The reference to amount 'recognised as deferred acquisition costs in accordance with IFRS' can be interpreted not to include 'deferred revenue' for the short-term insurers. However, it is clear that the long-term insurers should take into account both the 'deferred acquisition costs' and 'deferred revenue'.

Response: Accepted. Legislative changes will be proposed to section 28(3) in the 2019 Draft TLAB such that this subsection takes into account both 'deferred acquisition costs' and 'deferred revenue'.

7.3. Consequential amendments to tax treatment of doubtful debts for banks in terms of section 11(jA)

(Main reference: Section 11(*jA*) of the Act: new clause in the Draft TLAB)

In 2018, an amendment was made to section 11(*jA*) of the Act as a consequential amendment to the 2017 amendments dealing with tax treatment of doubtful debts for banks. The 2018 amendment made provision for the exclusion of any holding company as defined in the Banks Act as a controlling company was already excluded from the scope of section 11*(jA)*.

Comment: The 2018 amendment made in the Act has created unintended consequences because the definition of "holding company" in the Banks Act refers to the definition of "holding company" in the Companies Act, 2008. This results in a situation where a bank that controls a subsidiary is excluded from the ambit of section 11(*jA*).

Response: Accepted. A proposal will be included in the 2019 Draft TLAB to clarify that the reference to "holding company" in section 11(*jA*) should refer to a "holding company that is not a bank, to give effect to the original intention.

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8. INCOME TAX: BUSINESS (INCENTIVES)

8.1. Refining the Special Economic Zone (SEZ) tax incentive regime

8.1.1 Aligning the tax provisions of SEZ with the overall objectives of the SEZ programme

(Main reference: Section 12R of the Act; clause 18 of the Draft TLAB)

A. Background of the of the SEZ regime

The SEZ regime was preceded by the Industrial Development Zone (IDZ) programme which was introduced in South Africa in 1993 which was intended to promote new investment in the country by providing focused administrative support as well as some indirect tax benefits to enterprises that operated in designated industrial areas. There has been a review on the effectiveness of the IDZ programme which resulted in the introduction of the SEZ regime. The SEZ regime was introduced in terms of the Special Economic Zone Act, No.16 of 2014 (SEZ Act) but only came into operation on 9 February 2016. In order to provide further support to the SEZ regime, income tax benefits were introduced to the Act in 2013 for qualifying companies operating within the SEZ. These benefits included an accelerated depreciation allowance on capital structures (buildings) and improvements and a reduced corporate tax rate of 15 per cent instead of the current 28 per cent for qualifying companies.

Currently, the income tax provisions for qualifying companies operating within an SEZ do not expressly make a provision for a new investment requirement or for an expansion of an existing company to qualify for income tax benefits. The absence of this in the legislation gives rise to unintended results where pre-existing and relocated businesses could unjustifiably benefit from the income tax benefits which are mainly aimed at attracting new and expanded manufacturing businesses.

The 2019 Draft TLAB contains proposed changes to make provision for qualifying companies to only qualify for the income tax benefits if the companies are:

- newly established businesses carrying on a new trade or a trade that was not carried on by a connected person; or
- expansions of pre-existing businesses of businesses originally operating within an IDZ or outside an IDZ where such expansions result in an increase in the gross income of a company that amounts to at least 100 per cent of the gross income of that company before any expansion. The required gross income increment in the gross income of the company should be determined with reference to the highest gross income derived by that company during any of the three immediately preceding years of assessment

Comment: The proposed expansion requirements are very inflexible and do not look into other complexities which are faced by businesses in their growth and expansion evidence.

Response: <u>Accepted.</u> In order to have a better indicative tool to assess whether an expansion benefits the fiscus, legislative changes will be proposed in the 2019 Draft TLAB to consider the number of new jobs that have been created on a net basis in order to determine if a qualifying company is eligible for the tax benefits. Furthermore, companies will need to provide evidence of their projections and expected return growth in the medium term (i.e. three years) to further corroborate their claims of expected growth.

Comment: Many businesses started their operations in 2013 when the SEZ tax incentives were first introduced into the Act. The test as to whether a taxpayer is carrying on a new business should look back to when the SEZ tax rules were first inserted. In addition, the test is very stringent as a new business is considered to be one that was never carried on by a connected person, whether in South Africa or in another country.

Response: <u>Accepted.</u> Changes will be proposed in the 2019 Draft TLAB to change the effective date for the new business test. The test will be aligned with the introduction of the SEZ tax incentives in the Act. In addition, a taxpayer will only fail the new business test if it relates to a trade previously carried on in South Africa.

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8.1.2 Reviewing the SEZ anti-profit shifting measures

(Main reference: Section 12R of the Act; clause 18 of the Draft TLAB)

In 2015, changes were made to the income tax rules for the SEZ regime to introduce an anti-profit shifting measure that prevent the risk of having profits of ordinary tax paying companies which are not operating within designated and approved SEZs (thus taxed at the normal corporate tax rate of 28 per cent), to be transferred to qualifying companies operating under the SEZ regime which are taxed at a lower rate of 15 per cent. The risk to the fiscus is that these transfers are made between companies which are connected persons to each other. This anti-avoidance measure wholly disqualifies a qualifying company from claiming any of the SEZ income tax benefits.

It came to government's attention that the current anti-avoidance measure that employs the all-or-nothing approach may affect some legitimate business models or transactions that were entered into when some companies established their businesses within an SEZ, before the SEZ regime came into effect and before the introduction of anti-avoidance measures came into effect. Their business models require them to transfer goods and products to sales companies that are often connected persons in relation to those SEZ qualifying companies.

To address this concern, proposed changes to the existing anti-avoidance measure to change the all-or-nothing approach were included in the Draft TLAB to ensure that a company is not wholly disqualified from claiming the income tax benefits for the SEZ regime. In other words, to make allow a qualifying company, in respect of transactions with any connected person in relation to that qualifying company that is below a 20 per cent threshold, to enjoy the 15 per cent preferential tax rate. Additionally, to make provision for a qualifying company to be treated as carrying on a separate trade outside of the SEZ relating to the income with its connected person, in as far as it exceeds the threshold, to be subject to the normal corporate tax rate of 28 per cent.

Comment: The currently proposed amendments are administratively burdensome and undermine the tax incentive as most business models make transfers between connected persons. It is submitted that domestic transfer pricing should rather be applicable.

> *Response*: Not Accepted. The proposed amendments with regard to the anti-avoidance measures contained in the 2019 Draft TLAB will be withdrawn and the current all-or-nothing rule will continue. In the interim, SARS will need to first determine its capacity to administer and audit domestic transfer pricing under the SEZ incentive. Should SARS indicate that the necessary capacity is available to conduct domestic transfer pricing and that it is a focus area for tax administration, legislative proposals in this regard will be made in the next legislative cycle.

8.2. Reviewing the allowable deduction for investors investing in a venture capital company

(Main reference: section 12J of the Act: clause 17 of the Draft TLAB)

The venture capital company (VCC) tax incentive regime was introduced in the Act in 2008. The main aim of the VCC tax incentive regime is to raise equity funding in support of the socio-economic development of small business which otherwise would not have had access to market funding due to either or both their size and inherent risk. In terms of the VCC regime, taxpayers investing in a VCC are allowed an upfront deduction equivalent to the expenses incurred by a taxpayer in acquiring shares issued to that taxpayer by a VCC. However, the deduction is reversed and included as a recoupment in a taxpayer's income should that taxpayer dispose of those shares in a VCC within 5 years after acquiring them.

When the VCC tax incentive regime was introduced in 2008, the rules contained very strict criteria including limitations and lifetime limitations on allowable tax expenditure incurred by VCC shareholders. In order to get the VCC regime to gain more traction, over time and specifically in 2015, further changes were made to the tax legislation so as to broaden the scope of the VCC regime. As a result, the uptake of the VCC tax incentive regime has grown significantly since 2015 leading to a telling investment into the economy. It has come to government's attention that a segment of ultra-high net worth taxpayers opts to invest disproportionately high amounts into VCCs before the tax year end thereby reducing their taxable income and as such undermining the progressivity of our personal income tax system. In an effort to balance the benefit and perceived effectiveness of the VCC tax incentive regime whilst limiting high tax expenditure (as a measure of revenue

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forgone) to the fiscus, it was proposed that changes be made in the VCC tax incentive regime to limit the amount to be deducted in respect of taxpayers investing in VCC shares to R2.5 million per annum.

Comment: The proposed amendment was met with much resistance. A plethora of issues were raised including but not limited to:

- Cost to secure capital: The proposed cap would limit the viability of VCC funds through the now required increased number of investors to get to a viable fund size,
- Corporate appetite: The proposed limitation makes it an undesirable investment for corporate investors, including those that target corporate investors in the Enterprise and Supplier Development space (as referred to in the BBBEE codes) and as such there shouldn't be a limitation for corporate investors
- Quantifying the average: The calculation of the proposed limitation is flawed in that although the arithmetic average as used by National Treasury is logical it instead should have been a median approach for purposes of the determination of the amount.
- During public workshops held on 5 and 6 September 2019, some commentators suggested that if Government is of the view that the cap should remain, there should be a difference between natural persons and corporate investors or Government should provide accelerated deduction on the amount to be deducted.

Response: <u>Noted.</u> The proposed cap is a targeted measure to address the disproportionate amount of expenditure incurred by VCC shareholders and its impact on the fiscus. It is aimed at balancing the benefit and perceived effectiveness of the VCC tax incentive regime, whilst still protecting the fiscus. That said, it is proposed that legislative changes be proposed in the 2019 Draft TLAB to change the limitation of the amount to be deducted in respect of taxpayers investing in a VCC to distinguish between natural persons (including trusts), which will remain at R2.5 million, and corporate investors, which will increase to R5 million.

Comment: The proposed limitation, regardless of limitation value, has a probable negative impact on compliance through the VCC shareholder's 'connected person' anti-avoidance measure, as amended in 2018. An investor who already invested their allocation of e.g. R50 million within a VCC share class (as was allowable at the time of investment and with the understanding / promotion from the VCC that the investment relies on further large capital raises from other taxpayers), are now prejudiced, since they now hold a much larger stake (and carry significantly more risk) in that VCC share class, given the:

- inability of other big potential investors to match the amount due to the cap, or

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- the VCC's inability to attract a sufficient number of smaller investments in time before the end of the relevant 36-month period which, potentially, can be immanent.

Response: Accepted. Legislative changes will be proposed in the 2019 Draft TLAB in order to mitigate any non-compliance risk on the current VCCs as a result of the proposed 2019 legislative amendments.

8.3. Refinement of the Employment Tax Incentive Regime

8.3.1 Updating the employment tax incentive to align with the national minimum wage

(Main reference: section 4 of the Employment Tax Incentive Act: clause 77 of the Draft TLAB)

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The programme aims to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as qualifying employees) through a cost sharing mechanism with Government, while leaving the wages received by the qualifying employees unaffected. The ETI Act affords employers who are registered for PAYE and hire qualifying employees the ability to decrease their PAYE liability. The amount by which the employer's PAYE liability can be reduced by is prescribed by a formula, and is calculated based on the wages paid to the qualifying employees.

One of the conditions for claiming the incentive is that the wage paid to eligible employees should exceed the applicable wage regulating measure, specifically a collective agreement, a sectoral determination or a binding bargaining council agreement. If none of these are applicable, a minimum wage of R2 000 per month is eligible for the ETI.

During 2018 legislation was promulgated to implement the National Minimum Wage. The National Minimum Wage Act introduced a national minimum wage of R20 per hour or R3 500 per month. To ensure that Government policies are aligned, some of the provisions relating to wage regulating measures in the ETI Act should be updated to reflect the provisions of the new National Minimum Wage Act.

Comment: Wage rate applicable to learnership agreement may differ to that stipulated in National Minimum Wage Act. As working days vary per month, an effective hourly rate is therefore impacted. This makes it difficult to convert hourly rates to a monthly rate.

Response: Partially Accepted. Clarification on the conversion may be given through guidance by SARS, since a legislative amendment is not the appropriate mechanism to give such guidance.

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Comment: Amendments should only become effective on 1 March 2020.

Response: Not Accepted. The National Minimum Wage Act came into effect on 1 January 2019. The proposed effective date of 1 August 2019 in the 2019 Draft was the start of the first month after the Draft TLAB was published for comment.

Comment: Propose that alternative minimum of R2 000 per month rather be expressed as an hourly rate, to simplify ETI admin.

Response: Noted.

8.3.2 Clarifying the interaction between the employment tax incentive and the special economic zone provisions

(Main references: sections 1 and 6 of the Employment Tax Incentive Act: clauses 76 and 78 of the Draft TLAB)

Both the Act and ETI Act contain special tax dispensation for SEZ regime. The Act SEZ tax rules make provision for qualifying companies that operate within an SEZ to be taxed at a reduced corporate tax rate of 15 per cent instead of the 28 per cent that is generally applicable to other companies. Furthermore, these companies qualify for accelerated allowances, amounting to 10 per cent of the cost of the building each year over a period of 10 years, on buildings and improvements to buildings owned by them.

The ETI Act makes provision for employers operating within an SEZ to qualify for the ETI. The ETI was introduced by Government as a mechanism to support employment growth in South Africa with a particular focus on the employment of the youth. The ETI tax incentive is available for any employer in respect of a qualifying employee if that employee is 18 years old and not more than 29 years old. However, if the employer operates through a business located within an SEZ, that employer can benefit from the ETI in respect of its employee that renders services to that employer with an SEZ without any regard to the age of that employee.

The ETI Act, unlike the SEZ rules contained in the Act does not clearly provide a specified criterion for employer companies operating within an SEZ to benefit from the ETI without having the age limit as a restriction. As a result, the ETI Act currently makes provision for all employers operating within an SEZ to benefit from the ETI in respect of all their employees without any regard for the age limit. Failure by the ETI Act to have a limitation that only allows this extended incentive to only qualifying companies has the potential of resulting in non-qualifying companies and, even more worrying, non-manufacturing companies (such as logistics and warehousing entities) getting the ETI in respect of all their employees. In order to ensure that Government policy is applied in a uniform manner in both the ETI Act and the Act, it is proposed that amendments should be made to the ETI Act.

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*Commen*t: Effective date should be prospective, and not retrospective.

Response: Accepted. Changes will be proposed in the 2019 Draft TLAB to postpone the effective date to 1 March 2020.

8.4. Repeal of the retrospective approval of tax exempt status for Public Benefit Organisations (PBOs) and recreational clubs

(Main references: sections 30(3B) and 30A(4)f the Act: clauses 34 and 35 of the Draft TLAB)

The Act currently affords the Commissioner the discretion to approve an organisation as a public benefit organisation (PBO) (in terms of section 30(3B) or recreational club (in terms of section 30A(4) retrospectively. Once approved as a PBO or recreational club, the receipts and accruals of such entity are exempt from income tax provided that certain conditions in section 10 are met. In the 2019 Draft TLAB, changes were proposed to delete sections 30(3B) and 30A(4) of the Act and to remove obsolete transitional measures initially introduced to provide organisations that were exempt from the Act under the repealed legislation the opportunity to re-apply under section 30 and section 30A of the Act. Organisations were granted until December 2004 to re-apply under section 30 and until December 2010 to reapply under section 30A of the Act.

Comment: There deletion of the provisions allowing the Commissioner to retrospectively approve a PBO or recreational club as an exempt entity will have adverse financial effects for such entities. This is due to the fact that the limited resources available to such entities make it difficult for them to deal with tax technical issues on a timeous basis.

Response: Noted. The granting of the retrospective approvals to PBOs and recreational clubs that have been in existence for several years has the consequence that previously taxed receipts and accruals become exempt. This results in refunds having to be paid by SARS with interest, dating back, including years that have already prescribed. As opposed to deleting the relevant provisions, PBOs or recreational clubs seeking retrospective approval as an exempt entity shall be granted such approval if they meet the requirements, and at the Commissioner’s discretion.

9. INCOME TAX: INTERNATIONAL

9.1. Reviewing the comparable tax exemption of controlled foreign companies (CFC)

(Main reference: Section 9D of the Act: clause 10 of the Draft TLAB)

The CFC rules contain an exemption known as a comparable tax exemption which makes provision for CFCs operating in foreign countries where tax payable in that foreign country is at least 75 per cent of what would have been payable in South

Africa, had the South African tax rules applied. The comparable tax exemption excludes that foreign business income from the net income calculation of the CFC. Partly, the comparable tax exemption seeks to protect the South African tax base whilst providing the need for South African multinational entities to be competitive offshore by disregarding all tainted, passive and diversionary controlled foreign company income if little or no South African tax is payable. In light of the global trend towards lower corporate tax rates, a review was conducted and it came to light that the current 75 per cent threshold is no longer comparable. As a result, providing little or no assistance to cater for South African CFCs operating in major trading partner countries. In this regard, it is proposed that the comparable tax exemption threshold be reduced to 67.5 per cent from the current percentage of 75 per cent.

Comment: It has become globally acceptable that a corporate tax rate of 15 per cent and higher is not considered to be "low". Using 15 per cent as a reasonable benchmark, it is the taxpayer's view that an appropriate comparable tax exemption would be 53.5 per cent.

Response: Not Accepted. Currently, South Africa's major trading partners in which the majority of the CFCs are located are covered by the proposed comparable tax exemption of 67.5 per cent. The comparable tax exemption will be assessed each financial year in order to determine its competitiveness and comparability, and if necessary legislative changes will be proposed based on such assessment.

9.2. Considering the "affected transaction" concept in the arm's length transfer pricing rules

(Main reference: Section 31 of the Act: clause 36 of the Draft TLAB)

The Act contains transfer pricing rules aimed at preventing a reduction in the South African taxable income as a result of mispricing or incorrect characterisation of transactions. This is done through the application of the arm's length principle on transactions entered between "connected parties". The "affected transaction" definition relating to the arms-length transfer pricing rules in the Act only applies to connected persons as defined. The application of these rules to connected persons only has the unintended consequence that the transfer pricing rules in respect of transactions between "associated enterprises" are not always captured. On the other hand, in both the OECD and the UN Model Tax Convention, this concept of "affected transaction" applies to associated enterprises and not only to connected persons. In order to address this anomaly, it is proposed that the "affected transaction" definition be expanded to cover transactions between associated enterprises.

Comment: The proposed amendment to import the concept of "associated enterprises" into the Act is inappropriate. For example, in the context of the OECD model tax convention, taxpayers are of the view that the term is not defined and is deliberately vague and broadly described to avoid the restricting or overriding domestic law definitions that trigger the application of transfer pricing rules. Therefore, the description of the term "associated enterprise" in the OECD model tax convention is certainly not intended to represent a standard benchmark definition. Its incorporation into domestic law will create significant uncertainty as to when the transfer pricing rules are applicable. Furthermore, the new definition would require further definitions, elaborations and clarifications of participation, control, management and enterprise.

Response: Noted. SARS will further provide guidance on the interpretation of the term "associated enterprise". In order to give SARS and taxpayers more time to consider the interpretation of the term "associated enterprise", it is proposed that the effected date of this provision be postponed by a year from 1 January 2020 to 1 January 2021.

9.3. Reviewing the definition of permanent establishment

(Main reference: Section 1 of the Act: clause 2 of the Draft TLAB)

On 7 June 2017, South Africa signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). In line with preserving the sovereignty of countries, signatories of the MLI have the right to make a list of their reservations and notifications which is known as the MLI position of that country. South Africa took the MLI position not to expand the definition of permanent establishment (PE). As a consequence, a misalignment ensued between South African's tax treaties still using the narrow definition of PE and the Income Tax Act definition using the expanded definition. In order to address this misalignment, it is proposed that amendments be made in the Income Tax Act to align the definition of PE with the SA MLI position.

Comment: It is not clear why this amendment is necessary. Before the MLI, the definition of "permanent establishment" in section 1 of the Act was, in any event, never aligned with the definitions of that term contained in South Africa's DTAs. Consequently, there has always been (and will always be) a "misalignment". Critically, from a policy perspective, we do not see the rationale for attempting to align what is essentially a domestic law source provision with a DTA concept. SA's reservation in the MLI simply establishes our "two-way" DTA position. The definition in section 1 focuses solely on inbound activities by non-residents. One would have expected SA to cast the net slightly wider (as the post-2018 definition does) to catch inbound foreign investors in our domestic source rules, before giving them the opportunity to benefit from the potentially narrower DTA provisions

Response: Noted. The proposed amendment to the definition of permanent establishment will be withdrawn from the 2019 Draft TLAB.

10. VALUE-ADDED TAX

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10.1. VAT treatment of Foreign Donor Funded Projects

(Main references: Sections 1 and 50(1) of the VAT Act: clauses 64 and 70 of the Draft TLAB)

An Official Development Assistance Agreement (ODAA) is an international agreement that is binding on the Republic in terms of section 231(3) of the Constitution of the Republic of South Africa. ODAA's involve support from foreign institutions in the form of grants / funding, technical assistance, provision of assets for a specific project, etc. ODAA's, if they meet certain requirements of the VAT Act, may be registered (as a "foreign donor funded project") for VAT in order to reclaim any VAT incurred on expenditure, thereby ensuring that the funds provided are not used to pay taxes in South Africa. The requirements of the VAT Act are not very clear on what the policy position is regarding the requirements that must be met to be registered as a "foreign donor funded project" for VAT purposes. The proposed amendments in the 2019 Draft Bill will provide clarity on what these requirements are.

Comment: The proposed amendments are not clear as to the impact of the proposed amendments on existing projects. Further, clarity is required regarding the process to be followed to register the project as a foreign donor-funded project.

Response: Accepted: A guideline will be issued by SARS providing clarity on the process to be followed. With regard to the impact on current projects, changes will be made in the 2019 Draft TLAB to provide that the proposed amendments will only be applicable to those projects that apply for registration on or after the 01 April 2020.

Comment: The proposed amendment states that each project must be registered separately for VAT. This is cumbersome. It is proposed that where one entity manages many such projects, the entity be entitled to register all the various projects under one VAT registration number.

Response: Not Accepted: Each project has its own terms and conditions, its own implementation plan, its own funding requirements, end date, etc. For these reasons, each project will be required to be registered separately in order to remain separately identifiable. Further, the VAT system does not permit a vendor to be issued with more than one VAT registration number, unless it is registering different branches. By including this proposed amendment to section 50(1), it is proposed that each project be registered as a branch of the vendor that is the "implementing agency" of the various projects.

10.2. Reviewing section 72 of the VAT Act

(Main reference: Section 72 of the VAT Act: clause 71 of the Draft TLAB)

Section 72 of the VAT Act permits the Commissioner the discretion to make arrangements and decisions to overcome difficulties, anomalies or incongruities that taxpayers may face in applying any provision of the VAT Act. These difficulties, anomalies or incongruities would have arisen as a result of the manner

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in which a vendor or class of vendors conducts his, her or their business, trade or occupation. Over the past years, challenges arose regarding the application of the mandatory wording of the other provisions of the VAT Act versus the discretionary wording of the provisions of section 72 of the VAT Act. The proposed amendment in the 2019 Draft TLAB seeks to clarify and amend the section so as to align section 72 with the policy intent of the other VAT provisions.

Comment: Clarity is required on how the proposed amendments will impact on current rulings, including whether vendors can apply for an extension of current rulings.

Response: Accepted. Transitional rules will be implemented to deal with current rulings, including applications for extensions of current rulings.

Comment: The proposed amendment states that the decision of the Commissioner may not be contrary to the construct and policy of the VAT Act as a whole or of any specific provision of the Act. The policy as it relates to the various provisions of the Act is generally unknown, save for the published SARS documents which are (for the most part) general in nature.

Response: Not Accepted. The policy intent may be determined by the reference to overall scheme of the Act and to secondary aids to interpretation, such Budget Speeches, Budget Reviews and the Explanatory Memoranda that are published with legislative amendments. SARS also publishes various guidelines, Interpretation Notes and rulings.

11. AD-VALOREM EXCISE DUTIES

11.1. Ad-valorem excise duties on imported motor vehicles

(Main reference: Section 65 of the Customs and Excise Act: clause 63 of the Draft TLAB)

The ad valorem excise duty is a taxation on luxurious products to improve the progressivity of the tax system and raise revenue. It is imposed on passenger and light commercial vehicles, according to a progressive formula. The current system, which takes into account the Automotive Production Development Programme run by the Department of Trade and Industry as well as the Production Rebate Credit Certificates issued by ITAC, creates a favourable ad valorem excise tax treatment or outcome for imported vehicles over locally manufactured vehicles. As a result, it is proposed that the ad valorem calculation is based on the full customs value without factoring in the rebates so as to ensure that local production is not disadvantaged.

Comment: Policy certainty is a critical element in any investment decision in the Automotive Industry. Decisions relating to investing in vehicle production facilities are made at least 4 – 6 years in advance of the commencement of production. The MIDP / APDP frameworks have been accepted by global decision makers as reliable and stable policy instruments, and the South African OEMs have therefore managed to secure significant investment in South Africa to date, and several OEMs already have commitments for further future investments. Significant changes to key policy instruments on short notice will lead to deterioration in investor confidence and could place future production programs at risk.

Response: Accepted. The proposed amendment was part of the dti's APDP review process into the new South African Automotive Masterplan ("SAAM") 2021- 2035. National Treasury will align the implementation date with the start of the SAAM in 2021.

Comment: To facilitate and sustain exports, the duty savings (Customs duty as well as the Ad Valorem excise tax saving) realised via the application of Productive Rebate Credit Certificates ("PRCC") are incorporated into costing models to reduce the high production costs stemming from labour, water, electricity and freight costs. Any loss in the value of these savings would therefore have a negative impact on future cost competitiveness of locally produced vehicles in the export markets. This ad valorem excise duty amendment will drastically reduce the package of incentives and negatively impact the international cost competitiveness of the SA OEM's exports to that of other leading international competitors. There is a need to ensure that the Trade Related Investment Measures (TRIMS) and support measures remain stable so that through the companies' cost competitiveness advantage, it can drive localisation, increase employment, sustainability and growth as per SA Automotive Masterplan (SAAM). It will remove approximately R2bn from the TRIMS package.

Response: Accepted: National Treasury will investigate how the current ad-valorem formula can be adjusted for the overall change to be revenue neutral, to mitigate the impact on the automotive industry. It is proposed that the detail on the adjustment to the ad-valorem formula be discussed within the executive oversight committee, which has overseen the development of the SAAM, in order to finalise the new structure before the Budget announcement in February next year.

Draft Tax Administration Laws Amendment Bill

12. Income Tax: Administration

12.1. Declarations and written undertakings with regard to withholding tax on royalties, and interest and dividends tax where a Double Tax Agreement applies

(Main references: Sections 49E, 50E, 64G and 64H; clauses 2, 3, 5 and 6 of the Draft Bill)

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To ease the compliance burden in respect of the withholding taxes on royalties and interest, it is proposed that the requirement to submit a declaration before each payment be removed and be replaced by a requirement to provide such a declaration once every two years, along with an undertaking to inform the payor if circumstances change during that period.

Comment: There is no requirement for a taxpayer to obtain a declaration and a written undertaking in respect of each transaction. It is clear from the law and from the SARS forms (WTRD, WTID) that the declaration includes a written undertaking to inform the withholding agent of a change in circumstances affecting the treaty relief. As such, it is apparent that the declaration is valid for all payments of royalties, interest and dividends until such time as the recipient informs the withholding agent otherwise.

Response: <u>Noted.</u> This is not a universal view. The proposed amendment was requested by industry and hence, in order to create certainty, aims to clarify the fact that a taxpayer need not obtain a declaration and a written undertaking in respect of each transaction for royalties and interest.

Comment: It is not clear from the proposed amendments that the declarations and written undertakings need to be submitted before the first payment is made.

Response: <u>Comment misplaced.</u> The wording of the proposed amendment clearly states that the declaration and written undertaking must be submitted before the date of payment.

Comment: It is not clear why the amendments to sections 49E and 50E regarding the declarations and written undertakings that need only be done once (before the first payment is made) where more than one payment is made to the same foreign person within a period of two years are not also applied to section 64G.

Response: <u>Accepted.</u> An amendment will be proposed in this regard.

Comment: It is noted that no validity period limitation is to be imposed on declarations and undertaking forms submitted in terms of section 64FA. For consistency purposes all declarations and undertaking forms should be treated on the same basis, i.e. be subject to the same validity period limitations.

Response: <u>Accepted.</u> An amendment will be proposed in this regard

Comment: The existing undertakings in respect of dividends are open ended and without time limitation. The proposed amendment to insert a two year validity will add to the administrative burden of taxpayers and withholding agents. Withholding agents will be required to review all declarations and written undertakings, manually record the date of the declarations and written undertakings and request, on an ongoing basis, updated documents for the declarations and written undertakings that are older than two years. The two-year validity period should be removed or alternatively extended to five years or at least three years.

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Response: Partially accepted. The two year period will be extended to three years to reduce the frequency of requiring updated declarations and undertakings. Coupled with the change proposed below, this will reduce the compliance burden on withholding agents.

Comment: The introduction of a two year expiry period for declarations and written undertakings with regards to dividends tax provisions creates an extensive administrative burden on regulated intermediaries. At the time that dividends tax was introduced, regulated intermediaries implemented processes and procedures so as to obtain the required declarations, as well as the existing undertakings. These processes and procedures include measures to contact or re-confirm the validity of the original declarations should a change in circumstances occur of which the regulated intermediary is aware. To require regulated intermediaries to obtain new declarations on a bi-annual basis would put an unreasonable administrative burden on these entities as it is not only a burdensome exercise to contact all clients and obtain responses from all clients but it is also a very costly exercise that would increase the costs of administration and require system enhancements and additional resources to facilitate a daily monitoring and to follow up the ageing of thousands of such declarations.

Response: Accepted. If a regulated intermediary applies the Financial Intelligence Centre (FIC) legislation or the Common Reporting Standard (CRS) regulations in relation to the declarations, i.e. the content of the declarations is monitored under or subject to the anti-money laundering, “know your client”, or CRS requirements, no time limitation will be imposed on the validity of the declarations and undertakings.

Comment: Proposed amendments should provide clarity from when the two year period is calculated. The declarations and written undertakings should no longer be valid after a period of two year from the date of submission of the declarations and written undertakings – which is before the first payment was made to that foreign person).

Response: Accepted. It will be clarified that the period will run from the date of the declaration.

Comment: Section 64G(4) also does not clarify that the declaration or written undertaking referred to in section 64G(2) and 64G(3) will become invalid after a period of two years from the date when the declaration or written undertaking were submitted.

Response: Comment misplaced. See the proposed amendment to section 64G(4) (clause 5) of the draft Bill, where the two year validity period is proposed for purposes of declarations and written undertakings submitted in terms of this section.

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Comment: It is noted that the proposed amendment will come into operation on date of promulgation of the Tax Administration Laws Amendment Bill, 2019. This effective date will not afford withholding agents sufficient time to review and request updated declarations and written undertakings. Consequently, on or after date of promulgation of the Act, any dividend or interest payments made to a beneficial owner based on an invalid declaration and written undertaking (i.e. dated more than two years before) would be a contravention of the Income Tax Act, 1962, or, if the withholding agent processed the payment without applying the relevant exemption or reduced rates, the withholding agent will be required to process refunds and correct the SARS reporting once the client's updated declaration and undertaking are received. This would place a substantial administrative burden on the withholding agent.

Response: <u>Accepted.</u> Regulated intermediaries that apply FIC legislation or the CRS regulations will not have to undertake this exercise in view of the change proposed above. A deferred implementation date of 1 July 2020 will be proposed, which will provide other withholding agents an adequate opportunity to refresh the declarations and undertakings that they hold, while not requiring withholding agents that are obtaining a declaration for each payment to continue doing so for an extended period.

12.2. Proposal to bring assessment of donations tax under Chapter 8 of the Tax Administration Act

(Main reference: Section 60; clause 4 of the Draft Bill)

Chapter 8 of the Tax Administration Act, 2011, deals with assessments. The proposed deletion is a technical correction to bring the assessment of donations tax under Chapter 8.

Comment: The repeal of section 60(5) is regarded as a technical correction to bring the assessment of donations tax under Chapter 8 of the Tax Administration Act, 2011. However, section 60(5) does not only deal with assessment, but also with the payment of donations tax. Chapter 8 of the Tax Administration Act does not specifically provide for the Commissioner to assess either the donor, donee or both as is catered for in section 60(5). It is proposed that this section should not be deleted in its entirety and that the nuances of the assessment for donations tax for a donor and done as currently set out in section 60(5) should be specifically catered for in the Tax Administration Act.

Response: <u>Accepted.</u> The proposed amendment will be deleted.

12.3. Proposed penalty for incomplete returns submitted in terms of paragraph 14 of the Fourth Schedule to the Income Tax Act

(Main reference: Paragraph 14 of the Fourth Schedule; clause 7 of the Draft Bill)

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The proposed amendment aims to clarify that the penalty in terms of this paragraph may also be imposed where an employer submits a return that is not in the prescribed form and manner i.e. an incomplete return.

Comment: The proposed amendment aims to extend the penalty in terms of this paragraph to instances where an employer submits a return that is not in the "prescribed form and manner i.e. an incomplete return". It is submitted that form and manner has nothing to do with completeness and as the proposal is currently worded, any mistake or omission on the form submitted, no matter how insignificant, could be argued to render the employer liable for the penalty. This is overly punitive. The penalty should be limited to cases in which there are material omissions or inaccuracies on the form, or if the form is not submitted at all by the due date.

Response: Partially accepted. The proposed amendment will be reworded to clarify that the penalty will only be invoked if the employer submits an incomplete return i.e. if information required in terms of the return is not submitted.

13. Customs and Excise: Administration

13.1. Sharing of information required to administer carbon offsets and greenhouse gas emissions reporting

(Main references: section 4; clause 10 of the draft Bill)

The proposed amendments to sections 4(3) and (3A) provide the authorisation for the sharing of information required to administer carbon offsets and greenhouse gas emissions reporting with the Department of Energy and the Department of Environmental Affairs. Provision is also made for the sharing of information with authorised dealers in foreign exchange to assist such dealers in the verification of applications for advance foreign exchange payments in respect of goods that are to be imported. It is anticipated that the sharing of such information will aid in the verification of legitimate financial flows.

Comment: Neither the Carbon Tax Act, 2019, nor the draft Carbon Offset Regulations requires an officer to disclose any information to the Department of Mineral Resources and Energy (DMRE). The process requires the DMRE to issue a taxpayer who has retired carbon credits into the South African carbon offset system with a certificate. The taxpayer must include this certificate in their submission to SARS as part of their self-assessment. No part of the process requires information to be sent from SARS or National Treasury to the DMRE. The amendment inserting paragraph (ivA) into the proviso to section 4(3) is therefore unnecessary.

Response: Not accepted. The draft carbon tax rules under the Customs and Excise Act, 1964, which have been published by SARS for public comment for a second time, require the carbon taxpayer to provide any documents substantiating that taxpayer's self-assessment on its carbon tax account at the request of the Commissioner. Such substantiating documents could include the carbon offset certificate from DMRE. SARS will verify the validity of carbon offset allowance claims and carbon offset certificates against the third party data accessed from DMRE. SARS may need to share taxpayer-specific information with DMRE as part of that verification process. SARS, by virtue of its role in the implementation of the carbon tax, has an obligation to inform DMRE of any clients that it encounters who may be non-compliant with DMRE's carbon offset administration requirements.

Comment: The wording of the proposed insertion of paragraph (ivB) in the proviso to section 4(3) should not refer to the National Atmospheric Emissions Inventory System but rather to National Greenhouse Gas (GHG) Emissions reporting.

Response: Accepted. The provision will be amended to refer to greenhouse gas emissions reporting.

Comment: The current reporting process for greenhouse gas emissions is manual, but it is expected to be the same once the automated system is in place. In this process, the data provider reports to the Department of Environment, Forestry and Fisheries (DEFF) and the taxpayer (being the same entity) separately submits the carbon tax self-assessment to SARS. The verification of data reported against carbon tax liability submitted is a request for confirmation from SARS to DEFF. There is no part of the process that requires any official of SARS or National Treasury to provide information to DEFF. This amendment is therefore unnecessary.

Response: Not accepted. SARS will access third party data from DEFF for its enforcement of carbon tax licensing, accounting and payments. During such vetting and auditing processes, SARS may need to share taxpayer-specific information with DEFF. For purposes of the enforcement of the carbon tax, SARS has to assist in ensuring that the DEFF third party database is complete.

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13.2. Application of Part D of Chapter 11 of the Tax Administration Act for recovery of debt

(Main reference: section 114A; clause 16)

The proposed amendment makes provision for options, in addition to those dealt with in section 114 of the Customs and Excise Act, for the collection of debt owed to SARS in terms of that Act, by making Part D of Chapter 11 of the Tax Administration Act, 2011, with the necessary changes as the context may require, applicable for purposes of the Customs and Excise Act.

Comment: Chapter XI of the Customs and Excise Act, 1964, already contains penal provisions. The amendment results in a legal overlap and should be removed.

Response: Accepted. The proposed amendment will be deleted.

14. Value-Added Tax: Administration

14.1. Commissioner to prescribe particulars to be contained on tax invoice issued by a foreign supplier of electronic services

(Main reference: Section 20; clause 18 of the Draft Bill)

Section 20(5B) requires the Minister to prescribe the particulars to be contained on a tax invoice issued by a foreign supplier of electronic services, by regulation. This regulation has not been issued, but the Commissioner has issued Binding General Ruling No. 28 in this regard. The proposed amendment removes the requirement for the Minister to prescribe these particulars per regulations and now enables the Commissioner to prescribe them by public notice in the Gazette.

Comment: Changes made to these invoices should generally not happen very often but could have profound effects for the foreign suppliers should they be required as generally changes to taxpayer ERP systems would be both costly and time consuming. Clarification is sought as to reasoning behind why the delegation of a matter, that could have profound implications for taxpayers, has changed from the Minister to the Commissioner.

Response: Noted. The function to be performed in terms of this section is primarily administrative in nature i.e. dealing with the particulars of a tax invoice. Hence it is regarded as a function to be fulfilled by the Commissioner rather than the Minister. Furthermore, the Commissioner has already provided guidance in this regard through Binding General Ruling No.28. The public notice to be issued will replicate, with the necessary changes, the contents of this ruling, which already provides clarity and certainty to foreign suppliers of electronic services.

15. Skills Development Levies Act: Administration

15.1. Prescription period for refunds

(Main reference: Section 7; clause 21 of the draft Bill)

In terms of section 190(4) of the Tax Administration Act, 2011, a refund must be claimed within certain specified time-periods. The proposed amendment aims to align the refund provisions in the Skills Development Levies Act with section 190 of the Tax Administration Act, 2011, to provide that a refund by the Director-General in terms of the Skills Development Levies Act, must be claimed by the employer within 5 years from the date the levy was paid in terms of the Act.

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Comment: It is not clear what constitutes “claimed” as section 190(4) of the Tax Administration Act, 2011, does not require a refund to be claimed, it merely states that SARS must pay a refund if a person is entitled to the refund and sets out the prescription periods for the refund. It is proposed that the term “claimed” should be clarified or the Tax Administration Act should be amended to align with the proposed amendment.

Response: <u>Comment misplaced.</u> The commentator fails to take cognisance of section 190(4)*(c)* of the Tax Administration Act, 2011, inserted by the Tax Administration Laws Amendment Act, 2018, which provides that an amount will be regarded as a payment to the National Revenue Fund unless a refund is made in the case of an erroneous payment claimed by a taxpayer within the periods referred to (i.e. 3 years in the case of an assessment by SARS or 5 years in the case of self-assessment) but not paid by SARS within the period. Skills Development Levies is a self-assessment tax hence the prescription period of 5 years is proposed. From a drafting perspective, the proposed amendment will be further refined to align it more closely with the provisions of section 190(4) of the Tax Administration Act.

16. Unemployment Insurance Contributions Act: Administration

16.1. Prescription period for refunds

(Main reference: Section 9; clause 22 of the draft Bill)

In terms of section 190(4) of the Tax Administration Act, 2011, a refund must be made within certain specified time-periods. The proposed amendment aims to align the refund provisions in the Unemployment Insurance Contributions Act with section 190 of the Tax Administration Act, 2011, to provide that a refund by the Commissioner in terms of the Unemployment Insurance Contributions Act, must be claimed by the employer within 5 years from the date the levy was paid in terms of the Act.

Comment: It is not clear what constitutes “claimed” as section 190(4) of the Tax Administration Act, 2011, does not require a refund to be claimed, it merely states that SARS must pay a refund if a person is entitled to the refund and sets out the prescription periods for the refund. It is proposed that the term “claimed” should be clarified or the Tax Administration Act should be amended to align with the proposed amendment.

Response: <u>Comment misplaced.</u> The commentator fails to take cognisance of section 190(4)*(c)* of the Tax Administration Act, 2011, inserted by the Tax Administration Laws Amendment Act, 2018, which provides that an amount will be regarded as a payment to the National Revenue Fund unless a refund is made in the case of an erroneous payment claimed by a taxpayer within the periods referred to (i.e. 3 years in the case of an assessment by SARS or 5 years in the case of self-assessment) but not paid by SARS within the period. Unemployment Insurance Contributions is a self-assessment tax hence the

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prescription period of 5 years is proposed. From a drafting perspective, the proposed amendment will be further refined to align it more closely with the provisions of section 190(4) of the Tax Administration Act.

17. Tax Administration

17.1. Written notice of intention to institute legal proceedings against Commissioner

(Main reference: Section 11; Clause 25 of the draft Bill)

A one week notice period has proven to be impractical in practice to give effect to the rationale for the notice, i.e. to enable SARS an opportunity to investigate the matter further and to decide how to resolve the dispute, for example by exploring a dispute resolution process, thereby avoiding litigation at the public's expense. The proposed amendment increases the current one week period to 21 business days in order to afford SARS sufficient time to investigate the matter to see if it can be resolved without resorting to litigation, unless a competent court directs otherwise, for example in the case of urgency. In comparison, for example, the Institution of Legal 9

Proceedings Against Certain Organs of State Act, 2002, provides that no legal proceedings for the recovery of a debt may be instituted against an organ of state unless the creditor has given the organ of state six months' written notice, from the date the debt became due, of his or her or its intention to institute the legal proceedings in question.

Comment: The Memorandum of Objects justifies the extension of the notice period that is required to be provided, by a taxpayer to SARS, to inform SARS that legal proceedings will be instituted against the Commissioner in the High Court by comparing it to section 3(2) of the Institution of Legal Proceedings Against Certain Organs of State Act, 2002, in which, according to the Memorandum of Objects, it is stated that no legal proceedings for the recovery of debt may be instituted unless six months' written notice, from the date the debt became due, is provided to the organ of state.

Section 3(2) of the Act, however, states that a notice must be served within six months from the date on which the debt became due. Hence this section merely limits the time in which a notice can be served and does not state that six months' notice must be given before proceedings for the recovery of a debt may be instituted.

The reference to the Act in the Memorandum of Objects should be removed or corrected to reflect the correct context.

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Response: Accepted. The Memorandum of Objects will be amended to refer to the correct section in the Legal Proceedings Against Certain Organs of State Act, 2002, namely section 5(2). This states that no process referred to in section 5(1) of that Act may be served, as contemplated in that subsection, before the expiry of a period of 60 days after the notice, where applicable, has been served on the relevant organ of state in terms of section 3(2)*(a)*.

Comment: Most proceedings instituted by taxpayers in these instances are to compel SARS to comply with its obligations as set out in the Tax Administration Act, 2011, when SARS fails to do, for example rejection of an application to suspend payment or refusal to pay a refund. In the case of a rejection of an application for suspension of payment SARS may institute enforcement proceedings to recover a tax debt, once 10 business days have passed since the date the application is rejected. Therefore, it is imperative that a taxpayer, whose application has been rejected, has the option to institute urgent proceedings in the High Court to review SARS' decision before the period of 10 business days has elapsed.

Hence, the extension of the time period for SARS to reply will be to the detriment of taxpayer's rights, and could result in a surge of urgent applications against SARS. This will also put further pressure on the already overburdened State Attorney's offices. One week is sufficient time to resolve the majority of issues and no amendment is required. Alternatively, it is proposed that the notice period be reduced to 10 business days to ensure fairness to both SARS and the taxpayer and to ensure that a taxpayer can timeously institute legal proceedings without having to resort to a court order to institute legal proceedings on shorter notice.

Response: Partially accepted. A revised period of 10 business days will be proposed and the situation will be monitored.

17.2. Assessment based on an estimate where no return is submitted or required

(Main reference: Section 91; clause 36 of the Draft Bill)

The proposed amendment aims to clarify when SARS may make an assessment based on an estimate if no return is submitted or required, i.e. only when a return is required and not submitted or a return is not required but payment is and has not been made.

Comment: The wording of the proposed amendment to section 91(4), which is incorrectly located under section 191, is still unclear and it could still be questioned whether the payment failure requirement applies to both the non-submission and where a return is not required.

Response: Accepted. The proposed amendment will be relocated and reworded to ensure clarity.

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17.3. Set-off of amounts against outstanding customs and excise debt

(Main references: Section 191; clause 36 of the draft Bill)

The proposed amendment aims to clarify that SARS may set-off refunds against the outstanding tax debt of the taxpayer as well as amounts outstanding in terms of customs and excise legislation, even if there is no outstanding tax debt. In such instances the full amount is then utilised towards customs and excise debt.

Comment: The proposed amendment aims to clarify that SARS may set-off refunds against the outstanding tax debt of the taxpayer as well as amounts outstanding in terms of customs and excise legislation, even if there is no outstanding tax debt. In such instances the full amount is then utilised towards the customs and excise debt.

This amendment should only become effective once SARS' systems are capable of providing additional information to taxpayers with respect to debt equalisation.

Response: Not accepted. The set-off of refunds against amounts outstanding in terms of customs and excise legislation is not a new principle. The principle applied prior to the enactment of the Tax Administration Act, 2011, where amounts refundable in terms of the Income Tax Act, 1962 (section 102(3)) as well as the Value-added Tax Act, 1991 (section 44(6)), could be set off against customs and excise debt. Section 76C of the Customs and Excise Act, 1964, similarly permits the set-off of customs and excise refunds against any outstanding tax debt.

17.4. Mandatory non-disclosure penalties

(Main references: Sections 210 and 212; clauses 37 and 38 of the Draft Bill)

To ensure that structures and arrangements designed to circumvent the internationally agreed CRS are brought to SARS' attention, it is proposed that the Minister be empowered to include the OECD's model mandatory disclosure rules in a revised set of CRS regulations and that failure to comply with the rules be subject to similar penalties to those that exist for non-compliance with the existing reportable arrangement legislation in the Act.

Comment: It is not clear how the introduction of a penalty for non-disclosure under the mandatory disclosure rules will address the concern set out in the Memorandum of Objects, which seemingly relates to structures and arrangements that are designed to circumvent such disclosure requirements. If a structure is successful at doing so by falling outside of the requirements, then a penalty cannot apply. The purpose of the proposed penalty must be clarified.

Response: Comment misplaced. The mandatory disclosure rules, as set out in the draft CRS Regulations made available for public comment in May 2019, deal with attempts to circumvent CRS reporting.

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Comment: It is not clear whether the penalty will apply separately in relation to each account that is not reported or whether it will apply in aggregate for each reporting period. The legislation should clearly stipulate on what basis the penalty is proposed to be levied.

Response: Noted. The penalty is triggered where there is a failure to report the arrangement or structure and is not account based.

Comment: The title of section 212 refers to “Reportable arrangement and mandatory disclosure penalty”. The proposed amendment to section 212(1)*(b)* reads as follows “…..who fails to disclose the information required to be disclosed under the regulations.” As there is a difference between the terms “mandatory and “required” it is proposed that the term “required” be deleted and the subsection be amended to read as follows: “….who fails to disclose mandatory information under the regulations”.

Response: Not accepted. The term “mandatory disclosure” is used for consistency with international model legislation. The information is required to be disclosed under the regulations (rather than being optional), which is a formulation used throughout the Tax Administration Act, 2011.

Comment: The regulations issued under section 257 should refer to the ‘static’ definition of “intermediary” i.e. as defined at a given date, in order to avoid problems similar to those that necessitated the proposed change to the definition of “permanent establishment” in Clause 2(1)*(i)* of the Taxation Laws Amendment Bill, 2019.

Response: Comment misplaced. A full definition of intermediary is provided in the draft CRS Regulations made available for public comment in May 2019.

17.5. Remission of understatement penalty upon full disclosure or arrangement to SARS

(Main reference: Section 223; clause 39 of the Draft Bill)

The proposed amendment is a technical correction to effect clarity regarding the levying of the understatement penalty where a taxpayer has made full disclosure or an arrangement with SARS.

Comment: It is not clear what is meant by “made full disclosure”. This could be interpreted to mean all the information that is required to be provided to SARS has been provided or it could mean that all information related to the arrangement has been provided to SARS, whether there is a requirement (or a mechanism) to do so or not. It is submitted that it is the former which should apply.

Response: Noted. This is existing wording. SARS will provide guidance in this regard.

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Comment: Both the disclosure requirement and the opinion requirement require these to be in place by "the date that the relevant return was due". This is problematic for two reasons:

- Some taxes do not require the submission of a return and therefore there is no due date; and
- In some cases, the return may be filed later in order to obtain the opinion that supports the filing position.

It is submitted that the key consideration is whether the disclosure or opinion was in place at the time that the return is submitted or the tax is paid, if no return is required to be submitted.

Response: Not accepted. This is existing wording. The definition of return includes a self-assessment. Self-assessment is defined to mean a determination of the amount of tax payable under a tax Act by a taxpayer and submitting a return which incorporates the determination of the tax or if no return is required, making a payment of the tax. Hence the due date in these cases is the due date for payment. Using a later date would implicitly encourage late filing or payment, which would prejudice compliant taxpayers.

17.6. Criminal sanctions for erroneous, incomplete or false documents submitted to SARS

(Main references: Section 234; clause 40 of the Draft Bill)

The proposed amendment is a consequential to the coming into effect of the Legal Practice Act, 2014.

Comment: The Memorandum of Objects states that a criminal sanction would now be imposed if any document required to be submitted to SARS is erroneous, incomplete or false. It fails to mention that this sanction is only relevant if the person wilfully and without just cause submits such documents.

Response: Accepted. The Memorandum of Objects will be amended as proposed, since these existing requirements make it clear that *bona fide* inadvertent errors are not subject to criminal sanction.

17.7. Consequential amendments: Enactment of Legal Practice Act

(Main references: Sections 12 and 240A; clauses 26 and 41 of the Draft Bill)

The proposed amendment clarifies that any document required to be submitted under a tax Act to SARS that is erroneous, incomplete or false, is subject to criminal sanction under section 235.

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Comment: The proposed amendment of section 240A(1)*(b)* to make provision for reference to the Legal Practice Council established under the Legal Practice Act, 2014, (the LPA) is welcomed. However, uncertainty exists as to the rationale for the proposed retention of section 12(2)*(b)* of the Tax Administration Act, 2011, dealing with advocates, while deleting the corresponding provision as regards attorneys.

It must be noted that the LPA specifically makes provision for transitional arrangements in respect of advocates, attorneys, conveyancers and notaries.

> *Response:* Accepted: Section 12(2)*(b)* of the Tax Administration Act, 2011, dealing with advocates will be deleted.

Comment: The LPA retained the distinction between ‘attorney’ and ‘advocate’, including the recognised ‘referral rule’ with the exception of an advocate referred to under section 34(2)(b) of the LPA who is required to hold a Fidelity Fund certificate. Therefore, it begs the question whether all references to ‘attorney’ under the Tax Administration Act, 2011, should merely be replaced with ‘legal practitioner’.

> *Response:* Not accepted. The word “legal practitioner” must be read in context. The context will determine what the nature of the relevant legal practitioner is.

Comment: As of 1 November 2018, the Legal Practice Council (LPC) replaced the four law societies and Bar Councils as the statutory regulator of the legal profession with those bodies being relegated to mere member bodies. In terms of the amendment to section 240A, the LPC must be recognised by SARS as a recognised controlling body and will thus be required to comply with all the necessary regulatory provisions attached to this, such as those stipulated in section 240A(1) and section 243. It should be ensured that the LPC has agreed to this and is in a position to comply with the necessary provisions.

> *Response:* Noted. This is a necessary consequence of the LPC succeeding all the bodies previously referred to section 240A(1)*(b)* and *(c)*.

Comment: It is proposed that section 240A(1)*(b)* be deleted from a future date to enable such organisations to fully comply with section 240A(3) and transition to that regulatory regime in the next 12 months.

> *Response:* Accepted. The relevant organisations will be required to submit the information required in terms of section 240A(3) at the end of the last period of their existence.

17.8. Update of provisions relating to confirmation of taxpayer’s tax compliance status to take account of recent system developments

(Main references: Section 256; clause 43 of the Draft Bill)

The proposed amendments update the provisions relating to a taxpayer’s tax compliance status to take account of recent system developments that speed up the process. It furthermore enables the Commissioner to, by public notice, insert a *de minimis* for the amount of outstanding tax debt that will contribute to a taxpayer's tax compliance status as being indicated as non-compliant.

Comment: The wording of section 256(2) appears to exclude the possibility of a taxpayer applying for a TCC him/herself. Section 256 should clearly distinguish and/or clarify what the procedures and implications are, for both a taxpayer and a taxpayer's client applying for a taxpayer's tax compliance status, should they be different.

Response: Comment misplaced. A taxpayer always has access to his or her tax compliance status through the eFiling platform. The section regulates third party access to this information.

Comment: A distinction should be made in the subsection between the provision of access to a taxpayer's compliance status and the actual confirmation (determination) of the taxpayer's compliance status as they are two distinct processes. The 21 business days appears excessive if it relates merely to third party access to a taxpayer's tax compliance status – and not to the actual confirmation of the tax compliance status as is alluded to in the latter part of the subsection. Providing access to a taxpayer's tax compliance status should be instantaneous once the status has been confirmed (determined).

Response: Not accepted. The 21-day period refers to the time-period SARS requires to verify or confirm internally whether or not there are circumstances that may preclude SARS providing the taxpayer with the ability to grant third party access to the taxpayer's tax compliance status.

Comment: As it is our understanding that all three requirements as set out in section 256(3) should be fulfilled before a taxpayer's tax compliance status can be reflected as compliant, the "or" at the end of subsection (3)*(b)* should be changed to "and".

Response: Accepted. The wording will be amended as proposed.

Comment: Subsection (3)*(b)* aims to insert a *de minimis* amount for the amount of outstanding tax debt that will contribute to a taxpayer's tax compliance status as being indicated as non-compliant. However, the word "or" is used to separate the different debts in the section, so the *de minimis* amount is not exclusionary. The section should be amended so that the objective of inserting a *de minimis* as set out in the Memorandum of Objects is met.

Response: Accepted. The wording will be amended as proposed.

Comment: It is requested that consideration be given to exclude tax debts subject to a request for suspension in terms of section 164(2). Pending a decision from a senior SARS official to suspend payment, after such a request has been made, a taxpayer's tax compliance status should not be adversely affected for the period commencing on the day that SARS receives such a request and ending 10 business days after notice of SARS' decision to the taxpayer.

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Response: Accepted. The proposed amendment will be reworded to include the period for which SARS may not proceed with collection steps under section 164(6).

Comment: Subsection (4) lists items that must be included on a "verification" of the tax compliance status of a taxpayer. The use of the word "verification" in this context does not make grammatical sense as "verification" is a process. The word "verification" should be removed and another alternative word (perhaps "confirmation") should be inserted in its place.

Response: Accepted. The proposed amendment will be reworded. The word "verification" will be replaced with the word "indication" for consistency with subsection (7).

Comment: Subsection (5) now enables the Commissioner to provide access to a taxpayer's tax compliance status as at the date of the request or a previous date as prescribed by the Commissioner by public notice. This prescribed date had to previously be prescribed by the Minister. Reasons as to why this authority has changed from the Minister to the Commissioner should be included in the Memorandum of Objects.

Response: Accepted. The proposed amendment providing for the Commissioner to prescribe the date has been deleted.

Comment: It is unclear what the consequences would be in subsection (6) if the access provided was provided in error. The subsection should provide for instances where an error was made in providing access to a taxpayer's tax compliance status.

Response: Accepted. The existing wording in this regard will be retained.

Comment: It is unclear by whom the fraud, misrepresentation or non-disclosure of material facts should have been perpetrated. It is also unclear what the process and implications would be if the taxpayer disproved the allegations. It is proposed that the subsection should make it clear that it is the taxpayer's fraud, misrepresentation or non-disclosure of material facts that may lead to the revocation of the access and furthermore provide for the steps to be taken where the taxpayer disproves the allegations within the 14 days.

Response: Noted. This is existing wording. As access is granted on application by the taxpayer, revocation would implicitly be linked to fraud, misrepresentation or non-disclosure by the taxpayer. If the taxpayer makes use of the notice period of at least 14 days to disprove the allegations, the requirements for revoking access will not be met. Furthermore, as section 256(2) refers to business days, the reference to 14 days in section 256(6) will be changed to 10 business days for purposes of consistency.

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Annexure A (Organisational contributors)

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8.	BMW SA	Ms Lize-Marie Reyneke
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29.	JSE	Anne Clayton
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32.	KPMG	Bosman, Lesley
33.	LAW SOCIETY SA	Kris Devan
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40.	Mianzo Asset Management	Luvo Tyandela
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44.	MR PRICE GROUP	Susan Gertenbach
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54.	PWC	Linda Mathatho
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59.	SAIT	Beatrie Gouws
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65.	SKYE EDUCATION	Henri Papp
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70.	TOYOTA SOUTH AFRICA MOTORS	Jenny Maré
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Annexure B (individual contributors)

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