MEDIA STATEMENT

Taxation Laws Amendment Bills, 2012: General Overview

I. Process

National Treasury is releasing today the 2012 Taxation Laws Amendment Bills for public comment. The draft Taxation Laws Amendment Bill, the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2012 (introduced in March 2012), and the Tax Administration Amendment Bill give effect to most of the 2012 Budget Review tax proposals. The remaining tax proposals which have a later implementation date because they require more consultation (e.g. retirement proposals, carbon tax), or require specific legislation (e.g. the gambling tax), will be published for comment later this year or next year.

The draft Taxation Laws Amendment Bill deals with the substantive aspects of the tax proposals made in the 2012 Budget Review and the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2012, addresses changes to rates and thresholds. The draft Tax Administration Amendment Bill, 2012 deals with changes to the administrative provisions of tax Acts administered by SARS, including the Tax Administration Act. The draft legislation and explanatory memorandum can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites.

The draft 2012 Taxation Laws Amendment Bill and Tax Administration Amendment Bill are published for public comment prior to formal introduction in Parliament. The Standing Committee of Finance will also convene hearings into these bills before their formal introduction in Parliament. In the meantime, National Treasury also invites public comments, and will engage separately with stakeholders, including through workshops to be held in early August 2012. Thereafter, National Treasury and the South African Revenue Service will revise the bills, taking into account public comments, and then introduce them in parliament for the more formal process. This process is in accordance with the Money Bills Procedure and Related Matters Act, No 9 of 2009.

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

II. Content

A. Income tax: Individuals, employment and saving

- Variable cash remuneration: A recurring issue is the mismatch of the payment of variable cash remuneration (such as overtime pay, leave pay, commission, bonuses and travel reimbursement) and the tax payments thereon. It is proposed the deduction of applicable taxes and the payment of these to SARS be done at the same time as the variable cash remuneration is paid to an employee. This will simplify payroll management and employee tax issues.

- Employer-provided rental vehicles: Taxpayers who use for private purposes vehicles provided by their employers are subject to fringe benefit taxation based on a formula which takes into account ownership and running costs. This formula does not make provision for cases where the vehicle is rented by an employer under an operating lease and may therefore lead to over-taxation. It is proposed that in case of rented vehicles (in terms of an operating lease), fringe benefit taxation applicable to employer-provided vehicles be limited to the aggregate employer cost.

  Post-tax contribution relief for compulsory annuities: The current dispensation allows a taxpayer to take tax free a portion of his annuity at retirement, with the remaining annuity portion being subject to income tax. It is proposed that taxpayers who do not take out their tax free portion on retirement be taxed only on that portion of their retirement annuity income that would have been taxed had they opted for the tax-free lump sum on retirement.

B. Income tax: Business

- Relief for debt reductions: Given the global economic environment, many businesses are reducing their debt levels, including through workouts. The proposed regime streamlines the tax rules so as to reduce the possibility that these debt reduction strategies will trigger a capital gains tax liability for the debtor. In the main, debt reduction should lead to the reduction of tax attributes, with ordinary recoupments triggered only as a last resort. Debt cancellations will no longer trigger capital gains.

- Debt-financed acquisitions (section 45 part II): In 2011, acquisitions of businesses using debt in terms of Section 45 were identified as problematic. The 2011 legislation allowed for such acquisitions to continue under controlled circumstances, with the understanding that the main problems were related to the use of excessive borrowings and debt instruments with share-like features. As part of the two-phased approach announced in the 2012 Budget Review, the proposed legislation seeks to recharacterise artificial debt as shares when the debt contains key share-like features (however, these rules will come into effect in 2014). On the other hand, the proposed legislation will allow interest deductions in respect of debt-financed share acquisitions under the same

controlled circumstances currently allowed in the case of section 45 debt-financed acquisitions. Rules aimed at controlling excessive interest deductions will remain an issue for 2013.

- Annual mark-to-market taxation: Modern international accounting and tax trends are moving away from the realisation principle (i.e. recognising gains or losses only upon disposal and realisation) towards an annual mark-to-market fair value principle. Key financial institutions (e.g. banks and insurers) have requested that the South African tax system be re-aligned in favour of annual mark-to-market taxation so as to promote tax and accounting convergence, thereby reducing tax compliance costs. The proposal essentially places certain financial institutions (i.e. banks, brokers and policyholders funds of long-term insurers) on an annual basis of mark-to-market taxation for annual unrealised gains and losses. Transitional relief exists for the switchover from realised to unrealised gains and losses.

- Property investment entities: Property loan stock companies and property unit trusts are not in sync with international real estate investment funds, known as real estate investment trusts (REITs). For instance, property loan stock companies have an informal conduit treatment only via linked shares and debentures. Property unit trusts, on the other hand, cannot reorganise themselves without triggering a capital gains tax liability. It is proposed that listed property loan stock companies and property unit trusts be subject to the same tax regime, provided they are classified by the JSE as real estate investment trusts (REITs). The net effect will be to allow deductible distributions to shareholders of these REITs if at least 75 per cent of taxable income of the property investment entity stems from rentals or property subsidiaries. The deduction will be applicable to distributions in respect of shares. These entities will also be exempt from capital gains tax. Discussions will continue on how to deal with the issue of unlisted property investment entities.

C. Income tax: International

- Cross-border restructurings: In 2011, the rules for the reorganisation of businesses operating across borders extended to cover cross-border transfers. The proposed legislation streamlines these rules so that the rules are more co-ordinated conceptually and allow for section 45 to be applicable to the transfer offshore of assets as part of the reorganization. As a result, the rules will allow for the transfer of assets from abroad into South Africa, or from a South African company to a foreign-based company under its control, without these transfers being deemed a disposal and therefore triggering a capital gains tax liability.

  With the advent of comprehensive reorganisation rules, the participation exemption for capital gains can be narrowed. The participation exemption upon the disposal of foreign equity shares will now apply solely to disposals to independent foreign entities if the non-share consideration (e.g. debt instruments

and cash) has an equal or greater value than the shares transferred. The proposed narrowing of the participation prevents the exemption from being misused as a means to undermine the tax base or to facilitate tax-free indirect migrations.

- Financial centre of Africa initiatives: The proposed legislation continues to enhance South Africa as a financial centre. Amongst other measures, the proposed legislation provides relief to South African multinationals from double taxation. The proposed legislation also provides relief so that foreign-owned investment funds that are managed by South African-based managers are not subject to South African tax merely the involvement of local manager.

- Revised deemed disposal charge upon cessation of residence: The proposed legislation aligns with international norms the tax treatment of the sale of assets when the owner ceases to be a South African resident. As a result, a departing person's year of assessment will be deemed to have ended immediately a day before that person becomes a resident of another country. Also, departing persons other than companies will be deemed to have disposed of all their assets at market value immediately before the end of that year of assessment. A company, on the other hand, will be deemed to have distributed all of its assets and been liquidated, and then been reconstituted the following day as a new foreign company. Foreign residency will only start in the new year of assessment. The proposed rules clarify that a double tax treaty does not exempt a person from capital gains tax.

D. Indirect tax

- Securities Transfer Tax (STT) – market-making exemption: The STT is a financial transaction tax imposed on the purchases of shares (equities) on the secondary market. A number of transactions are however exempted from this tax, including those transactions where brokers (i.e. authorised users of the exchange) are acting as principal (as opposed to acting as an agent) in order to promote market-making. The applicability of STT has, however, been unclear in instances where companies use subsidiary companies to facilitate market-making in derivatives. The draft legislation makes clear that this form of market-making will also be exempted from the STT. The new treatment will be backdated to transactions dating back to 1 January 2009.

E. Tax administration (Tax Administration Amendment Bill, 2012)

- *Penalties on underestimation of provisional tax:* The estimated provisional tax payable may, in some instances, be lower than the actual payments of tax by the end of the tax year. Under current law, however, a provisional tax penalty may apply solely due to this situation even if no provisional tax is due. The proposed legislation eliminates a penalty under these circumstances.

- Regulation of tax practitioners: The Bill proposes the introduction of a recognised controlling body (RCB) model for the regulation of tax practitioners to be housed

in the Tax Administration Act, due to commence later in 2012. This proposal follows from the discussions over the last few months sparked by the Minister of Finance's comments about the tax compliance of some of the registered tax practitioners. The proposed model, the first phase in the regulation of tax practitioners, will use existing bodies and provide a framework to ensure that tax practitioners are appropriately qualified and that a mechanism for dealing with misconduct addressing is available both to taxpayers and SARS.

III. Public Comments

National Treasury is formally requesting public comments on the above-mentioned proposals. For ease of reference and to facilitate processing, it would be appreciated if all comments are arranged in accordance with the explanatory memorandum. It would also be helpful if the legal nature of the problem is stated, along with a "detailed" factual description of the relevant transaction and context. Treasury would also appreciate proposed solution for each of the stated problem.

Comments should be sent by email to nomfanelo.mpotulo@treasury.gov.za or by fax to (012) 315 5516 and to acollins@sars.gov.za or by fax to (012) 315 5516. Please ensure that these comments reach the National Treasury or the SA Revenue Service by 31 July 2012.

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