

**14 September 2017**

**Draft Response Document on Taxation Laws Amendment Bill, 2017 and  
Tax Administration Laws Amendment Bill, 2017**

**(Based on report-back hearings to the Standing Committee on Finance  
in Parliament)**



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## **1. BACKGROUND**

### **1.1. PROCESS AND PUBLIC COMMENTS**

Subsequent to the tax pronouncements made by the Minister of Finance (the Minister) as part of the 2017 Budget announcements on 22 February 2017, a number of draft tax bills were published that give effect to the tax proposals announced in the Budget.

The draft tax bills are split into two separate categories. These include the money bills in terms of section 77 of the Constitution dealing with national taxes, levies, duties and surcharges – the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (the Draft Rates Bill) and the Draft Taxation Laws Amendment Bill (the Draft 2017 TLAB)) and an ordinary bill in terms of section 75 of the Constitution, dealing with tax administration issues – the Draft Tax Administration Laws Amendment Bill (the Draft 2017 TALAB).

The Draft Rates Bill was published for public comment on the same day as the Budget (22 February 2017) and contained the monetary adjustments to the personal income tax tables, customs and excise duties and other tax instruments that were announced in Budget 2017. The National Treasury and SARS briefed the Standing Committee on Finance (SCoF) on the Draft Rates Bill on 23 May 2017. Public comments to the SCoF were presented at hearings that were held on 31 May 2017 and 6 June 2017. A report back was made to SCoF on the public comments on the Draft Rates Bill on 14 June 2017.

The Draft 2017 TLAB and the Draft 2017 TALAB contain the remainder of the tax announcements made in Chapter 4 and Annexure C of the 2017 Budget Review which are more complex, technical and administrative in nature. Due to the complex nature of these draft bills, greater consultation with the public is required on their contents. The Draft 2017 TLAB and the Draft 2017 TALAB were published on 19 July 2017 for public comment. The National Treasury and SARS briefed the SCoF on the Draft 2017 TLAB and the Draft 2017 TALAB on 15 August 2017. The public was given an opportunity to provide National Treasury and SARS with written comments. That process closed on 18 August 2017.

### **1.2. PUBLIC COMMENTS**

National Treasury and SARS received responses from 1 420 organisations and individuals (see Annexure A attached) on the Draft 2017 TLAB and the Draft 2017 TALAB. Public comments to the SCoF were presented at a hearing that was held on 29 August 2017. There were 11 organisations that submitted their comments to the SCoF for public hearings.

Subsequently, National Treasury and SARS held public workshops on the public comments on 4 and 5 September 2017. This Draft Response Document contains

draft responses to the most pertinent issues raised by the public during the public hearings and workshops.

### **1.3. POLICY ISSUES AND RESPONSES**

Provided below are the responses to the policy issues raised by the public comments received in respect of the Draft 2017 TLAB and Draft 2017 TALAB from written submissions and during the public hearings. These comments will be taken into account in finalising the bills to be tabled. Comments that are outside the scope of the bills are not taken into account for purposes of this response document.

### **1.5. SUMMARY**

This response document includes a summary of the main written comments received on the Draft 2017 TLAB and the Draft 2017 TALAB released on 19 July 2017 as well as the issues raised during the public hearings held by the SCoF.

The main comments that arose during the public hearings and the other main issues in the Draft 2017 TLAB and the Draft 2017 TALAB are:

- Repeal of foreign employment income exemption
- Tax relief for Bargaining Councils regarding tax non-compliance
- Refinement of measures to prevent tax avoidance through the use of trusts;
- Addressing the circumvention of anti-avoidance rules dealing with share buy-backs and dividend stripping;
- Addressing the abuse of contributed tax capital provisions
- Tax implications of debt relief
  - Addressing the tax treatment of debt relief for the benefit of mining companies;
  - Addressing the tax treatment of debt relief for dormant group companies;
  - Addressing the tax treatment of conversions of debt into equity and artificial repayment of debt;
- Refinement to third-party backed shares;
- Changes to the tax treatment of banks and other financial institutions due to introduction of International Financial Reporting Standard 9 (IFRS 9);
- Exclusion of impairment adjustments from the determination of taxable income in section 24JB;
- Amendments to the tax valuation method for long-term insurers due to the introduction of Solvency Assessment and Management (SAM) framework;
- Strengthening anti-avoidance measures related to mining environmental rehabilitation funds;
- Extending the scope of the non-recoupment rule for venture capital companies
- Industrial Policy Projects – window period extension;
- Refinement of rules prohibiting deduction of tainted intellectual property;
- Extending the application of controlled foreign company rules to foreign companies held via foreign trusts and foundations;

- Clarifying the VAT treatment of leasehold improvements;
- VAT vendor status of Municipalities;
- Date of payment of estate duty;
- Timing and accrual of interest payable by SARS;
- Taxation of reimbursive travel allowance;
- Dividends on share schemes; and
- Decisions by SARS.

## **Draft Taxation Laws Amendment Bill**

### **2. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT**

#### **2.1. Repeal of foreign employment income exemption**

(Main reference: section 10(1)(o)(ii) of the Act: clause 14 of the Draft Bill)

The 2017 Draft TLAB contains a proposal to repeal the current section 10(1)(o)(ii) employment income exemption in respect of South African residents.

*Comment:* The tax will have a severely negative impact on finances, and remittances to South Africa, especially for those on relatively lower incomes. This includes amounts remitted to family members to fund living costs in SA, investment of foreign income in some family run businesses and money spent in South Africa during visits.

*Response:* Accepted. The proposal will be changed to allow the first R1 million of foreign remuneration to be exempt from tax in South Africa if the individual is outside of the Republic for more than 183 days as well as for a continuous period of longer than 60 days during a 12 month period. The exemption threshold should reduce the impact of the amendment for lower to middle class South African tax residents who are earning remuneration abroad. The effect of the exemption will also be that South African tax residents in high income tax countries are unlikely to be required to pay any additional top up payments to SARS.

*Comment:* The cost of living in foreign countries is higher than in South Africa, and should be taken into account in the design of the tax. The higher cost would include consumption taxes, high foreign levies, fees and user charges which cannot be taken account as foreign tax credits.

*Response:* Noted. The tax system does not usually cater for differences in the cost of living and other countries do not include consumption taxes, and other indirect taxes and charges, in the granting of a foreign tax credit. The exemption threshold will, however, mitigate these types of concerns and is a simpler and cleaner solution compared to a country-by-country cost of living adjustment.

*Comment:* Individuals and households made the decision to work and live abroad based on the current tax treatment, which had been in place since the introduction of

the residence based system of taxation in 2001. It seems unfair that there will be such a sudden and large change in tax liabilities in one year, especially if taxpayers made plans according to a three to five year contract.

*Response:* Partially accepted. To allow greater time for individuals to either adjust their contracts or their circumstances and to finalise or formalise their tax status, it is proposed that the effective date for this proposal is extended to 1 March 2020.

*Comment:* There are only two out of 196 other countries that have implemented such a proposal. The amendment is unduly harsh and puts SA apart from comparator countries.

*Response:* Not accepted. The policy mentioned in these two countries is where individuals are taxed based on citizenship. The proposal is not based on citizenship, but is instead based on tax residency and is a commonly found principle amongst other countries with a residence based system of taxation.

*Comment:* This proposal will lead to an acceleration of formal emigration from South Africa or to South Africans giving up their passports. While the capital gains tax exit charge might result in a short run revenue gain, the loss in future revenue and remittances would be greater.

*Response:* Not accepted. The proposal is not related to citizenship and should not lead to South Africans giving up their passports as the application rests solely on tax residency. Individuals who give up their passports may find they are still tax resident in South Africa and may still be liable for South African tax.

*Comment:* This proposal will lead to an accelerated breaking of SA tax residence, including people who have been out of the country for more than 5 years. Some had envisaged retirement in SA, but will now not be willing or able to do so.

*Response:* Noted. The formalisation of the tax residency status of South African tax residents who left the country many years ago is to be encouraged. South Africans who are no longer tax resident is welcome to return to South Africa in future and there are no barriers from a tax perspective to do so if their tax affairs are in order.

*Comment:* This proposal increases the cost of employment of SA tax residents who work abroad. This will disadvantage them relative to other foreign workers, and could jeopardise the growth of SA multinational companies in other tax jurisdictions (or bias their hiring in favour of foreign workers).

*Response:* Noted. The introduction of the capped exemption should alleviate the increased taxation costs associated with employing South Africans abroad.

*Comment:* The foreign tax credit can only be claimed on assessment. This means that PAYE taxpayers and provisional taxpayers have to pay taxes in two jurisdictions

and only claim the credit afterwards – this would result in severe cash flow problems. Provisional tax liabilities would also be difficult to estimate.

*Response: Not accepted.* Employers are currently able to apply for a hardship directive from SARS that effectively would take foreign employment taxes into account in the determination of PAYE, which effectively removes the incidence of being taxed twice during the course of a year and only being able to claim foreign tax credits on assessment at a later stage. For provisional taxpayers the law and forms currently do allow taxpayers to include foreign taxes paid in their calculations and should not result in adverse cash flow consequences.

*Comment:* There are very long delays to process and allow foreign tax credits. This proposal would overwhelm the current system.

*Response: Not accepted.* The tax credit system as administered by SARS is already functioning and the increase in applications for credits should be limited due to the availability of the exemption threshold.

*Comment:* Amendments are required to section 6quat, namely to take social security and pension contributions into account and include deductions under section 11(k) and 11F.

*Response: Not accepted.* Social security contributions have a different nature compared to taxes on income as they imply a potential future benefit for those contributions (such as a state pension). State pensions paid by other countries to South African tax residents are free from tax and allowing a credit for these contributions could be seen as allowing a tax deduction for both contributions and payments. It is general international practice to only allow taxes on income as foreign tax credits and not social security contributions. Individuals who would like a deduction for pension contributions are welcome to contribute to a local retirement annuity fund.

*Comment:* The draft legislation goes further than the proposal in Annexure C of the 2017 Budget Review.

*Response: Noted.* The proposal was revised when drafting the proposed legislation since if an exemption only applied to employment in jurisdictions with no income tax it may inadvertently have favoured other jurisdictions with very low income taxes. The revised proposal attempts to equalise the tax treatment of South African tax residents rendering employment services in all countries.

*Comment:* It is unfair to impose taxes on people who are not present in SA to enjoy the benefits of public expenditure.

*Response: Not accepted.* The residence based system of taxation is premised on the fact that tax residents of a country are liable for tax on their worldwide income if they are tax resident in that country, which is usually determined by applying an “ordinarily resident” or a physical presence test. If the individual does not meet



the physical presence test and is not “ordinarily resident”, the individual would not be a South African tax resident and is unlikely to benefit from public expenditure. South Africa would then not tax the individual on worldwide income.

## **2.2. Tax relief for Bargaining Councils regarding tax non-compliance**

(Main reference: Part II of Act: clauses 95 to 100 of the Draft Bill)

Some Bargaining Councils have not deducted PAYE from a large number of members for holiday, sick leave and end of the year payments or have not been paying income tax in respect of the growth/returns generated from their financial investments. The Bargaining Councils’ non-compliance with tax legislation potentially extends back a number of decades. Based on the consultation process with the Department of Labour, most of these Bargaining Councils would be at risk of closure or would suffer severe financial distress if high penalties and interests are imposed for non-compliance. Given the unique circumstances of this case, the 2017 Draft TLAB proposes the following relief for Bargaining Councils:

- Non-compliant Bargaining Councils will be required to pay a levy of 10% of the total PAYE that should have been deducted from all payments made to their members between 1 March 2012 and 28 February 2017;
- Non-compliant Bargaining Councils will be required to pay a levy of 10% of the total untaxed investment income between 1 March 2012 and 28 February 2017;
- The relief will apply in respect of the 5 year period, starting from 1 March 2012 to 28 February 2017. The 5 year period is linked to the period for record keeping required in terms of the Tax Administration Act; and
- Non-compliant Bargaining Councils must submit a return and pay the levy to SARS on or before 1 September 2018 to benefit from the relief.

The relief does not apply if the Bargaining Councils complied with employees’ tax withholding obligations, tax was assessed by SARS before 23 February 2017 or tax was paid for the period 1 March 2012 to 28 February 2017.

*Comment:* The proposed relief for Bargaining Councils is extraordinarily generous and raises serious questions as to whether it is fair and equitable that such relief should be granted. The relief may arguably be unconstitutional on the basis that it places Bargaining Councils in a favoured position *vis-a-vis* other taxpayers. The favourable treatment may not be in terms of law of general application and may not be reasonable and justifiable. Accordingly, it is suggested that the proposed relief be reconsidered.

*Response:* Not accepted. The proposed relief for Bargaining Councils is not discriminatory in nature. It would be grossly prejudicial to treat the proposed relief for Bargaining Councils differently to amnesties that were given in the past. In 2003, Chapter I of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003, gave effect to an amnesty as was proposed in the 2003 Budget Review. Chapter I of the said Act allowed for South African residents to disclose their foreign assets accumulated or transferred in contravention of Exchange

Control without being exposed to any civil or criminal liability. In order to ensure that the Exchange Control amnesty had maximum effect, Chapter I also contained accompanying tax measures that exonerated South African residents for failing to disclose certain amounts (from both foreign and domestic sources) that should have been taxed if that failure ultimately related to foreign assets.

In 2006, the Minister of Finance introduced a tax amnesty that was specific to a certain class, i.e. small business taxpayers. The purpose and objective of the tax amnesty for small business was to: (1) broaden the tax base; (2) facilitate the normalisation of the tax affairs of small businesses; and (3) increase and improve the tax compliance culture of small businesses. This amnesty was contained in separate legislation in Chapter 1 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006.

The relief proposed for Bargaining Councils is not intended to prejudice the integrity of the tax system insofar as tax policy formulation is concerned. Although the proposed relief is nominally targeted at Bargaining Councils, it will assist both the Bargaining Councils and approximately 1.8 million employees, who could otherwise be affected, to regularise their tax affairs. In this respect it is no different from prior amnesties described above in respect of certain classes of taxpayers or income to enable the taxpayers to comply with the tax law. The point is well made, however, that such relief should be carefully considered and should not be regular feature of the tax system, so as not to undermine taxpayer morale.

*Comment:* The proposed relief for Bargaining Councils raises questions as to why separate legislation for this relief is introduced instead of dealing with this matter via the normal Voluntary Disclosure Programme rules available in the Tax Administration Act.

*Response:* Not accepted. There are different facts and circumstances for each type of fund at each of the respective Bargaining Councils. As a result, there are different views about the liability to withhold taxes at the Bargaining Council level and the employer level. This in itself would imply that there is a systemic problem that requires a focused intervention aimed at regularisation of tax affairs. In addition, the administrative burden to file voluntary disclosures should not fall on the approximately 1.8 million members of Bargaining Councils.

*Comment:* The provisions of Part D of Chapter 14 of the Tax Administration Act dealing with compromise of tax debt should be applied to non-compliant Bargaining Councils in appropriate circumstances instead of the extraordinary generous tax relief proposed in the 2017 Draft TLAB

*Response:* Not accepted. That is not the correct comparator to this case. The proposed 10% levy for the Bargaining Councils relief is not overly generous as compared to previous amnesties introduced in the past. The aforementioned small business amnesty imposed a levy of up to 5 %, whereas the foreign assets tax amnesty applied a levy of 2%.

*Comment:* There are a number of uncertainties regarding the correct tax treatment of the contributions to, benefits paid and investment income of Bargaining Councils and the current legislation applicable to Bargaining Councils funds does not provide a one size fits all solution. In addition, based on the contractual structure, and type of these funds, they may have totally different tax consequences, affecting the employer, the member and the Bargaining Council. It is proposed that the tax treatment of Bargaining Councils be confirmed before a decision is made to provide relief for non-compliance.

*Response:* Partially accepted. Bargaining Councils are currently being engaged to find means to address inconsistencies that were pointed out in comment submissions and consultations. During the comment and consultations process it became apparent that there is significant variation in the treatment of funds by different Bargaining Councils, not to mention different types of funds in each Bargaining Council. While we did not receive a large volume of comments from Bargaining Councils, the four sets of comments that we received – along with the discussions that occurred as part of the workshops – have indicated that further engagement of Bargaining Councils is appropriate.

### **2.3. Addressing the circumvention of rules dealing with employee based share incentive schemes**

(Main references: sections 8C and 8C(1A), paragraphs 64E, 80 and 80(2A) of the Eighth Schedule to the Act: clauses 72 and 73 of the Draft Bill)

The 2017 Draft TLAB contains a proposal to clarify the interaction of the provisions of section 8C(1A) and the provisions of the Eighth Schedule by inserting a new paragraph 64E of the Eighth Schedule which makes provision for amounts that are included in the employees' taxable income in terms of the anti-avoidance provisions of section 8C(1A) to be disregarded for capital gains tax purposes.

*Comment:* Paragraph 80(1) of the Eighth Schedule should also be amended to remove the exclusion of section 8C equity instruments and be made subject to paragraph 64E of the Eighth Schedule, which should be amended to also cater for distributions of equity instruments by an employee share trust.

*Response:* Noted.

*Comment:* Subparagraph (C) of paragraph (jj) of the proviso to section 10(1)(k)(i) of the Income Tax Act, should be deleted in its entirety, amounts derived directly or indirectly from subparagraphs (A) and (B) should be retained and the proposed paragraph (kk) would then be unnecessary.

*Response:* Noted.

*Comment:* Section 10B(6)(b)(ii) of the Income Tax Act should be deleted as unnecessary in light of the section 8C(1)(a)(ii) of the Income Tax Act.

Response: Noted.

#### **2.4. Increase of thresholds for exemption of employer provided bursaries to learners with disabilities**

(Main Reference: new provision – section 10(1)(qA) of the Act: clause 14 of the Draft Bill)

In the 2017 Budget Review, a proposal was made to increase the threshold of the exemption for employer provided bursaries to relatives of the employees. As a result, changes were made in the 2017 Draft Rates Bill to increase the remuneration eligibility threshold for employees from R400 000 to R600 000 and the monetary limits for bursaries from R15 000 to R20 000 for education below NQF level 5 and from R40 000 to R60 000 for qualifications at NQF level 5 and above. In addition, in order to cater for the limited resources in the majority of schools in South Africa for facilities to properly accommodate learners with disabilities, the 2017 Draft TLAB proposes that a new exemption threshold for employer provided bursaries in respect of learners with disabilities be introduced as follows:

- The monetary limit in respect of exempt bursaries for learners with disabilities be set at R30 000 per annum in the case of Grade R to 12, including qualifications in NQF levels 1 to 4 (monetary limit set at R20 000 for learners without disabilities);
- The monetary limit in respect of exempt bursaries for learners with disabilities be set at R90 000 per annum in the case of qualifications at NQF levels 5 to 10 (monetary limit set at R60 000 for learners without disabilities).

*Comment:* General response was to welcome the introduction of this provision.

*Response:* Noted.

*Comment:* Increase the remuneration threshold above R600 000 per year, and also expand to post-graduate programmes.

*Response:* Not accepted. This is a new provision. For the time being we are mirroring the design of the existing section 10(1)(q), though with higher maximum thresholds for the bursary amount. Extensions of the design – as suggested above – can perhaps be accommodated in future when there is a better sense of the impact of this amendment.

*Comment:* Clarify employer obligations to verify disability status of bursary holders, along with family connection and duty of “care and support”.

*Response:* Accepted. The current documentation for verifying disability status could be used. Further clarity could be provided through interpretation or guidelines issued by SARS.

## 2.5. Refinement of measures to prevent tax avoidance through the use of trusts

(Main reference: section 7C of the Act: clause 4 of the Draft Bill)

In 2016, an anti-avoidance measure aimed at curbing the transfer of growth assets to trusts for estate planning purposes through the use of interest-free or low interest loans was introduced in the Income Tax Act (the Act). Under the current anti-avoidance measure, the interest forgone in respect of interest-free or low interest loans arising in exchange of which natural persons transfer assets or advanced to trusts to fund the acquisition of assets are treated as an on-going and annual donation made by the lender on the last day of the year of assessment of the lender. It has come to Government's attention that taxpayers have already devised schemes to attempt to circumvent this anti-avoidance measure by making low interest or interest free loans to a company that is a connected person in relation to that company. In order to counter the abuse, the 2017 Draft TLAB proposes to extend the scope of this anti-avoidance measure to cover interest free or low interest loans made to a company that is a connected person in relation to a trust. In view of the fact that this anti-avoidance measure intends to close a loophole created as a result of 2016 tax amendments, the proposed provision in the 2017 Draft TLAB will come into operation on the date of publication of the 2017 Draft TLAB for public comment, i.e., 19 July 2017. In addition, the 2017 Draft TLAB contains a provision that excludes employee share based schemes from the application of this anti-avoidance measure as these trusts are not set up for estate planning purposes.

*Comment:* The explanatory memorandum indicates that companies that are held by trusts will be included in the rule. However, the wording in the 2017 Draft TLAB refers to companies that are connected persons in relation to a trust and does not require a shareholding by the trust in that company. The connected person test for trusts goes much further than what the explanatory memorandum indicates to be the intention of National Treasury.

*Response:* Accepted. The explanatory memorandum correctly indicates the type of companies envisaged. As such, a shareholding requirement will be included in the 2017 Draft TLAB to indicate that only companies in which trusts hold shares will be subject to the anti-avoidance measure. As a result, interest free or low interest loans made to companies in which a trust holds at least 20 per cent of the shares or voting rights will be subject to this anti-avoidance measure.

*Comment:* The 2017 Draft TLAB includes loans made to companies in the scope of the anti-avoidance measure. However, the provision that deems interest forgone to be an on-going donation available in the current section 7C(4) of the Act has not been extended to loans made to such companies.

*Response:* Accepted. The loans made to companies envisaged under this anti-avoidance measure will also be made subject to the deeming provision under section 7C(4) of the Act.

*Comment:* The Draft 2017 TLAB contains amendments made to section 7C that seek to include interest-free or low interest loans made to companies held by trusts in the

anti-avoidance measure. It is understood that this has been done in order to curb the circumvention of the current rules that only apply to interest-free or low interest loans made to trusts by using companies to indirectly benefit trusts. However, it should be noted that when the anti-avoidance measure was first introduced in 2016, it was accepted that in some instances interest-free or low interest loans that are made to trusts do not always result in the tax free transfer of wealth as some trusts have been established for other purposes that do not evade tax. In order to exclude those acceptable uses of trusts, various exclusions relating to the loans made to trusts that do not avoid tax were included. By including companies held by trusts in the anti-avoidance measure, it is also necessary to ensure that exclusions relating to the acceptable use of trusts must also be extended to interest-free or low interest loans made to companies held by trusts that do not result in the tax free transfer of wealth.

*Response: Accepted.* Where relevant, exclusions will be extended to interest-free or low interest loans made to such companies that to cover scenarios where companies held by trusts are used for purposes other than to indirectly facilitate the tax free transfer of wealth. In particular the following exclusions relating to companies held by trusts are envisaged:

- Any company that is an approved public benefit organisations for tax purposes;
- An the interest-free or low interest loan made to a company that is established as an asset protection vehicle in respect of a primary residence to the extent that the loan made to it was used to facilitate the acquisition of the primary residence by the company;
- An the interest-free or low interest loan made to a company that constitutes an affected transaction as defined in section 31(1) and is subject to the provisions of that section;
- An the interest-free or low interest loan made to a company in terms of a sharia compliant financing arrangement; or
- An the interest-free or low interest loan made to a company that is subject to the anti-value extraction rules under the Dividends Tax regime (i.e. section 64E(4)).

*Comment:* The 2017 Budget Review proposed that there would be an exclusion for all business trusts (and by extension, business companies held by trusts), however such proposal in not included in the 2017 Draft TLAB.

*Response: Not accepted.* In 2016 an exclusion to the anti-avoidance measure was included for vesting trusts. This is because the income and assets vest in the beneficiaries of trusts and are thus included in the estate of those beneficiaries. With regards to discretionary trusts, this vesting does not occur outside of the trustees' discretion and often such trusts are used for estate planning for this exact reason. It is therefore not considered prudent to exclude all business trusts. The current exclusion of vesting trusts is adequate and in line with the intention of the provision. It then follows that companies held by trusts which are set up for estate planning purposes should also not be excluded as the benefit they derive

from interest free or low interest loans is reflected in the value of the shares held by the trust.

## **2.6. Transferring retirement fund benefits after reaching normal retirement date**

(Main Reference: Section 1 of the Act, the definition of ‘pension fund’, ‘provident fund’ and ‘retirement fund lump sum benefit’; paragraphs 2 and 7 of the Second Schedule to the Act: clauses 1, 61 and 64 of the Draft Bill)

The 2017 Draft TLAB contains a proposal that allows employees to transfer their benefits into a retirement annuity fund for later consumption. Transfers to preservation funds are not currently included in the proposal, since it could result in withdrawal of all the benefits in a lump sum, rather than preservation, and a restricting that withdrawal would further add to complexity.

*Comment:* It is requested that the ability to transfer funds after the normal retirement date also be extended to pension and provident funds and to pension preservation and provident preservation funds as well as retirement annuity funds. To remove any possibility of these funds being withdrawn in a “once off withdrawal” it is proposed that specific amendments are included in the Income Tax Act to disallow such withdrawals in respect of these amounts.

*Response:* Partially accepted. It is proposed that the proposed amendments are adjusted to allow for transfers after retirement to pension preservation and provident preservation funds to allow for greater choice for retirees. The Income Tax Act will be amended to ensure that transfers made to these funds after the normal retirement date cannot be withdrawn in the same manner as other transfers to preservation funds.

*Comment:* Adjustments should be made to allow multiple transfers of the retirement benefit to different funds to allow for a staggered retirement, but only if the amount transferred to each fund is above the *de minimis*.

*Response:* Not accepted. The proposal will create additional complications, especially around the enforceability of the *de minimis* which could undermine the intention for preservation.

## **2.7. Tax exempt status of pre-march 1998 build-up in public sector funds**

(Main Reference: Paragraphs 5(1)(e) and 6(1)(b)(v) of the Second Schedule to the Act: clauses 62 and 63 of the Draft Bill)

Amendments are proposed in the 2017 Draft TLAB relating to the Second Schedule to allow for the exemption, in respect of pre-March 1998 benefits, to apply in cases where one additional transfer to a different fund occurs of benefits originally coming out of a public sector fund.

*Comment:* Members should be allowed as many transfers as necessary in respect of pre-March 1998 public sector funds.

*Response:* Not accepted. There remains a concern, from an administrative point of view, about the ability to trace these funds through multiple transfers. The additional transfer as proposed in the draft legislation should adequately accommodate members and pension fund administrators concerns relating to the current restriction.

## **2.8. Removing the 12-month limitation on joining newly established pension or provident fund**

(Main Reference: Paragraph (b)(iii) of the proviso to the definition of 'provident fund' and paragraph (c)(ii)(cc) of the proviso to the definition of 'pension fund' in section 1 of the Act: clause 1 of the Draft Bill)

In order to encourage employees to contribute towards their retirement and remove practical difficulties, the 2017 Draft TLAB proposes that the current limit of 12 month period be removed so that employees are allowed to join a new established pension or provident fund at any time, subject to the rules of the fund.

*Comment:* The removal of the provision in the draft legislation implies that pension and provident funds would be able to disallow employees from joining the fund. It is suggested that the proviso remains, but only the reference to the 12 month limitation is removed.

*Response:* Accepted.

## **2.9. Deduction in respect of contributions to retirement funds**

(Main Reference: section 11F of the Act: clause 19 of the Draft Bill)

As part of the wider retirement reform objectives, the tax deductibility of contributions to retirement funds was harmonised across all retirement funds through a replacement of section 11(k) from 1 March 2016, where the same deduction now applies to both employer and employee contributions to pension funds, provident funds and retirement annuity funds. This inclusion has created technical complications, since the opening proviso in section 11(k) requires carrying on of a trade. However, not all allowable contributions to retirement funds relate only to income generated from the carrying on of a trade, which led to a specific exemption for retirement annuity funds under 11(n)(i)(ff) before 1 March 2016. It also creates administrative anomalies, such as generating an assessed loss if contributions are above the allowable limit when taxable capital gains are a part of the higher limit. The 2017 Draft TLAB proposes that a new section be inserted to remove the inconsistencies and anomalies that arise from the current location of the provisions. Additionally, a new limiting criteria for the allowable deduction is proposed to avoid circumstances that can create an assessed loss.

*Comment:* The proposed insertion of section 11F(2) appears to change the interpretation of this section. It was believed that taxable capital gains should be included in determining the 27.5% limit, but no deduction should be allowed against



those taxable capital gains. Any eligible amounts over the limit should be carried over to be deducted in the following year.

*Response:* Noted. The introduction of section 11F(2) is intended to be of a technical nature and is not intended to create a change in policy on the deduction. The current understanding, that the taxable capital gain is included when calculating the 27.5% limit but no deduction is allowed against taxable capital gains is correct. The wording will be reviewed to assess whether it can be made clearer in the draft legislation.

*Comment:* The effect of the amendment should not be made retroactive as some retirement fund members may already have been assessed based on the previous legislation.

*Response:* Not accepted. The shift in position and the rewording of the provision is not intended to change the policy from when the amendment was introduced. The revised provisions only attempt to rectify anomalies that may have arisen (such as the creation of an assessed loss instead of the deferral of a deduction).

*Comment:* The new section does not solve the problem as the provisions of section 23(g) must also be applied.

*Response:* Accepted. The wording will be revised to remove the application of section 23(g).

## **2.10. Amendments to Unemployment Insurance Contribution Act**

(Main reference: Section 4 of the Unemployment Insurance Act, Act 4 of 2002: clause 86 of the Draft Bill)

The 2017 Draft TLAB contains a proposal to align the Unemployment Insurance Contributions Act, 2002 with the changes in the Unemployment Insurance Act, 2001, with regard to the removal of exemptions for certain types of employees.

*Comment:* Proposed deletions from the Unemployment Insurance Contribution Act should be matched with amendments to the Unemployment Insurance Act.

*Response:* Comment misplaced. These amendments were published in Government Gazette 40557 dated 19 January, 2017.

*Comment:* There is not complete alignment between the wording of the Unemployment Insurance Act and the Unemployment Insurance Contributions Act with regard to the description of particular groups of public office bearers.

*Response:* Noted.

### **2.11. Amendments to Skills Development Levies Act**

(Main reference: Section 3 of the Skills Development Levies Act, Act 9 of 1999: clause 85 of the Draft Bill)

The 2017 Draft TLAB contains a proposal that seeks to reinstate section 3 of the Skills Development Levies Act which was incorrectly deleted by section 88 of the Taxation Laws Amendment Act, 2016.

*Comment:* The reinstated section still refers to paragraph 11C of the Fourth Schedule to the Act, which was deleted.

*Response:* Partially accepted. The repeal of paragraph 11C of the Fourth Schedule only took effect on 1 March 2017, while the reinstatement of section 3 is proposed to become effective on 19 January 2017. A deletion of the superfluous exemption under section 3(4)(e) which refers to paragraph 11C of the Fourth Schedule can only be effective from 1 March 2017.

### **2.12. Amendment to Employment Tax Incentive Act**

(Main reference: Section 4 of the Employment Tax Incentive Act, Act 26 of 2013: clauses 88 and 89 of the Draft Bill)

The 2017 Draft TLAB contains a proposal that seeks to clarify a smooth practical application of the provisions of Employment Tax Incentive Act.

*Comment:* The proposed effective date of 1 March 2017 cannot be met by payroll systems.

*Response:* Accepted.

## **3. INCOME TAX: BUSINESS (GENERAL)**

### **3.1. Addressing the circumvention of anti-avoidance rules dealing with share buy-backs and dividend stripping**

(Main reference: section 22B and paragraph 43A of the Eighth Schedule to the Act: clauses 33 and 70 of the Draft Bill)

The Act contains rules in section 22B and paragraph 43A of the Eighth Schedule that target avoidance schemes known as dividend stripping. Dividend stripping occurs when a seller of shares in a company avoids paying income tax or capital gains tax arising on the sale of shares in that company by ensuring that the company in which the shares to be sold are held, declares an exempt dividend prior to the sale of shares in that company. The exempt dividend declared decreases the value of the shares in that company prior to the sale of shares in that company. As a result, the seller extracts value from the company selling the shares through tax exempt dividends. Thereafter, the seller can sell the shares at less value, thereby avoiding paying a normal tax.

Currently, section 22B and paragraph 43A of the Eighth Schedule to the Act attempt to prevent the use of dividend stripping schemes by providing that where a company sells shares in another company and that company as part of the sale arrangement borrows money from the purchaser of these shares, any tax exempt dividend received within 18 months of the sale in respect of the sold shares will be subject to income tax or capital gains tax in the hands of the seller. In order for the anti-avoidance rules to apply, the debt funding for the shares must be provided by the purchaser of the shares or alternatively be guaranteed by any connected person in relation to the purchaser of the shares. In order to curb the use of share buy backs schemes as well as circumvention of dividend stripping rules, the 2017 Draft TLAB extends the application of the current rules in section 22B and paragraph 43A to apply to the following circumstances:

- The person disposing of the shares in another company must be a resident company;
- The company disposing of the shares (together with connected persons in relation to that company) must hold at least 50% of the equity shares or voting rights in that other company or at least 20% of the equity shares or voting rights in that other company if no other person holds the majority of the equity shares or voting rights; and
- An exempt dividend was received or accrued within 18 months prior to the disposal of the target company shares or an exempt dividend was received or accrued by reason of or in consequence of the disposal of the target company shares irrespective of how that exempt dividend was funded.

In view of the fact that this is an anti-avoidance measure aimed at preventing the erosion of the tax base, it is proposed that this provision should come into operation on the date of publication of the 2017 Draft TLAB for public comment, i.e., 19 July 2017 and apply in respect of any disposal on or after that date.

*Comment:* The extended anti-avoidance measures will apply to share sale transactions where there is no avoidance taking place as the measures will taint all dividends received in the preceding 18 months irrespective of whether they are related to or linked to the share sale. The dividend policies consistently applied by companies are ignored. It is proposed that the rule focuses either on extraordinary dividends or that the 18 month period should be reduced to 12 months.

*Response:* Partially accepted. The period of 18 months will remain. However, in addition to the anti-avoidance measures applying in respect of dividends arising by reason of or in consequence of a share disposal, the 2017 Draft TLAB will be changed to limit the application of the rules to dividends that are considered excessive as compared to a normally acceptable dividend (known as extraordinary dividends) received by a company within 18 months preceding the disposal of a share in another company. In this regard, any dividends received within 18 months preceding a share disposal in respect of that share that exceed 15 per cent of the higher of the market value of the share disposed of (as determined at the beginning of the 18 month period and

the market value of the shares on the date of disposal) will be treated as extraordinary dividends and will therefore be subject to the anti-avoidance measure.

*Comment:* The anti-avoidance measure is too wide and negatively affects vanilla preference shares typically used by companies to raise funding. These preference shares carry a coupon linked directly to the prime interest rate and are redeemable at their original subscription price after as long as 10 years. In some instances the preference dividends for the past years are all accumulated but not declared and are only declared upon redemption. This means that all those preference dividends are tainted.

*Response:* Accepted. The 2017 Draft TLAB will be changed to contain an exclusion in respect of preference shares to the extent that the dividends are determined with reference to a specified rate of interest to the extent that the rate of interest does not exceed 15 per cent. Preference dividends that are paid in excess of this rate of 15 per cent will be regarded as extraordinary dividends for purposes of anti-avoidance measures.

*Comment:* The Draft 2017 TLAB indicates that the proposed changes to section 22B and paragraph 43A of the Eighth Schedule will apply in respect of disposals on or after the date on which the Draft 2017 TLAB was published for public comment (19 July 2017). This means that the new rules will apply retrospectively to dividends received prior to 19 July 2017. In particular, the changes will affect transactions that were already entered into but are subject to suspensive conditions.

*Response:* Partially accepted. The proposed effective date will be changed to ensure that arrangements whose terms were finally agreed to by the parties to them on or before 19 July 2017 will not be subject to the new provisions of section 22B and paragraph 43A of the Eighth Schedule to the Act. Only those arrangements that were not finalised on 19 July 2017 as well as any future arrangements will be subject to the new provisions.

*Comment:* The proposed qualifying shareholding threshold of 50 per cent and 20 per cent where no other person holds the majority of the shares is unlikely to curb the abuse aimed at. In a listed environment, there is unlikely to be a 20 per cent shareholder. It is proposed that the threshold should be reduced to 5 per cent or other measures be put in place to combat schemes that involve firstly reducing the shareholding to below 20 per cent. In addition, it is proposed that the 20 per cent test that has been added to the qualifying interest definition should apply where no other person (whether alone or together with connected persons) holds a majority stake.

*Response:* Accepted. It is acknowledged that in the listed environment a lower shareholding in a listed company can confer a significant influence upon a shareholder. It is therefore prudent that a separate shareholding benchmark be considered for shareholding in listed companies. A shareholding of 10 per cent will therefore be proposed with regard to listed companies.

With regard to non-listed companies, the proposed 50% and 20% under the definition of a qualifying interest for purposes of the anti-avoidance measures will remain. On the other hand, with regard to the 20 per cent shareholding test, the anti-avoidance measures will be applicable to a 20 per cent shareholding unless any other person (whether alone or together with connected persons) holds a majority shareholding as opposed to the current rule that require one other person to hold the majority shareholding alone.

*Comment:* In order for the anti-avoidance measures to apply to any investor in shares, the qualifying interest requirement must be met. The proposed qualifying shareholding threshold is 50 per cent irrespective of the shareholding of other shareholders and 20 per cent where no other person holds the majority of the shares in the company. It is noted that where no shareholder holds a majority shareholding in a company, the 20 per cent shareholding rule can potentially affect BEE partners where a consortium can hold a shareholding of 20 per cent or more.

*Response:* Noted. It is clear that the qualifying interest test is being perceived differently by different classes or groups of taxpayers. In some instance the 50 per cent rule is adequate in other instances (as is the case in respect of shareholdings in listed companies) lower levels of shareholdings need to be considered for the application of the anti-avoidance rules.

With regards to the shareholding level in respect of BEE partners, it is true that these anti-avoidance measures will be applicable. However, it is important to note that these rules will apply in the instance that the BEE partner undertakes a disinvestment and disposes of the shares it holds in a company. From a policy perspective, the purpose of the anti-avoidance measures is to ensure that share disposals reflect the ordinarily expected tax consequences of a disinvestment (i.e. CGT when the shares are held on capital account or an inclusion of proceeds in income if the shares are held on revenue account). As with all other share investors, the share disposal of BEE partners should be subject to these anti-avoidance measures in the instance that the value of their shares has been reduced by exempt dividends. It should be noted that smaller BEE holdings in non-listed companies or holdings held by individuals (rather than companies) would not be subject to these anti-avoidance measures.

*Comment:* The current proposed qualifying interest definition that must be met in order for the anti-avoidance measures to apply, refers to a direct or indirectly interest held by a company in another company. The reference to an indirect interest is confusing as it appears to refer to an indirect shareholding in a company. In the instance where say Company A holds all the shares in Company B which in turn holds 50 per cent of the shares in Company C, it is suggested that Company A (and not only Company B) will be subject to the provisions of the anti-avoidance measure if the shares of Company C are sold by Company B. The application of the anti-avoidance measure in such an instance must be clarified.

*Response:* Accepted. It is accepted that the reference to an indirect shareholding goes a step further as it brings into consideration a company that did not receive a dividend from the company in which the shares being disposed of are held but have rather received a dividend that is declared to it by another company that directly received a dividend from the company in which the shares are being sold.

The policy intention is that when a company shareholder disposes of its shares in another company, consideration must be given as to whether the value of the shares has been reduced in favour of an exempt dividend. It is currently intended that the anti-avoidance measures should apply only to the company shareholder that directly benefits from the avoidance of the tax on the sale of shares. As such, the reference to the indirect interest will be removed from the qualifying interest definition.

*Comment:* The interaction of the anti-avoidance measures and the corporate roll-over provisions that defer the tax impact of disposals has not been fully catered for. The formulation of the re-characterisation of the exempt dividends into proceeds or income is problematic. For purposes of re-characterising the exempt dividends received in respect of shares held as capital assets, the proposed paragraph 43A provides that the exempt dividends will “be taken into account...as part of proceeds from the disposal of those shares”. On the other hand, when re-characterising the exempt dividends received in respect of shares held as trading stock, the proposed section 22B simply provides that exempt dividends should “be included in the income of that company in the year of assessment in which those shares are disposed of”.

Under the corporate roll-over rules, tax consequences are deferred by provisions that either allow the taxpayer disposing of assets to disregard (at the time of the disposal that qualifies for roll-over treatment) the disposal of assets or recognise the disposal but prescribe a base cost consideration. From the wording of the re-characterisation provisions in paragraph 43A, the exempt dividends are treated as proceeds only if part of a disposal. This means the proceeds from disposal of shares held as capital assets are ignored at that point in time as for purposes of the roll-over provisions, the disposal of shares that qualifies for roll-over relief is disregarded.

Conversely, this deferral is not provided for in the proposed section 22B in respect of shares held as trading stock. This is because the exempt dividends are simply included in the income of the taxpayer in the year of assessment in which those shares are disposed of. These provisions are misaligned and regard should be given on clarifying the application of section 22B when roll-over treatment applies to the disposal of shares.

*Response:* Not accepted. The purpose of the corporate roll-over rules is to defer adverse tax consequences that normally arise in respect of disposals of assets. These include CGT, income tax and Dividends Tax consequences arising from sale of assets, liquidation distributions and unbundling. The deferral of adverse tax consequences is achieved by transferring the tax attributes (i.e. base cost or trading stock value) of the assets or investments being transferred. This ensures

that upon disposal in the future, the growth in the value of the asset or investment is then fully taxable.

However, when shares are disposed of in terms of a transaction that qualifies for roll-over relief, the fiscus loses out on this growth in the value of the asset if the asset's value is stripped by way of exempt dividends. In this regard, it is not intended that the corporate roll-over provisions should be abused to overcome the proposed anti-avoidance measures dealing with dividend stripping embarked on prior to a transaction that qualifies for roll-over relief.

As such, the anti-avoidance measures will be amended to ensure that they are not avoided by taxpayers by taking advantage of the corporate roll-over provisions. Instead, taxpayers should structure their transaction to rather defer the adverse tax consequences of disposals using the corporate roll-over rules rather than extracting the value of their equity investments through dividend stripping and then using the corporate roll-over provisions to undermine the anti-avoidance rules that seek to address dividend stripping.

*Comment:* The current proposals make no distinction between cash distributions and distributions *in specie*. It is submitted that such disposals do not present a concern from a policy point of view as they do not involve a cash value strip of the shares disposed of

*Response:* Not accepted. In some instances, taxpayers achieve restructures by distributing assets that the shareholder company wants to keep. These types of arrangements also affect the value of the shares the shareholder company subsequently sells. It may be argued that these high value assets are then directly held by the shareholder company and that CGT would be paid on them in the future. However, these arrangements defer the tax that would have been collected on these assets.

### **3.2. Addressing abuse of contributed tax capital provisions**

(Main reference: section 8G of the Act: clause 11 of the Draft Bill)

Government has identified transactions in terms of which South African subsidiary companies with foreign parent shareholders are increasing their Contributed Tax Capital (CTC), thereby avoiding payment of dividends tax through capital distributions to its foreign parent shareholders, as these capital distributions do not qualify as dividends, and thereby not being subject to dividends tax. These capital distributions are generally not subject to CGT in the hands of foreign parent shareholders, if the underlying assets are not immovable property situated in South Africa and therefore not within the South African CGT net. The 2017 Draft TLAB proposes amendments in the Act to address the abuse of CTC. In view of the fact that this is an anti-avoidance measure aimed at preventing the erosion of the tax base, it is proposed that this provision should come into operation on the date of publication of the 2017 Draft TLAB for public comment, i.e. 19 July 2017 and applies in respect of any shares issued on or after that date.

*Comment:* The proposed amendment should be more targeted to an issue of shares to non-resident structures and not to residents as any such resident would be subject to an eventual tax implication in respect of any distribution of CTC. In addition the proposed provision is too narrow in that it limits its application to the issue of shares to companies. The same potential for mischief arises in respect of shares in SA resident companies held by persons other than companies

*Response:* Accepted. Changes will be made to the 2017 Draft TLAB to be more targeted as the immediate policy concern is the permanent erosion in an international context, as unlike SA residents where there is an eventual CGT impact, there is no recourse for the fiscus to impose taxation on non-residents in respect of any distribution of CTC.

*Comment:* In light of the government's promotion of South Africa as a feasible destination as a gateway into Africa, this anti-avoidance measure should only apply to the acquisition of shares in a resident target company (SA-Opco) by the new interposed company (SA-Holdco) and not to the acquisition of shares in non-residents target companies by SA-Holdco. For example, a multinational group of companies decides to use South Africa as a location for the holding of its African operations. To this end, the foreign structure (F-Co) disposes of its shareholdings in its African subsidiaries to SA-Holdco (the holding company of SA-Opco) in exchange for an issue of shares in SA-Opco. As the proposed provision reads, the CTC of the shares issued by SA-Holdco will be equal to the CTC of the shares of the African subsidiaries. This makes no sense in the context of such an arrangement.

*Response:* Accepted. The multinational group of companies' aspect will be addressed through the above-mentioned targeted amendment that will be made in the 2017 Draft TLAB.

*Comment:* The draft Explanatory Memorandum refers to a concern relating to essentially a 'disguised sales-of-shares' utilising a subscription-and-buyback mechanism which results in an uplift in the CTC of the target company. The draft legislation does not contain any measures to address this mechanism of abuse.

*Response:* Noted. The above-mentioned measures and the application thereof will be investigated first and proposals in this regard may be submitted for consideration in a future Budget Review cycle.

*Comment:* The interaction between the new proposed section 8G and section 42 of the Act is unclear and it is proposed that the new section 8G be amended to exclude section 42, especially in respect of listed shares.

*Response:* Not accepted. The provisions of section 42 of the Act will override the provisions of the newly inserted section 8G in light of the established overriding clause in section 41(2) of the Act which clearly states that any of the re-organisation rules, including section 42, would override any other provision in the Act unless stated otherwise. It is however important to note



that there could be other issues regarding the interaction between the re-organisation rules and the calculation of CTC which will be considered for submission in a future Budget Review cycle.

*Comment:* Consideration should be given to relax the new section 8G anti-avoidance provisions in vanilla transactions and scenarios where there is no pre-existing relationship between the non-resident structure (F-Co) and the ultimate unrelated target company (SA-Opco) when F-Co purchases shares in a new interposed company (SA Holdco) who uses it to invest in SA-Opco.

*Response:* Noted. Where relevant, changes will be made to take cognisance of ownership before the transaction.

### **3.3. Tax implications of debt relief**

In the current economic climate, there are various mechanisms by which a debtor may settle a debt with the creditor or a creditor may forgo a claim to have a debt repaid due to the high indebtedness of the debtor. The Act contains rules that give rise to tax implications in instances where a debt is cancelled, waived, forgiven or discharged in return for a payment that is less than the amount of the principal debt or for no payment. The tax implications depend on how the debt that is cancelled, waived, forgiven or discharged was utilised. If a debt was used to acquire a capital asset used for business purposes which qualifies for specific capital allowance deductions, paragraph 12A of the Eighth Schedule makes provision for the amount of debt that is reduced, cancelled, waived, forgiven or discharged to reduce the base cost of such capital asset. This will result in a higher capital gain when such capital asset is sold in future. On the other hand, if a debt was used to finance operating expenses (e.g., rental expenses or employee salaries, which qualified as tax deductible expenditure), section 19 of the Act makes provision for the reversal of the income tax deductions previously granted in respect of operating expenses by subsequently adding the amount so deducted to the taxpayer's income.

#### **3.3.1 Addressing the tax treatment of debt relief for the benefit of mining companies**

(Main reference: section 36 of the Act: clause 48 of the Draft Bill)

The capital gains tax rules provided in paragraph 12A of the Eighth Schedule mentioned above (dealing with tax implications in respect of debt that was used to acquire a capital asset) does not apply to mining companies. This is due to the fact that mining companies have a special tax regime and are required in terms of section 36 of the Act to account for their capital expenditure in respect of capital assets differently from companies in other sectors. In order to address this disparity and to assist in the current economic climate, the 2017 Draft TLAB proposes that specific rules dealing with tax treatment of debt relief for mining companies be introduced.

*Comment:* The current proposed wording of the new section 36(7EA) only makes reference to the tax treatment of debt that is used to fund an amount of capital expenditure. Unlike the provisions of section 19 and paragraph 12A

of the Eighth Schedule that makes specific reference to debt used to directly fund expenditure (i.e. debt arising because a debtor funded expenditure through credit extended by the creditor) or indirectly fund expenditure (i.e. debt arising from loan funding that is subsequently used to pay expenditure), the proposed provision seems to suggest that only debt that directly funds an amount of capital expenditure is envisaged. This issue needs to be clarified in the wording of section 36(7EA).

*Response: Noted.* Currently, the existing provisions that deal with the tax treatment of debt that is subsequently reduced, cancelled, waived, forgiven or discharged apply to both debt directly or indirectly used to fund certain expenses. The inclusion of debt forgiveness rules for mining companies in the 2017 Draft TLAB is intended to be an extension of the rules to mining companies on the same basis with the same scope. As such, the 2017 Draft TLAB will be changed to clarify that the debt relief rules applicable to mining apply to both debt that was used to directly fund capital expenditure and debt that was used to indirectly fund capital expenditure.

*Comment:* There are various exceptions to the current tax dispensation in respect of debt relief contained in the Act. However, it does not appear that the proposed section 36(7EA) has the same exceptions.

*Response: Accepted.* The current exceptions applicable to debt that fund capital expenditure (i.e. exceptions contained in paragraph 12A of the Eighth Schedule to the Act) will be extended to apply to mining companies.

*Comment:* The definition of capital expenditure includes notional amounts like in the case of certain gold mines and certain amounts relating to low-cost residential units for employees. These amounts would not have been funded by any debt. When a reduction amount arises, must these amounts also be reduced?

*Response: Noted.* From a practical perspective it is not desirable to complicate the application of the debt reduction rules by requiring taxpayers to track and isolate notional amounts for purposes of excluding them from the rule. As such, notional amounts of capital expenditure will not be subject to the proposed rules in section 36(7EA).

*Comment:* The proposed section 36(7EA) is subject to a proviso that provides for the tax treatment of any excess amount of a debt that is subsequently reduced, cancelled, waived, forgiven or discharged after the capital expenditure of a mining company has been fully reduced. Under the proviso, such excess is includable in the gross income of the mining company in terms of paragraph (j) of the definition of gross income. However, the reference to the term "mining company" in the proviso is technically incorrect and is misaligned with the terms used in the current provisions of section 36 and paragraph (j) of the definition of gross income. Reference should rather be made to a taxpayer carrying on mining operations.

*Response: Accepted.* Amendments will be made in the 2017 Draft TLAB to refer to a taxpayer carrying on mining operations.

*Comment:* The proposed tax relief rules for mining companies do not take into account how the reduction of capital expenditure is to be applied in respect of the ring-fenced mining operations. It should be clarified if a taxpayer must only reduce the capital expenditure of the mine that the debt that is subsequently reduced, cancelled, waived, forgiven or discharged previously funded or is the capital expenditure of other mines that the same taxpayer operates also affected?

*Response: Accepted.* It is intended that only the capital expenditure of the mine that was funded with debt that is subsequently reduced, cancelled, waived, forgiven or discharged should be reduced by the resulting reduction amount. As such, changes will be made in the 2017 Draft TLAB to clarify this intention.

### **3.3.2 Addressing the tax treatment of debt relief for dormant group companies**

(Main reference: section 19 and paragraph 12A of the Eighth Schedule to the Act: clauses 30 and 68 of the Draft Bill)

Paragraph 12A(6)(d) of the Eighth Schedule makes provision for an exemption for debt that is reduced, cancelled, waived, forgiven or discharged in respect of loans between companies forming part of the same group of companies in South Africa. This implies that where a debt between South African group companies is reduced, waived, cancelled, forgiven or discharged and that debt was used to acquire a capital asset, the amount of debt that is now reduced, cancelled, waived, forgiven or discharged is not to be applied to reduce the base cost of that capital asset. The above-mentioned intragroup relief provided in paragraph 12A(6)(d) of the Eighth Schedule only applies in instances where a debt was used to acquire a capital asset in terms of paragraph 12A of the Eighth Schedule and does not extend to apply in instances where a debt was used to fund operating expenditure in terms of section 19. Absence of this relief creates technical impediments for dormant group companies that wish to wind up as they would not have resources to pay tax on the debt recouped. In order to assist in this regard, the 2017 Draft TLAB proposes that the current relief for group companies available in paragraph 12A(6)(d) of the Eighth Schedule be restricted to dormant companies and to intra-group debt converted to equity and be extended to section 19.

*Comment:* The proposed amendment in 2017 Draft TLAB narrows the current group exception that is contained in paragraph 12A and limits it to apply in respect of debt owed by dormant companies to the extent that the debt arose between group companies as contemplated in section 41 of the Act. Under the exception, a company is only considered to be a dormant company if during the year that the debt is waived and the 3 immediately preceding years of assessment and it did not:

- Carry on any trade;
- Receive or accrue any amount;

- Transfer any assets to or from the company; and
- Incur or assume any liability.

These requirements are too stringent. Firstly, the period is too long as it requires that a company should be dormant for 4 years of assessment before the exception applies. Secondly, the other restrictions do not take the practicalities of dormant companies into account. These companies may be trying to sell their residual assets and may also incur liabilities in respect of statutory requirements such as audit fees. Lastly, these companies may also receive passive income like interest on past investments. It is proposed that the proposed requirements on dormant companies be relaxed.

*Response: Accepted.* Changes will be made in the 2017 Draft TLAB to provide that a company will be considered to be a dormant company for purposes of applying the exception if the company did not carry on a trade in the year of assessment that a debt from a group company (as contemplated in section 41) is subsequently reduced, cancelled, waived, forgiven or discharged and during the immediately preceding year.

*Comment:* The Draft 2017 TLAB indicates that the changes in this respect come into operation on 1 January 2018. This effective date is not clear as it does not indicate whether it applies in respect of debt arising on or after this date or debt that is reduced, cancelled, waived, forgiven or discharged on or after that date.

*Response: Noted.* The effective date will be amended to apply in respect of years of assessment commencing on or after 1 January 2018. As such the rules will come into operation on 1 January 2018 and will apply to any debt that is reduced, cancelled, waived, forgiven or discharged in respect of years of assessment commencing on or after 1 January 2018.

### **3.3.3 Addressing the tax treatment of conversions of debt into equity and the artificial repayment of debt**

(Main reference: sections 19, 19A, 19B and paragraph 12A of the Eighth Schedule to the Act: clauses 30, 31 and 68 of the Draft Bill)

One of the mechanisms of settling a debt is the conversion of debt owed by a company into equity in that company. For example, a debt may be settled by a debtor by the issue of shares in the debtor company where the market value of the shares reflects the face value of the debt. This type of debt settlement is usually entered into in respect of loans advanced to the company by the controlling shareholder of that company with the objective of assisting subsidiaries in financial distress to attain a healthy financial position. The 2017 Draft TLAB makes provision for the conversion of debt into equity, provided that the debtor and the creditor are companies that form part of the same group of companies. However, in order to ensure that this provision is not abused, it is proposed that any interest that was previously allowed as a deduction by the borrower in respect of that debt be recouped in the hands of the borrower, to the extent that such interest was not subject to normal tax in the hands of the

creditor. In addition, where the creditor company and the debtor company cease to form part of the same group of companies within 6 years of the debt conversion, a deemed reduction amount is triggered.

*Comment:* The proposed amendments in the 2017 Draft TLAB imply that an amount may only be excluded from the provisions of section 19 and paragraph 12A of the Eighth Schedule if these provisions are firstly actually applicable. In the past share issues at excessive subscription prices were used merely as a mechanism to circumvent the debt reduction rules and simply add unnecessary complexity to what, in substance, a reduction of debt for inadequate consideration. The proposed exclusions in sections 19A and 19B in the 2017 Draft TLAB of debt that is converted to shares complicates this further because it is unclear whether such conversions result in a reduction amount.

*Response: Accepted.* The current definition of a reduction amount has technical limitations in respect of covering all instances of debt concessions. Debt compromises such as, for example, subordination agreements that recognise, in effect, that the value of the claim that the creditor holds is less than the face value of that claim are arguably not covered in all instances. The same applies in respect of conversions of debt into equity. The benefits arising from any concession or compromise or debt restructuring arrangement should, from a policy point of view, be subject to the same rules. As such, amendments will be proposed in respect of the definition of a reduction amount in the 2017 Draft TLAB to ensure that the debt reduction rules apply in respect of all forms of debt restructuring arrangements. The proposed exclusion from section 19 in respect of debt to share conversions will be limited to debt between companies in the same group of companies as defined in section 41 that arose when those companies formed part of that group of companies. The current proposal in paragraph 12A regarding intra-group debt will be aligned with this proposal.-

*Comment:* The current proposal in section 19A of the 2017 Draft TLAB exclusion of debt to equity conversions between group companies requires that the interest on the debt that was not subject to normal tax should be recouped. In some instances withholding tax on interest is paid as opposed to normal tax. Where an amount of interest was previously subject to withholding tax, the recoupment rule in respect of previous interest should not apply.

*Response: Partially accepted.* The current proposal in section 19A dealing with recoupment rule in respect of interest that was not previously subject to normal tax will be deleted. This is due to the proposal that the exclusion of debt to equity conversions will be limited to apply only between companies that form part of the same group of companies as contemplated in section 41 of the Act. If the proposed provisions only apply between companies that form part of the same group of companies as contemplated in section 41 of the Act is, it follows then that all amounts of interest that accrued previously would have been subject to normal tax.

*Comment:* The proposed de-grouping rule in section 19B of the 2017 Draft TLAB is extremely penal. The de-grouping provision is a 6-year rule. Such a rule will severely impede the ability of groups to manage their affairs, particularly given that it effectively applies to both the debtor and creditor companies. For example, if the group wished to wind up or dispose of the creditor company this would result in the trigger of section 19B. Similarly, the capitalisation of a debt may be a precursor to the disposal or part-disposal of or introduction of a new investor into the debtor company. Our primary submission is that the proposed section 19B should be withdrawn. Alternatively, the de-grouping period should be substantially reduced from an effective 6 years of assessment to 2 years.

*Response:* Accepted. The current proposal in section 19B dealing with recoupment in respect of intra-group debt exchanges for or converted to shares will be deleted.

*Comment:* The Draft 2017 TLAB indicates that the changes in this respect come into operation on 1 January 2018. This effective date is not clear as it does not indicate whether it applies in respect of debt arising on or after this date or debt that is reduced, cancelled, waived, forgiven or discharged on or after that date.

*Response:* Noted. The current proposal in section 19B dealing with recoupment in respect of intra-group debt exchanges for or converted to shares will be deleted, consequently, the effective date will be deleted.

### **3.4. Refinement to third-party backed shares**

(Main reference: section 8EA of the Act: clause 8 of the Draft Bill)

The Act contains third party backed share anti-avoidance provisions in section 8EA aimed at dealing with preference shares with dividend yields backed by third parties. The dividend yield of third-party backed shares is treated as ordinary revenue per section 8EA unless the funds derived from the issue of the third-party backed shares were used for a qualifying purpose. This rule equally applies to domestic and foreign dividends. In 2014 amendments were effected to the Act to allow for the pledging of the equity shares and associated debt claims in the issuer of the preference shares by the holder(s) of shares in that issuer of the preference share. However, the 2014 changes do not cover situations where the funds were to refinance any debt or other preference shares that were used for a qualifying purpose or to finance any dividends payable on another preference share that was used for a qualifying purpose.

In order to address concerns regarding the fact that the qualifying purpose test is too narrow, and may impede legitimate transactions, the 2017 Draft TLAB proposes an amendment to the legislation by removing the requirement for exclusion in subsection (3)(b)(vii)(aa) that the issuer of equity shares must use the funds solely for the acquisition of equity shares in an operating company.

*Comment:* Amendment could lead to possible confusion between the application of 8EA(3)(b)(iii)(bb) and new 8EA(3)(b)(vii) on the ceding and pledging of rights and claims against the issuer of the security.

*Response:* Not accepted. The amended section 8EA(3)(b)(vii) does not act as a replacement to any other current provision within section 8EA. The two subparagraphs identified in the comments are applied separately and through different triggers to each other – if the taxpayer owns more than 20% of the issuer that taxpayer would be carved out from the ambit of section 8EA(2) and in the alternative if there is any guarantee by a shareholder of the issuer which is limited to its shareholding, regardless of shareholding percentage, then the taxpayer would also fall outside of the provisions of section 8EA(2).

#### **4. INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)**

##### **4.1. Changes to the tax treatment of banks and other financial institutions due to introduction of International Financial Reporting Standard 9 (IFRS 9)**

(Main reference: section 24JB of the Act: clause 43 of the Draft Bill)

In 2018, the financial reporting of financial assets and liabilities will no longer be governed by International Accounting Standard 39 (IAS 39), but will be governed by International Financial Reporting Standard 9 (IFRS 9). Some of the provisions of the Act, in particular section 24JB (dealing with the tax treatment of banks and some other financial institutions) follow the accounting treatment contemplated in IAS39. In order to take into account the change in accounting standard, the 2017 Draft TLAB proposes to align the tax treatment of banks and some other financial institutions as referred to in section 24JB with IFRS9, subject to certain exceptions.

*Comment:* The proposed amendment in the 2017 Draft TLAB does not address the reversal of any unrealised amount that was previously recognised in other comprehensive income statement prior to 1 January 2018.

*Response:* Accepted. Changes will be made in the 2017 Draft TLAB to take into account for tax purposes the unrealised fair value changes that were recognised in other comprehensive income prior to 1 January 2018 will now be recognised in profit or loss statement as from 1 January 2018.

*Comment:* There is no interaction between the proposed deemed disposal at market value rule and other provisions of the Act where a financial asset that was within the scope of section 24JB prior to 1 January 2018 now falls outside its scope and *vice versa* as from 1 January 2018.

*Response:* Not accepted. It is submitted that when financial assets or financial liability is no longer governed by section 24JB, general tax rules will apply and therefore no amendment is required in this regard.

*Comment:* The proposed amendment in section 24J of the Draft TLAB removes the reference to “alternative method” given the fact that generally accepted accounting practice “gaap” is no longer applicable. It is proposed that the current reference to “alternative method” in section 24J should be retained given that to a large extent it is being relied on to avoid minor discrepancies between the tax treatment and accounting treatment of some assets.

*Response:* Accepted. The alternative method will be retained, however, the definition of ‘alternative method’ will be updated.

#### **4.2. Exclusion of impairment adjustments in the determination of taxable income in section 24JB**

(Main reference: section 11(jA) of the Act: clause 17 of the Draft Bill)

On 17 February 2012, SARS issued a directive for the tax treatment of doubtful debts by banks that applied with effect from the 2011 year of assessment. The SARS directive only applied to banks and does not apply to other financial service providers. This directive only applied to banks as long as IAS39 is applied by banks for financial reporting purposes. In the 2017 Budget Review, it was proposed that as IAS 39 is being replaced by IFRS 9, the principles of the SARS directive be reviewed and incorporated in the Act. Furthermore, the 2017 Budget Review propose that section 24JB should exclude impairment adjustments provided for under IFRS 9 as these impairment adjustments aim to provide for future risks instead of focusing solely on the current losses in the determination of taxable income as contemplated in section 24JB.

In view of the fact that banks that are registered in terms of the Banks Act are treated differently from other financial services providers in that they are highly regulated by the South African Reserve Bank (SARB) and subject to stringent capital requirements, in order to avoid a negative impact on the banking sector, the 2017 Draft TLAB proposes that amendments be made to the Act to allow banks the following:

- 25% of IFRS 9 loss allowance relating to impairment based on annual financial statements;
- 85% instead of 25% of an amount classified as being in default in terms of Regulation 67 issued under the Banks Act and administered by SARB.

*Comment:* The stage 3 category of impairment allowance should refer to the IFRS 9 definition of “credit impaired financial asset” only, which equates to the stage 3 impairments for IFRS 9 rather than referencing to Regulation 67 of the Banks Act.

*Response:* Not accepted. Firstly, banks apply sophisticated models to determine impairment of loans which are highly regulated by SARB and this reference is deemed to be necessary. Secondly, the concept “default” is critical to the implementation of IFRS 9 but IFRS 9 does not define the term “default”. The suggested definition of “credit impaired financial asset” includes references to



defaults but largely, IFRS 9 requires each entity to define the term and this would not result in alignment between banks.

*Comment:* For purposes of stage 3 category of impairment, the proposed 85 per cent allowance of an amount classified as being in default in terms of Regulation 67 issued under the Banks Act and administered by SARB only applies to credit exposure and not retail exposure such as individuals' revolving credit, credit card, and overdraft.

*Response:* Accepted. Changes will be made to the 2017 Draft TLAB in order for the proposed 85 per cent allowance to include the retail exposure.

*Comment:* The allowance for impairment losses is capped to include banks only and effectively excluding other financial institutions. This proposed allowance should apply to all taxpayers that are moneylenders and impair financial assets in terms of IFRS 9.

*Response:* Noted. The proposed amendments in the 2017 Draft TLAB only apply to banks and not to other moneylenders or financial services providers due to the fact that banks that are registered in terms of the Banks Act are treated differently from other financial services providers in that they are highly regulated by SARB and subject to stringent capital requirements. The impact of the extension of the proposal to other moneylenders or financial services providers will be investigated and may be considered in the future.

*Comment:* The industry request that for stage 3 category of impairment, the proposed 85 per cent allowance is inadequate and should be increased to 100 per cent.

*Response:* Not accepted. The proposed percentage of 85% instead of 100% was based on ensuring that it yields a relatively tax revenue neutral position for both the fiscus and the banking industry.

*Comment:* In general, the proposed impairment allowances (stages 1 to 3 at 25 per cent, 25 per cent and 85 per cent) are less than the current ruling applicable to banks on impairment losses (which is 25 per cent, 80 per cent and 100 per cent) and this reduction will negatively impact the banks in a single year and therefore request a phase-in period of at least three years.

*Response:* Noted. In the past, phase in provisions were allowed in order to reduce a significant negative cash flow impact on industries as a result of tax amendments. These phase-in provisions were introduced after quantifying the general impact on the relevant industry.

*Comment:* The proposed impairment provisions under IFRS 9 include "lease receivable". Given that lease receivables are covered by other provisions of the Act, lease receivables should be excluded.

*Response: Accepted.* Changes will be made to the 2017 Draft TLAB so that the proposed impairment provisions exclude lease receivables.

#### **4.3. Amendments to the tax valuation method for long-term insurers due to the introduction of Solvency Assessment and Management (SAM) framework**

(Main reference: section 29A of the Act: clause 46 of the Draft Bill)

In 2016, amendments were made to the Act to cater for the tax treatment of long term insurers as a result of the introduction of SAM and the new Insurance Act. Although the 2016 tax amendments are explained clearly in the 2016 Explanatory Memorandum (EM), there are certain aspects that may still cause uncertainty in applying the legislation. These aspects include changes to the definitions of “adjusted IFRS value” and the “phasing in amount”. In order to address these concerns and to clearly give effect to the policy rationale as explained in the 2016 EM, the 2017 Draft TLAB proposes that further changes be made in the legislation.

*Comment:* The proposed amendments only address the deferred acquisition cost (DAC). A deferred revenue liability (DRL) is recognised in respect of fees received upfront and until the fees amount is earned for IFRS purposes it is reported as DRL liability in the statement of financial position (balance sheet). The DRL is the inverse of DAC and both are created as a consequence of IFRS requirements as stated above. These two concepts should be addressed in the definition of “adjusted IFRS value” so that they do not cause uncertainty.

*Response: Accepted.* The proposed definition of “adjusted IFRS value” will be changed to include DRL.

*Comment:* Risk policy fund should have a tax rate of 0 per cent in order to eliminate the impact of anomalies that result from unrealised losses recognised in the risk policy fund.

*Response: Partly accepted.* The risk policy fund should not be taxed at a tax rate of 0 per cent. However, a further amendment to the deduction rules applicable to risk policy funds will be proposed in order to address the concern raised.

## **5. INCOME TAX: BUSINESS (INCENTIVES)**

### **5.1. Strengthening anti-avoidance measures related to mining environmental rehabilitation funds**

(Main reference: section 37A of the Act: clause 38 of the Draft Bill)

The Act contains rules to cater for environment rehabilitation by mining companies as envisaged in the Mineral and Petroleum Resources Development Act and National Environmental Management Act. As a result, contributions by mining companies to mining rehabilitation trusts or companies are tax deductible, subject to certain conditions. In order to ensure that the above-mentioned tax benefit obtained in respect of mining rehabilitation funds is used for its intended purpose, the Act makes

provision for penalties to be imposed for contraventions of these provisions. It has come to Government's attention that the funds contributed to mining rehabilitation trusts/companies are being withdrawn and used to fund activities not related to rehabilitation or the closure of the mine, despite the current penalties contained in the Act. In addition, the penalty provisions provided in the Act are difficult to enforce due to the fact that they provide for the inclusion of an amount, depending on the nature of contravention, in the taxable income of the mining company or mining rehabilitation fund. In order to curb non-compliance, the 2017 Draft TLAB proposes certain amendments regarding penalty provisions as well as reporting requirements to be imposed on mining rehabilitation funds.

*Comment:* Clarity is required whether the proposed penalty in the 2017 Draft TLAB as contemplated in section 37A(8) will apply in addition to the penalties already charged in terms of section 37A(6) & (7).

*Response:* Partially accepted. Although published wording is clear as to whom the penalty will apply, additional changes will be made to further streamline the penalty provisions referred to in sections 37A(6) and (7) and to relax the penalty provision of section 37A(8).

*Comment:* One of the reasons highlighted for the proposed changes is that the mining company (the holder of the right) in question may no longer have the means to pay the tax in respect of the penalty. However, the proposed provisions continue to impose a tax liability on the mining company in the case of contraventions. It is not clear how this addresses the concern where the mining company has no ability to pay the tax in question.

*Response:* Accepted. Proposed legislation will be changed to further ensure that the fiscus is presented with a better recourse through the Act to ensure accountability on the payment of the penalty provisions.

*Comment:* The proposed penalties should again be at the discretion of the Commissioner and subject to appeal under section 223(3) of Tax Administration Act especially section 37A (8) which is excessive and which would heavily penalise small administrative errors.

*Response:* Accepted. Changes will be made in the 2017 Draft TLAB to relax the penalty provision in section 37A(8) through various measures. Legislation will be amended to deal specifically with small administrative breaches and the proposed relaxation of section 37A(8) the amount of penalties imposed in sections 37A(6) and (7) will be increased from 40 per cent to 50 per-cent.

*Comment:* The new proposed reporting requirements should be removed as under the financial provisioning regulation for mining rehabilitation, issued by the Department of Environmental Affairs, disclosure should be sufficient and SARS can always determine movement of funds in trust/company through tax returns.

*Response:* Not accepted. The fiscus will have to re-divert already limited and strained resources to facilitate the short fall in rehabilitation cost should any party default on their provisioning for rehabilitation and as such National Treasury can't afford not to have a direct access to any information in this regard.

*Comment:* Tax legislation not the correct measure to prevent material misappropriation where as an example if a trust or company is penalised, will it be able to pay the penalty from the funds bearing in mind that the limited objects of the fund would not include paying tax penalties.

*Response:* Accepted. Changes will be made in the proposed 2017 Draft TLAB to avoid circular penalty after a breach in provisions by the trust or company.

## **5.2. Extending the scope of the non-recoupment rule for venture capital companies**

(Main reference: section 12J of the Act: clause 26 of the Draft Bill)

The 2017 Draft TLAB contains a proposal that the tax deduction should not be recouped in respect of a return of capital on a VCC share if that share has been held by the taxpayer for a period of longer than five years.

*Comment:* The proposed amendments are welcomed but do not extend as far as indicated in terms of Budget Review with indicated intended changes to 'qualifying company'

*Response:* Noted. The proposed impact of amendments to 'qualifying company' will be investigated and may be submitted for consideration in a future Budget Review cycle.

## **5.3. Industrial Policy Projects – window period extension**

(Main reference: section 12I of the Act: clause 25 of the Draft Bill)

The Act contains rules that allow taxpayers an additional investment and training allowance in respect of Industrial Policy Projects, provided that they meet certain criteria prescribed by way of regulation. In order to assess the overall effectiveness of the Industrial Policy Projects, Government will evaluate the relevant tax expenditure before it is considered for renewal at the end of the stipulated window period, which is set for 31 December 2017. In order to allow sufficient time for review of the Industrial Policy Projects incentive to be completed, the 2017 Draft TLAB proposes that the window period should be extended from 31 December 2017 to 31 March 2020. While the above-mentioned window period for the tax incentive is extended, the current approval threshold of R20 billion in potential investment and training allowances will not be increased, due to the fact that currently, tax revenues are under severe pressure in a fiscally constrained environment.

*Comment:* In general the proposed extension of the window period is welcomed to allow for a review of the incentive however the decision to not increase the incentive budget leads to increased uncertainty about the availability of the incentive.

*Response:* Not accepted. Budgetary constraints and the proposed review of effectiveness of incentive limit the possibility of an increase of the allocated budget.

## **6. INCOME TAX: INTERNATIONAL**

### **6.1. Refinements of rules prohibiting deduction of tainted intellectual property**

(Main reference: section 23I of the Act: clause 37 of the Draft Bill)

The 2017 draft TLAB proposes, that the rules prohibiting the deduction on of tainted intellectual property will no longer apply where the net income of a controlled foreign company (CFC) is in deemed to be zero as a result of the application of the controlled foreign company high tax exemption.

*Comment:* The proposed exclusion replicates the wording of the CFC high tax exemption in section 9D. However, it does not replicate the wording as to how foreign tax payable is to be determined.

*Response:* Noted. The alignment of the provisions of the CFC high tax exemption under section 9D and the proposed amendment with respect to how the foreign tax payable must be determined will be considered.

### **6.2. Extending the application of controlled foreign company rules to foreign companies held via foreign trusts and foundations**

(Main reference: section 9D and section 25BC of the Act: clauses 13 and 45 of the Draft Bill)

In order to close a loophole created by the fact that the current CFC rules do not capture foreign companies held by interposed foreign trusts and foundations the 2017 draft TLAB proposes that CFC rules be extended so that foreign companies held through a foreign trust or foreign foundation and whose financial statements from part of the consolidated financial statements, as defined in the IFRS 10, of a resident company be treated as a CFC. Further, it is proposed that new rules be introduced to deem any distributions made by a foreign trust or foreign foundation that holds shares in a foreign company that would have been regarded as a CFC if no foreign trust or foundation was interposed to be income in the hands of South African tax residents.

*Comment:* The proposed amendments are too broad. The definition of a CFC in the context of foreign companies held by trusts does not contain any threshold for the level of interest in a trust required to be held by residents.

*Response:* Partly accepted. The proposed amendment will be revised with a view to make them more targeted to the mischief that sought to be addressed.

*Comment:* Clarity needs to be provided on the interaction between section 25BC and sections 7(8), 9D, 25B (2A) and the Eighth Schedule attribution and distribution rules.

*Response:* Accepted. The proposed amendment will be revised to provide clarity on the interaction between the proposed amendments and the existing rules in order to remove any potential double taxation.

*Comment:* Clarity should be provided regarding the application of foreign tax credit provisions of section 6quat to section 25BC.

*Response:* Noted. Taking into account the above-mentioned proposed changes to the scope of the proposed amendments the need for an extension of foreign tax credit rules may not be necessary.

*Comment:* The proposed amendments contain significant loopholes, for example, it is simple to avoid the definition by splitting the shareholding of the foreign company between 2 or more foreign trusts such that each holds no more than 50 per cent of the participation rights in the foreign company.

*Response:* Accepted. The proposed rules will be refined in order to close potential loopholes.

## **7. VALUE-ADDED TAX**

### **7.1. Clarifying the VAT treatment of leasehold improvements**

(Main reference: Sections 8(29), 9(12), 10(28) and 18C of the VAT Act: clauses 75,76,77 and 81 of the Draft Bill)

The 2017 draft TLAB proposes that amendments be made in the VAT Act to clarify that leasehold improvements by a lessee on leasehold property qualify as a taxable supply of goods to the lessor, subject to certain conditions.

#### ***Deemed Supply***

*Comment:* The xproposed wording of section 8(29) of the 2017 Draft TLAB suggests that where a (vendor) lessee makes leasehold improvements for no consideration, in circumstances where the lessee will use the property and improvements for taxable supplies or mixed supplies there will be a deemed taxable supply by the lessee to the lessor. It is our view that the deeming provision is in fact not necessary, since there is an actual supply of goods by the lessee to the lessor, in respect of leasehold improvements affected, on the basis of accession.

*Response: Accepted.* The intention of the amendment was to deem the supply to be that of goods rather than services. Changes will be made in the wording of the proposed legislation in order to make this clear.

### ***Time of Supply***

*Comment:* The proposed amendment contains the time of supply rule for a deemed supply that is envisaged in section 8(29). Although the proposed introduction of section 9(12) (the time of supply provision) would provide clarity in some cases as to the time of supply, it may also cause the time of supply to be suspended for an indefinite period. To illustrate, where the lessee or lessor disputes the completion of the leasehold improvements or where it is unclear what constitutes completion, the time of supply may not be triggered. It is submitted that the proposed section 9(12) should be reconsidered, in light of the above comments. If the proposed wording is to remain, then we recommend that a definition of “completed” be introduced to try to avoid ambiguity in relation to the time of supply.

*Response: Not Accepted.* It will be difficult to define the word “completed” in the VAT Act simply because each case will have to be based on its facts and circumstances. The meaning of the term “completed” should be guided as far as possible by using the date of approval for occupation by the relevant municipality. Therefore, the date stipulated on the occupation certificate, or such similar document given by the municipality in respect of the improvement to that fixed property, should suffice. Further, as we understand it, these types of arrangements are generally concluded by an agreement and the date stipulated on the agreement can also suffice. In the absence of the prior two options, one can consider third party information, such as, an architect’s certificate.

### ***Value of Supply***

*Comment:* In cases where a (vendor) lessee makes leasehold improvements for no consideration, this falls under a barter transaction and the rules regarding the VAT treatment of barter transaction as set out in the Atlantic Jazz Festival case should be applied – i.e. The Value of Supply for both the lessor and the lessee must be the amount stipulated in the agreement or if no amount is stipulated, then the Open Market Value (s3).

*Response: Not Accepted.* There is a difference in interpretation in this regard between barter transaction and set-off. Changes will be made in the legislation in order to make the wording of the provision clear.

### ***Other issues***

*Comment:* The proposed amendments only address the scenario where the lessee receives no payment or set-off from the lessor for the leasehold improvements. These scenarios rarely occur in practice. It is proposed that amendments be made to the Act to deal with the time and value of supply in relation to leasehold improvements where the lessee either receives a reduction in rental or a complete waiver of rental from the lessor in return for the cost involved in effecting the leasehold improvements.

*Response: Accepted.* The impact of introducing new provisions in this regard will be investigated and may be considered in the future.

*Comment:* The term “leasehold improvements” must be defined in the VAT Act so that vendors are aware of whether it refers to all improvements (temporary or permanent) or only those that are permanent and accede to the property of the lessor.

*Response: Not accepted:* The terminology is well-understood for tax purposes and is guided by case law and common law. Further, the Explanatory Memorandum states quite clearly that the improvements must be of a permanent nature. If they were not, then they do not accede to the building, thereby becoming the property of the lessor.

## **7.2. VAT vendor status of Municipalities**

(Main reference: Section 8 of the VAT Act: clause 75 of the Draft Bill)

The 2017 draft TLAB proposes that amendments be made in the VAT Act to address the unintended consequences as a result of structural changes (such as disestablishment or merger) to certain municipalities due to Local Government elections that took place on 3 August 2016.

*Comment:* Any exceptions to the law that are specific to one type of taxpayer is unconstitutional, immoral, unjust and inequitable and hence contrary to the Promotion of Administrative Justice Act. Other taxpayers also face similar difficulties – e.g. during group restructuring where the structure does not involve a going concern and hence section 8(2) cannot be applied. The buyer and seller face cash flow problems. It is proposed that a similar relief be afforded to group structures without the stringent requirements of going concerns.

It is further proposed that banks (for example) that are forced to re-capitalise due to regulatory requirements should also be permitted these exceptions.

*Response: Not Accepted.* These exceptions are not new to the VAT Act. Previously, these exceptions were introduced in the VAT Act during the merger of universities and when municipality branches merged. These exceptions are provided to assist taxpayers in addressing unintended consequences as a result of structural changes that are beyond the control of the taxpayer and arise by operation of law, in this case the Municipal Structures Act.



## Draft Tax Administration Laws Amendment Bill

### 8. Estate Duty Act, 1955 (EDA)

#### 8.1. Date of payment of estate duty

(Main reference: Section 9C; clause 1)

*Comment:* The new section proposed is welcomed as it will provide clarity on the date for payment of estate duty (i.e. in the notice of assessment) but there are certain issues that were the subject of discussion by the Davis Tax Committee, including but not limited to increasing the section 4A abatement and the section 4(q) surviving spouse exemption of the EDA, which have not been dealt with in the draft Bills.

*Response:* Noted. The issues mentioned are money Bill issues that fall outside the ambit of the announcements made in the 2017 Budget.

### 9. Income Tax Act, 1962 (ITA)

#### 9.1. Timing and accrual of interest payable by SARS

(Main reference: Section 7D; clause 3)

*Comment:* Amendment is welcomed. However, it is hoped that this was not included because of the delays of refund payments that had been experienced from SARS, taking into consideration the implications that the delay of such payments would have on taxpayers.

*Response:* Noted. The difficulty the proposed amendment seeks to address is most commonly encountered when returns or assessments are revised, whether in favour of SARS or taxpayers. It does not change the amount of interest payable to compensate taxpayers for the time value of money as a result of any payment delay by SARS.

*Comment:* The proposed amendment makes a substantive change to the timing of a tax event. It should be included in the Draft 2017 TLAB and renumbered so as not to conflict with another proposed amendment in the Draft 2017 TLAB.

*Response:* Accepted.

#### 9.2. Taxation of reimbursive travel allowances

(Main reference: paragraph 1 of the Fourth Schedule; clause 9)

*Comment:* The impact of the 12,000 kilometre limitation, which is part of the simplified method for reimbursing employees for business travel, on

remuneration for PAYE purposes and the income tax consequences need to be clarified in the Memorandum of Objects.

*Response:* Noted. The reference to “the rate per kilometre for the simplified method” in the proposed amendment for PAYE purposes is not affected by the existing 12,000 kilometre limitation. The limitation is only relevant to the taxpayer’s eligibility for the simplified method on assessment. The Memorandum of Objects will be adjusted to further provide clarity in this regard.

**9.3. Spread of PAYE cap on deductible retirement fund contributions over year**  
(Main reference: paragraph 2 of the Fourth Schedule; clause 10)

*Comment:* The proposed spreading of the R350,000 annual cap on retirement fund contributions for PAYE purposes means that a person who exceeds the R29,167 monthly cap in a single month but not in others will not be able to benefit from unused amounts in the other months.

*Response:* Not accepted. Permitting the R350,000 to be used “at will” during a year places a second or subsequent employer in an impossible position if employment changes during the year. A rolling, cumulative approach introduces significant complexities in payroll systems, as well as differences between employees depending on whether the higher contribution takes place earlier or later in the year. As the monthly cap only applies for PAYE purposes, any unused portion of the annual cap will be taken into account on assessment.

**9.4. Dividends on employee share incentive schemes**  
(Main reference: paragraph 11A of the Fourth Schedule; clause 11)

*Comment:* During numerous workshops with SARS and NT in prior years, the practical considerations around taxing dividends as remuneration were highlighted. While most of the proposals as they stood then were withdrawn, some dividends remained taxable as remuneration and an amendment is now proposed to require that PAYE be withheld on such dividends.

The difficulty in identifying an employee shareholder from a normal shareholder in the listed company environment must be highlighted. All shares are processed via a Central Securities Depository Participant (CSDP). The CSDP will be unable to identify the employee shareholders from the normal shareholders as well as the shares held by the employee in a share incentive scheme versus the shares held outright by the employee in a personal capacity.

In the employer-employee relationship the dividends cannot be separated from the CSDP process, which will result in the 20% being deducted; alternatively the CSDP will have to rely on the employee providing a declaration that no dividends tax should be withheld as the dividends are subject to normal tax.

It is proposed that the provision should be deleted as it is not possible to manage dividends taxable as remuneration under the current dividends tax and PAYE systems as they are vastly divergent.

*Response:* Partially accepted. The proposed wording will be changed to delete the proposal that the person by whom the dividend is distributed (a CSDP in the above comment) must deduct or withhold PAYE. Where an employee holds shares through a share incentive scheme, the employer or person from whom the shares were acquired, acting on behalf of the employee, should inform the CSDP, under section 64H(2) of the ITA, that no dividends tax must be withheld from the relevant dividend in terms of section 64F(1)(f) of the ITA. The PAYE must be withheld or deducted by the employer or person from whom the shares were acquired.

## 10. Tax Administration Act, 2011 (TAA)

### 10.1. Amendment or withdrawal of decisions by SARS

(Main reference: section 9; clause 25)

*Comment:* We are unaware of this internal remedy in section 9 of the TAA, and how to practically take advantage of it. We were unable to find descriptions and processes in relation to this internal remedy on the SARS website, for example, on the page “Dispute Resolution Process”.

In the circumstances, it is submitted that, in order to properly achieve the purpose of the relevant amendment, as well as the apparent purpose of section 9 of the TAA more generally, details of this internal remedy should either be legislated or fully set out in some other formal publication to enable taxpayers to make use of the relevant remedy.

*Response:* Noted. The proposed amendment relates specifically to the amendments last year with respect to estimated royalty payments under the Mineral and Petroleum Resources Royalty (Administration) Act, 2008. Although these amendments were closely modelled on the provisional tax system in the Income Tax Act, 1962, a technical difference meant that section 9 did not cover SARS’ adjustments to estimated royalty payments. The difficulty was pointed out after the response document was released and it was noted for the 2017 legislative cycle. More generally, section 9 of the TAA is the enabling provision that allows a SARS official, in the official’s discretion or at the request of a taxpayer, to amend or withdraw decisions that are not subject to objection and appeal, so ensuring that the *functus officio* principle does not apply. It is thus separate from the dispute resolution process and instead forms a legislative underpinning for SARS’ internal complaints resolution procedures, managed by the SARS Complaints Management Office. Details of this process are available on the SARS website, for example, under [Contact Us > How do I...? > Lodge a complaint](#).

## **10.2. Fraudulent refunds – hold on a taxpayer’s account by bank**

(Main reference: section 190; clause 31)

*Comment:* The proposed amendment goes further than enabling a bank to place a hold on a taxpayer’s account - it requires the bank to do so. The obligation to place a hold should not be automatic but should be on SARS’ instruction or at the discretion of the bank after taking into account all factors, including taxpayer representations.

*Response:* Not accepted. The hold in question is a short and narrow one. It applies for a maximum of two business days when a bank “reasonably suspects” that a refund payment by SARS “is related to a tax offence”, e.g. VAT refund fraud. Requiring prior consultation with the account holder would render the provision ineffective, given the speed with which amounts can be transferred to other accounts. The hold may be lifted if either SARS or a High Court directs otherwise, so a taxpayer who believes the hold is inappropriate may approach either to make their case.

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