



**NATIONAL
TREASURY**

REPUBLIC OF SOUTH AFRICA



EXPLANATORY MEMORANDUM

ON THE

DRAFT TAXATION LAWS AMENDMENT BILL, 2019

21 July 2019

[W.P. – '19]

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1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

1.1 EXTENDING THE SCOPE OF AMOUNTS CONSTITUTING VARIABLE REMUNERATION

[Applicable provision: Section 7B of the Act, No. 58 of 1962 (“the Act”)]

I. Background

In 2013, section 7B was introduced to the Act. The main aim of this section was to match the timing between accrual and payment of various forms of variable remuneration. Consequently, the introduction of section 7B made provision for certain amounts to be deemed to accrue to the employee when they are actually paid.

II. Reasons for change

It has come to Government’s attention that the current scope of section 7B is limited. There are certain types of variable remuneration that are not currently catered for in this section. This includes for example, night shift allowances and standby allowances paid by employers to employees. As a result, the problem that section 7B was intended to address still remains as some types of variable remuneration remain outside the ambit of this section.

III. Proposal

In order to address this anomaly, it is proposed that the current wording of section 7B be changed from applying to specific payments to apply to amounts bearing certain generic characteristics. As a result, it is proposed that section 7B should cater for remuneration that bears the following general characteristics:

- a. The employee is only entitled to the amount once services have been rendered;
- b. The amount the employees is entitled to cannot be determined in advance;
- c. The employees entitled to these amounts cannot be determined in advance;
- d. The payment of said amount is subject to some sort of approval process prior to its payment;
- e. The amount due to the employee varies from month to month.

IV. Effective date

The proposed amendments will come into operation on 1 March 2020 and apply in respect of any year of assessment commencing on or after that date.

RETIREMENT REFORMS

1.2 ALIGNING THE EFFECTIVE DATE OF TAX NEUTRAL TRANSFERS BETWEEN RETIREMENT FUNDS WITH THE EFFECTIVE DATE OF ALL RETIREMENT REFORMS

[Applicable provisions: Paragraph 6(1)(a) of the Second Schedule to the Act]

I. Background

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 annuitise retirement benefits. These retirement fund reform amendments were supposed to come into effect on 1 March 2015.

However, when Parliament was passing legislative changes to these amendments, Parliament postponed the effective date for the annuitisation requirements for provident funds until 1 March 2016. During the 2016 legislative cycle, Parliament again postponed the effective date until 1 March 2019. Further, during the 2018 legislative cycle, Parliament once more postponed the effective date to 1 March 2021. These postponements were due to continuing negotiations within the National Economic Development and Labour Council (“NEDLAC”).

II. Reasons for change

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, which makes provision for tax neutral transfers between retirement funds. Failure to change the effective date in the above-mentioned provision resulted in the non-taxable treatment of transfers from pension funds to provident or provident preservation funds with effect from 1 March 2019.

The earlier effective date of 1 March 2019 for the tax neutral transfers from pension to provident or provident preservation funds creates a loophole as the intention was to align the effective date of the tax neutral transfers from pension to provident or provident preservation funds with the effective date of retirement fund reform amendments, which is 1 March 2021.

III. Proposal

In order to include the 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 effective date of retirement fund reform amendments, which is 1 March 2021.

IV. Effective date

The proposed amendments are deemed to have come into operation on 1 March 2019.

1.3 EXEMPTION RELATING TO ANNUITIES FROM A PROVIDENT OR PROVIDENT PRESERVATION FUND

[Applicable provision: Section 10C of the Act]

I. Background

In 2014, changes were made in the Act allowing the exemption of non-deductible retirement contributions when determining the taxable portion of compulsory annuities received from a pension, pension preservation or retirement annuity fund. However, this exemption is not applicable to provident or provident preservation fund members. The rationale behind excluding provident and provident preservation funds from this exemption was based on the fact that these fund members were not required by the rules of the provident and provident preservation fund to utilise at least two-thirds of their fund benefit upon retirement to acquire or purchase a compulsory annuity (provident or provident preservation fund members were allowed to receive their full retirement benefit as a lump sum upon retirement).

II. Reasons for change

With effect from 1 March 2016, Government proceeded with the introduction of some of the broader objectives of retirement reforms in the Act to ensure greater equity across income groups. As a result, contributions by both employers and employees to pension, provident and retirement annuity funds will qualify for a tax deduction, subject to a cap. On the other hand, contributions by employers to pension, provident and retirement annuity funds on behalf of employees will become a taxable fringe benefit in the hands of the employee.

Following the above-mentioned amendments in the Act, members of provident or provident preservation funds receiving an annuity found themselves in a position where any non-deductible contributions could only be off-set against the lump sum received. The balance of the non-deductible contributions in excess of the lump sum received are in effect forfeited or lost.

It has come to Government's attention that over the past years, a number of provident and provident preservation funds have, by virtue of amending their plan rules, allowed their retiring members the ability to opt to acquire or purchase annuities with their fund benefits.

III. Proposal

In order to promote Government's policy of a uniform approach to the tax treatment of all retirement funds, it is proposed that provident and provident preservation fund members who receive annuities are afforded the same exemption status that would be applicable to other retirement fund members (that any non-deductible contributions be allowed as an exemption when determining the taxable portion of annuities received from a provident or provident preservation fund).

The ability to deduct any non-deductible contributions made to a provident or provident preservation fund in determining the taxable annuity received from such fund will apply in relation to annuities received on or after 1 March 2020.

IV. Effective date

The proposed amendments will come into operation on 1 March 2020 and apply in respect of any year of assessment commencing on or after that date.

1.4 TAX TREATMENT OF BULK PAYMENTS TO FORMER MEMBERS OF CLOSED FUNDS

[Applicable provision: New paragraph 2D of the Second Schedule to the Act]

I. Background

In 2007, paragraph 2C was introduced into the Second Schedule to the Act to allow for the income tax exemption in respect of a lump sum benefit or part thereof, received or accrued to a person subsequent to the person's retirement, death or withdrawal or resignation from a fund and in consequence of, or following upon an event contemplated by the rules of the fund. In 2008 changes were made to paragraph 2C of the Second Schedule to the Act to make provision for the Minister of Finance to prescribe an event by notice in the Government Gazette in terms of which the above-mentioned extraordinary payments by the retirement funds will qualify for income tax exemption.

Consequently, in 2009, the Minister of Finance published a notice in Government Gazette No. 32005 (GG 32005) prescribing an event referred to in paragraph 2C of the Second Schedule to the Act in terms of which the following extraordinary lump sum payments by the retirement funds qualified for income tax exemption:

- a. Any amount received by or accrued to a person from a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund in consequence of a payment to such fund by the administrator of such fund as a result of income received by the administrator prior to 1 January 2008 that was not disclosed to such funds (loosely referred to as "undisclosed secret profits");
- b. Any amount received by or accrued to a person from a pension fund or provident fund contemplated in paragraph (a) or (b) of the definition of "pension fund" in section 1 of the Act, to the extent that that amount is similar to a payment in terms of a surplus apportionment scheme contemplated in section 15B of the Pension Funds Act, No. 54 of 1956 ("the Pension Funds Act") (loosely referred to as "surplus calculations");
- c. Any amount received by or accrued to a person from a pension preservation fund or provident preservation fund to the extent that it was paid or transferred to such a fund-
 - o As an unclaimed benefit contemplated in paragraph (c) of the definition of "unclaimed benefit" in section 1 of the Pension Funds Act (loosely referred to as "unclaimed benefits"); or
 - o As a result of or in consequence of an event contemplated in paragraph (a) of GG 32005.

II. Reasons for change

Paragraph 2C of the Second Schedule to the Act read together with the notice published by the Minister of Finance in GG 32005 prescribing an event referred to in paragraph 2C of the Second Schedule to the Act, makes provision for instances where the extraordinary lump sum payments are made by registered, active retirement funds.

When the notice was published by the Minister of Finance in GG 32005, some retirement funds were no longer registered. These deregistered retirement funds had already paid the above-mentioned extraordinary lump sum payments to the fund administrators. The fund administrators had not yet paid these extraordinary lump sum payments to the affected members and/or beneficiaries. These extraordinary lump sum payments are currently still held by the respective fund administrators.

In view of the fact that paragraph 2C of Second Schedule to the Act read together with the notice published by the Minister of Finance in GG 32005 makes provision for the extraordinary lump sum payments to be made by registered active retirement funds, extraordinary lump sum payments made by fund administrators in this regards will not qualify for income tax exemption.

III. Proposal

In order to ensure consistent tax treatment in respect of extraordinary lump sum payments it is proposed that changes be made in the Second Schedule to the Act and a revised notice published by the Minister of Finance in the Government Gazette making provision for the payment of extraordinary lump sums currently held by fund administrators on behalf of deregistered funds to qualify for tax exempt treatment, provided that they meet the criteria to be determined by the Minister of Finance in the notice.

IV. Effective date

The proposed amendments will come into operation on the date to be determined by the Minister of Finance by notice in the Government Gazette.

1.5 REVIEWING THE TAX TREATMENT OF SURVIVING SPOUSE PENSIONS

[Applicable provision: Paragraph 2 of the Fourth Schedule to the Act]

I. Background

The Act makes provision for members of retirement funds to deduct contributions to their retirement funds from their taxable income when determining their monthly employees' tax liability and annual income tax payable. Upon the death of a spouse, the surviving spouse may be entitled to receive a monthly pension known as the "surviving spouse's pension", which is paid by the retirement fund of the deceased spouse which the deceased spouse was a member of prior to death. This "surviving spouse's pension" is taxable in the surviving spouse's hands and is subject to Pay-As-You-Earn (PAYE) withholding by the retirement fund making the payment.

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. Generally, the result of the assessment is often that the surviving spouse has a tax liability that exceeds the employee's tax withheld by the employer and retirement fund(s) during the year of assessment, since the aggregation of income pushes them into a higher tax bracket.

II. Reasons for change

It has come to Government's attention that in most cases, the surviving spouse does not foresee the additional tax liability as a result of the aggregation of income which pushes the surviving

spouse into a higher tax bracket. This creates a cash flow burden and a tax debt for the surviving spouse. Further, this is becoming financially burdensome for the surviving spouses, and has, in many cases had adverse effects on the surviving spouse's financial capacity.

III. Proposal

In order to assist with alleviating the financial burden in this regard, the following is proposed:

- a. that the tax rebates applicable to the surviving spouse are not taken into account by the retirement fund(s) when calculating the taxes to be withheld on the "surviving spouse's pension";
- b. any PAYE excessively withheld will be refunded upon assessment.

The above proposal will only be applicable in instances where recipients of the "surviving spouse's pension" also receive other employment income. As a result, retirement funds are required to apply for an annual tax directive from SARS, the tax directives will advise the retirement fund whether or not the fund should be disregarding the tax rebates when calculating the taxes due on amounts paid by them.

IV. Effective date

The proposed amendments will come into operation on 1 March 2020 and apply in respect of any year of assessment commencing on or after that date.

2. INCOME TAX: BUSINESS (GENERAL)

2.1 ADDRESSING ABUSIVE ARRANGEMENTS AIMED AT AVOIDING THE ANTI-DIVIDEND STRIPPING PROVISIONS

[Applicable provisions: Paragraph 12A and paragraph 43A of the Eighth Schedule to the Act]

I. Background

The anti-avoidance rules dealing with dividend stripping were first introduced in the Act in 2009. Dividend stripping normally occurs when a shareholder company that intends on disinvesting in a target company avoids income tax (including capital gains tax) that would ordinarily arise on the sale of shares. This is achieved when a shareholder company (that either controls or has a significant influence over a target company) ensures that the target company declares a large dividend to it prior to the sale of shares in that target company to a prospective purchaser. This pre-sale dividend, which is exempt from Dividends Tax (in the case of a resident dividend that declares and pays a dividend to another resident company), decreases the value of shares in the target company. As a result, the shareholder company can sell the shares at the lowered share value thereby avoiding a much larger capital gains tax burden in respect of sale of shares.

In 2017, amendments were made in the Act in order to strengthen the anti-avoidance rules dealing with dividend stripping. As a result of the 2017 changes, exempt dividends that are paid to a

shareholder company within 18 months of a disposal of shares held by that shareholder company are currently regarded as extra-ordinary dividends and are treated as proceeds or income that is subject to tax in the hands of that shareholder company. Further, in 2018, amendments making provision for the anti-avoidance rules dealing with dividend stripping rules to override corporate re-organisation rules which were made in 2017 were reversed to ensure that those 2017 amendments do not hinder legitimate reorganisation transactions.

II. Reasons for change

It has come to Government's attention that certain taxpayers have embarked on abusive tax schemes aimed at circumventing the current anti-avoidance rules dealing with dividend stripping arrangements. These schemes involve millions of Rands and have a potential of eroding the South African tax base. These latest schemes involve, for example, a substantial dividend distribution by the target company to its shareholder company combined with the issuance, by that target company, of its shares to a third party or third parties. The ultimate result is a dilution 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. The shareholder company ends up, after the implementation of this arrangement, with a lowered effective interest in the shares it holds in the target company without triggering the current anti-avoidance rules. This is because the current anti-avoidance rules are triggered when there is a disposal of shares while these new structures do not result in an ultimate disposal of the shares but a dilution of the effective interest in the shares of the target company.

III. Proposal

It was proposed in Annexure C of the 2019 Budget Review that amendments should be made to the current anti-avoidance rules to curb the use of these new dividend stripping arrangements. Furthermore, given the abusive nature of these arrangements, it was proposed that the amendments should come into effect from the date of the announcement, which was on the 2019 Annual National Budget Day, (i.e. 20 February 2019). This means that the proposed amendments to the legislation on anti-avoidance rules dealing with dividend stripping will come into effect from 20 February 2019 and apply to dividend stripping schemes entered into on or after 20 February 2019. These legislative interventions will not apply in respect of dividend stripping schemes entered into before 20 February 2019.

In terms of the proposed amendments the anti-avoidance dealing with dividend stripping rules will operate as follows:

A. The anti-avoidance rules will no longer apply only at the time when a shareholder company disposes of shares in a target company.

For purposes of ensuring that the new avoidance arrangements will also be subject to the dividend stripping rules, a deemed disposal will be imposed on such arrangements. This deemed disposal will be imposed solely for purposes of the dividend stripping rules and will result in an income inclusion or capital gain in the hands of the shareholder company. For this purpose, the deemed disposal rule will operate as follows:

- A shareholder company will, for purposes of the anti-avoidance rules dealing with dividend stripping, be deemed to have disposed of its shares in the target company, if the target company issues shares to another party and after that issuance of

shares, it is determined that the effective interest held by the shareholder company in the target company is reduced by reason of that issuance of shares.

- In such an instance, the shareholder company will be deemed to have disposed of a percentage of the shares it holds in the target company immediately after the share issue that results in a decrease in the effective interest it holds in the shares of the target company. The percentage envisaged is the percentage by which the effective interest held by the shareholder company in the target company has been reduced by as a result of the issuance of shares.

IV. Effective date

The proposed amendments will be deemed to have come into operation on 20 February 2019 and apply in respect of shares held by a company in another company if the effective interest of those shares held by that company in that other company is reduced by reason of shares issued by that other company, on or after 20 February 2019 to a person other than that company.

CORRECTING ANOMALIES ARISING FROM APPLYING VALUE-SHIFTING RULES

2.2 CLARIFYING THE EFFECT OF DEFERRED TAX ON THE APPLICATION OF VALUE-SHIFTING RULES

[Applicable provision: Section 24BA of the Act]

I. Background

In 2012, value shifting rules were introduced under section 24BA of the Act. The purpose of these rules is to ensure that all asset-for-share transactions are entered into on a value-for-value basis (i.e. an asset must be acquired in exchange for an issue of shares of an equal market value).

Section 24BA of the Act provides that where a company acquires an asset in exchange for the issue of shares by that company and the market value of the asset immediately before the disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares. In addition, the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess.

On the other hand, where a company acquires an asset in exchange for an issue of shares by that company and the market value of the shares immediately after that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

II. Reasons for change

A company is required to report its financial position in the financial statements to its shareholders as well as in the annual tax return filed to SARS. With regard to the reporting of the financial position in respect of the acquisition, holding and use of an asset, a company will report its financial position in the financial statements in accordance with accounting principles. On the other hand, with regard to the reporting in respect of the acquisition, holding and use of an asset in the annual

tax return, a company will report in accordance with the provisions of the Act. For accounting purposes, the write-off periods reflecting the rate of depreciation of an asset may be different from the write-off periods prescribed in the Act.

The difference in the write-off periods of assets in terms of accounting principles and those stipulated in the Act results in what is called in accounting terms “temporary differences” due to the manner in which assets are reported for accounting purposes and for tax purposes. These temporary differences imply that companies will calculate their tax liability based on different taxable income amounts as a result of different write off periods. As a result, a company will either pay more or pay less tax on its accounting profit as compared to what it would have if these assets were written off in terms of the Act. In instances where temporary differences result in more taxes being payable for accounting reporting, than the taxes that would have been payable if the asset was written of in accordance with the provisions of the Act, a deferred tax asset is recognised as less taxes are expected to be paid in the future. In instances where the temporary differences result in less taxes being payable for accounting purposes, than the taxes that would have been payable if the asset was written of in accordance with the provisions of the Act, a deferred tax liability is recognised as more taxes are expected to be paid in the future.

Concerns have been raised regarding the potential effect of deferred tax and in particular, a deferred tax liability on the market value of shares that were issued in exchange for the asset. The market value of such shares must be compared to the market value of the asset acquired by the company in terms of the value shifting rules. As a point of departure, only instances of value shifting should trigger the application of the value shifting rules. Differences between the market value of the shares issued and the market value of assets acquired, should not trigger the value shifting rules if such a difference is not due to value shifting but as a result of temporary differences that result in a deferred tax liability that affects the value of the shares following the acquisition of an asset.

III. Proposal

In order to address these concerns, it is proposed that changes be made in the tax legislation so that the value shifting rules are only triggered in instances where high value assets are transferred in exchange for low value shares. The proposed amendments will provide that where differences in the market value of the shares issued differs from the market value of asset acquired solely as a result of temporary differences that give rise to a deferred liability, the value shifting rules should not apply.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of acquisitions made on or after that date.

2.3 CLARIFICATION OF THE INTERACTION OF THE VALUE-SHIFTING RULES AND THE DEEMED EXPENDITURE INCURRED RULES FOR ASSETS ACQUIRED IN EXCHANGE FOR THE ISSUE OF SHARES

[Applicable provisions: Sections 24BA and 40CA of the Act]

I. Background

The Act contains rules in section 24BA and section 40CA aimed at preventing the transfer of high value assets to a company in return for low value shares issued by the company and the issuance of high value shares for low value assets. Section 40CA provides that a company that acquires an asset in exchange for an issue of shares in itself is deemed to have incurred expenditure in respect of the acquisition of that asset that is equal to the market value of those shares immediately after the acquisition. This means that a company that acquires an asset in exchange for the issue of its shares is deemed to have a base cost in the case of capital asset or a cost of trading stock in the case of trading stock for that asset.

On the other hand, section 24BA provides that where a company acquires an asset from a person in exchange for an issue of shares by that company and the market value of the asset immediately before that disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares and the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess. Further, where a company acquires an asset from a person in exchange for the issue of shares and the market value of the shares immediately after that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

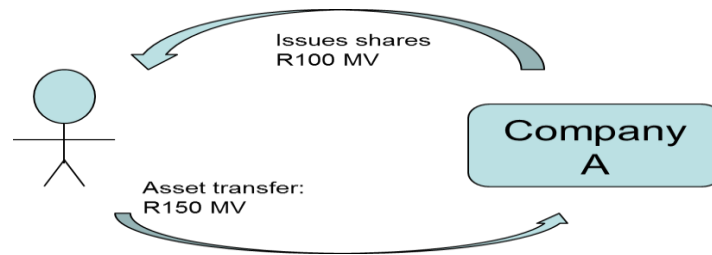
II. Reasons for change

Currently, the provisions of the Act do not adequately address the interaction of the above-mentioned rules. In particular, it is not clear if a company should adjust the deemed expenditure incurred in terms of section 40CA in respect of an asset acquired in exchange for the issue of its own shares with the amount of the capital gain triggered in terms of section 24BA. This lack of clarity results in potential double taxation. Potential double taxation will arise in the instance that the company subsequently disposes of the asset due to the fact that the company would have paid tax on the capital gain triggered by section 24BA which is currently not deemed to be expenditure incurred.

Example 1: Potential double taxation under current rules

Facts:

Company A acquires an asset with a market value of R150 from Person X and as consideration for the assets, Company A issues shares with a market value of R100 after the transaction.



Results:

In terms of ordinary principles, Person X has a base cost of R150 for the shares issued by Company A as he incurred a cost equal to the market value of his asset in order to acquire the shares. In terms of section 40CA, Company A is deemed to have a base cost of R100 for the assets (i.e. being the market value of the shares it issued immediately after the transaction).

Given the difference in value, section 24BA applies to the transaction. As a result, Company A is deemed to have a capital gain of R50 (i.e. the market value of the assets immediately before the transaction of R150 – the market value of the shares issued immediately they are issued of R100). In addition, Person X must reduce his base cost for the shares R50, therefore not allowing for a base cost increase for shares of a lower value.

This results in a situation where Company A holds assets with a market value of R150 in respect of which shares worth R100 and a capital gain of R50.

III. Proposal

In order to provide clarification on the interaction between the two set of rules contained in section 24BA and section 40CA, it is proposed that changes be made in the deemed expenditure incurred rule in section 40CA. The proposed changes will provide that the deemed expenditure incurred by a company that acquires an asset in exchange for the issue of its own shares must be equal to the sum of the market value of the issued shares immediately after the acquisition of the asset in respect of the asset and any deemed capital gain which arose in terms of the value shifting rules in respect of the acquisition of that asset.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of acquisitions made on or after that date.

REFINING PROVISIONS AROUND THE SPECIAL INTEREST DEDUCTION FOR DEBT FUNDED SHARE ACQUISITIONS

2.4 CLARIFYING THE EXCLUSION FROM CLAIMING INTEREST DEDUCTION FOR DEBT FINANCE ACQUISITIONS FOR START-UP BUSINESSES

[Applicable provision: Section 24O of the Act]

I. Background

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. The policy rationale for the special interest rules in section 24O was to discourage the use of multiple step debt push down structures used by taxpayers to obtain interest deductions in respect of debt used to acquire shares of income producing business. One of the requirements for these rules is that an operating company must be a company where at least 80 per cent of that company's receipts and accruals constitute income as defined (i.e. gross receipts and accruals less receipts and accruals that are exempt for tax purposes) and that income must have been generated from its business of providing goods and services.

In 2015, changes were made in section 24O to align these rules with the underlying policy objective and to ensure that taxpayers could no longer claim the special interest deduction when the value of the shares of the holding company of an operating company was largely derived from non-income producing fellow subsidiaries of an income producing operating company. As a result, share interests that qualify for the special interest deduction were limited to shares whose value was largely determined with reference to the value of shares of operating companies where at least 90 per cent of their value was derived from an income producing operating company.

II. Reasons for change

It has come to Government's attention that there are conflicting views regarding the application of these rules and that some taxpayers intend on claiming the special interest deduction in respect of newly established companies. For example, a prospective company shareholder would raise interest-bearing debt to capitalise a newly established company. In turn, the newly established company uses the funding from its now shareholder to acquire income producing assets and embarks on its trade. As a result, the shareholder then claims a special interest deduction in respect of the interest incurred in respect of the interest-bearing debt used to capitalise the newly established company when it subsequently generates income and meets the definition of an operating company (at least 80 per cent of a company's receipts and accruals constitutes income).

The above-mentioned view goes against the policy rationale for the introduction of the special interest deduction. The special interest deduction is meant to provide for a deduction where interest bearing debt is used to acquire shares in established companies with income producing assets that already generate high levels of income.

Consequently, in the Final Response Document on Taxation Laws Amendment Bill, 2018 and Tax Administration Laws Amendment Bill, 2018 (dated 17 January 2019 on page 19), Government stated that the current provisions of the special interest deduction do not support the deduction of interest on interest-bearing debt used to capitalise newly established companies that upon capitalisation do not qualify as operating companies as yet. In addition, the definition of an "acquisition transaction" envisages an acquisition of a controlling interest in a company that is,

upon acquisition, already an operating company or a controlling company in relation to an operating company.

III. Proposal

The proposed clarification of the exclusion of acquisitions of shares in companies that are not operating companies or controlling companies on the date of the acquisition of shares in an operating company seems to be more of a restatement of the current requirements for claiming the special interest deduction. It is, nevertheless, still proposed that changes be made in section 24O of the Act to explicitly provide that an acquisition transaction envisages a situation where the controlling shares being acquired by a company that is not a part of the same group of companies as the company in which the shares are being acquired are shares in a company that, is on the date of that acquisition, either an operating company or a controlling company in relation to an operating company.

IV. Effective date

The proposed amendments are deemed to have come on 1 January 2019 and apply in respect of interest incurred during years of assessment ending on or after that date.

2.5 AMENDING THE SPECIAL INTEREST DEDUCTION RULES IN RESPECT OF SHARE ACQUISITIONS FUNDED BY DEBT TO ALLOW FOR DEDUCTIONS AFTER AN UNBUNDLING TRANSACTION

[Applicable provision: Section 24O of the Act]

I. Background

Since the introduction of section 24O in 2012, a company may qualify for a deduction in respect of interest it incurs on an interest-bearing debt that it issues, assumes or uses to fund an acquisition of a direct controlling share interest in an operating company or an indirect controlling share interest in an operating company held through a controlling group company in relation to that operating company. The companies involved must, however, form part of a domestic group of companies. The acquiring company can continue to claim the special interest deduction as long as it also remains within the same domestic group of companies as that operating company or that holding company in relation to that operating company.

II. Reasons for change

In some instances, a company may be unable to acquire a direct controlling interest in an operating company but may be able to acquire only an indirect controlling interest by acquiring the shares in a controlling group company in relation to that operating company. The interest incurred in respect of the debt used to fund the acquisition of the shares in the controlling group company will be deductible if the acquisition meets requirements of section 24O. It is uncertain, however, if that company may continue to claim the deduction in respect of such interest should the controlling group company unbundle the shares it holds in the operating company to that company, i.e. 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.

Taxpayers have submitted that certainty should be provided in such an instance the company can still claim a deduction in respect of the interest incurred on the debt as it would in any event have qualified for a deduction had it initially acquired a direct controlling interest in the operating company. Furthermore, following an unbundling there will no longer be any concerns about an indirect shareholding whose value may not be significantly derived from the value of an operating company.

III. Proposal

Group restructures that result in a company that had acquired an indirect controlling share interest in an operating company, holding a direct controlling share interest in an operating company will be more clearly accommodated in the legislation. It is proposed that the legislation should clearly state that where an unbundling transaction results in a company holding a direct controlling share interest in an operating company, that company may continue to claim the special interest deduction.

IV. Effective date

The proposed amendment is deemed to have come into operation on 1 January 2019 and applies in respect of years of assessments ending on or after that date.

CLARIFYING THE INTERACTION BETWEEN CORPORATE REORGANISATION RULES AND OTHER PROVISIONS OF THE ACT

2.6 CLARIFYING THE TAX TREATMENT OF TRANSFER OF INTEREST BEARING INSTRUMENTS IN TERMS OF CORPORATE REORGANISATIONS

[Applicable provisions: Sections 24J and 41 of the Act]

I. Background

The Act contains specific provisions in section 24J that regulates the incurral and accrual of interest in respect of "instruments". In this respect, section 24J defines the term instrument to include "any interest-bearing arrangement or debt". In the event an "instrument" is disposed of, section 24J(4) of the Act requires the holder of an instrument to account for an adjusted gain or adjusted loss on transfer or redemption of an instrument in the year of assessment during which the instrument is transferred or redeemed.

The adjusted gain or adjusted loss on the transfer of an instrument for the holder of an instrument equals the "transfer price" of such instrument plus any payments received by the holder during the accrual period in which it is transferred less the "adjusted initial amount" at the beginning of that accrual period less the accrual amount for that accrual period less payments made by the holder during that period. The "transfer price" is defined in section 24J of the Act as "the market value of the consideration payable or receivable, as the case may be, for the transfer of such instrument as determined on the date on which that instrument is transferred."

Sections 42, 44, 45 and 47 of the Act provide for the deferral of tax when assets are moved between companies forming part of the same 'group of companies', as defined in section 41 of the Act. However, when the transferor company disposes of an interest bearing instrument, those sections deem a disposal of the interest bearing instrument to be an amount equal to the base

cost of such an interest bearing instrument or the amount taken into account in terms of section 11(a) or section 22(1) or (2) of the Act.

II. Reasons for change

As stated above that the Act contains corporate reorganisation rules aimed at providing tax neutral transfer of assets between companies that form part of the same group of companies. However, the current corporate reorganisation rules do not specifically address the interaction of the definition of “transfer price” in section 24J of the Act which is equal to market value as stated above with the deemed proceeds prescribed by the corporate reorganisation rules of the Act which is equal to the base cost of such an asset or the amount taken into account in terms of section 11(a) or section 22(1) or (2) of the Act.

III. Proposal

In order to ensure accrued interest and a change in market value of an instrument as a result of changes in market interest rates are reflected in the taxable income of the transferor of an instrument it is proposed that the corporate rules should not override the application of section 24J of the Act. As a result, the transferor will realise an adjusted gain or adjusted loss on transfer of an interest bearing instrument in terms of section 24J of the Act despite transferring these interest bearing instruments in terms of the corporate rules.

IV. Effective date

The proposed amendment will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

2.7 CLARIFYING THE TAX TREATMENT OF TRANSFER OF EXCHANGE ITEMS IN TERMS OF CORPORATE REORGANISATIONS

[Applicable provisions: Sections 24I and 41 of the Act]

I. Background

A. Foreign exchange differences

A taxpayer may carry out transactions denominated in a currency other than the South African Rand (i.e. a foreign currency). Currencies, including the South African Rand, are volatile and as a result, the price or amount for which the currency of one country can be exchanged for another country's currency, referred to as an exchange rate, fluctuates. For tax compliance purposes, a taxpayer must reflect the transactions entered into by that taxpayer in South African Rands and therefore must translate the foreign currency amounts to South African Rands. When currencies are translated from one to the other, exchange differences (either a gain or loss) will arise depending on the performance of the South African Rand in relation to that of the foreign currency that denominated a taxpayer's transaction.

Section 24I of the Act determines the exchange differences (foreign exchange gains and losses) in respect of exchange items that must be included in or deducted from a taxpayer's income.

These differences are determined at the end of each year of assessment or on the date that exchange item is realised or transferred. However, in the instance of differences in respect of exchange items between connected parties and companies that form part of the same group of companies, there is a deferral of inclusions and/or deductions in respect exchange differences until the exchange item is realised.

B. Corporate reorganisations

The Act contains corporate reorganisation rules that make provision for roll over relief in respect of the transfer of assets and the assumption of qualifying debt between taxpayers. This, therefore, includes assets or liabilities that may be denominated in foreign currency. Furthermore, for purposes of applying the roll-over provisions, currently the provisions governing the corporate reorganisation rules override (unless specifically indicated to the contrary under those provisions) the other provisions of the Act.

II. Reasons for change

At issue is that the current corporate reorganisation rules do not provide clarity on the interaction of these rules and the realisation of exchange gains or exchange losses in respect exchange items that are transferred under a reorganisation transaction.

There are conflicting views on whether unrealised and deferred exchange differences on exchange items transferred in terms of corporate reorganisation rules should be deferred under corporate reorganisation rules or whether an exchange difference should be included or deducted (as the case may be) when an exchange item is transferred in terms of a reorganisation rule.

III. Proposal

In order to clarify the interaction between corporate reorganisation rules and provision governing the inclusion and deduction of exchange gains or exchange losses it is proposed amendments be made in the corporate reorganisation rules to ensure that when an exchange item is transferred, the unrealised and deferred exchange differences on that exchange item should be realised and is not deferred. As a point of departure, these changes are necessary as currently section 41(2) provides that the corporate reorganisation rules override all other provisions of the Act. As such, is it proposed that section 41(2) should be amended to clarify that the corporate reorganisation rules do not override the provisions of section 24I in respect of triggering gains or losses upon the realisation or transfer of an exchange item.

The proposed interaction between corporate reorganisation rules and section 24I of the Act can be illustrated with the following example:

Example

Facts:

Company A advanced a loan of \$100 to foreign subsidiary company B during year of assessment 1 when X\$1:R1. The loan was not hedged and was disclosed as a long-term loan for financial reporting purposes. The following table details the sequence of events.

<u>Transactions</u>		
Year 1	Loan advanced by Co A to Foreign SubCo B	\$100
	Transaction spot	1
	Year end spot	5
Year 2	Transfer of loan to Local Subco C	
	Disposal date spot	6
	Year end spot	7
Year 3	Settlement of loan	
	Realisation spot	10 α

Results:

		Company A	Foreign Sub B
Year1	Exchange difference on translation ito24I(3)(a)	400	
	Deferral in terms s24I(10A)(a)	-400	
Year2	Exchange difference on realisation ito24I(3)(a)	100	
	Exchange difference on realisation ito24I(10A)(b)	400	
	Exchange difference on translation ito24I(3)(a)		100
	Deferral in terms s24I(10A)(a)		-100
Year3	Exchange difference on realisation ito24I(3)(a)		300
	Exchange difference on realisation ito24I(10A)(b)		100

In summary, the seller is taxed on all previous exchange differences upon realisation of the exchange item, whilst the purchaser may only defer exchange differences from the date of acquisition of the exchange item.

IV. Effective date

The proposed amendment will come into operation on 1 January 2020 and applies in respect of years of assessment commencing on or after that date.

2.8 HARMONISING THE TIMING OF DEGROUING CHARGE PROVISIONS FOR INTRA-GROUP TRANSACTIONS AND CONTROLLED FOREIGN COMPANY RULES

[Applicable provisions: Sections 9D, 9H and 45 of the Act]

I. Background

A. Controlled foreign company rules

A Controlled Foreign Company (CFC) is defined in section 9D of the Act as any foreign company if more than 50 per cent of the total participation rights or voting rights in that company are directly or indirectly held or exercisable by one or more persons that are residents. In 2017, changes were made to the definition of a CFC in section 9D of the Act to regard as a CFC as any foreign company where the financial results of that foreign company are reflected in the consolidated financial statements of any company that is a resident as required under International Financial Reporting Standards (IFRS) 10.

Section 9D(2)(b) of the Act makes provision for the determination of a CFC income when a foreign company ceases to be a CFC. When a foreign company ceases to be a CFC at any stage during a year of assessment before the last day of the foreign tax year of that foreign company, section 9D(2)(b)(ii) of the Act determines that an amount equal to a proportional amount of the net income of the company must be included in income of residents. The foreign tax year is stated to end on the day the foreign company ceases to be a CFC and the proportional amount is calculated from the first day of the foreign tax year of the CFC to the day before the company ceases to be a CFC.

B. Ceasing to be a controlled foreign company

When a foreign company ceases to be a CFC, section 9H(3) of the Act triggers an exit event for a foreign company that ceases to be a CFC. The CFC is deemed to have disposed each of its assets on the date immediately before the day on which that foreign company ceased to be a CFC and reacquired those assets on the day that the foreign company ceased to be a CFC. Furthermore, the foreign tax year of a foreign company that ceases to be a CFC is deemed to have ended on the date immediately before the day it ceased to be a CFC and the next foreign tax year is deemed to have commenced on the day it ceased to be a CFC.

C. Exiting the group of companies in terms of corporate reorganisation rules

Section 45 of the Act provides for the deferral of tax when assets are transferred between companies forming part of the same 'group of companies', as defined. However, whenever the transferee company exits the group of companies in relation to the transferor, but retains an asset acquired within the last six years under an intra-group transaction, a deemed capital gain is

determined for the asset. This is commonly referred to as a de-grouping charge. This de-grouping charge could also be triggered for an asset that constitutes an equity share if the transferee ceases to be a CFC in terms of section 45(4)(bA)(i)(bb) of the Act. In this scenario, the capital gain is taken into account in the determination of the net income of the foreign company in its year of assessment when it ceases to be a CFC. That would be the day after the foreign tax year ends in terms of section 9H(3)(d)(i) and the day after the proportional amount of the net income is determined in terms of section 9D(2)(b)(ii).

II. Reasons for change

At issue is the misalignment in the timing of the rules for the determination of net income of a CFC under sections 9D, 9H and 45 of the Act due to the fact that the de-grouping charge provisions in the corporate reorganisation rules deem a capital gain to arise in the year of assessment in which a de-grouping takes place. However, the provisions for determining the net income of CFCs and the provisions for ceasing to be CFCs, when read together, determine that the year of assessment in which the 'de-grouping event occurs' commences and ends on the same day but the period for which the net income should be determined ended on the day before the foreign company ceases to be a CFC.

III. Proposal

In order to address the above-mentioned misalignment, it is proposed that changes be made in the tax legislation and the capital gain as the exit charge for intra-group transactions in the case of a foreign company ceasing to be a controlled foreign company be triggered on the date before the day the transferee company ceases to be a controlled foreign company. The proposed changes will enable the capital gain to be taken into account in the net income to be imputed to residents when a foreign company ceases to be a CFC.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

2.9 AMENDING THE CORPORATE REORGANISATION RULES TO CATER FOR COMPANY DEREGISTRATION BY OPERATIONAL LAW

[Applicable provision: Section 41 of the Act]

I. Background

The Act contains corporate reorganisation rules that make provision for roll over relief in respect of the transfer of assets between companies forming part of the same economic unit as well as their natural person shareholders. Further, in order to qualify for the roll over relief, the corporate reorganisation rules contain certain requirements and anti-avoidance provisions that taxpayers must adhere to. With regard to corporate reorganisation rules dealing with amalgamation transactions and transactions relating to liquidation, winding-up and deregistration, these rules currently contain a requirement for the liquidation, winding-up or deregistration of one of the parties to these transactions.

In the case of an amalgamation transaction, these rules require that an amalgamated company (i.e. the company that disposes of all its asset to another company in respect of an amalgamation transaction) must be terminated soon after that amalgamation transaction. In the case of a transaction relating to liquidation, winding-up and deregistration, these rules require that a liquidation company (i.e. a company that disposes of all its assets to its shareholders in anticipation of or in the course of its liquidation, winding-up or deregistration) should also be terminated soon after that transaction.

Further, these corporate reorganisation rules contain measures that disqualify taxpayers from benefiting from roll over relief if the necessary steps to liquidate, wind-up or register an amalgamated company or a liquidating company have not been taken within 36 months of the transaction. However, a longer period than the above-mentioned 36 months may be allowed if the SARS Commissioner determines that such longer period is justified as envisaged in the Act.

II. Reasons for change

In the case of two of the corporate reorganisation rules (namely, “amalgamation transactions” and “transactions relating to liquidation, winding up and deregistration”), the Act currently contains a requirement for the liquidation, winding-up or deregistration of one of the parties to these transactions. In particular, it is required that an amalgamated company (i.e. the company that disposes of all its asset to another company in terms of an amalgamation transaction) must be terminated soon after that amalgamation transaction. In the case of a transaction relating to liquidation, winding-up and deregistration, it is also required that a liquidation company (i.e. a company that disposes of all its assets to its shareholders in anticipation of or in the course of its liquidation, winding-up or deregistration) should also be terminated soon after that transaction.

In order to ensure that taxpayers comply with the requirement regarding the termination of an amalgamated company and a liquidating company, the income tax act contains rules that disqualify taxpayers from benefiting from tax deferral if the necessary steps to liquidate, wind-up or deregister an amalgamated company or a liquidating company have not been taken within 36 months of the transaction. A longer period may however, be allowed if the Commissioner of the South African Revenue Service determines that a longer period is justified. In this regard, the envisaged steps are specifically listed in the tax legislation.

In this respect, section 116 of the Companies Act, No.71 of 2008 (the Companies Act), requires that a notice detailing the amalgamation or merger must be prepared in the prescribed manner and form after a resolution approving an amalgamation or merger has been adopted by each company that is a party to that arrangement. Furthermore, it is required that the notice should be furnished to the Companies and Intellectual Property Commission (the Commission). Once the Commission has received this notice, section 116(5)(b) empowers the Commission to deregister any of the amalgamating or merging companies that did not survive the amalgamation or merger. However, companies which deregister in terms of section 116(5)(b) of the Companies Act, pursuant to a statutory amalgamation or merger have not been catered for in the list of steps contained in the Act.

III. Proposal

In order to ensure that statutory amalgamations and mergers are not unfairly excluded from qualifying for tax deferral, it is proposed that the current list of steps taken for liquidation, winding-up and deregistration should be amended by including instances where companies lodge a notice to the Commissioner as contemplated in section 116 of the Companies Act.

IV. Effective date

The proposed amendment will come into operation on 1 January 2020 and apply in respect of acquisitions made on or after that date.

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

REVIEWING THE REAL ESTATE INVESTMENT TRUST (REIT) TAX REGIME

3.1 CLARIFICATION OF THE DEFINITION OF RENTAL INCOME IN A REIT TAX REGIME IN RESPECT OF FOREIGN EXCHANGE DIFFERENCES

[Applicable provision: Section 25BB of the Act]

I. Background

The special tax dispensation of a listed company that is a Real Estate Investment Trusts (“REIT”) or a company that is a subsidiary of a REIT (“controlled company”) makes provision for a flow-through principle in respect of income and capital gains to be taxed solely in the hands of the investor and not in the hands of REIT or a controlled company. In turn, a REIT or a controlled company may claim distributions to its investors as a deduction against its income. This deduction may only be claimed if a distribution is a “qualifying distribution” that is more than 75 per cent of the gross income of a REIT or a controlled company consisting of “rental income”.

The term “rental income” is defined in section 25BB(1) of the Act to mean any of the following amounts received by or accrued to a REIT or a controlled company:

- a. an amount received or accrued for the use of immovable property, including any penalty or interest charged on the late payment of such amount;
- b. any dividend, other than a share buy-back contemplated in paragraph (b) of the definition of “dividend” in section 1(1) of the Act, from a company that is a REIT at the time of the distribution of that dividend;
- c. a qualifying distribution from a company that is a controlled company at the time of that distribution;
- d. a dividend or foreign dividend from a company that is a property company at the time of that distribution;
- e. any amount recovered or recouped under section 8(4) in respect of an amount of an allowance previously deducted under section 11(g), 13, 13bis, 13ter, 13quat, 13quin or 13sex of the Act.

II. Reasons for change

In order for REITs or controlled companies to diversify and multiply returns for its investors, many South African REITs or controlled companies have embarked on investments in real estate outside South Africa. In order to hedge its exposure to foreign currency fluctuations, as well as secure stable returns to investors in respect of its foreign real estate investments, a REIT or a controlled company may enter into forward exchange contracts (FEC).

At issue is the current tax treatment of any unrealised exchange gains or losses determined on the above-mentioned FECs of a REIT or a controlled company. Any unrealised exchange gains or losses arising from the above-mentioned FECs of a REIT or a controlled company are in terms of paragraph (n) of the definition of gross income in section 1 and in section 24I(3) of the Act taken into account in determining the taxable income of such REIT or such controlled company. This implies that unrealised exchange gains or losses arising from the above-mentioned FECs of a REIT or a controlled company do not qualify as “rental income” of a REIT or a controlled company, even though they are incurred solely for the earning of such “rental income”.

III. Proposal

In order to address this anomaly, it is proposed that changes be made to the definition of “rental income” in section 25BB of the Act to include any foreign exchange gains and deduct foreign exchange foreign exchange losses arising in respect of an “exchange item” relating to a “rental income” of a REIT or a controlled company.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.2 CLARIFICATION OF THE INTERACTION BETWEEN CORPORATE REORGANISATION RULES AND REITS TAX REGIME

[Applicable provisions: Sections 25BB, 42, 44 and 45 of the Act]

I. Background

The Real Estate Investment Trusts (REITs) tax regime, allows for the tax-free earning of rental income and capital gains a REIT. The investor is taxed on dividends declared by the REIT and also on gains from the disposal of shares in the REIT. In order to enable this tax treatment under the REIT regime, the REIT is allowed to claim distributions to its investors as a deduction against its income. This deduction may only be claimed if a distribution is a “qualifying distribution” that is, more than 75 per cent of the gross income of the REIT consists of rental income including income from property entities.

Further section 25BB(5) of the REITs tax regime in the Act makes provision for a capital gains tax exemption in respect of the following disposals by a REIT or a controlled company:

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

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

A disposal by a REIT or controlled company of any asset that is not listed above as envisaged in section 25BB(5) of the REITs tax regime is subject to normal tax, including capital gains tax if applicable.

In turn, the Act contains corporate reorganisation rules aimed at providing for the tax neutral transfer of assets between companies that form part of the same group of companies, provided certain requirements are met. For example, when a transferor disposes of an allowance asset and the transferee company, in turn, acquires that allowance asset as such, the corporate reorganisation rules allow for the tax neutral transfer of such allowance asset. However, the corporate reorganisation rules make provision for certain anti-avoidance measures to be triggered, for example, the rolled over capital gain to be added back to the taxable income of the company, if a company that acquired the asset, disposes of such asset within a period of 18 months of acquisition.

II. Reasons for change

At issue is the interaction of the above-mentioned anti-avoidance measures contained in the corporate reorganisation rules and the provisions of section 25BB(5) of the REIT tax regime.

In certain instances if the immovable property is disposed of by a REIT within 18 months, the anti-avoidance measures contained in the corporate reorganisation rules require that the rolled over capital gain in respect of such immovable property be added to the taxable capital gain of the REIT for the year of assessment in which the disposal of the immovable property takes place. On the other hand, section 25BB(5) of the REITs tax regime provides for capital gains exemption in respect of disposals of certain immovable property by a REIT. The anti-avoidance measures contained in the corporate reorganisation rules when read with the provisions of section 25BB(5) of the REITs tax regime create a discrepancy because in general, corporate reorganisation rules override the provisions for the taxation of REITs in section 25BB of the Act.

III. Proposal

In order to ensure that the rules for the REITs tax regime are aligned with the corporate reorganisation rules, it is proposed that amendments be made in the tax legislation so that corporate reorganisation 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 reorganisation rule.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.3 CONSEQUENTIAL AMENDMENTS TO THE TAX TREATMENT OF FOREIGN REINSURANCE BUSINESS OPERATING A BRANCH IN SOUTH AFRICA

[Applicable provisions: Sections 28 and 29A of the Act]

I. Background

The Insurance Act No. 18 of 2017 (the Insurance Act) which was promulgated on 18 January 2018 is aimed at replacing and/or consolidating substantial parts of the Long-term Insurance Act and the Short-term Insurance Act. The Insurance Act also makes provision for foreign reinsurers to operate a reinsurance business in South Africa through a branch, provided that the foreign reinsurer is granted a license, establishes a representative office as well as a trust in South Africa.

Consequently, in 2017, changes were made in section 28 of the Act, dealing with tax treatment of short term insurance business. These changes made provision for a foreign reinsurer that is a long-term or short-term that conducts insurance business through a branch of that foreign reinsurer as envisaged in the Insurance Act to be deemed as a short-term insurer for purposes of the Act.

The above-mentioned 2017 changes in the Act follow changes that were made in the Act in 2015 and 2016, as a result of introduction of Solvency Assessment and Management (SAM) Framework for a short-term insurer and long-term insurer.

With regard to short-term insurer, the 2015 amendments to section 28(3) of the Act made provision for a short-term insurer to claim deductions in terms of this subsection that is equal to the sum of liabilities on investments contracts relating to short-term insurance business in accordance with International Financial Reporting Standards (IFRS) and amounts recognised as insurance liabilities in accordance with 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 cost.

However, with regard to long-term insurers, the 2016 changes made to section 29A of the Act made provision for the following: (i) introduction of a new definition of value of liabilities, (ii) introduction of a new definition of adjusted IFRS value, as well as (iii) transitional rules aimed at prescribing a phasing in amount and the method and period of phasing in.

II. Reasons for change

At issue is whether the 2017 changes to section 28 of the Act making provision for a foreign reinsurer that is a long-term insurer that conducts insurance business through a branch of that foreign reinsurer as envisaged in the Insurance Act to fall under the ambit of section 28 also changed the nature of taxation of a foreign reinsurer that is regarded as a long-term insurer in terms of section 29A of the Act.

In particular, it is not clear which of the IFRS liabilities in a long-term insurance business conducted through a branch of a foreign insurer would be allowed as a deduction in terms of section 28(3) of the Act. Further, section 28(3) of the Act due to the fact that a deduction is only allowed for the amount of insurance liabilities recognised in accordance with IFRS, relating to “premiums” and “claims”.

III. Proposal

In order to provide clarification on the tax treatment of a foreign reinsurer that is a long-term that conducts insurance business through a branch in South Africa and falls under the ambit of section 28 of the Act, the following changes are proposed in the Act:

A. New section 28(3) of the Act

It is proposed that a new subsection be introduced in section 28 of the Act that allows a foreign reinsurer that is a long-term that conducts insurance business through a branch in South Africa to deduct insurance liabilities based on the concept of “adjusted IFRS value” as used in section 29A of the Act. This will have the effect that insurance liabilities will be determined net of negative liabilities and the other adjustments under section 29A will create alignment with the taxation of domestic insurers that are conducting the same type of business than the foreign insurer through its South African branch.

B. Section 29A of the Act

In addition, it is proposed that changes be made in section 29A of the Act to clarify that insurance business conducted by a non-resident reinsurer through a South African branch must be taxed only in terms of section 28 of the Act.

IV. Effective date

The proposed amendment will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

REVIEWING THE TAX TREATMENT OF LONG-TERM INSURERS

3.4 REFINEMENT TO TAXATION OF RISK POLICY FUNDS OF LONG-TERM INSURERS

[Applicable provision: Section 29A of the Act]

I. Background

With effect from 1 January 2016, risk policies issued by the long-term insurer during the year of assessment commencing on or after 1 January 2016 and other policies issued by the long-term insurer before that year of assessment which the insurer elected to be allocated to the risk policy fund are taxed in a fifth fund known as the risk policy fund (“RPF”). Every long-term insurer is required to establish five separate funds and to maintain such funds. The taxable income derived by a long-term insurer in respect of the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund must be determined separately in accordance with the Act as if each such fund had been a separate taxpayer.

In essence, “risk policy” is defined in Section 29A(1) of the Act as a policy issued by an insurer during the insurer’s year of assessment commencing on or after 1 June 2016 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, and excludes a contract of insurance in terms

of which annuities are being paid. However, policies under which annuities are being paid are specifically excluded from being classified as a risk policy.

Further, the definition of “risk policy” includes any policy in respect of which an election has been made to allocate to the risk policy fund all policies or one or more classes of policies that share substantially similar contractual rights and obligations that would have constituted risk policies if they were issued prior to the year of assessment commencing on or after 1 January 2016.

II. Reasons for change

As stated above, a policy under which annuities are being paid is specifically excluded from being classified as a risk policy. That said, a risk policy may result in the payment of benefits in instalments under certain circumstances that can only be determined at the time that a claim arises. This does not necessarily result in a separate policy that pays annuities.

In instances 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.

III. Proposal

It is 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. Consequently, changes should be made to section 29A of the Act so that the application of sections 29A(4)(a)(ii) and 29A(6) of the Act should exclude risk policies.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.5 REFINEMENT OF THE PHASING-IN TRANSITIONAL RULES FOR LONG-TERM INSURERS

[Applicable provision: Section 29A of the Act]

I. Background

Before 2016, the taxation method for determining taxable profits of a long-term insurer in section 29A of the Act was based on transfers from the Untaxed Policyholder Fund (UPF), Individual Policyholder Fund (IPF), Company Policyholder Fund (CPF) and Risk Policy Fund (RPF) to the Corporate capital Fund (CF). The taxable transfers were determined as the difference between the market value of the assets allocated to the policyholder funds and the value of the liabilities of these funds. The value of liabilities was calculated on the basis determined by the Chief Actuary of the Financial Services Board (FSB) in consultation with the Commissioner of SARS.

In 2016, amendments were made in section 29A of the Act, regarding the tax valuation method for long-term insurers due to the introduction of Solvency Assessment and Management Framework (SAM). These amendments included the following:

- a. definition of “value of liabilities”;
- b. definition of “adjusted IFRS value”;
- c. transitional rules: “phasing-in amount” and period of phasing-in

In particular, the transitional rules dealing with the “phasing-in amount and a phasing-in period” of six years were introduced as an interim measure aimed at stabilising tax collections by SARS and reducing the financial impact on certain long-term insurers due to these regulatory proposed changes. The “phasing-in amount” is the fixed amount representing the difference relating to policies allocated to a fund between the liabilities for tax purposes and the liability disclosed in the insurer’s published audited annual financial statements for 2017 adjusted to the manner of disclosure and reporting applied in 2015. The “phasing-in amount” is applied by including a reducing amount in the calculation of adjusted IFRS value over a period of six years for years of assessment ending after June 2018.

II. Reasons for change

At issue is the fact that unlike other phasing-in provisions available in the Act, the current phasing-in transitional rules for long-term insurers in section 29A of the Act do not address the treatment of any portion of the “phasing-in amount” not yet phased-in, if the taxpayer ceases to be in the business of long-term insurer during the six-year period.

III. Proposal

In order to address this anomaly, it is proposed that the cessation rules be introduced to accelerate the phasing-in of the new IFRS valuation methodology for long-term insurers ceasing to conduct long-term insurance business during the phase-in period of six years.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment ending on or after that date.

4. INCOME TAX: BUSINESS (INCENTIVES)

REFINING THE SPECIAL ECONOMIC ZONE (SEZ) REGIME

4.1 ALIGNING THE PROVISIONS OF SEZ WITH THE OVERALL OBJECTIVES OF THE SEZ PROGRAMME

[Applicable provision: Section 12R of the Act]

I. Background

The SEZ regime was preceded by the Industrial Development Zone (IDZ) programme which was introduced in South Africa in 1993. The IDZ programme was intended to promote new investment in South Africa by providing focused administrative support as well as some indirect tax benefits to enterprises that operated in designated industrial areas. The administrative support included the provision of customs controlled areas located in the IDZs where dedicated SARS officials were situated to provide the enterprises with support for any customs and value-added-tax (VAT) requirements. The indirect tax benefits included no import duty being levied on imports for production-related raw materials, including machinery and assets used in production with the aim of exporting the finished products. In addition, VAT zero-ratings were provided for some supplies procured in South Africa.

Following a review on the effectiveness of the IDZ programme, which indicated that further support for greenfield activities was required, the SEZ regime was introduced in terms of the Special Economic Zone Act, No.16 of 2014, and (SEZ Act) which only came into operation on 9 February 2016. Under the new SEZ regime, existing IDZs were converted into SEZs, as well as allowing the designation of further SEZs. In order to provide further support to the new SEZ regime, income tax benefits were introduced to the Act in 2013 in respect of qualifying companies operating within the SEZ. These income tax 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 those qualifying companies provided that they meet certain requirements as described in the Act.

II. Reasons for change

Section 4(1) of the SEZ Act lays out the purpose of SEZs. In this respect, the SEZs are regarded as an economic tool that can be used to promote national economic growth, the exportation of goods and a way of attracting targeted foreign and domestic investments and technology. Furthermore, the policy around the eligibility criteria for entities wishing to operate within the SEZs was set out in a Department of Trade and Industry (DTI) policy document titled “Policy on the Development of Special Economic Zones in South Africa (2012)” under discussion point 3.3. Eligibility Criteria of SEZ Designation.

In respect to access to SEZs, this policy document provides that access to SEZs will be restricted to new businesses or expansions of existing businesses. In addition, the policy around existing businesses that were already in the IDZs and those operating outside of the IDZs was clearly articulated. In this respect –

“Existing businesses already set up or functioning in an existing IDZ in South Africa before the commencement of the SEZ Act, however their eligibility to the SEZ incentive package will be contingent on them meeting the incentive criteria. Re-locations of existing businesses into SEZs will not be eligible...”

On the other hand, the current income tax provisions for qualifying companies operating within an SEZ does not expressly make a provision for a requirement that only a new company or an expansion of an existing company may qualify for income tax benefits. Lack of this requirement in the tax legislation results in unintended result that old, existing and re-located businesses could unjustifiably benefit for income tax benefits that are only aimed at attracting new and expanded manufacturing businesses.

III. Proposal

In order to align the provisions of the SEZ tax regime with the overall policy objective of an SEZ programme discussed in the policy document titled “Policy on the Development of Special Economic Zones in South Africa (2012)” as well as to counter the potential unintended consequence of old, existing and re-located businesses claiming the income tax benefits aimed at attracting new and expanded manufacturing businesses, it is proposed that changes be made in the legislation to clarify the policy intention. As a result, it is proposed that changes be made in the Act to make provision for qualifying companies to only qualify for the income tax benefits provided that the companies are:

- a. newly established businesses; or
- b. expansions of existing businesses of businesses originally operating with an IDZ or outside of 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. In order to ensure that companies do not wind down their operations immediately before locating their operations into an SEZ for purposes of undermining this requirement, it is proposed that the required 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. Furthermore, where a company operated outside an SEZ prior to such an expansion, it will be required that any expansion embarked on by that company should not result in a closure or reduction of the production, number of employees and gross income of the business carried on by that company or a connected person in relation to that company outside an SEZ.

IV. Effective date

The proposed amendment is deemed to have come into operation on 1 January 2019 and applies in respect of years of assessments ending on or after that date.

4.2 REVIEWING THE SEZ ANTI-PROFIT SHIFTING AND ANTI-AVOIDANCE MEASURES

[Applicable provision: Section 12R of the Act]

I. Background

The Act contains rules dealing with the special tax incentive for the SEZ regime. Although the income tax rules for the SEZ regime were first introduced in the Act in 2013, they were only intended to take effect when the SEZ Act comes into operation. The SEZ Act only came into operation of 9 February 2016. Despite this delay in the promulgation of the SEZ Act, some companies had already established their businesses within the intended designated SEZs, even before the coming into effect of the provisions of the above-mentioned acts.

In 2015, changes were to the income tax rules for the SEZ regime to introduce the anti-profit shifting anti-avoidance measure that mitigates against the risk that profits of ordinary tax paying companies that do not operate within the designated and approved SEZs and are taxed at a company tax rate of 28 per cent may be artificially transferred to qualifying companies under the SEZ regime that are taxable at a lower rate of 15 per cent in instances that they are connected persons in relation to each other. In its operation, the anti-avoidance measure wholly disqualifies a qualifying company from claiming any of the SEZ income tax benefits (i.e. tax rate of 15 per cent and the accelerated building allowance or 10 per cent of the cost to the qualifying company) if more than 20 per cent of its deductible expenditure incurred or more than 20 per cent of its income arises from transactions with connected persons.

The above-mentioned anti-avoidance measure is important and necessary for South Africa to meet the international minimum standards set by the OECD Forum for Harmful Tax Practices and European Union Code of Conduct Group (Business Taxation).

II. Reasons for change

At issue is the fact that the above-mentioned anti-avoidance measures to the SEZ tax regime were introduced in 2015, after the introduction of the SEZ tax regime in 2013, after some companies had already established their businesses within the SEZs, but before the coming into effect of the SEZ regime in 2016.

It has come to Government's attention that the current anti-avoidance measure that operates on an all-or-nothing basis may affect some legitimate business models or transactions that were entered into when some companies established their businesses within the SEZs, before the SEZ regime came into effect and before the introduction of these anti-avoidance measures. 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. These sales companies then on-sell the goods to the customers both within the SADC region including South Africa.

III. Proposal

In order to address this issue, it is proposed that changes be made to the current anti-avoidance measure to remove the all on an all or nothing basis and ensure that a company is not wholly disqualified from claiming the income tax benefits for the SEZ regime. The proposed anti-avoidance measure will make provision for a qualifying company to be treated as carrying on a separate trade outside of the SEZs and be subject to a business tax rate of 28 per cent in respect of taxable income determined by considering income and deductible expenditure that exceeds the set thresholds. With respect to income that is below the set thresholds, the company will still qualify for income tax benefits for the SEZ regime (i.e. be taxed at a rate of 15 per cent and claim the accelerated building allowance).

Based on the above, it is proposed that the rate of 28 per cent will apply to taxable income determined by taking into account the following:

A. Treatment of income derived from transactions with connected persons

So much of the income received by or accrued to a qualifying company in respect of transactions with any connected person in relation to that qualifying company, if that connected person is:

- a. a resident; or
- b. not a resident and those transactions are attributable to a permanent establishment of that connected person in the Republic.

as exceeds 20 percent of the total income of that qualifying company.

B. Treatment of deductible expenditure incurred in respect of transactions with connected persons

So much of the deductible expenditure incurred by a qualifying company in respect of transactions with any connected person in relation to that qualifying company, if that connected person is:

- a. a resident; or
- b. not a resident and those transactions are attributable to a permanent establishment of that connected person in the Republic

as exceeds 20 percent of the total deductible expenditure of that qualifying company.

IV. Effective date

This amendment is deemed to have come into operation on 1 January 2019 and applies in respect of years of assessments ending on or after that date.

4.3 REVIEWING THE ALLOWABLE DEDUCTION FOR INVESTORS INVESTING IN A VENTURE CAPITAL COMPANY

[Applicable provision: Section 12J of the Act]

I. Background

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.

When the VCC tax incentive regime was introduced in 2008, the rules contained a very strict investor criterion. As a result, a natural person who invests in the VCC shares was eligible for a 100 per cent deduction of the amount invested, however, the deduction was limited to R750 000 per tax year. In turn, individual investors were also subject to a lifetime deduction limit of R2 250 000.

In 2011, changes were made in the VCC tax incentive regime in order to make it more attractive. General relaxation of requirements of the provisions of the VCC tax incentive regime was made

so as to increase the intake in this regard. As a result, ceilings and prohibitions associated with investors seeking a deduction were completely removed. For example, the natural person limitation of deduction to R750 000 per tax year as well as the lifetime deduction limit of R2 250 000 was removed. This implied that all taxpayers, both natural persons and legal entities can now freely obtain a full deduction for investing in a VCC, without any monetary threshold limitation.

In order to get the VCC regime to gain more traction, in 2015, further changes were made in 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 over the past three years leading to a telling investment into the economy.

II. Reasons for change

The primary aim of the tax system is to generate sufficient revenue to support government's funding priorities. By providing relief to taxpayers via targeted tax incentives like exemptions, deductions and credits, Government also encourages socio-economic development.

Over the past two years, Government has endeavored to end abuse within the VCC tax incentive regime by making changes in the provisions of the VCC Tax incentive regime aimed at re-emphasising an incentive for true venture capitalists that saw the same value-add in the VCC tax incentive regime as Government and not just as another method of finance especially of own projects.

Despite Government's efforts to introduce these anti-avoidance measures, it has come to government's attention that some taxpayers are still attempting to undermine the objectives and principles of the VCC tax incentive regime to benefit from excessive tax deductions. Based on administrative data on tax expenditure, the average expenditure per annum incurred by a new VCC shareholder to obtain VCC shares ranged between R1,3 million at its lowest to R2,1 million at its highest over the past 4 years.

III. Proposal

In an effort to balance the benefit and perceived effectiveness of the VCC tax incentive regime whilst still protecting the bottom-line impact of high tax expenditure (as a measure of revenue forgone) on the fiscus, it is proposed that changes be made in the VCC tax incentive regime to reintroduce a limitation of the amount to be deducted in respect of taxpayers investing in VCC shares.

To consider the effect of inflation and to further balance the intended impact of the VCC tax incentive on both small business and the fiscus, it is proposed that the tax deduction in respect of investment in VCC shares should be limited to R2,5 million per annum per VCC shareholder.

IV. Effective date

The proposed amendment comes into operation on 21 July 2019 and applies in respect of expenditure incurred by the taxpayer on or after that date.

REFINING THE EMPLOYMENT TAX INCENTIVE REGIME

4.4 UPDATING THE EMPLOYMENT TAX INCENTIVES (ETI) TO ALIGN WITH THE NATIONAL MINIMUM WAGE

[Applicable provision: Section 4 of the Employment Tax Incentive Act, No 26 of 2013 “the ETI Act”]

I. Background

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. After its initial 3 years, and based on a process of review and consultation with NEDLAC the programme was extended for a further two years. In light of the need to support youth employment, as indicated in the State of the Nation Address (SONA) delivered on 15 February 2018, and following further consultations with NEDLAC, the programme was further extended to 28 February 2029.

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. The monthly wages used in applying the formula are categorised as follows:

- a. Wages of R2 000 or less;
- b. Wages of between R2 001 and R4 000; and
- c. Wages of between R4 001 and R6 500.

II. Reasons for change

During 2018 significant amendments were promulgated to implement the National Minimum Wage. The National Minimum Wage Act, No. 9 of 2018 (“the NMW 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 wages available in the NMW Act should also be reflected in the category of wages contemplated in the ETI Act.

III. Proposal

In order to achieve the above-mentioned alignment of Government policies, it is proposed that in addition to the “wage regulating measures” currently defined in the ETI Act, the national minimum wage should also be included as one of the eligibility criteria for purpose of claiming the ETI. As a result, it is proposed that changes be made to the ETI Act so that the higher of the national minimum wage or the other wage regulating measures should therefore be the applicable minimum wage as contemplated in the NMW Act.

On the other hand, the minimum wage of R2 000 per month available in the ETI Act should remain in place for categories of workers or companies that may be exempt from the national minimum wage. Sectors where a lower minimum wage rate applies, as indicated in the Second Schedule of the NMW Act should still be able to claim the ETI, even if their minimum wage is below R2 000

per month, as is currently the case for many learnerships (as catered for in the 'R 2000 or less' wage category mentioned above).

IV. Effective date

The proposed amendments will come into operation on 1 August 2019.

4.5 CLARIFYING THE INTERACTION BETWEEN THE EMPLOYMENT TAX INCENTIVE AND THE SEZ PROVISIONS

[Applicable provisions: Sections 1 in respect of the definition of “special economic zone” and 6 of the ETI Act]

I. Background

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 current 28 per cent that is generally applicable to other companies. Furthermore, these companies qualify to claim 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.

On the other hand, 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 can only be claimed by 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 claim 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

II. Reasons for change

In order to benefit from the income tax incentives contained in the Act, a company carrying on a business within the SEZ area must meet certain requirements to ensure that the SEZ incentives are claimed by acceptable manufacturing businesses (i.e. businesses that are not involved in the disqualified trades listed in the Act or listed by the Minister of Finance by notice in a Government Gazette. In terms of the Act, for a company to be a qualifying company a company must be a company that –

- a. is tax resident in South Africa
- b. operates within a designated SEZ area
- c. carry on business through a fixed place of business situated within a designated SEZ area
- d. derives 90 per cent or more of its income from the carrying on of a business or rendering of services within one or more SEZs; and
- e. is not carrying on a disqualified trade listed in the Act and in terms of the Government Gazette.

In contrast, the ETI Act does not clearly provide a specified criterion for employer companies operating within an SEZ that want to claim 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 claim 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) claiming the ETI in respect of all their employees.

III. Proposal

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 ETI Act. In this regard, it is proposed that the definition of the “special economic zone” in the ETI Act should be amended to align it with the definition contained in the Act. Furthermore, it is proposed that it should be clarified that in order for a company to claim the ETI incentive without any age limit, that company should be a qualifying company as contemplated in the Act for purposes of claiming the income tax incentives under the SEZ regime.

IV. Effective date

The proposed will be deemed to have come into operation on 1 March 2019.

5. INCOME TAX: INTERNATIONAL

REVIEWING CONTROLLED FOREIGN COMPANY RULES

5.1 REVIEWING THE COMPARABLE TAX EXEMPTION

[Applicable provision: Section 9D(2A) further proviso (i)(aa) and (ii)]

I. Background

The South African controlled foreign company rules contain an exemption known as a comparable tax exemption. This exemption 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, to exclude the foreign business income from the net income calculation of the CFC. The main aim of this exemption is to reduce the compliance burden of South African multinationals from being taxed on foreign business profits and thereafter claiming credit against South African income tax.

In addition, 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.

II. Reasons for change

In the context of the global trend towards lower corporate tax rates, in 2018, the Minister announced in the Budget Review the intention to review the comparable tax exemption in order to determine whether an amendment is warranted. Based on the above-mentioned statement, 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 in the current world order.

III. Proposal

Based on the above, it is proposed that the comparable tax exemption threshold be reduced to 67.5 per cent from the current percentage of 75 per cent.

IV. Effective date

The proposed amendments will come into effect and apply in respect of the years of assessment ending on 1 January 2020

5.2 ADDRESSING CIRCUMVENTION OF CONTROLLED FOREIGN COMPANY ANTI-DIVERSIONARY RULES

[Applicable provision: Section 9D(9A) of the Act]

I. Background

The Act contains anti-avoidance provisions in section 9D aimed at taxing South African residents on the net income of a controlled foreign company (CFC). In order to strike a balance between protecting the South African tax base and the need for South African multinational entities to be competitive, the South African CFC rules contains various exemptions. That said, CFC income which is generally regarded as tainted income, for example, passive income and diversionary income does not qualify for any of the CFC exemptions.

Currently, the South African CFC rules contain three sets of anti-diversionary rules in 9D(9A) of the Act, namely, CFC inbound sales, CFC outbound sales and CFC connected person services. These CFC anti-diversionary rules are aimed at ensuring that CFC activities are not being used to shift taxable income offshore through transfer mispricing.

II. Reasons for change

It has come to Government's attention the current CFC anti-diversionary rules do not adequately address multi-layered structures that fragment the current diversionary transaction link for tax. Certain multinational enterprises are circumventing CFC anti diversionary rules by diverting profits to members of the group that are subject to tax at a lower rate and are not subject to the specific anti-diversionary rules. This is achieved by the imposition of additional CFCs in the supply chain between the South Africa resident connected person and the independent non-resident supplier or customer.

III. Proposal

In order to prevent the circumvention of the CFC anti-diversionary rules, it is proposed that changes be made in section 9D of the Act to extend the anti-diversionary rules to include both direct and indirect transactions between:

- a. the South African connected person and an independent non-resident customer for the export of goods;
- b. an independent non-resident supplier and the South African connected person for the import of goods; and
- c. the controlled foreign company and the South African connected person for the rendering of services.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

5.3 REVIEWING THE DEFINITION OF PERMANENT ESTABLISHMENT

[Applicable provision: Section 1 of the Act definition of “permanent establishment”]

I. Background

On 7 June 2017, South Africa signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, commonly referred to as a Multilateral Instrument (MLI). The main aim of the MLI is to modify the application of thousands of bilateral tax treaties concluded to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. The MLI applies alongside existing tax treaties. In line with preserving signatory countries' sovereignties, signatory countries of the MLI have the right to make reservations and notifications, noted as MLI positions with regards to various provisions of the MLI.

On March 2018, the OECD published amendments in the Report on BEPS Action 7 to Article 5. This Report resolved to expand the threshold of the definition of “permanent establishment” (PE) in terms of Article 5(5). The amendments made to Article 5, are to address concerns surrounding the potential for companies to engage in BEPS activities by entering into arrangements that artificially avoid the existence of PEs. These arrangements include the use of a dependent agent who does not formally conclude contracts, using commissionaire arrangements and similar strategies.

The pre-March 2018 version of Article 5(5) of the Model Tax Convention (MTC) pre-BEPS version provided the following:

“a person acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise”.

Therefore, if the authority to conclude contracts is not habitually exercised, there is no deemed PE. Contracts concluded with the third party on behalf of the principal but in the name of the agent would also not create a deemed PE. It is possible for a foreign enterprise to have a PE in a Contracting State, despite not having a “fixed place of business”, if a dependent agent has and habitually exercises an authority to conclude contracts on its behalf.

The post March 2018 updated version of Article 5(5) of the MTC provides that an enterprise is deemed to have a PE in a Contracting State.

“where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise”.

In this regard, the person’s actions on behalf of the enterprise will be sufficient to conclude that the enterprise participates in a business activity in the state concerned.

That said, the above March 2018 amendments to the definition of Article 5(5) of the OECD MTC are not regarded as a minimum standard. As a result, countries are allowed to reserve the right not to apply the entirety of Article 5 to its Covered Tax Agreements (CTAs).

II. Reasons for change

Currently, “permanent establishment” is defined in section 1 of the Act to mean a PE as defined in article 5 of the OECD MTC. The reference in the Act definition of PE to a PE as defined in Article 5 of the OECD MTC implies that if changes are made to article 5 of the OECD MTC, then the Act definition of PE changes automatically. Consequently, when changes were made in March 2018 by the OECD to Article 5(5) (dealing with PEs) of the MTC, this automatically updated the Act definition of PE to be similar to the OECD, with effect from March 2018.

That said, when South Africa signed the MLI in June 2017, South Africa took a position in the MLI and reserved its right not to update Article 5(5), dealing with PE. As a result, South Africa’s tax treaties remain in line with the pre-March 2018 version of Article 5(5) of the Model Tax Convention (MTC).

The Act definition of PE, which currently refers to the post March 2018 updated version of Article 5(5) of the MTC and the South Africa MLI position which refers to the pre-March 2018 version of Article 5(5) of the MTC creates a misalignment.

III. Proposal

In order to address the above-mentioned misalignment and to align the Act definition of PE with South Africa’s MLI position, it is proposed that changes be made in the Act so that the definition of “permanent establishment” in section 1 of the Act should refer to the pre-March 2018 version of Article 5(5) of the MTC.

IV. Effective date

The proposed amendment will be deemed to have come into operation on 1 March 2018 and apply in respect of years of assessment commencing on or after that date.

5.4 CLARIFICATION OF THE QUALIFYING CRITERIA FOR DOMESTIC TREASURY MANAGEMENT COMPANY

[Applicable provision: Section 1 of the Act - definition of “Domestic Treasury Management”]

I. Background

In 2013, Government introduced the DTMC regime. The main objective of this regime was to encourage listed South African multinational companies which are registered with the Financial Surveillance Department (FSD) of the South African Reserve Bank (SARB) to relocate their treasury operations to South Africa. Consequently, changes were made in the Act to insert the definition of DTMC with effect from years of assessment commencing on or after 27 February 2013.

The Act definition provided that a DTMC must be a company that is:

- a. incorporated or deemed to be incorporated in South Africa;
- b. that has its place of effective management in South Africa; and
- c. that is not subject to exchange control restrictions by virtue of being registered with the financial surveillance department of the SARB.

In 2018, changes were made in the Act to remove the requirement that a DTMC be incorporated or deemed to be incorporated in South Africa, due to the fact that this requirement was burdensome for companies that were incorporated offshore but had their place of effective management in South Africa or wanted to move their place of effective management to South Africa.

II. Reasons for change

Currently, there is misalignment between the definition of DTMC in the Act and in SARB Circular 5/2013. Although amendments were made in the Act in 2018 to delete the requirement that the DTMC must be incorporated or deemed to be incorporated in South Africa, however, no corresponding changes were made in SARB Circular 5/2013.

III. Proposal

In order to clarify this perceived tension between SARB policy and tax policy, the following is proposed:

- a. that the requirement that a domestic treasury management company be incorporated or deemed to be incorporated in South Africa be re-instated in the Act in respect of new companies that are registered with SARB for the first time on or after 1 January 2019.

- b. that the requirement that a domestic treasury management company be incorporated or deemed to be incorporated in South Africa should not apply to those companies that were already incorporated or deemed to be incorporated offshore if registered with SARB before 1 January 2019.

IV. Effective date

The proposed amendment will be deemed to have come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

5.5 REVIEWING OF THE “AFFECTED TRANSACTION” DEFINITION IN THE ARM’S LENGTH TRANSFER PRICING RULES

[Applicable provision: Section 31 of the Act definition of “affected transaction”]

I. Background

In 1995, the transfer pricing rules were introduced in the Act. Over the years, changes were made to the South African transfer pricing rules to be in line with international standard. The main aim of the transfer pricing provisions in section 31 of the Act is to prevent a reduction in South African taxable income as a result of mispricing or incorrect characterisation of transactions. As a general matter, a taxpayer is required to adjust its taxable income to reflect arm's length amounts if it enters into transactions with a “connected person” as defined in section 1 of the Act, on terms or conditions that are not at arm's length, derives a tax benefit from such terms and conditions and the connected person is tax resident outside South Africa. South Africa like most countries has adopted the OECD and UN “arm’s length principle” as a benchmark for income tax purposes.

II. Reasons for change

Both the OECD and UN use the concept of “associated enterprises” when applying the arm’s length principle, which is the internationally recognised tax standard for allocating profits resulting from transactions between associated enterprises. The concept of “associated enterprises” is described in the Commentary on Article 9 of the OECD MTC as parent and subsidiary companies and companies under common control.

The wording of Article 9(1) of both the OECD and UN MTC is as follows:

“Where:

- a. an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
- b. the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

On the other hand, South Africa still uses the concept of “connected persons” when applying the arm’s length principle. The fact that South Africa does not have or use the concept of associated enterprises when applying the arm’s length principle presents a challenge in application of the transfer pricing rules in respect of transactions between “associated enterprises” that are not regarded connected persons.

III. Proposal

In order to address this anomaly, it is proposed that changes be made in section 31 of the Act so that the scope of the transfer pricing rules be extended to also include transactions between persons that are not connected persons, but that are “associated enterprises” as described in Article 9(1) of the MTC on Income and on Capital of the OECD.

IV. Effective date

The proposed amendment will come into operation on 1 January 2020 and applies in respect of years of assessment commencing on or after that date.

5.6 CLARIFICATION OF THE INTERACTION OF CAPITAL GAINS TAX AND FOREIGN EXCHANGE TRANSACTION RULES

[Applicable provisions: Section 24I and paragraph 43 of the Eighth Schedule to the Act]

I. Background

In general, the tax treatment of effects of changes in foreign currency falls under two main provisions, namely section 24I of the Act and paragraph 43 of the Eighth Schedule to the Act. Section 24I of the Act generally recognises foreign exchange gains and losses on an annual basis irrespective of whether the gains or losses are realised.

On the other hand, paragraph 43 of the Eighth Schedule to the Act has two sets of capital gain or loss currency rules that are available when disposing of assets. The first set of capital gains tax rules relates to the method for calculating capital gains and losses for natural persons and non-trading trusts that dispose of an asset in foreign currency after having acquired that asset in the same foreign currency. Therefore, natural persons and non-trading trusts determine the capital gain or loss in the relevant foreign currency followed by a translation to local currency, e.g. Rand.

In turn, the second set of capital gains tax rules for companies and trading trusts, acquiring or disposing of an asset in foreign currency, requires that both proceeds and the base cost be translated to local currency, e.g. Rand. In short, the capital gain or loss is determined in local currency after translating the base cost and proceeds to local currency using either spot rates or average rates.

II. Reasons for change

The current rules in paragraph 43(6A) of the Eighth Schedule excludes the application of the second set of capital gains tax rules mentioned above to companies and trading trusts in order to avoid duplication of the currency gains and losses arising under section 24I. In particular, paragraph 43(6A) of the Eighth Schedule to the Act excludes foreign debt which includes foreign bonds that can give rise to a capital gain or capital loss. In general, this exclusion is applicable to

the disposal of debt and related derivative instruments such as forward exchange contracts and foreign currency option contracts.

Based on the above, it can be argued that once a company and trading trust are excluded from the application of paragraph 43(1A), that company or trading trust must determine a capital gain or loss under general rules taking into account sections 24I and 25D of the Act. As a result, paragraph 43 of the Eighth Schedule does not apply. This non-application of paragraph 43 of the Eighth Schedule to the Act can be illustrated with the following examples:

Example 1

Facts:

Company B acquired a foreign bond as long-term investments during its first year of assessment for X\$100 when the exchange rate was X\$1:R1. At the end of the first year of assessment the exchange rate was X\$1:R1,40 and at the end of year 2 X\$1:R2. On the last day of year 2 Company B disposed of the bond for an amount accrued of X\$120.

<i>Result:</i>	
<i>Section 24I applied to the foreign bond that is an exchange item</i>	
End of first year of assessment X\$100 × R1,40	R 140
Less: Date of acquisition X\$100 × R1	(100)
Income inclusion	<u>40</u>
Date of disposal at the end of second year of assessment X\$100 × R2	200
Less: Beginning of second year of assessment X\$100 × R1,40	(140)
Income inclusion	<u>60</u>
<i>Section 25D</i>	
Amount received or accrued X\$120 × R2 [para 35 read with s 25D(1)]	240
Less: Arguably reduction of amounts included in income under s 24I	(100)
Proceeds (para 35)	140
Less: Base cost X\$100 × R1 [para 20(1)(a) read with s 25D(1)]	(100)
Capital gain	<u>40</u>

Example 2

Facts:

Company C advanced a foreign currency loan of X\$100 to Company D during its first year of assessment when X\$1:R1. At the end of the first year of assessment the exchange rate was X\$1:R1,40 and at the end of year 2 X\$1:R2. On the last day of year 2 after Company D was liquidated Company C received only X\$80 in full and final settlement of the loan.

Result:**Section 24I**

	R
End of first year of assessment X\$100 × R1,40	140
<i>Less: Date loan was advanced X\$100 × R1</i>	<u>(100)</u>
Income inclusion	<u>40</u>
Date loan was realised X\$100 × R2	200
<i>Less: Beginning of second year of assessment X\$100 × R1,40</i>	<u>(140)</u>
Income inclusion	<u>60</u>

Since X\$20 of the debt was bad, Company C is entitled to a deduction of R20 (X\$20 × (2 – 1) under s 24I(4)). The sum of the amounts included or deducted from Company C's income is thus R40 + R60 – R20 = R80.

Section 25D

Amount received or accrued X\$80 × R2 [para 35 read with s 25D(1)]	160
<i>Less: Amount included in income under s 24I \$80 × (R2 – R1)</i>	<u>(80)</u>
Proceeds (para 35)	80
<i>Less: Base cost X\$100 × R1 [para 20(1)(a) read with s 25D(1)]</i>	<u>(100)</u>
Capital loss	<u>(20)</u>

Based on the above-mentioned examples, paragraph 43 of the Eighth Schedule was not applied. Instead section 25D of the Act was applied even though paragraph 43 of the Eighth Schedule should be capable of dealing with the translation of such gains and losses.

In addition, it is unclear how the foreign currency gain and loss provisions interact with capital gains provisions as section 24I of the Act determines exchange gains and losses over the lifetime of an exchange item while paragraph 35(3)(a) eliminates amounts from proceeds on disposal of an asset.

III. Proposal

In order to clarify the interaction between the currency gains and losses determined under section 24I of the Act that are forming part of a capital gain or capital loss, it is proposed that the rules for companies and trading trusts in paragraph 43 of the Eighth Schedule to the Act be amended by inserting a new proviso to provide an appropriate mechanism for eliminating double taxation.

IV. Effective date

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

6. VALUE ADDED TAX

6.1 CLARIFYING FINANCIAL SERVICES TO INCLUDE THE TRANSFER OF OWNERSHIP OF REINSURANCE RELATING TO LONG-TERM REINSURANCE POLICIES

[Applicable provision: Section 2(1)(i) of the Value Added Tax Act No. 89 of 1991 (“the VAT Act”)]

I. Background

Section 2(1)(i) of the VAT Act deems specific activities including the provision or transfer of ownership of a long-term insurance policy or the provision of reinsurance in respect of such policy as financial services. In turn, section 12(1)(a) of the VAT Act makes provision for the exemption of financial services. This implies that the actual provision of reinsurance in respect of a long-term insurance policy is an exempt financial service.

II. Reasons for change

At issue is the fact that the provisions of the VAT Act do not specifically address the VAT treatment of the transfers of ownership of reinsurance relating to long-term insurance to another reinsurer, due to the fact that such transfer is not specifically included under activities regarded as financial services in section 2(1)(i) of the VAT Act. In addition, there are conflicting views as to whether the transfer of ownership of reinsurance relating to long-term insurance to another reinsurer is exempt or not. There is a view that since the underlying policy is exempt and the reinsurance of the underlying policy is exempt, then surely it was not the intention of the legislature to omit these transactions from being specifically included under activities regarded as financial services in section 2(1)(i) of the VAT Act.

III. Proposal

In order to provide clarity as to the VAT treatment of the transfer of ownership of reinsurance relating to long-term insurance to another reinsurer, it is proposed that changes be made to section 2(1)(i) of the VAT Act to specifically include these as activities falling within financial services.

IV. Effective date

The proposed amendments will come into operation on 1 April 2020.

6.2 REFINING THE VAT CORPORATE REORGANISATION RULES

[Applicable provision: Section 8(25) of the VAT Act]

I. Background

The VAT Act contains rules in section 8(25) that provide for VAT relief by treating the supplier and the recipient of goods or services as the same during corporate reorganisation transactions, between companies that form part of the same group of companies, provided certain requirements are met. This provision is similar to the corporate reorganisation provisions available in the Income Tax Act, which are aimed at providing tax neutral transfer of assets during corporate reorganisations, between companies that form part of the same group of companies.

However, section 8(25) of the VAT Act further provides that if the corporate reorganisation transactions take place in terms of section 42 or 45 of the Act, the VAT relief is only available if the transfer relates to the transfer of an enterprise, or part of an enterprise capable of separate operation, as a going concern.

II. Reasons for change

Currently, the relief provided in terms of section 8(25) does not apply to corporate reorganisation transactions where the only asset transferred will be fixed property that will be leased back to the supplier once transfer of the property is completed. The supply is not capable of operating separately and the property itself is currently not an income-earning property. This creates adverse cash flow for the group of companies with regards to the input tax credits of the recipient and the output tax liability of the supplier.

III. Proposal

In order to address this anomaly, it is proposed that changes be made in section 8(25) of the VAT Act so as to provide VAT relief to group companies in instances where a fixed property is transferred in terms of corporate reorganisations as envisaged in section 42 or 45 of the Income Tax Act, dealing with “Asset-for-share transactions” and “Intra-group transactions”, provided that specific requirements are met.

In order to maintain the policy rationale explained in the Explanatory Memorandum to the 2009 Taxation Laws Amendment Bill and thereby prevent abuse of this provision, it is proposed that the relief in terms of section 8(25) be limited to the transfer of fixed property, only in instances where supplier and the recipient have agreed in writing that, immediately after the sale, the supplier will lease back the fixed property being transferred.

IV. Effective date

The proposed amendments will come into operation on 1 April 2020.

6.3 REVIEWING SECTION 72 OF THE VAT ACT

[Applicable provision: Section 72 of the VAT Act]

I. Background

When VAT was introduced in South Africa in 1991, the VAT Act contained provisions in section 72 that provides the Commissioner with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption from tax provided for in terms of the VAT Act, provided that the Commissioner is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of the VAT Act. The arrangement or decision by the Commissioner as provided under section 72 of the Act must have the effect of assisting the vendor to overcome the difficulty, anomaly or incongruity without having the effect of substantially reducing or increasing the taxpayer's ultimate liability for VAT.

II. Reasons for change

In 1996, the Constitution of the Republic of South Africa ("Constitution") came into effect. The introduction of the Constitution in 1996 came after the introduction of the VAT Act in 1991. 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.

III. Proposal

In view of the fact that the provisions of the VAT Act are in itself mandatory, in order to address the above-mentioned anomaly, it is proposed that changes be made in section 72 of the VAT Act to align the provisions of this section with the spirit of the other provisions of the VAT Act.

IV. Effective date

The proposed amendments are deemed to have come into operation on 21 July 2019.

6.4 REFINING THE VAT TREATMENT OF FOREIGN DONOR FUNDED PROJECTS

[Applicable provision: Section 1(1) definition of "enterprise", "foreign donor funded project", "person", new definition of "implementing agency", sections 8(5B) and 50(1) of the VAT Act]

I. Background

In 2006, changes were made in tax legislation to make provision for the tax treatment of foreign donor funded projects in terms of the Official Development Assistance Agreement (ODAA). ODAA is an international agreement 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, etc.

The VAT Act provides that if the project meets the requirements of the definition of “Foreign Donor Funded Project” (“FDFP”) in section 1(1) of the VAT Act, the project is a person as defined and is deemed to have made a zero-rated supply to the foreign donor in terms of section 11(2)(q) of the VAT Act. Accordingly, the project will be required to register for VAT with the South African Revenue Service (SARS) and thereafter claim all VAT incurred on expenses as input tax, thereby ensuring that the funds are not utilised to pay any VAT.

In order to implement the foreign donor funded project in South Africa in terms of the ODAA, a further project agreement flowing from the ODAA may be entered into, which specifically relates to a particular project. This project agreement may appoint a specific government department as being responsible for the implementation of the particular project. In turn, the above-mentioned government department may facilitate the implementation of the project by entering into another agreement with another entity, called the “implementing agency”, thereby sub-contracting the particular project to another “implementing agency” or “subcontractor”. Further, the subcontractor may further subcontract parts of the particular project to other vendors. There are also instances where the foreign donor contracts directly with various implementing parties in relation to various parts of the project.

II. Reasons for change

The above-mentioned scenarios have created confusion regarding who must register the project as a foreign donor funded project for VAT as required in terms of the VAT Act, who is entitled to the input tax claims and who is the actual implementing agency. In view of the fact that the implementing agency is required to facilitate the project and report on the progress of the project as well as ensuring that the funds are used for only the specified project and not to pay taxes or any other unrelated costs, consequently, the implementing agency is the one required to register the foreign donor funded project for VAT purposes and the registered foreign donor funded project is entitled to claim the input tax credits on expenses incurred in relation to the project. However, in instances where the foreign donor has contracted directly with various implementing parties, there may be more than one implementing agency and hence more than one FDFP that is entitled to register for VAT purposes in relation to one main project.

There is further confusion on what requirements need to be met before a project may be registered for VAT with SARS as a FDFP. The current definition in the VAT Act creates uncertainty and does not cater for all the policy requirements that need to be met before SARS will register a project as such. As a result, registrations of foreign donor funded projects for VAT purposes are often delayed due to the need for SARS to constantly seek clarity from National Treasury.

III. Proposal

In order to address the above-mentioned uncertainty, it is proposed that the definition of “foreign donor funded project” in section 1(1) of the VAT Act be extended to further clarify what will qualify as a FDFP for VAT purposes. The new definition makes reference to approval by the Minister of Finance. It is proposed that a guideline will be issued by SARS outlining what requirements will need to be met before the Minister of Finance will approve a project as a FDFP. The guideline will further outline a streamlined process to be followed in order to obtain such approval. Once the written approval of the Minister of Finance is obtained, then only will SARS register the project as a FDFP for VAT purposes.

It is further proposed that the definition of “enterprise” be amended to include the activities of an implementing agency in respect of the FDFP rather than the activities of the FDFP. The “implementing agency” will be defined to refer to the government of the Republic, any institution

or body established and appointed by a foreign government as contemplated in section 10(1)(bA)(ii) of the Income Tax Act to perform its functions in terms of the ODAA or any person who has entered into a contract with either of these parties to implement, operate, administer or manage a FDFP.

As a consequence of these amendments, it is proposed that the definition of “person” be amended to remove FDFP’s from the definition.

Further, in order to ensure that the implementing agency ring-fences the activities relating to the FDFP, it is proposed that section 50(1) be amended to require the project to be registered as a separate entity from the other enterprise activities of the implementing agency.

IV. Effective date

The proposed amendments will come into operation on 1 April 2020.

7. CLAUSE BY CLAUSE

CLAUSE 1

Estate Duty Act: Amendment to section 3

In 2015, changes were made in section 3(2) of the Estate Duty Act by inserting a new paragraph (bA). The main aim of the amendments was 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. The proposed changes should be deemed to have come into effect in respect of the estate of a person who died on or after 1 January 2019 and also applies to any contributions made on or after 1 March 2015.

CLAUSE 2

Income Tax Act: Amendment to section 1

Sub-clause (a): Definition of “dividend”- The current definition of “dividend” exclude an amount transferred or applied that constitutes an acquisition by a company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67 (B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.81 of section 5 of the JSE Limited Listings Requirements. In 2016, Government granted exchange licenses to the following stock exchanges, namely, A2X, 4AX, ZARX and EESE. As a result, it is proposed that changes be made in the definition of dividend to apply to the above-newly stock exchanges, provided that they meet the substantially the same requirements contemplated in the JSE Limited Listing Requirements.

Sub-clauses (b) – (d): Definition of “domestic treasury management company” - See notes on **CLARIFICATION OF THE QUALIFYING CRITERIA FOR DOMESTIC TREASURY MANAGEMENT COMPANY**

Sub-clause (e): Definition of “gross income” - The proposed amendment seeks to delete the reference and application of an obsolete tax concept in the definition of gross income. Paragraph (n)(ii) of the definition of “gross income” deems amounts falling under section 8(4) of the Act to be from a source within the Republic. This latter requirement was introduced at the time South Africa had a source system of taxation and was designed to prevent taxpayers from exporting depreciable assets and then arguing that the proceeds on disposal were from a source outside the Republic, and hence not subject to recoupment. However, since the introduction of the

worldwide basis of taxation in 2000, this rule is no longer required. In fact, it results in unintended consequences.

Sub-clause (f): Definition of “identical share” - The proposed amendment corrects a grammatical error and changes the word “Listing” to “Listings”.

Sub-clause (g): Definition of “permanent establishment” - See notes on **REVIEWING THE DEFINITION OF PERMANENT ESTABLISHMENT**

Sub-clause (h): Definition of “provident fund” - The proposed amendment seeks to afford employees the ability to effect tax-free transfers from an employer provided provident fund into an employer provided pension fund immediately prior to retirement, provided that the provident fund the retirement benefits are transferred from and the pension fund the retirement benefits are transferred to are provided by the same employer.

Sub-clause (i): Definition of “return of capital” - The current definition of “return of capital” exclude an amount transferred or applied that constitutes an acquisition by a company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67 (B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.81 of section 5 of the JSE Limited Listings Requirements. In 2016, Government granted exchange licenses to the following stock exchanges, namely, A2X, 4AX, ZARX and EESE. As a result, it is proposed that changes be made in the definition of dividend to apply to the above-newly stock exchanges, provided that they meet the substantially the same requirements contemplated in the JSE Limited Listing Requirements.

CLAUSE 3

Income Tax: Amendment to section 7B

See notes on **EXTENDING THE SCOPE OF AMOUNTS CONSTITUTING VARIABLE REMUNERATION**

CLAUSE 4

Income Tax: Amendment to section 7C

The proposed amendment to the heading of section 7C seeks to match the scope of the heading with the current policy intent to read as follows: “**Loan, advance or credit granted to trust by connected person**”.

CLAUSE 5

Income Tax: Substitution of section 7F

Currently, the wording of section 7F allows a person to claim a deduction of interest repaid to SARS. Before a deduction may be allowed in terms of section 7F, a further condition that must be complied with is that interest that must be repaid to SARS should have been included in the taxable income of that person. For example, section 10(1)(i) makes provision for natural persons to obtain interest exemption, and this may result in no taxable portion of interest. As a result, it is proposed that changes be made in section 7F to address this anomaly.

CLAUSE 6

Income Tax: Amendment to section 8

Sub-clause (a): Currently, section 10(1)(nA) of the Act makes provision for exemption in respect certain employment-related allowances, for example, a uniform allowance. As a result, if the allowance is exempt in terms of section 10(1)(nA), such amount is excluded from “income” as defined in the Act. However, section 8(1) of the Act includes any such allowance, that are for example exempt in terms of section 10(1) (nA) of the Act directly into a person’s taxable income. This means that, notwithstanding that the allowance is exempt, it becomes subject to tax as a result of its direct inclusion into taxable income in terms of section 8(1) of the Act. In order to address this anomaly, it is proposed that changes be made in section 8(1) of the Act to exclude exempt allowances or advance in terms of section 10(1) from taxable income.

Sub-clause (b): The Act contains section 7B, which makes provision for matching the timing between accrual and payments of various variable remuneration. Section 7B of the Act deems a person’s travel reimbursement to accrue on the date that it is paid. However, there is an anomaly, for example, if a person travels during say February and the reimbursement is paid in March, those kilometres travelled in February cannot be claimed against the following year’s travel allowance. In essence a deduction is forfeited as the distance to which the allowance paid relates is not travelled in the year of assessment the reimbursement is paid. The proposed addition of a proviso to subparagraph (ii) in subsection (1)(b) seeks to align a person’s kilometres travelled for business purposes with the accrual of the allowance received in relation to said travel

Sub-clause (c): Currently, paragraph 12(2)(c) of the Eighth Schedule to the Act triggers a deemed disposal for capital gains tax purposes when an asset which was not held as trading stock commences to be held as trading stock. However, there is no similar deemed disposal and reacquisition rules in the recoupment provisions in section 8(4)(k) of the Act for allowance assets to trigger a recoupment of previous allowances. In order to address this anomaly, it is proposed that changes be made in the Act by inserting a new subparagraph (iv) in section 8(v)(k) of the Act.

CLAUSE 7

Income Tax: Amendment of section 8B

The proposed amendment to the definition of “broad-based employee share plan” in subsection (3) seeks to delete words that refer to the old Companies Act, 1973.

CLAUSE 8

Income Tax: Amendment of section 8E

The proposed amendments to the definition of “hybrid equity instrument” in paragraphs (a), (b) and (e) seek to clarify the scope of the definition of hybrid equity instrument by clarifying that any part redemption of a share refers to a distribution of an amount constituting a return of capital or a foreign return of capital in respect of that share as it is impossible to otherwise redeem a portion of a share.

CLAUSE 9

Income Tax: Amendment of section 8EA

Sub-clause (a): The proposed amendment deletes the definition of “enforcement obligation” in respect of provisions relating to third party backed shares.

Sub-clauses (b) to (d): The proposed amendments are consequential amendments as a result of the deletion of the definition of “enforcement obligation” in this provision.

CLAUSE 10

Income Tax: Amendment of section 9D

Sub-clause (a): Paragraph (b) of the definition of “controlled foreign company” - In 2018, paragraph (b) of the definition of controlled foreign company was inserted in section 9D of the Act. However, unlike paragraph (a) of the definition of controlled foreign company, the current paragraph (b) does not contain any exclusion for a headquarter company. In order to correct this, it is proposed that changes be made in paragraph (b) of the definition of controlled foreign company to insert the headquarter company exclusion.

Sub-clause (b): See notes on **HARMONISING THE TIMING OF DE-GROUPING CHARGE PROVISIONS FOR INTRA-GROUP TRANSACTIONS AND CONTROLLED FOREIGN COMPANY RULES**

Sub-clause (c): See notes on **REVIEWING THE COMPARABLE TAX EXEMPTION**

Sub-clauses (d) to (f): See notes on **ADDRESSING CIRCUMVENTION OF CONTROLLED FOREIGN COMPANY DIVERSIONARY RULES**

CLAUSE 11

Income Tax: Amendment of section 9HA

The proposed amendment in subsection (1) paragraph (c) deletes the word “contemplated” and replaces it with the word “defined” as a matter of style and consistency.

CLAUSE 12

Income Tax: Amendment of section 9HB

The proposed amendment in subsection (1)(b)(1) corrects a grammatical error and changes the words “transfer or” to “transferor”.

CLAUSE 13

Income Tax: Amendment of section 10

Currently, section 10(1)(j) makes provision for exemption of central banks of foreign countries. However, this exemption is subject to the discretion of the Minister of Finance. The proposed amendment to subsection (1)(j) seeks to delete the Minister’s discretion in this regard.

CLAUSE 14

Income Tax: Amendment of section 10C

See notes on **EXEMPTION RELATING TO ANNUITIES FROM A PROVIDENT OR PROVIDENT PRESERVATION FUND**

CLAUSE 15

Income Tax: Amendment of section 11

In 2018, changes were made in section 11(j) of the Act in order to provide certainty, the specific criteria for determining the doubtful debt allowance be included in the Act. The proposed amendment in paragraph (j)(i)(aa) for subitem (B) are consequential and seek to align the policy intent.

CLAUSE 16

Income Tax: Amendment of section 12B

The proposed amendment to the wording after subsection (1)(h)(iii) seeks replaces the “and” test with the “or” test in order to clarify that any machinery, plant, implement, utensil or article used in any one method of generating electricity as listed in subsection(1)(h) can be subject to the deduction as contemplated in this section.

CLAUSE 17

Income Tax: Amendment of section 12J

Sub-clause (a): The proposed amendment in paragraph (b) of the definition of “qualifying company” seeks to clarify that the controlled company group test is not a once-off test but that it needs to be met from the date of acquisition (from the date of issue of the shares to the venture capital company) and any time during every year of assessment after that date.

Sub-clause (b): The proposed amendment in subsection (2) is a consequential amendment to include referencing to subsection (3B) after the insertion of that subsection in 2018 in the Act.

6.5 Sub-clause (c): See notes on REVIEW THE ALLOWABLE DEDUCTION FOR INVESTORS INVESTING IN A VENTURE CAPITAL COMPANY

CLAUSE 18

Income Tax: Amendment of section 12R

See notes on **ALIGNING THE TAX PROVISIONS OF SEZ WITH THE OVERALL OBJECTIVES OF THE SEZ PROGRAMME**

CLAUSE 19

Income Tax: Amendment of section 13*bis*

The proposed amendment to the further proviso to subsection (1) correct a grammatical error and changes the word “the” to “that” and the word “setoff” to “set-off” respectively.

CLAUSE 20

Income Tax: Amendment of section 18A

The proposed amendment in paragraph (a) of subsection (1) replaces the word “from” with the words “in the determination” in order to clarify the structural order of the section 18A deduction as taxable income is only finally determined after the section 18A deduction.

CLAUSE 21

Income Tax: Amendment of section 20A

The proposed amendment to subsection (4) corrects a grammatical error by deleting the word “the” as superfluous.

CLAUSE 22

Income Tax: Amendment of section 22

The proposed addition of the proviso to subsection (1) seeks to clarify the uncertainty that has come to Government’s attention on how the value of trading stock is to be “brought to account”,

that is, whether the amount must be included directly in paragraph (b) of the definition of “taxable income” or whether it should be included in income or gross income. It is proposed that clarity be provided by making changes in the Act confirming that closing stock must be included in gross income.

CLAUSE 23

Income Tax: Amendment of section 22B

See notes on ADDRESSING ABUSIVE ARRANGEMENTS AIMED AT AVOIDING THE ANTI-DIVIDEND STRIPPING PROVISIONS

CLAUSE 24

Income Tax: Amendment of section 23C

In 2015, Regulations dealing with “determined value” in paragraph 7(1) of the Seventh Schedule on retail value in respect of right of use of motor vehicle came into effect. The proposed amendment in subsection (1) seeks to align the policy intention as outlined in the Regulation and clarify that VAT is to be included in the “determined value” used to calculate the fringe benefit arising in the employee’s hands.

CLAUSE 25

Income Tax: Amendment of section 23I

See notes on REVIEWING THE COMPARABLE TAX EXEMPTION

CLAUSE 26

Income Tax: Amendment of section 23M

The proposed amendment to subsection (3)(b) seeks to better clarify the structural application of the formula in this provision.

CLAUSE 27

Income Tax: Amendment of section 23O

The proposed amendments in section 23O deletes the words “that is applied” as these words are confusing and are against the policy intent of this provision.

CLAUSE 28

Income Tax: Amendment of section 24BA

See notes on CLARIFYING THE EFFECT OF DEFERRED TAX ON THE APPLICATION OF VALUE SHIFTING RULES

CLAUSE 29

Income Tax: Amendment of section 24I

Currently, paragraph (b) of the definition of “local currency” in section 24I requires that Rand must be used as the local currency for exchange items that are not attributable to a foreign permanent establishment. However, headquarter companies are excluded from the provisions of paragraph (b). In order to align the provisions of the Act, it is proposed that amendments should be made in paragraph (b) of the definition of “local currency” to exclude domestic treasury management companies and international shipping companies.

CLAUSE 30

Income Tax: Amendment of section 24O

Sub-clause (a): Definition of “acquisition transaction”: See notes on **CLARIFYING THE EXCLUSION CLAIMING INTEREST DEDUCTION FOR DEBT FINANCE ACQUISITIONS FOR START-UP BUSINESSES**

Sub-clause (b): The proposed amendment in subsection (3) is a technical correction to ensure that the proviso applies to both paragraphs (a) and (b) of that subsection.

Sub-clause (c): The proposed insertion of subsection (5): See notes on **AMENDING THE SPECIAL INTEREST DEDUCTION RULES IN RESPECT OF SHARE ACQUISITIONS FUNDED BY DEBT TO ALLOW FOR DEDUCTIONS AFTER AN UNBUNDLING TRANSACTION**

CLAUSE 31

Income Tax: Amendment of section 25BB

Definition of “rental income” See notes on **CLARIFICATION TO THE DEFINITION OF RENTAL INCOME IN A REITs TAX REGIME IN RESPECT OF FOREIGN EXCHANGE DIFFERENCES**

CLAUSE 32

Income Tax: Amendment of section 28

See notes on **CONSEQUENTIAL AMENDMENTS TO THE TAX TREATMENT OF FOREIGN REINSURANCE BUSINESS OPERATING A BRANCH IN SOUTH AFRICA**

CLAUSE 33

Income Tax: Amendment of section 29A

Sub-clause (a): Definition of “insurer”: See notes on **CONSEQUENTIAL AMENDMENTS TO THE TAX TREATMENT OF FOREIGN REINSURANCE BUSINESS OPERATING A BRANCH IN SOUTH AFRICA**

Sub-clause (b): Definition of “policy”: See notes on **CONSEQUENTIAL AMENDMENTS TO THE TAX TREATMENT OF FOREIGN REINSURANCE BUSINESS OPERATING A BRANCH IN SOUTH AFRICA**

Sub-clauses (c) and (d): See notes on **REFINEMENT TO TAXATION OF RISK POLICY FUNDS OF LONG TERM INSURERS**

Sub-clause (e): See notes on **REFINEMENT OF THE PHASING IN TRANSITIONAL RULES FOR LONG TERM INSURERS**

CLAUSE 34

Income Tax: Amendment of section 30

The proposed deletion of subsection (3B) seeks to remove an obsolete transitional measure initially introduced to provide organisations that were already exempt from the Act under the repealed legislation the opportunity to re-apply under section 30 of the Act. Organisations were granted only until December 2004 to re-apply under section 30 of the Act.

CLAUSE 35

Income Tax: Amendment of section 30A

The proposed deletion of subsection (4) seeks to remove a now obsolete transitional measure initially introduced to provide recreational clubs that were already exempt from the Act under the repealed legislation the opportunity to re-apply under section 30A of the Act. Recreational clubs were granted only until December 2010 to re-apply under section 30A of the Act.

CLAUSE 36

Income Tax: Amendment of section 31

Sub-clauses (a) – (b): See notes on **REVIEWING OF THE “AFFECTED TRANSACTION” DEFINITION IN THE ARM’S LENGTH TRANSFER PRICING RULES**

Sub-clause (c): See notes on **REVIEWING THE COMPARABLE TAX EXEMPTION**

CLAUSE 37

Income Tax: Substitution of section 40CA

See notes on **CLARIFYING THE INTERACTION OF THE VALUE SHIFTING RULES AND THE DEEMED EXPENDITURE INCURRAL RULES FOR ASSETS ACQUIRED IN EXCHANGE FOR THE ISSUE OF SHARES**

CLAUSE 38

Income Tax: Amendment of section 41

Sub-clause (a): See notes on the following:

CLARIFYING THE TAX TREATMENT OF TRANSFER OF INTEREST BEARING INSTRUMENTS IN TERMS OF CORPORATE REORGANISATIONS

CLARIFYING THE TAX TREATMENT OF TRANSFER OF EXCHANGE ITEMS IN TERMS OF CORPORATE REORGANISATIONS

CLARIFYING THE INTERACTION BETWEEN CORPORATE REORGANISATION RULES AND REITs TAX REGIME

Sub-clauses (b) and (c): See notes on **AMENDING THE CORPORATE REORGANISATION RULES TO CATER FOR COMPANY DEREGISTRATION BY OPERATION OF LAW**

CLAUSE 39

Income Tax: Amendment of section 42

See notes on **CLARIFYING THE INTERACTION BETWEEN CORPORATE REORGANISATION RULES AND REITs TAX REGIME**

CLAUSE 40

Income Tax: Amendment of section 44

See notes on **CLARIFYING THE INTERACTION BETWEEN CORPORATE REORGANISATION RULES AND REITs TAX REGIME**

CLAUSE 41

Income Tax: Amendment of section 45

Sub-clause (a): The proposed amendment for the words following item (aa) in subsection (4)(b)(i) is consequential to the increase in the CGT inclusion rate for companies.

Sub-clause (b): See notes on **HARMONISING THE TIMING OF DE-GROUPING CHARGE PROVISIONS FOR INTRA-GROUP TRANSACTIONS AND CONTROLLED FOREIGN COMPANY RULES**

Sub-clause (c): See notes on **CLARIFYING THE INTERACTION BETWEEN CORPORATE REORGANISATION RULES AND REITs TAX REGIME**

CLAUSE 42

Income Tax: Amendment of section 64EA

The proposed amendment to the words preceding paragraph (a) deletes an obsolete reference to section 64J which has been repealed.

CLAUSE 43

Income Tax: Amendment of section 64G

The proposed amendment to subsection (1) deletes an obsolete reference to section 64J which has been repealed.

CLAUSE 44

Income Tax: Amendment of section 64H

The proposed amendment to subsection (1) deletes an obsolete reference to section 64J which has been repealed.

CLAUSE 45

Income Tax: Amendment of paragraph 12 of the First Schedule

The proposed amendment to subparagraph (2) deletes an obsolete reference to section 11(q) which has been repealed.

CLAUSE 46

Income Tax: Insertion of paragraph 2D of the Second Schedule

See notes on **TAX TREATMENT OF BULK PAYMENTS TO FORMER MEMBERS OF CLOSED FUNDS**

CLAUSE 47

Income Tax: Amendment of paragraph 6 of the Second Schedule

See notes on **ALIGNING THE EFFECTIVE DATE OF TAX NEUTRAL TRANSFERS BETWEEN RETIREMENT FUNDS WITH THE EFFECTIVE DATE OF ALL RETIREMENT REFORMS**

CLAUSE 48

Income Tax: Amendment of paragraph 2 of the Fourth Schedule

See notes on **REVIEWING THE TAX TREATMENT OF SURVIVING SPOUSE PENSIONS**

CLAUSE 49

Income Tax: Amendment of paragraph 28 of the Fourth Schedule

The proposed amendments correct the punctuation in order to correctly refer to employees' tax as a matter of style and consistency.

CLAUSE 50

Income Tax: Amendment of paragraph 1 of the Eighth Schedule

The proposed amendment in the definition of "market value" deletes the word contemplated and replaces it with the word defined as a matter of style and consistency.

CLAUSE 51

Income Tax: Amendment of paragraph 12A of the Eighth Schedule

The proposed amendment to subparagraph (1) deletes obsolete definitions to "allowance asset" and "capital asset" which have both been repealed

CLAUSE 52

Income Tax: Amendment of paragraph 19 of the Eighth Schedule

Sub-clause (a): The proposed amendment in paragraph 19 clarifies the interaction between paragraph 19 and paragraph 43A.

Sub-clause (b): The proposed amendment in subparagraph (3)(b)(ii) makes provision for foreign dividends that are exempt from normal tax under section 10B(2)(e) of the Act to be included in the definition of exempt dividend in paragraph 19.

CLAUSE 53

Income Tax: Amendment of paragraph 20 of the Eighth Schedule

Sub-clause (a) The proposed amendment in subparagraph (1)(e) seeks to delete the requirement in paragraph 20(1)(e) of the Eighth Schedule that expenditure incurred in improving or enhancing the value of an asset still be reflected in the state or nature of the asset at the time of its disposal. By way of background, the wording of paragraph 20(1)(e) was adapted from subsection 110-25(5) of the Australian Income Tax Assessment Act, 1997. However, with effect from 1 July 2005 the Australian Income Tax Assessment Act was amended to remove the requirement that expenditure be reflected in the state or nature of the asset at the time of the CGT event. However, no consequential amendments were made in the Eighth Schedule to the Income Tax Act. As a result, the proposed changes in paragraph 20(1)(e) of the Eighth Schedule seeks to correct this inconsistency.

Sub-clause (b): The proposed amendment in subparagraph (2)(a) seeks to create policy certainty by specifically prohibiting bond registration costs and bond cancellation costs from forming part of the base cost of an asset.

Sub-clause (c): The proposed amendment in subparagraph (3)(b)(iii) updates the reference to the provisions dealing with debt forgiveness rules to include paragraph 12A(3) in order to clarify the interaction between paragraph 20 and paragraph 12A.

CLAUSE 54

Income Tax: Amendment of paragraph 29 of the Eighth Schedule

The amendment in subparagraph (4)(a)(iii) deletes an obsolete reference to paragraph 67 of the Eighth Schedule. Paragraph 67 of the Eighth Schedule was deleted by section 85 of the Taxation Laws Amendment Act 23 of 2018 with effect from the date of promulgation of that Act, namely, 17 January 2019, and was replaced by section 9HB on the same date.

CLAUSE 55

Income Tax: Amendment of paragraph 35 of the Eighth Schedule

The proposed amendment in subparagraph (3)(c) seeks to clarify that the proceeds in respect of a disposal will not be reduced in instances where an agreement is cancelled or terminated and the asset is reacquired by the person who that disposed of the asset.

CLAUSE 56

Income Tax: Amendment of paragraph 38 of the Eighth Schedules

Sub-clause (a): The proposed amendments to paragraph 38(1) delete an obsolete reference to paragraph 67 of the Eighth Schedule. Paragraph 67 of the Eighth Schedule was deleted by section 85 of the Taxation Laws Amendment Act 23 of 2018 with effect from the date of promulgation of that Act, namely, 17 January 2019, and was replaced by section 9HB on the same date; and seeks to clarify that the provisions of paragraph 38(1) apply where assets are disposed by means of a donation or for an inadequate consideration between persons who are connected persons in relation to each other immediately prior to and immediately after the disposal.

Sub-clause (b): The proposed amendment in paragraph 38 (1)(b) deletes the word “and paid” to clarify that to the amount does not need to be actually paid in order for the base cost to be recognized for purposes of this paragraph.

CLAUSE 57

Income Tax: Amendment of paragraph 40 of the Eighth Schedule

The amendments in paragraph 40 delete obsolete references to paragraph 67 of the Eighth Schedule. Paragraph 67 of the Eighth Schedule was deleted by section 85 of the Taxation Laws Amendment Act 23 of 2018 with effect from the date of promulgation of that Act, namely, 17 January 2019, and was replaced by section 9HB on the same date.

CLAUSE 58

Income Tax: Amendment of paragraph 43 of the Eighth Schedule

Sub-clause (a): Amendments to subparagraph (1A): See notes on **CLARIFICATION OF THE INTERACTION OF CAPITAL GAINS TAX AND FOREIGN EXCHANGE TRANSACTION RULES**

Sub-clause (b): Amendments to subparagraph (5)(b): Paragraph 43(5)(b) regulates the currency in which the expenditure in respect of an asset must be accounted for by the acquirer of an asset under various deeming provisions. Currently, this paragraph makes reference only to section 9HA, dealing with disposal by deceased person. It is proposed that changes be made to this paragraph to include reference to section 25, dealing with taxation of deceased estates.

CLAUSE 59

Income Tax: Amendment of paragraph 43A of the Eighth Schedule

Sub-clauses (a) – (b): The proposed amendments in the definition of “extraordinary dividend” insert the word “means” in order to clarify the provision for ease of application.

Sub-clauses (b): The proposed amendment in subparagraph (1) deletes the word “and” after the definition of “extraordinary dividend”

Sub-clauses (c): See notes on **ADDRESSING ABUSIVE ARRANGEMENTS AIMED AT AVOIDING THE ANTI-DIVIDEND STRIPPING PROVISIONS**

CLAUSE 60

Income Tax: Amendment of paragraph 56 of the Eighth Schedule

In 2018, changes were made to the debt forgiveness rules. The proposed amendment in subparagraph (2)(a) is a consequential amendment to clarify the interaction of paragraph 56 with the provisions of section 19(3) and paragraph 12A(3).

CLAUSE 61

Income Tax: Amendment of paragraph 80 of the Eighth Schedule

The proposed amendment in subparagraph (4) inserts the words “in respect of” for ease of reading and clarification.

CLAUSE 62

Customs and Excise Act: Continuation of certain amendments of Schedules to the Customs and Excise Act

The proposed amendments make provision for the continuation of certain amendments of Schedules to the Customs and Excise Act.

CLAUSE 63

Customs and Excise Act: Amendment of section 65

The amendment proposes the deletion of the reference in subsection (8) of section 65 to “non-rebated” customs duty, which has the effect that all customs duty payable on imported goods in terms of Part 1 of Schedule No. 1 must be taken into account when calculating the value for purposes of *ad valorem* duty on such goods, and not only non-rebated customs duty.

CLAUSE 64

Value Added Tax Act: Amendments to section 1

See notes on **REFINING THE VAT TREATMENT OF FOREIGN DONOR FUNDED PROJECTS**

CLAUSE 65

Value Added Tax Act: Amendment to section 2

See notes on **CLARIFYING FINANCIAL SERVICES TO INCLUDE THE TRANSFER OF REINSURANCE RELATING TO LONG TERM REINSURANCE POLICIES**

CLAUSE 66

Value Added Tax Act: Amendment to section 8

Sub-clause (a): See notes on **REFINING THE VAT TREATMENT OF FOREIGN DONOR FUNDED PROJECTS**

Sub-clause (b): See notes on **REFINING THE VAT CORPORATE REORGANISATION RULES**

CLAUSE 67

Value Added Tax Act: Amendment to section 8A

The proposed amendment in subsection (2)(c) seeks to correct a reference from section 24JA(5)(d) of the Income Tax Act to section 24JA(6)(a) of the Income Tax Act.

CLAUSE 68

Value Added Tax Act: Amendment to section 11

The proposed insertion of subsection (1)(w) seeks to correctly capture the zero-rating of sanitary towels (pads) which were zero-rated from 1 April 2019. The amendment was incorrectly zero-rated under section 11(1)(j) of the VAT Act. This amendment now creates a new section 11(1)(w) of the VAT Act to cater for the new zero-rated items.

CLAUSE 69

Value Added Tax Act: Amendment to section 24

The proposed amendment in subsection (1) seeks to cater for the deregistration of an enterprise registered under paragraph (b)(vi) of the definition of “enterprise” which has become necessary due to the increase in the registration threshold since 1 April 2019.

CLAUSE 70

Value Added Tax Act: Amendment to section 50

See notes on **REFINING THE VAT TREATMENT OF FOREIGN DONOR FUNDED PROJECTS**

CLAUSE 71

Value Added Tax Act: Amendment to section 72

6.6 See notes on REVIEWING SECTION 72 OF THE VAT ACT

CLAUSE 72

Value Added Tax Act: Amendment to Schedule 1 to the Value Added Tax Act

The proposed addition of paragraph (7)(d) seeks to correct a legislative oversight. When sanitary towels (pads) were zero-rated from 1 April 2019, the corresponding amendment relating to the exemption for VAT on the importation of sanitary towels (pads) was inadvertently not made in the legislation. This amendment now lists the specific items that will be exempt in terms of section 13(3) of the VAT Act.

CLAUSE 73

Value Added Tax Act: Amendment to Schedule 2 to the Value Added Tax Act

Sub-clause (a): The proposed deletion of item 22 in Part B seeks to correctly place sanitary towels (pads) which were zero-rated from 1 April 2019. The item was incorrectly listed under Part B which deals with “foodstuffs”.

Sub-clause (b): Sanitary towels (pads) were zero-rated from 1 April 2019. The proposed amendment seeks to create a new Part C to this Schedule in order to correctly place and list these items for purposes of the zero-rating.

CLAUSE 74

Securities Transfer Tax Act: Amendment of section 1

The proposed amendments to the definition of “collateral arrangement” correct grammatical errors and changes the word “Listing” to “Listings” throughout.

CLAUSE 75

Securities Transfer Tax Act: Amendment of section 8

Sub-clauses (a) and (b): Since September 2009, all share block shares are treated as property under paragraph (g) of the definition in the Transfer Duty Act, provided that VAT is not payable on the transaction. In order to align the provisions of tax legislations, it is proposed that changes be made in the Securities Transfer Tax Act to broaden the exemption in section 8(1)(n) and to delete section 8(1)(o) dealing with shares in share block companies.

Sub-clause (c): The proposed insertion of subsection (1)(v) seeks to align the provisions of Securities Transfer Tax Act with the provisions of the Income Tax Act by introducing a similar exemption to section 10(1)(j) of the Income Tax Act dealing with exemption in respect of central banks owned by foreign governments.

CLAUSE 76

Employment Tax Incentive Act: Amendment of section 1

Definition of “special economic zone”: See notes on **CLARIFYING THE INTERACTION BETWEEN THE EMPLOYMENT TAX INCENTIVE AND THE SEZ PROVISIONS**

CLAUSE 77

Employment Tax Incentive Act: Amendment of section 4

See notes on **UPDATING THE EMPLOYMENT TAX INCENTIVE TO ALIGN WITH THE NATIONAL MINIMUM WAGE**

CLAUSE 78

Employment Tax Incentive Act: Amendment of section 6

Sub-clause (a): See notes on **CLARIFYING THE INTERACTION BETWEEN THE EMPLOYMENT TAX INCENTIVE AND THE SEZ PROVISIONS**

Sub-clause (b): In the 2019 Draft Rates Bill, adjustments were made to the eligible income bands that qualify for the employment tax incentive. The proposed amendment to section 6(g) seeks to update one adjustment that was inadvertently left out in the 2019 Draft Rates Bill.

CLAUSE 79

Employment Tax Incentive Act: Amendment of section 7

In 2017, amendments were made to the tax charging provisions of all tax acts. The proposed addition of subsection (7) is a consequential amendment to align all the provisions of the Employment Tax Incentive Act to the above-mentioned 2017 amendments regarding the tax charging provisions.

CLAUSE 80

Taxation Laws Amendment Act, 2013: Amendment to section 13

The proposed amendments postpone the effective date of amendments to sections 8F(3)(b)(ii), 8F(3)(c)(ii) and 8F(3)(d) from 1 January 2019 to 1 January 2020.

CLAUSE 81

Taxation Laws Amendment Act, 2013: Amendment to section 15

The proposed amendments postpone the effective date of amendments to sections 8F(3)(b)(ii), 8F(3)(c)(ii) and 8F(3)(d) from 1 January 2019 to 1 January 2020.

CLAUSE 82

Taxation Laws Amendment Act, 2013: Amendment to section 62

The proposed amendment postpones the effective date of amendments to section 23M from 1 January 2019 to 1 January 2020.

CLAUSE 83

Carbon Tax Act: Amendment of section 1

The proposed addition of paragraph (e) to the definition of “person” seeks to clarify that any municipality that generates electricity does fall within the ambit of the Carbon Tax Act.

CLAUSE 84

Carbon Tax Act: Amendment of section 3

The proposed amendment of the words following paragraph (b) in subsection (3) seeks to clarify that the Carbon Tax Act will apply to any person that conducts an activity in the Republic that either meets or is above the emissions reporting threshold as specified in Schedule 2 resulting in greenhouse gas emissions. This ensures alignment with the Department of Environment, Forestry and Fisheries (DEFF) Technical Guidelines for the Mandatory Greenhouse Gas Reporting Regulation.

CLAUSE 85

Carbon Tax Act: Amendment of section 4

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.

Section 4(2) provides the formulas to be used to calculate the total GHG emissions and schedule 1 of the act provides a list of the emissions factors for the different greenhouse gases. Several technical corrections are proposed to some of the formulas in Section 4(2) to convert the emissions factors for the different GHGs into a single carbon dioxide equivalent measure. This includes

- Proposed correction of the formula for determining the emissions factor for energy emissions by converting the unit in which the GHG is expressed from kilograms to tonnes CO_{2e} for each GHG by dividing by a 1000.
- Proposed amendments to the emissions factor formula for fugitive emissions to provide for a conversion of the unit of the emissions factors for the different GHGs from volume to mass by multiplying by a density factor, where applicable, followed by multiplication by a 1000 to convert to tonnes.

CLAUSE 86

Carbon Tax Act: Amendment of section 5

The proposed amendments for Section 5 seeks to clarify the consumer price index which will inform annual adjustments to the rate of the carbon tax which becomes effective on 1 January for a tax period. To ensure transparency in the determination of the rate adjustment, it is proposed that the rate will be adjusted by the change in the CPI index over a 12 month period ending in November prior to the new tax period as published by Statistics South Africa.

CLAUSE 87

Carbon Tax Act: Amendment of section 7

The proposed amendments for section 7 seeks to clarify that a basic tax free allowance is provided for all activities defined in schedule 2 to ensure alignment with the design of the carbon tax where the level of the allowance ranges from 60 to 100 per cent for specific activities. It is proposed that the allowance in Section 7 is changed from a Basic Tax free allowance for fossil fuel combustion to a general Basic tax free allowance for all emission categories.

CLAUSE 88

Carbon Tax Act: Amendment of section 8

The proposed amendments for subsection (2) seeks to correct the allowance for process emissions to ensure alignment with the design of the carbon tax which provides for a flat 10 per cent tax free allowance for process emissions.

CLAUSE 89

Carbon Tax Act: Amendment of section 9

The proposed amendments for subsection (2) seeks to correct the allowance for process emissions to ensure alignment with the design of the carbon tax which provides for a flat 10 per cent tax free allowance for fugitive emissions.

CLAUSE 90

Carbon Tax Act: Amendment of section 13

The proposed amendment for subsection (1) seeks to clarify the policy intent that the offset allowance in this section is a discretionary allowance.

CLAUSE 91

Carbon Tax Act: Amendment of Schedule 1

The proposed amendments to the headings in Schedule 1 seek to align with the headings in the DEFF technical guideline for reporting GHG emissions.

CLAUSE 92

Carbon Tax Act: Amendment of Schedule 2

Several technical amendments are proposed for Schedule 2 to correct the names of the allowances and the level of the allowances for the different emissions categories including the 60 per cent basic tax free allowance and 10 per cent process emissions allowances for industrial processes.

CLAUSE 93

Short title and commencement