DRAFT RESPONSE TO COMMENTS ON

2013 TAXATION LAWS AMENDMENT BILL (TLAB) and TAX ADMINISTRATION LAWS AMENDMENT BILL (TALAB)

Standing Committee on Finance

Presenters: National Treasury & SARS | 11 September 2013

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Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Officials

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  - Cecil Morden
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  - Charles Makola
  - Hayley Reynolds
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  - Franz Tomasek
  - Catinka Smit
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  - Gerrie Swart

Process for 2013 TLAB and TALAB

- Published 2013 TLAB and TALAB for public comment on 4 July 2013
- Invited public comments by 5 August 2013
- Informal presentation by NT & SARS to SCOF: 24 July 2013
- SCOF Public hearings: 20 & 21 August 2013
- Draft response document:11 September 2013
- Tabling of Bill in late September or early October 2013

Main comments & concerns raised

1. Too many amendments – need to scale down on volume of the annual amendments
2. Limited time to comment
3. The retrospective nature of some of the amendments
4. Wide ranging nature of some amendments – unintended consequences
5. Many of the amendments welcomed e.g. retirement reform, incentives (SEZs, CERs, employer-provided low cost housing, bursaries, international shipping exemption etc.), VAT e-commerce, etc.

Draft 2013 TLAB - key issues commented on - 1

1. Alignment of tax treatment of individual-based insurance policies (i.e. disability insurance policies and income protection policies)
2. Retirement savings:
   - Contributions;
   - Valuation of Defined Benefits
   - Annuitisation of provident funds, whilst protecting vested rights of current members
3. Taxing dividends received for services rendered under normal income tax rules (anti-avoidance measure).
4. Uniform system of tax for non-property collective investment schemes and hedge funds
5. Protecting the tax base from base erosion and profit-shifting through excessive interest deduction and the use of artificial / hybrid debt.

Draft 2013 TLAB - key issues commented on - 2

6. Research and Development tax incentive

7. Exemption for international shipping transport entities

8. Uniform cross-border withholding regime to prevent base erosion

9. VAT registration

10. Foreign e-commerce suppliers to register for VAT, to ensure that they compete on equal footing with local e-commerce suppliers.

11. Mineral and Petroleum Royalty

12. Oil & Gas tax incentive (& fiscal stability) Tenth Schedule

2.2 Alignment of the tax treatment of individual – based insurance policies: Proposal

(Sections 10(1)(gG), 10(1)(gL) 23(r) & para 12C of the 7th Schedule)

- Two types of personal 'disability' insurance cover currently provided:

  - Income protection (covers actual loss of future income) contributions are tax deductible and pay-outs are taxed.

  - Capital protection (covers the loss of income-earning capacity, e.g. loss of limb) contributions are not tax deductible and tax-free on pay-outs.

- The reason for change is that is more equitable and provide for greater certainty if all personal insurance cover be treated equally for income tax purposes.

- Propose that in the case of income protection policies there be no deduction for premiums / contributions, and that pay-outs be free from tax for all personal insurance cover.

2.2 Alignment of the tax treatment of individual – based insurance policies: - Response (Main references: Sections 10(1)(gG) and new paragraph 12C of the Seventh Schedule, sections 10(1)(gL) and 23(r))

- *Comment:* Employees and employers would need to unwind and renegotiate all their disability policies since they will otherwise be over-insured. This would create a 'catastrophic administrative burden'. Recommend that the current policy is retained as it would remain in line with the tax treatment of similar policies in other countries such as Australia, New Zealand, Canada and Ireland.

- *Response:* Partially accepted. Under this proposal the tax treatment of premiums for income protection policies will align with the tax treatment of premiums for other personal insurance products, such as life insurance and gap cover, as it is viewed as a personal expense. However, it is agreed that the renegotiation of income protection policies will be administratively difficult and possibly could not be achieved in a short period of time. As a result, the implementation of the proposal will be delayed by a year to allow an additional period of time for employers and employees to renegotiate their income protection policies.

- Effective date 1 March 2015. instead 1 March 2014

2.4 Revised contribution incentives for retirement savings

(Sections 11(k) & 11(l), & para 2(l) of the 7th Schedule)

- Current system is too complex = increased costs & administrative burden.
- Allows some individuals & employers to benefit excessively.
- Government launched Retirement Reform proposals in 2011, 2012 and 2013 Budget, including recent paper on costs.
- In depth process of consultations with key stakeholders, incl. unions, and constituencies in NEDLAC
- First step towards implementing retirement reforms on harmonisation of tax treatment of contributions to, and benefits from, retirement funds:
  - Need to reduce complexity of the current system
  - Need to ensure greater equity.

2.4 Retirement savings - contribution incentives

(Sections 11(k) & 11(l), & para 2(l) of the 7th Schedule)

Source	Contribution type – base	% cap	Monetary cap	Retirement fund
Employer taxpayer	Employer contribution = fringe benefit = deemed employee contribution	Unlimited	Unlimited	All retirement funds
All individual taxpayers	The greater of remuneration or taxable income (excl. lump sum income). Rollover of non-deductible contributions & any amount that remains are not taxable upon exit. Contributions include amounts paid towards risk benefits & administration costs.	27.5%	Maximum of R350 000	All retirement funds

Effective date 1 March 2016. instead 1 March 2015

2.5 Valuation of fringe benefit for DB purposes

(Definitions of "DC component of a fund", "DB component of a fund", "retirement-funding income" in para 1 of the 7th Schedule & para 12D of the 7th Schedule)

- In future, contributions made by a employer to an approved SA retirement fund will be taxable as a fringe benefit in the hands of the employee.

- With a defined contribution fund (DC), the value of the employer contribution reflects the value of the fringe benefit for the employee.

- With a defined benefit fund (DB), the value is harder to calculate due to an inherent element of cross-subsidisation across members where the value of actual contributions does not match up with the member's benefits.

- Propose that the value of the fringe benefit with a DB fund be determined through the application of a formula approximating the increase in value of the annuity and lump sum benefit of the member as a result of one additional year of service, based on the value that the member will be entitled to as a retirement benefit.

2.6 Provident fund post-retirement annuity alignment

(The definitions of "pension fund", "provident fund", "retirement annuity fund", "pension preservation fund", & "provident preservation fund" in section 1, & para 6(1)(a) of the 2^{nd} Schedule)

- Currently members of provident funds cannot deduct their own contributions from income for tax purposes and are not required to annuitise at retirement, which means members often take entire retirement amount as cash lump sum & many spend it unwisely.

- Reasons for changes are:

  - Provident funds to be aligned to other retirement funds so that provident fund members enjoy the same benefits and protection; and

  - Members are reluctant to annuitise since they lose old age grant if annuity larger than the grant (problem of means-test).

2.6 Provident fund post-retirement annuity alignment

(The definitions of "pension fund", "provident fund", "retirement annuity fund", "pension preservation fund", & "provident preservation fund" in section 1, & para 6(1)(a) of the 2nd Schedule)

- Propose to require provident fund members to annuitise upon retirement, but protect vested rights of existing members (irrespective of whether member remains in the fund) by not requiring annuitisation –
  - in respect of any accumulated savings as at 1 March 2015 and any growth thereon; plus
  - for provident fund members above 55 years at 1 March 2016, any contributions made after 1 March 2016 to that provident fund and any growth thereon.

- Also raise the *de minimis* requirement to R150 000 (currently R75 000).

- Effective date 1 March 2016.

2.8 Share schemes income recognition: Response

(Section 10(1)(k)(dd)

- *Comment:* In the main, the proposal was found to be too broad, impacting on bona fide employee share schemes, and leading to inequity.

- *Response:* Accepted. It is agreed that the proposal was overly broad and that it exceeded the policy intent. The concerns raised in the submission were taken into account and the proposal was significantly narrowed.

- Anti-avoidance rules deal with situations where high-income earners use equity shares (and dividends) as a form of a disguised salary:
  - Ordinary revenue is triggered when restricted equity instruments are disposed of by employees (or fully vest for their benefit);
  - Ordinarily dividends are taxed at 15% under Dividends Tax. However, dividends from restricted employee share schemes are taxable as ordinary revenue unless the dividend falls into one of three categories of exceptions.

2.8 Share schemes income recognition: Response

(Section 10(1)(k)(dd))

- The proposed anti-avoidance measure is targeted at share schemes where the sole intent is to generate dividends for employees without the employees ever obtaining direct control of the shares (disguising salary as dividends).

- Propose that dividends be taxed as ordinary revenue in the hands of the recipient, if the dividend was received in terms of services rendered or by virtue of employment or holding of office (other than in respect of restricted equity instruments or shares held by the recipient).

- Effective date 1 March 2014

3.1 Hybrid Debt Instruments: Proposal

Section 8F & 8FA

- Two-fold regime: Rules focusing on the nature of the instrument itself (the corpus) and yield on instrument (interest)

- Both rules recharacterises the yield as dividends in specie (without recharacterising instrument (i.e. corpus)

- Recharacterisation on rules focusing on instrument (corpus) apply if:
  - The debt has features indicating that redemption is unlikely within a reasonable period (i.e. 30 years from date of issue);
  - The debt has features requiring a conversion into shares (at the behest of the debtor)
  - The redemption of the debt is conditional upon the solvency of the issuer

- Recharacterisation on rules focusing on yield (interest) apply if:
  - not determined with reference to a specified rate of interest or the time value of money
  - the yield is conditional on solvency

- Impact of proposal: no inclusion in income of payee and no deduction for payor

3.1 Hybrid Debt Instruments: Response

Section 8F & 8FA

- *Comment:* The effective date of the proposal should be moved forward to allow taxpayers to restructure their transactions.
- *Response:* <u>Accepted</u>. The effective date will be deferred to 01 April 2014 and the reclassification will apply in respect of amounts incurred on or after that date.

- *Comment:* The proposed rules are only applicable in respect of debt owed by resident companies. It is unclear why these rules are not applicable to branches of foreign resident companies.
- *Response:* <u>Accepted</u>. The proposal will apply to any company and not only to resident companies.

- *Comment:* The proposed rules should not apply to linked units debt issued by property companies and owned by pension funds, long and short insurance companies and a REIT.
- *Response:* <u>Accepted</u>. See comments under "Simplification of tax regime for collective investment schemes in non-property investments".

3.5 & 3.7 Acquisition debt and connected person debt interest limitations: Proposal

Sections 12N and 12P

- Aggregate deductions for interest on acquisition debt and connected person debt (in a **controlling relationship**) will be limited to:
  - Interest income, plus
  - 40 per cent of adjusted taxable income

- In determining adjusted taxable income:
  - interest received/accrued, currency gains/losses and CFC net income are excluded; and
  - Interest incurred, capital allowances and additional <u>75 per cent of rental income</u> is included

- Interest expense in excess of the limitation will be carried forward for a period of:
  - 6 years for acquisition debt; and
  - 10 years for connected person debt

3.5 Deductible interest limitation in respect of acquisition indebtedness: Response

(Main reference: Sections 23K, 23N and 23O)

- *Comment:* The effective date for the deletion of section 23K should be clarified as there is an inconsistency between the Bill and the explanatory memorandum with regards to the effective date.
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- *Response:* <u>Accepted</u>. The effective date will be clarified & be moved to <u>1 April 2014</u>.

- *Comment:* Section 23O (Reorganisations in controlling relationship): The 18 month rule, whereby interest deductions will be disallowed if there was a controlling relationship (more than 70 per cent) for 18 months in a 36 month period during which the debt was assumed, is considered to be too restrictive and excessive. The 70 per cent restriction is also questioned. It is noted that in BEE vehicles, the 70 per cent could have a meaningful and negative commercial impact and that it is too low and restrictive. It is proposed that this percentage be increased to 80 per cent or that the entire section 23O be scrapped.

- *Response:* <u>Accepted</u>. The limitation rules of interest deductions in respect of reorganisation and acquisition transactions between persons in a controlling relationship and the deferral rules of deductions in respect of debt between a debtor and creditor in a controlling relationship have been withdrawn from the draft Bill.

3.7 Deductible interest limitation in respect of loans between exempt persons and domestic companies: Response

(Main reference: Section 23P)

- *Comment:* The definition of a "controlling relationship" is confusing. Clarity should be provided as to the persons intended to be covered by this rule.

- *Response:* <u>Accepted</u>. The more than 70 per cent ownership test will be dropped. This rule will simply apply to a relationship between a company and any connected person in relation to that company.

- *Comment:* The definition of "creditor" is confusing and open ended. Clarity must be provided as to the meaning of the phrase "not subject to tax".

- *Response:* <u>Accepted</u>. The focus will be changed from the creditor not being subject to tax to the interest income (i.e. for the rules to apply the interest income must not be subject to tax).

3.6 Deferral of incurred expenditure between taxable payor and exempt payee

Section 23M Proposal

- Deduction of expenditure subject to temporary suspension if:
  - a controlling relationship exists between the payor and payee and
  - payee is exempt the exempt payee (i.e. from normal tax and withholding taxes)

- Expenditure will be deemed to have been incurred when the expense is actually paid

- Impact: deduction only allowed on actual payment

3.6 Deferral of incurred expenditure between taxable payor and exempt payee

Section 23M **Response**

- *Comment:* A number of concerns were raised regarding the wide scope of the aforementioned provisions, their interplay with the other debt limitation rules and possible impact on legitimate transactions.

- *Response:* <u>Accepted:</u> Given the potential impact of these rules on current commercial practice and the overall time constraints within the current legislative cycle, these proposals will be removed from the Bill for further consultation. Further consultation time is required to refine the proposals so that the right targets are impacted without having unintended adverse commercial effects.

4.2 Simplification of tax regime for collective investment schemes in non-property investments: Response

(Main references: New Section 10(1)(dA), section 25BA, and paragraph 61 of the Eighth Schedule)

- *Comment:* Interest received from linked debentures and other profit-linked loans will no longer be deductible under sections 8F and 8FA unless the entity is a REIT, controlled company or any other company that is wholly owned by a pension fund.
- *Response:* Accepted. As a transitional measure until legislation to regulate unlisted REITS is drafted, section 8F and 8FA have been amended.

- *Comment:* Unlisted property companies will fall foul of the debt-equity rules because they used linked units to capitalise. Many investors in this are old age pensioners on low incomes. At present the investors receive interest in respect of their debentures. The interest is linked to the underlying rental income return on property. Under the proposal, this interest is to be re-characterised as a dividend in the paying company.
- *Response:* Not accepted. It is questionable even under the current law whether the amount received by the investors under the circumstances is indeed interest. In any event, the process of extending the current REITs dispensation to unlisted REITS will only be commenced once the regulatory framework for unlisted REITS is finalised.

5.1 Refinement of the R&D regime: Proposal

Section 12D

Background

- The R&D tax regime provides substantial tax incentives aimed at ensuring that local R&D is globally competitive
- Under this regime, expenses incurred for purposes of conducting R&D are 100 per cent deductible
- An additional 50 per cent deduction may be claimed if the R&D is approved by the Minister of Science and Technology

Reason for change

- The adjudication committee has uncovered that the incentives can possibly be claimed in respect of activities that were never intended to fall within the ambit of the regime
- The language in the provisions also gives rise to uncertainties in interpretation
- Provisions will be streamlined in order to facilitate the adjudication process, particularly for projects in the pharmaceutical (generic medicines and clinical trials) and information and communication technology (ICT) related sectors.
- This will have the effect that some applications will be denied.

5.1 Refinement of the R&D regime: Response 1

Section 12D

- *Comment:* Retrospective amendment will result in harsh implications for taxpayers who have already engaged in R&D since that date and have relied on existing provisions in the law. The proposal will have an impact on provisional tax calculations, cash flow and planning and will require changes to financial statements where incentive was accounted for. Proposal results in uncertainty and is unfair.

- *Response:* Accepted. Amendments will be effective from 1 April 2014.

- *Comment:* The insertion of the term 'innovative' within the definition of R&D itself is irrelevant and, in absence of a clear definition, problematic for companies to interpret. The term should be removed as a qualifier, or alternatively, that language with clearer meaning and a meaning distinct from patentability is adopted.

- *Response:* Accepted. A definition for 'innovative' will be developed.

5.1 Refinement of the R&D regime: Response 2

Section 11D

- *Comment:* Requirement for R&D to be globally novel: Limiting applicability of the incentive to R&D that is in effect "world-beating" is directly contradictory to policy intention of parliament to encourage and stimulate home-grown investment. The definition is far too onerous (and subjective) and does not recognise that much R&D carried on in SA is to improve current state of art in SA and to ensure local developments match and leap ahead of global competition (many smaller local companies are competing with global giants). Most research in SA, like in most developing countries, relies on reverse engineering that leads to innovative improvements going forward – this will no longer qualify, with exception of pharmaceutical industry, which is concerning. No industry-specific treatment should be introduced and regulations / guidelines from DST are urgently needed (pharmaceuticals).

- *Response*: Noted. This requirement (proviso (f)) will be removed

5.2 Tax incentives for Special Economic Zones: Proposal

Section12Q

Background

- DTI has identified a lack of targeted tax incentives as one of the hindering factors to the success of Industrial Development Zones

Proposal

- Incentive to support of the DTI's broader initiative to improve governance, streamline procedures and provide more focused support for industry
- Companies operating within Special Economic Zones (SEZs) (approved by the Minister of Finance after consultation with the Minister of Trade and Industry) will be eligible for a favourable tax dispensation:
  - All businesses operating within approved SEZs will be eligible for accelerated depreciation allowances on capital structures and an employment incentive.
  - Certain companies (carrying on qualifying activities - to be specified by regulations within an approved SEZ – to be specified by regulations) will be subject to a reduced corporate tax rate of 15 per cent
  - All SEZs will qualify for VAT and customs relief similar to that for the current IDZs.

5.2 Tax incentives for Special Economic Zones: Proposal

Section12Q

- *Comment:* Requirement that 'not less than 90 per cent of the income of that company is derived from the carrying on of business or provision of services within that SEZs' seems incorrect: Several port areas are proposed and many companies will have activities elsewhere – the legislation reads as though they may not qualify for the incentive and may prompt larger companies to relocate.
- *Response*: Partially accepted. It is possible that companies may invest in more than one designated (by Minister of Finance) SEZ.

- *Comment:* Restrictiveness of 'qualifying company' definition: the 15% concept could be dropped and qualifying activities within the zone should instead be subject to partial taxation (at a 50% inclusion rate). One can solely focus on activity as opposed to the entity, thereby allowing entity freely within or outside the zone.
- *Response*: Not accepted. A new company will need to be set up for operations in SEZs. In addition, consideration will be given to prevent domestic transfer pricing between connected entities in and outside the designated SEZs.

5.3 Oil & Gas (Exploration and Production): Response

(Main reference: Tenth Schedule)

- *Comment:* Exclusion of onshore oil and gas operations from the definition of an 'oil and gas right': Unconventional gas (UCG) is an emerging industry in SA and Onshore UCG has not been explored yet, so its potential is as yet unproven. Onshore UCG operations are as complex, difficult and costly to bring to production as offshore oil and gas and may have a much longer pay out period.

- *Response:* Accepted. Our initial understanding was that there is much more risk (financial and otherwise) involved in offshore oil and gas activities. The submissions we have received to date in this regard indicate that the risk and reward profile for offshore and onshore oil and gas might be very similar and that unconventional gas exploration (i.e. shale gas) could also faces high risks. The Tenth Schedule will apply to both offshore and onshore oil and gas exploration and production. The need for a more flexible (sliding scale) tax regime for oil and gas (to take account of fluctuations in commodity prices) will be explored.

6.2 Exemption for international shipping transport entities

(Main reference: Section 12Q) - Proposal

- **Current position:**
  - International shipping transport conducted by SA companies is subject to tax at 28 per cent.
  - Net income of foreign shipping controlled foreign companies is exempt if the shipping is conducted outside SA
- **Reason for change:**
  - International trend is reduced taxation either through a tonnage tax or a total exemption for shipping activities
  - In view of these trends, the SA 28 per cent tax is uncompetitive
  - SA effort to revive shipping industry
- **Proposed change:**
  - New regime to exempt international shipping transport companies [Exemption include: Income Tax, Dividends Tax, CGT, and Withholding Tax on Interest]

6.2 Exemption for international shipping transport entities

(Main reference: Section 12Q) - Response

- *Comment:* It is not clear whether activities carried out by offshore support vessels supporting the offshore oil and gas industry would be included in the proposed regime.
- *Response:* Not accepted. Offshore activities of this nature are more akin to a service than transportation. The current dispensation is limited to shipping engaged in international transportation of goods and services.

- *Comment:* The current exemption of crew members on foreign ships should not be limited to crew members on South African registered ships. The effect of the amendment is that crew members on board foreign ships will now have to be outside the South Africa for a period of 183 days and more than 60 days of which have to be continuous, in order to qualify for exemption.
- *Response:* Accepted. The amendment to section 10(1)(o) was intended to add a new blanket exemption for crew members on-board South African registered ships and not change the existing exemption framework. The exemption of crew members' on-board foreign ships will be reinstated.

6.6 Uniform cross-border withholding regime to prevent base erosion - Response - 1

(Main references: Sections 37J through 37O and section 49A through 49G; new sections 49; 50 and 51)

- *Comment:* The old withholding tax on royalties (at a rate of 12%) was substituted for a new withholding tax at a rate of 15% with effect from 1 July 2013. In the current bill, the new withholding tax was deferred to 1 January 2015 without providing for the reinstatement of the old tax in the interim (i.e. the period between 1 July 2013 to 1 January 2015. As a result, there is confusion – i.e. whether to continue to withhold tax at an old rate of 12% or impose a new rate of 15% or simply assume that there is no longer withholding tax on royalties until 1 January 2015 (or until the error is rectified).
-
- *Response:* Accepted. The new withholding tax (current sections 49A to 49G) will be retained at a rate of 12%. The withholding tax rate will be increased to 15% with effect from 1 January 2015.
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6.6 Uniform cross-border withholding regime to prevent base erosion - Response – 2

(Main references: Sections 37J through 37O and section 49A through 49G; new sections 49; 50 and 51)

- *Comment:* The Bill proposes to impose withholding tax on service fees. It is questionable what the tax is intended to achieve considering that a number of Double Taxation Agreements does not confer taxing rights to a source country unless the foreign service provider has a permanent establishment in that country. It is also unfair for South Africa to impose a tax simply for the purposes of gathering information on whether there is a permanent establishment or not. The domestic payors are unlikely to have this information at their disposal; hence most payors will resort to withholding tax in order to err on the site of caution even if that tax will ultimately be refunded by SARS. This could cause significant cash flow problems for foreign service providers.

- *Response:* Noted. The withholding tax on services will be deferred to 1 January 2016 to provide sufficient time for further consultations and refinements.

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7.1 Streamlining Voluntary Registration - Response 1
(Section 23(3)(b); 23(3)(d); s24(5))

Comments:

- The proposed amendments does not assist in streamlining VAT registration. The proposals will pose an unbearable compliance burden to small business as well as the fact that restricting refunds presents a cash flow problem for small business. The R5 million threshold proposed for persons other than small business, is onerous and there is no clarity as to whether this expenditure threshold also includes pre-registration expenditure incurred. Furthermore, the requirement that the entity makes taxable supplies within the next 12 months must be deleted.

Response:

- Accepted: the proposed amendments will be withdrawn and replaced with a softer set of proposals:
- **Firstly**,
  – Small businesses that make less than R50 000 taxable supplies in a 12 month period will be allowed to register for VAT but only on the payments basis ;

7.1 Streamlining Voluntary VAT registration - Response 2

- A switch over to the invoice basis occurs after the threshold of R50 000 is breached but these person can choose to remain on the payments basis up to a threshold of R2,5m. SARS will have the power to deregister these persons if after 12 months these person have not made taxable supplies > R50 000
- There is no longer a withholding of refunds.

- **Secondly**,
  - The current section 23(3)(d) that applies to a limited number of persons seeking VAT registration will be clarified via regulation. Stated differently, the regulation will delineate types of activities that will quality for registration under this provision; activities include: oil and gas exploration, mining, farming, etc;
  - The expenditure threshold of R5million falls away, as does, the requirement that the person makes taxable supplies of R50 000 in a period of 12 months

7.2 Electronically supplied services – VAT registration

(Sections 1; 15(2)(a)(vii); 20 (5B) & 23(1A)) Response - 1

Comment:

- The definition of e-commerce services is too wide and ambiguous. It is too wide because a number of services supplied by foreign service providers will be caught by this provision (B2B and B2C);
- Ambiguity is associated with: what does the placing of an order entail and when does delivery of a service take place. The definition of e-commerce must be changed to "electronically supplied services" to align internationally.

Response:

- <u>Accepted</u>: the word definition "e-commerce services" will be replaced with "electronically supplied services". In order to provide more clarity, the types of electronically supplied services that would be subject to VAT will be prescribed in a regulation made by the Minister. This is in keeping with international trends

7.2 Electronically supplied services VAT registration - Response - 2

Comment:

- The proposed amendment should only apply to B2C transactions as the current reverse charge mechanism is robust enough for B2B transactions;
- The proposed amendment should not be limited to e-commerce services supplied by non-residents only as this could lead to VAT leakage if residents can provide e-commerce services from abroad

Response:

- Partially accepted: the non-resident requirement is deleted. There is no distinction made between B2B and B2C as it will increase compliance for the foreign supplier, coupled with the risk that private customers may mask as business customers to avoid the tax.

7.2 Electronically supplied services VAT registration - 3

Comment:

- The proposed registration threshold lacks a monetary threshold which means that the foreign supplier is forced to register for VAT even if R1 worth of supplies are made; local suppliers of electronic services are only forced to register if the R1m threshold in a 12 month period is exceeded;

Response: Partially Accepted: a R50 000 threshold is mooted for foreign suppliers of electronic services. A lower threshold is more appropriate as it would aid in levelling the playing field between local and foreign suppliers as the VAT registration liability will apply to a greater number of foreign suppliers and not just the bigger players.

Comment: the effective date of 1 January 2014 should be brought forward to 1 November/December 2013.

Response: Not Accepted: The implementation date is delayed to 1 April 2014 in order to accommodate SARS system readiness

8.1 Mineral & Petroleum Resources Royalty: Taxation of beneficiation

Comments:

- One of the key principles agreed to by industry and NT was that the royalty should be charged at the first saleable point as close to the mouth of the mine as possible, in order to fairly compensate the State for minerals extracted and not to tax beneficiation of minerals. The proposed amendments create a disincentive for extractors to beneficiate their minerals further than the minimum specified condition and incur a higher royalty charge.

- *Response*: Not Accepted: the first saleable point reference inextricably involves an element of beneficiation which is compensated for by a lower royalty rate.

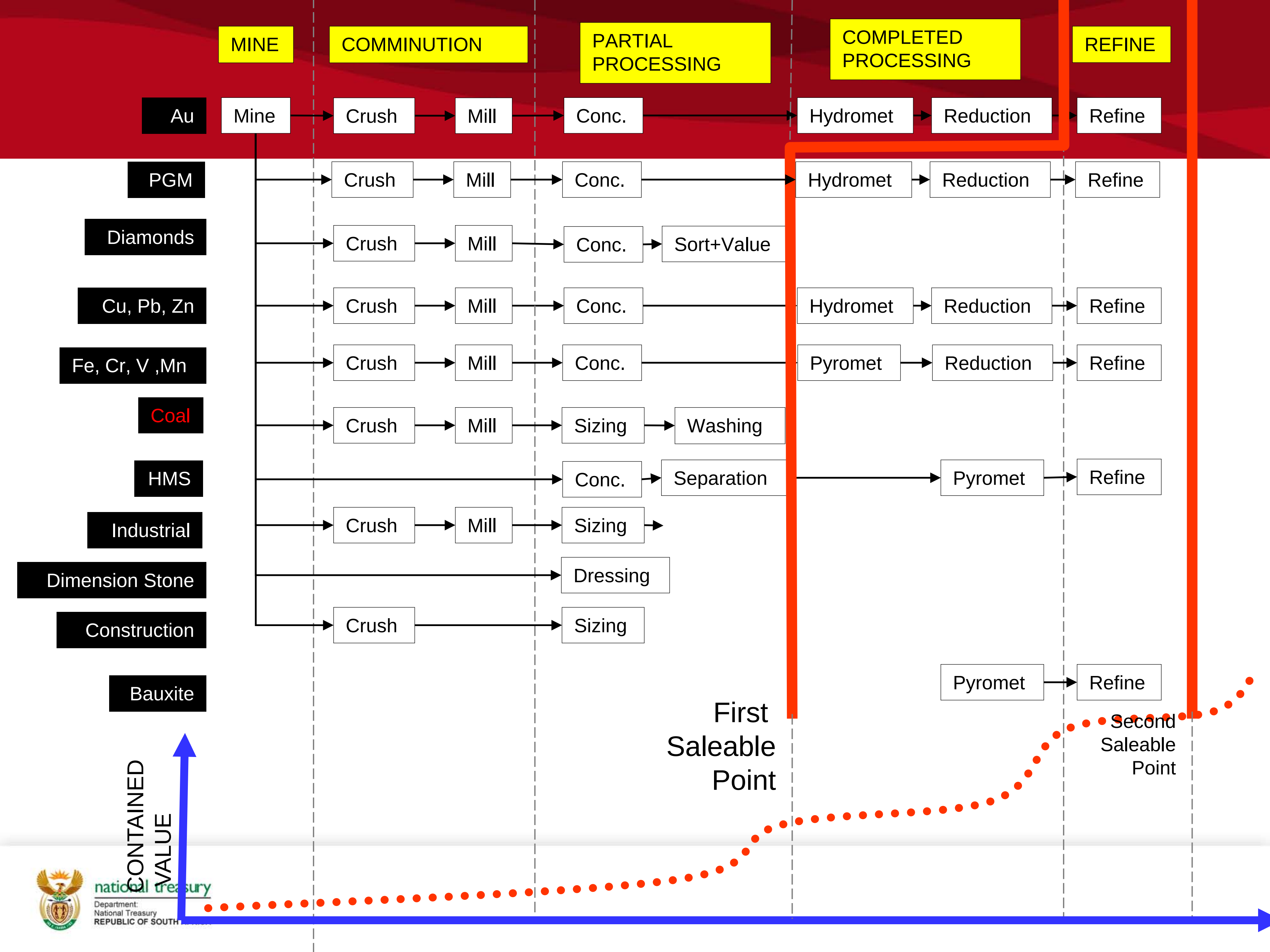
8.2 Mineral & Petroleum Resources Royalty: Minerals with ranges

Comment:

- The introduction of a range of 19 to 27MJ/kg for coal does not affect the market realities as actual deliveries of coal to Eskom range between 15-19 MJ/kg. It follows that a minimum range value of 15 is more appropriate

Response: Not Accepted:

- The Department of Mineral Resources has confirmed that the weighted average calorific value of sales of coal to Eskom is 18.9 MJ/kg. The highest coal grade for Eskom's purposes is currently 24.2 MJ/kg and the highest coal grade for export purposes is 25 MJ/kg


MINE
COMMINUTION
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COMPLETED PROCESSING
REFINE
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PGM
Crush
Mill
Conc.
Hydromet
Reduction
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Diamonds
Crush
Mill
Conc.
Sort+Value
Cu, Pb, Zn
Crush
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Conc.
Hydromet
Reduction
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Fe, Cr, V ,Mn
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Pyromet
Reduction
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First Saleable Point
Second Saleable Point
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Schedule 2 – Coal, 24 Nov 2008

- Grade A: *in situ* calorific value => than 27.5 GMJ/kg
- Grade B: *in situ* calorific value => than 26.5 GMJ/kg and < 27.5 GMJ/kg
- Grade C: in situ calorific value => than 19.0 GMJ/kg and < 26.5 GMJ/kg
- Grade D: *in situ* calorific value < than 19.0 GMJ/kg

EBIT (accounting depreciation?)

EBIT/Gross revenue (%)	2002	2003	2004	2005	2006	Average
DIAMONDS	43	24	25	38	47	**35**
MANGANESE	43	39	25	45	36	**38**
IRON ORE	33	22	18	42	49	**33**
MINERAL SANDS	42	28	16	16	25	**25**
PGM	37	21	20	21	39	**28**
GOLD	40	27	12	-6	21	**19**
COAL	23	14	14	17	14	**16**
CHROME	5	14	16	10	7	**10**
BASE METALS	2	-10	-3	-1	19	**1**

Estimated royalty rates – Refined / Metal

EBIT ("accounting" depreciation) /Gross revenue = X						
Y = 0.5 + X/12.5 (Max = 5.0)	2002	2003	2004	2005	2006	Average
PGM - metal (refined)	3.4	2.2	2.1	2.2	3.6	2.7
GOLD - metal (refined)	3.7	2.7	1.5	0.5	2.2	2.0

Estimated royalty rates – Unrefined

EBIT (“accounting” **depreciation) /Gross revenue = X**						
Y = 0.5 + X/9.0 (Max = 7.0)	2002	2003	2004	2005	2006	Average
DIAMONDS	5.3	3.1	3.3	4.8	5.7	4.4
MANGANESE	5.3	4.8	3.3	5.4	4.5	4.7
IRON ORE	4.2	3.0	2.5	5.1	6.0	4.1
MINERAL SANDS	5.1	3.6	2.2	2.3	3.3	3.3
PGM - Concentrate	4.6	2.8	2.8	2.8	4.8	3.6
COAL	3.0	2.0	2.0	2.4	2.0	2.3
CHROME	1.0	2.1	2.2	1.6	1.2	1.6
BASE METALS	0.7	0.5	0.5	0.5	2.6	0.7

Sales, Royalty Payments & Estimated Royalty Rates: 2010/11

	2010				2010/11		Estimated
	Sales				Royalty Payments		Royalty Rate
R mn	local	export	total	%	total	%	
Platinum	7 893	65 894	73 787	*28.7%*	481	*13.5%*	0.7%
Coal	33 702	37 477	71 179	*27.7%*	258	*7.3%*	0.4%
Gold	2 056	51 037	53 093	*20.7%*	515	*14.5%*	1.0%
Iron ore	3 270	40 148	43 419	*16.9%*	1 675	*47.1%*	3.9%
Manganese	1 321	9 340	10 661	*4.2%*	104	*2.9%*	1.0%
Copper	3 160	1 209	4 369	*1.7%*	125	*3.5%*	2.9%
Zinc	280	43	323	*0.1%*	69	*1.9%*	
Other					328	*9.2%*	
Total	**51 681**	**205 150**	**256 831**	**100%**	**3 555**	**100%**	1.4%

Sales, Royalty Payments & Estimated Royalty Rates: 2011/12

	2011				2011/12		Estimated
	Sales				Royalty Payments		Royalty Rate
R mn	local	export	total	*%*	total	*%*	
Coal	37 286	50 549	87 834	*27.5%*	297	*5.3%*	0.3%
Platinum	10 619	73 234	83 853	*26.3%*	853	*15.2%*	1.0%
Gold	3 633	65 258	68 891	*21.6%*	817	*14.6%*	1.2%
Iron ore	4 208	58 444	62 652	*19.6%*	2 501	*44.6%*	4.0%
Manganese	1 325	8 570	9 895	*3.1%*	149	*2.7%*	1.5%
Copper	3 938	1 495	5 433	*1.7%*	79	*1.4%*	1.5%
Zinc	169	233	403	*0.1%*	143	*2.5%*	
Other					772	*13.8%*	
Total	**61 178**	**257 783**	**318 961**	**100%**	**5 611**	**100%**	1.8%

Tax Administration Laws Amendment Bill 2013 (TALAB)

Acts amended by TALAB

- **Income Tax Act** (technical corrections)
- **Customs & Excise Act** (substantive amendment & technical corrections)
- **Skills Development Levies Act** (consequential amendment)
- **Unemployment Insurance Contributions Act** (consequential amendment)
- **Mineral and Petroleum Resources Royalty (Administration) Act** (technical correction)
- **Tax Administration Act** (substantive amendments & technical corrections)

9.1.2 Income Tax Act: Returns by recipients of exempt dividends (Section 64K)

Comment:

- Propose removal of amendment
- Imposes high & unnecessary administrative burden
- Information will be disclosed by exempt bodies (includes **all** companies) annually
- Contrary to nature of final withholding tax intended by legislature & other withholding tax regimes e.g. interest; PAYE

Response:

- <u>Not Accepted</u>: Examples do not deal with an exemption from an otherwise final withholding tax. SARS requires full sight of the exempt dividend flow so as to ensure that where one entity declares a dividend as being exempt it is in fact received by an exempt beneficial owner of the dividend
- Extensive consultation over more than two years, with different channels for larger and smaller taxpayers

9.2 Customs and Excise Act: Search and seizure; Criminal investigative powers (Section 4)

Search & Seizure – requirement for warrant

- **Comment**: Narrower requirements for issue of warrant
- **Response:** <u>Not Accepted</u>: Common standard used to obtain i.e. “reasonable grounds” for warrant application, does not deal with formal requirements of warrant

Criminal investigative powers

- **Comment:** SARS may only refer to or assist with investigations by SAPS not conduct them
- **Response:** <u>Not Accepted</u>: Constitutionally permissible, SARS may investigate & lay charge but not institute prosecution – prerogative of NPA

9.3.5 Tax Administration Act: Affording power to request returns to Commissioner (Section 25)

Comment:

- Obligation to submit & criteria for a return must be prescribed in a tax Act
- Affords wide power to Commissioner

Response:

- <u>Not Accepted</u>: Return is information gathering tool to obtain information from certain categories of taxpayers, internationally accepted that revenue authority has wide information gathering powers
- Similar scheme applies to third party returns – Commissioner imposes obligation in Public Notice & prescribes form & information required
- In practice, new returns required e.g. to obtain information for purposes of international tax agreement

9.3.9 Tax Administration Act: Extension of prescription period – reduced assessments (Section 99)

- **Comment:**
  - Proposal only affords relief if *request* made within period
  - Does not deal with situation where erroneous assessment discovered after prescription & inequitable to collect
- **Response:**
  - <u>Accepted</u>: New amendment proposed to deal with fraudulent returns without knowledge of taxpayer, undisputed errors by taxpayers and processing errors if inequitable to enforce and no other remedies available
  - Will also resolve reduced assessment requested but not issued

9.3.9 Tax Administration Act: Extension of prescription period – additional assessments

- **Comment**:
  - Conflicts with principle of finality & public interest in finality
  - Will result in protracted disputes around question of whether delaying tactics were present
  - SARS may abuse close to expiry of prescription period
- **Response:**
  - <u>Partially Accepted</u>: Existence of delaying tactics open to dispute and amendment does not address underlying issue of particularly complex audits
  - Alternative legislative solutions exist to assist with particularly complex matters, such as a specific extension of prescription period for these matters
  - Issue will be further researched for 2014 legislative programme

9.3.11 Tax Administration Act: Affording tax court powers of PAJA review (Section 117)

Comment

- Although welcomed, proposal possibly not legally tenable if only PAJA can assign jurisdiction
- Uncertain of practical implications for tax court

Response

- <u>Accepted</u>: Proposal based on constant demand for cost effective and accessible remedy for administrative decisions
- Arguable that another Act e.g. TAA may assign this power but further consideration & consultation needed
- No PAJA Rules of Procedure published and High Court Rules do not apply to tax court in this context

9.3.19 Tax Administration Act: Understatement penalty & *bona fide* inadvertent errors (Section 222)

Comment

- Amendment should be made retrospective to TAA commencement date
- TAA should prescribe criteria that SARS will consider

Response

- Partially Accepted: Amendment will apply from 1 October 2012
- Due to wide range of possible errors, legislatively prescribed criteria may unintentionally exclude deserving cases and include undeserving cases; guidance on interpretation of term will be developed by SARS

9.3.22 Tax Administration Act: Understatement penalty (USP) & retrospectivity (Section 270)

- **Comment:**
  - USP may not be imposed for understatement made or for tax period concluded before TAA commencement
  - Transitional section 270(6) should clarify this expressly
- **Response:**
  - Not Accepted: Analogy that SARS reduced speed limit retrospectively incorrect – not “offence” but determination of “fine” changed within pre-existing range of 0 – 200%; no express constitutional or case law prohibition
  - USP sought to cure defects of additional tax regime – penalty more predictable, fair and consistent
  - SARS will seek to address unanticipated consequences