



**REPUBLIC OF SOUTH AFRICA**

---

---

**EXPLANATORY MEMORANDUM**

**ON THE**

**TAXATION LAWS AMENDMENT BILL, 2017  
(DRAFT)**

**19 July 2017**

## TABLE OF CONTENTS

### EXPLANATION OF MAIN AMENDMENTS

<b>1.</b>	<b>INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT.....</b>	<b>4</b>
1.1.	TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE.....	4
1.2.	REPEAL OF FOREIGN EMPLOYMENT INCOME EXEMPTION.....	5
1.3.	REFINEMENT OF MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS.....	7
1.4.	EXCLUDING EMPLOYEE SHARE SCHEME TRUSTS FROM MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS.....	9
1.5.	CLARIFYING THE RULES RELATING TO THE TAXATION OF EMPLOYEE SHARE- BASED SCHEMES.....	10
1.6.	INCREASE OF THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES TO LEARNERS WITH DISABILITIES.....	12
1.7.	TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE.....	13
1.8.	TAX EXEMPT STATUS OF PRE-MARCH 1998 BUILD UP IN PUBLIC SECTOR FUNDS.....	14
1.9.	REMOVING THE 12-MONTH LIMITATION ON JOINING NEWLY ESTABLISHED PENSION OR PROVIDENT FUND.....	15
1.10.	POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.....	16
1.11.	DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS.....	17
<b>2.</b>	<b>INCOME TAX: BUSINESS (GENERAL).....</b>	<b>17</b>
2.1.	ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR THE BENEFIT OF MINING COMPANIES.....	17
2.2.	ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR DORMANT GROUP COMPANIES.....	20
2.3.	TAX TREATMENT OF CONVERSION OF DEBT INTO EQUITY AND ARTIFICIAL REPAYMENT OF DEBT.....	22
2.4.	ADDRESSING CIRCUMVENTION OF ANTI-AVOIDANCE RULES DEALING WITH SHARE BUY-BACKS AND DIVIDEND STRIPPING.....	25
2.5.	ADDRESSING ABUSE OF CONTRIBUTED TAX CAPITAL PROVISIONS.....	29
2.6.	INTERACTION BETWEEN THE “IN DUPLUM” RULE AND THE STATUTORY TAX LEGISLATION.....	32
2.7.	TAX IMPLICATIONS OF THE ASSUMPTION OF CONTINGENT LIABILITIES UNDER THE CORPORATE REORGANISATION RULES.....	34
2.8.	EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS.....	36
2.9.	THIRD-PARTY BACKED SHARES: AMENDMENT OF THE PROVISIONS TO COVER CERTAIN QUALIFYING PURPOSES.....	37
<b>3.</b>	<b>INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS).....</b>	<b>38</b>
3.1.	REFINEMENT TO THE TAXATION OF FINANCIAL ASSETS AND LIABILITIES DUE TO CHANGES IN ACCOUNTING STANDARD.....	38
3.2.	EXCLUSION OF IMPAIRMENT ADJUSTMENTS FROM THE DETERMINATION OF TAXABLE INCOME.....	40
3.3.	APPLICATION OF HYBRID DEBT INSTRUMENTS RULES IN RESPECT OF COVERED PERSONS DEFINED IN SECTION 24JB.....	42

3.4.	AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERS DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK.....	44
3.5.	TAX TREATMENT OF DEFERRED ACQUISITION COSTS BY LONG TERM INSURERS.....	47
<b>4.</b>	<b>INCOME TAX: BUSINESS (INCENTIVES).....</b>	<b>48</b>
4.1.	EXTENDING THE SCOPE OF NON-RECOUPMENT RULE FOR VENTURE CAPITAL COMPANIES .....	48
4.2.	CLARIFYING THE SCOPE OF TAX DEDUCTIBLE DONATION STATUS FOR INTERNATIONAL DONOR FUNDING ORGANISATIONS.....	49
4.3.	CORRECTING THE INCONSISTENT TAX TREATMENT BETWEEN CASH GRANTS AND IN-KIND GRANTS OF TRADING STOCK .....	50
4.4.	STRENGTHENING ANTI-AVOIDANCE MEASURES RELATED TO MINING ENVIRONMENTAL REHABILITATION FUNDS.....	52
4.5.	INDUSTRIAL POLICY PROJECTS – WINDOW PERIOD EXTENSION .....	54
<b>5.</b>	<b>INCOME TAX: INTERNATIONAL.....</b>	<b>55</b>
5.1.	REFINEMENTS OF THE DOMESTIC TREASURY MANAGEMENT COMPANY REGIME QUALIFYING CRITERIA .....	55
5.2.	REFINEMENTS OF RULES PROHIBITING DEDUCTION OF TAINTED INTELLECTUAL PROPERTY.....	56
5.3.	EXTENDING THE APPLICATION OF CONTROLLED FOREIGN COMPANY RULES TO FOREIGN TRUSTS AND FOUNDATIONS .....	58
<b>6.</b>	<b>VALUE ADDED TAX .....</b>	<b>60</b>
6.1.	CLARIFYING THE VALUE ADDED TAX TREATMENT OF LEASEHOLD IMPROVEMENTS .....	60
6.2.	VAT VENDOR STATUS OF MUNICIPALITIES .....	61
6.3.	CLARIFYING THE ZERO RATING OF INTERNATIONAL TRAVEL INSURANCE .....	62
6.4.	SERVICES SUPPLIED IN CONNECTION WITH CERTAIN MOVABLE PROPERTY SITUATED IN AN EXPORT COUNTRY .....	63
6.5.	GOODS SUPPLIED IN THE COURSE OF MANUFACTURING OF GOODS TEMPORARILY IMPORTED .....	64

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

## **1.1. TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

### **I. Background**

Some bargaining councils have not deducted Pay-As-You-Earn (PAYE) from a large number of members for holiday, sick leave and end of the year payments. The bargaining councils receive money as contributions for certain benefits from employers of their members (who have not deducted PAYE on those amounts) and at an appropriate time or upon occurrence of a certain event (depending on the rules of the bargaining council), the money is paid to the employees who are members of the bargaining council, without deducting PAYE.

Many bargaining councils have also not been paying income tax in respect of the growth/returns generated from the financial investments of the bargaining council.

### **II. Reasons for change**

It has come to Government's attention that the bargaining council's non-compliance with the tax legislation potentially extends back a number of decades. Given that some of these bargaining councils would be at risk of closure or would suffer severe financial distress if high penalties and interest are imposed for non-compliance, and given the unique circumstances of this case, specific set of provisions is required to address the situation.

### **III. Proposal**

It is proposed that a certain degree of relief be introduced in this regard. However, bargaining councils are expected to be fully tax compliant going forward and will not be afforded relief in future.

Based on the above, the following relief is proposed with regard to non-compliant bargaining councils:

- a. non-compliant bargaining councils will be required to pay a bargaining council levy of 10 per cent of the total employees' tax that should have been deducted from all payments made by the bargaining councils to their members between 1 March 2012 and 28 February 2017;
- b. non-compliant bargaining councils will be required to pay a bargaining council levy of 10 per cent of the income tax that should have been paid in respect of all undeclared income (growth/returns) received by them between 1 March 2012 and 28 February 2017;
- c. the relief will apply in respect of the 5 year period, beginning on 1 March 2012 to 28 February 2017. The 5 year period is linked to the period for record keeping requirements in terms of section 29 of the Tax Administration Act;
- d. bargaining councils must submit a return and pay the bargaining council levy to SARS on or before 1 September 2018; and

- e. bargaining councils that were tax compliant will not be entitled to this relief and will not be entitled to tax refunds.

#### **IV. Effective date**

The proposed amendments will come into effect on 1 March 2018.

#### **1.2. REPEAL OF FOREIGN EMPLOYMENT INCOME EXEMPTION**

[Applicable provision: section 10(1)(o)(ii) of the Act]

##### **I. Background**

###### *A. Domestic law*

Prior to 2001, South Africa applied a source-based system of taxation. All income which was from a source in South Africa and certain types of income which were deemed to be from a source in South Africa were taxable in South Africa. This had the effect that income that was not from a South African source or not deemed to be from a South African source was not subject to tax in South Africa. As a result, section 10(1)(o) of the Act granted an income tax exemption only in respect of foreign employment income earned by officers and crew members employed on board any South African ship if those officers and crew members were outside South Africa for more than 183 days during the year of assessment.

However, from 1 March 2001 South Africa moved to a residence based system of taxation. This means that South African tax residents are subject to tax on their worldwide income.

That said, the scope of the section 10(1)(o) of the Act exemption was extended to include South African residents who are outside South Africa for the purposes of rendering services for, or on behalf of, their employer for a period which, in aggregate, exceeds 183 full calendar days during any period of 12 months commencing or ending during a year of assessment. Days spent outside South Africa when a person is not in employment do not qualify as days outside for the purposes of this exemption and would therefore, not be taken into consideration for the purposes of determining the 183 day test. Further, the exemption only applies if, during the same period of 12 months, a person rendered services outside South Africa for a continuous period of at least 60 full days.

It is important to note that this exemption does not apply in respect of remuneration derived from services rendered outside South Africa for or on behalf of any employer in the national, provincial or local sphere of government or any public or municipal entity. Remuneration derived from holding of a public office to which that person was appointed or deemed to be appointed under an act of Parliament is also excluded from this exemption.

###### *B. Tax treaties*

South Africa has concluded more than 78 double taxation agreements (DTAs). The main purpose of a DTA is to eliminate double taxation of the same income, by allocating taxing rights between the source state and the residence state. The DTA article dealing with taxation of income from employment generally gives a source state a limited right to tax employment income received by individuals from the exercise of employment in the source state. On the other hand, the residence state has exclusive right to tax

employment income received by the resident individual in respect of services rendered in a source state if the following conditions are all met:

- a. the recipient of the income is not present in the source state for more than 183 days in twelve months;
- b. the remuneration is paid by an employer or on behalf of an employer who is not resident in the source state; and
- c. the remuneration is not borne by a permanent establishment of an employer in the source state.

If any of the above conditions is not met, the source state has a right to tax the income from employment exercised in the source state.

That said, the residence state is not precluded from taxing the same employment income. However, if the residence state imposes tax in respect of the same income, that residence state is required to provide relief from double taxation by way of a foreign tax credit or exemption.

## **II. Reasons for change**

When the section 10(1)(o)(ii) exemption was introduced in 2001, the main purpose of this exemption was to prevent double taxation of the same employment income between South Africa and the foreign host country. Also, during that time, South Africa had a more limited number of DTAs to assist with the prevention of double taxation. This exemption was never intended to create situations where employment income is neither taxed in South Africa nor in the foreign host country. As a result, the explanatory memorandum on the Revenue Laws Amendment Act, 2000, anticipated the possibility of the abuse of this exemption and stated the following: "The effect of this relief measure will be monitored to determine whether certain categories of employees abuse it to earn foreign employment income without foreign taxation."

It has come to Government's attention that the current exemption creates opportunities for double non-taxation in cases where the foreign host country does not impose income tax on the employment income or taxes on employment income are imposed at a significantly reduced rate.

In addition, this exemption creates unequal tax treatment between South African residents employed by a national, provincial or local sphere of government or any public or municipal entity and South African residents employed by the private sector. This is because the former employees do not qualify for the exemption in respect of foreign employment income, whereas employees in the private sector do qualify for the income tax exemption in respect of foreign employment income.

## **III. Proposal**

In view of the above, it is proposed that the current section 10(1)(o)(ii) exemption be repealed. As a result, all South African tax residents will be subject to tax on foreign employment income earned in respect of services rendered outside South Africa with relief from foreign taxes paid on the income under section 6*quat* of the Act.

#### **IV. Effective date**

The proposed amendment will come into effect on 1 March 2019 and applies in respect of years of assessment commencing on or after that date.

### **1.3. REFINEMENT OF MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS**

[Applicable provision: section 7C of the Act]

#### **I. Background**

An anti-avoidance measure aimed at curbing the tax-free transfer of wealth to trusts through the use of low interest or interest-free loans, advances or credit was introduced in 2016. In these tax avoidance schemes, a taxpayer transfers assets to a trust and the purchase price that the trust owes in respect of the assets is outstanding as a loan, advance or credit in favour of that taxpayer on which no interest or very low interest is charged. Alternatively, a taxpayer can advance a low interest or interest-free loan, advance or credit to a trust in order for the trust to use the money to acquire assets.

The use of low interest or interest free loans in this manner means that donations tax is avoided when the assets are transferred in exchange for a low interest or interest free loan, advance or credit because these transfers are treated as sale transactions and not donations. Furthermore, in some instances, the amount that is owed to the taxpayers (i.e. the loan claim) can remain outstanding and the trust may have no real intention to pay it off. Coupled with the above, in some instances taxpayers reduce or waive the loan which is supposed to be paid back to him or her. This way, the waived amounts will not form part of his estate for purposes of estate duty. However, the taxpayer can make his children and/or spouse beneficiaries of the trust.

In order to make these types of tax avoidance schemes less attractive to taxpayers, the anti-avoidance measure under section 7C came into effect on 1 March 2017 and applies to all new loans, advances or credit and loans, advances or credit that were already in existence on the date it came into effect. For purposes of the anti-avoidance measure in section 7C, an ongoing and annual donation is triggered whenever interest free loans, advances or credit or loans, advances or credit with low rates that are made to a trust by:

- a. a natural person; or
- b. a company that is a connected person in relation to a natural person that advanced the loan, advance or credit to the trust at the instance of that natural person.

There is, however, a limitation in that such a natural person or company that advances the loan, advance or credit should be a connected person in relation to the trust or must be a connected person to another person that is a connected person in relation to the trust.

This ongoing and annual donation is taxed in the hands of the natural person at a rate of 20 per cent. This is the case even when the company advances the loan, advance or credit to the trust. In every year of assessment of the trust that the interest free or low interest loan remains outstanding, the amount of the deemed donation made by the natural person to the trust is determined as the difference between the interest charged on the loan, advance or credit and the interest that would have been payable by the trust

had the interest been charged at the official rate of interest (as defined in the Seventh Schedule to the Act).

## **II. Reasons for change**

Since the introduction of the anti-avoidance measure, it has come to Government's attention that taxpayers have discovered ways to avoid the deemed annual donation triggered by the anti-avoidance measure.

### *A. Interest-free loans, advances or credit and low interest loans, advances or credit made to companies owned by trusts*

In order to avoid the application of the anti-avoidance measure, taxpayers advance interest free or low interest loans to companies whose shares are held by trusts. By advancing the loan to the company rather than the trust, the anti-avoidance measure will not apply as it currently only applies to loans advanced to trusts. As such, the fiscus will forgo the ongoing and annual donations tax on the deemed donation. These companies benefit from this low or no interest funding and tax can only be collected at a much later stage when the company makes distributions to the trust.

### *B. Transfer of loan claims to current or future beneficiaries of trusts*

Under this avoidance scheme, taxpayers enter into an arrangement under which the loan claim of the natural person who made the loan, advance or credit to the trust (or the natural person at whose insistence a company made a loan to a trust) is transferred to another natural person. The natural person that the loan claim is transferred to is usually a current beneficiary of the trust or a future beneficiary of the trust to which the loan, advance or credit is made, such as a child or a spouse. By subsequently transferring the loan claim, taxpayers argue that this breaks the link between the natural person who advanced the loan and the loan. Because of this, the natural person to whom the loan claim is transferred does not account for the deemed ongoing and annual donation as that natural person did not advance the loan to the trust.

## **III. Proposal**

In order to curb the abovementioned avoidance, it is proposed that interest free or low interest loans, advances or credit that are made by a natural person or a company (at the instance of a natural person) to a company that is a connected person in relation to a trust should also fall under the anti-avoidance measure.

Furthermore, where a person that is a connected person in relation to a trust acquires a loan claim to an amount owing by that trust in respect of a loan, advance or credit that was originally advanced by a natural person or a company (at the instance of a natural person) to that trust, the person who acquires that claim will be deemed to have advanced the amount of that claim as a loan on the date that person acquired that claim.

## **IV. Effective date**

The proposed amendment will come into effect on 19 July 2017 and applies in respect of any amount owed by a trust or company in respect of a loan, advance or credit provided to that trust before, on or after that date.



## **1.4. EXCLUDING EMPLOYEE SHARE SCHEME TRUSTS FROM MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS**

[Applicable provision: section 7C of the Act]

### **I. Background**

The anti-avoidance measure dealing with the tax treatment of interest-free or low interest loans, advances or credit was introduced in 2016. The anti-avoidance measure applies to loans, advances or credit made to a trust by either a natural person or, at the natural person's instance, by a company in which that person together with connected persons in relation to that natural person hold an interest of at least 20 per cent. In terms of the anti-avoidance measure, interest forgone in respect of interest-free or low interest loans, advances or credit made to trusts is treated as an ongoing and annual donation made by the natural person on the last day of the year of assessment of the trust.

The amount of the deemed donation made by the natural person to the trust is determined as the difference between the interest charged on the loan, advance or credit and the interest that would have been payable by the trust had the interest been charged at the official rate of interest (as defined in the Seventh Schedule to the Act). As a result of the anti-avoidance measure, donations tax is triggered and charged at a rate of 20 per cent on that deemed donation.

### **II. Reasons for change**

Trusts are used for various purposes other than to facilitate the transfer of wealth through the use of interest free or low interest loans, advances or credit. As a result, various uses of trusts and/or loans are specifically excluded from the application of the anti-avoidance measure. These include:

- a. special trusts that are established solely for the benefit of persons with disabilities as referred to in paragraph (a) of the definition of "special trust" in section 1 of the Act;
- b. trusts that fall under public benefit organisations as contemplated in section 30 of the Act;
- c. vesting trusts (where the vesting rights and contributions of the beneficiaries are clearly established);
- d. loans that are advanced to a trust, to the extent that a loan used by the trust for funding the acquisition of the primary residence of the lender;
- e. a loan that constitutes an affected transaction and is subject to the provisions of section 31 of the Act;
- f. loans provided to the trust in terms of a sharia compliant financing arrangement; and
- g. a loan that is subject to the anti-value stripping provisions of section 64E(4) of the Act.

In addition to the above, the anti-avoidance measure may have a negative impact on some employee shares schemes that often make use of trusts to hold shares in the employer company (or its associate) that will be allocated to qualifying employees. These

types of trusts are established to facilitate incentive programmes for employees and cannot be treated in the same manner as trusts that are established to transfer wealth.

### **III. Proposal**

In order ensure that employee share schemes are not negatively affected, it is proposed that a specific exclusion for employee incentive schemes should be provided. However, certain requirements must be met for the exclusion to apply. These requirements are introduced in order to ensure that owners of businesses do not abuse the exclusion to transfer wealth to family members that are in the employ of the business.

In the first instance, it will be required that the trust should be a trust that is created solely for purposes of giving effect to an employee share incentive scheme in terms of which that loan, advance or credit was provided by a company to that trust for purposes of funding the acquisition, by that trust, of shares in that company or in any other company forming part of the same group of companies as that company. Secondly, shares (or other equity instruments that relate to or derive their value from shares in a company) may only be offered by that trust to someone by virtue of that person being in the full-time employment of a company or holding the office of director of a company. Lastly a person that is a connected person in terms of paragraph (d)(iv) of the definition of “connected person” in relation to a company or any other company forming part of the same group of companies as that company (i.e. a person that holds at least a 20 per cent interest either individually or collectively with connected persons) may not participate in that scheme.

### **IV. Effective date**

The proposed amendment will be deemed to have come into effect on 1 March 2017 and applies in respect of any amount owed by a trust in respect of a loan, advance or credit provided to that trust before, on or after that date.

## **1.5. CLARIFYING THE RULES RELATING TO THE TAXATION OF EMPLOYEE SHARE- BASED SCHEMES**

[Applicable provisions: sections 8C and 8C(1A) of the Income Tax Act No. 58 of 1962 (“the Act”), new paragraph 64E, paragraph 80(2) and paragraph 80(2A) of the Eighth Schedule to the Act]

### **I. Background**

The Act contains anti-avoidance rules aimed at preventing employees from characterising an employment income amount that is fully taxable at 45 per cent (for example salary or bonus) as capital gains or dividends, which are taxed at lower rates or even exempt dividends. Section 8C (which deals with the taxation of directors and employees for vesting equity instruments) makes provision for the taxpayer to include the gain generated from the equity instrument granted in terms of the employee share scheme, in the income for the year in which the equity instrument vests in that taxpayer.

In 2015, amendments were made to the Act to address the anomaly that the disposal of an equity instrument by the trust to the qualifying beneficiary constitutes a non-event for capital gains tax (CGT) purposes in terms of paragraph 11(2)(j) of the Eighth Schedule. Consequently, clarification was made in various provisions of the Act to defer the recognition of the capital gain in the employee share trust when it disposes of shares to an employee until the equity instrument is unrestricted and vests for purposes of section 8C. In particular, a new paragraph 80(2A) was inserted in the Eighth Schedule to clarify

that where the trust disposes of shares and the profits vests into the hands of qualifying employee beneficiaries, then the provisions of paragraph 80(2) will not apply if such amount is to be taken into account in the hands of those qualifying employee beneficiaries for the purposes of section 8C of the Act.

In turn, in 2016, changes were made to section 8C to introduce measures to deal with schemes where restricted shares allocated to employees are liquidated in return for an amount qualifying as a dividend rather than restricted shares with an embedded gain. As such, amounts received by or accrued to employees through liquidations of restricted equity instruments effected whilst a restriction is still in place will be regarded as remuneration and be subject to tax at the employees applicable marginal tax rate.

The 2016 changes also included changes in section 10(1)(k)(i) of the Act to exclude from dividend exemption certain dividends in respect of restricted equity instrument scheme.

## **II. Reasons for change**

It has come to Government's attention that the 2016 changes relating to section 8C(1A) of the Act overlap with the 2015 amendments made to paragraph 80(2A) of the Eighth Schedule dealing with the tax treatment of capital gains arising from disposals by employee share trusts. Section 8C(1A) of the Act seeks to include in income of the employee amounts derived through liquidation of restricted equity instruments effected before the restrictions fall away. This implies that the capital gain received by employees who are holders of a restricted equity instrument will be taxed as income. On the other hand, paragraph 80(2A) of the Eighth Schedule seeks to prevent the so called "conduit pipe principle" in respect of gains arising on the disposal of trust assets which are vested in beneficiaries of the trust. Paragraph 80(2A) of the Eighth Schedule seeks to clarify that where the trust disposes of shares and the profits vests into the hands of the qualifying employee beneficiary, then the capital gains arising from such disposal will be taxed in the hands of the trust and not in the hands of the employee beneficiary, if such gain is to be taxed as income in the hands of the employee beneficiary in terms of section 8C of the Act.

The interaction between section 8C(1A) of the Act and paragraph 80(2A) of the Eighth Schedule could result in a capital gain arising from the disposal of shares by a trust being subject to CGT in the hands of the trust and capital gains arising from liquidation of a restricted share being subject to income tax in the hands of the employee. The application of the above-mentioned provisions may create double taxation as capital gains arising from the disposal of shares by a trust will be subject to CGT in the hands of the trust, even in cases where the capital gains arising from liquidation of restricted equity instruments have been taxed as income in the hands of the employee. As such, the interaction between section 8C(1A) of the Act and paragraph 80(2A) of the Eighth Schedule needs to be addressed.

## **III. Proposal**

In order to address the anomaly arising from the interaction between section 8C(1A) of the Act and paragraph 80(2A), it is proposed that amendments be made to the Act by inserting a new paragraph 64E into the Eighth Schedule (which deals with disposals by a trust in terms of a share incentive scheme), to clarify that amounts included in the employee's income in terms of section 8C of the Act will be disregarded by the share incentive scheme for CGT purposes. In addition, changes will be made to paragraph 80(2) of the Eighth Schedule to clarify that these provisions will be subject to paragraph

64E of the Act. In turn, it is proposed that paragraph 80(2A) of the Eighth Schedule be deleted.

#### **IV. Effective date**

The proposed amendments will be deemed to have come into effect on 1 March 2017 and apply in respect of any amount received or accrued on or after that date.

### **1.6. INCREASE OF THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES TO LEARNERS WITH DISABILITIES**

[Applicable provision: section 10(1)(qA) of the Act]

#### **I. Background**

Currently, the Act makes provision for tax exemption for all *bona fide* bursaries or scholarships granted by employers to employees or relatives of qualifying employees, subject to certain monetary limits and other requirements.

In 2016, changes were made to the Act to increase the monetary limits for employer provided bursaries to relatives of employees. If a bursary or scholarship is awarded to a relative of the employee, the exemption will apply only if the employee's remuneration does not exceed R400 000 during the year of assessment. In addition, the amount of the bursary or scholarship will be exempted up to a limit of R15 000 for studies from Grade R to 12 including qualifications in National Qualifications Framework (NQF) levels 1 to 4 and R40 000 for qualifications in NQF levels 5 to 10.

#### **II. Reasons for change**

In the 2017 *Budget Review*, a proposal was made to increase the threshold of the exemption for employer provided bursaries to relatives of employees. As a result, changes were made in the 2017 Rates and Monetary Amounts and Amendment of Revenue Laws Amendment 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 required to properly accommodate learners with disabilities, Government proposed, in the 2017 *Budget Review*, a new exemption threshold for employer provided bursaries in respect of learners with disabilities. The costs encountered by educating students and learners with disabilities tend to exceed the costs faced by students and learners without disabilities. This may be due to a number of factors, such as:

- a. specialised facilities and equipment;
- b. specialised personnel;
- c. specialised methods and modes of instruction; and
- d. specialised transport.

### **III. Proposal**

In order to take into account the high costs of educating learners with disabilities, it is proposed that a new monetary limit be introduced as follows in cases where bursaries and scholarships are granted by employers to dependents with disabilities of qualifying employees:

- i. The monetary limit in respect of exempt bursaries or scholarships 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; and
- ii. The monetary limit in respect of exempt bursaries or scholarships for learners with disabilities be set at R90 000 per annum in the case of qualifications at NQF levels 5 to 10.

On the other hand, it is proposed that the monetary limit in respect of remuneration of qualifying employees with learners with disabilities should, as for those without learners with disabilities, be raised to R600 000 per annum.

In addition, it is proposed that the proposed relief for employer provided bursaries for the benefit of learners with disabilities be limited to employees and dependents of employees. Eligible dependents will be those who are under the family care and support of such employee as defined in paragraph (c) of the definition of “dependent” in section 6B(1) of the Act. Also, the determination of disability status will refer to the determination of disability as defined in section 6B(1) of the Act.

Further, it is proposed that the expenses covered by the bursary or scholarship should include the elements that relate to educational services that are specific to learners and students with disabilities. These expenses are already described in the South African Revenue Services (SARS) document titled: “LIST OF QUALIFYING PHYSICAL IMPAIRMENT OR DISABILITY EXPENDITURE” in the case where the cost is carried by the taxpayer.

### **IV. Effective date**

The proposed amendment will come into effect on 1 March 2018 and applies in respect of years of assessment commencing on or after that date.

#### **1.7. TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE**

[Applicable provisions: In section 1 of the Act, the definition of ‘pension fund’, ‘provident fund’, and ‘retirement fund lump sum benefit’ and, paragraph 2 and a new paragraph 7 of the Second Schedule]

#### **I. Background**

In 2014, changes were made in the Act to allow individuals to elect to retire, and the date on which the lump sum benefit accrued to the individual depended on the date on which the individual elected to retire and not on the normal retirement age. As a result, members of retirement funds were allowed to postpone ‘retirement’ by keeping their benefits within their funds past the ‘normal retirement age’. Retirees may now “elect to retire” at any age of their choice subject to the rules and regulations of each individual fund.

The above changes were initially considered because employees were failing to make a timely election as to the proportion of their benefit they wished to take as a lump sum. This was making it difficult for employers to make appropriate arrangements and to withhold the correct amount of income tax for retirement purposes; therefore employers were falling foul of their withholding obligations.

Subsequently, it was also considered desirable from a policy point of view, that if a member is able to continue to work or support themselves alternatively, it is good that their benefits be preserved as long as possible.

## **II. Reasons for change**

While members may retain benefits within respective funds, they may no longer make contributions to those funds. The members are thus effectively inactive.

In the case of employer funds, the employee may also have left the employ of the company and may wish to sever ties with the employer. The employer would also be left with the burden of having to keep in touch with an inactive member and deal with additional administration.

While employer funds can prohibit employees from retaining their benefits within the funds to avoid these issues, it would defeat the policy intent of the amendment since employees would simply withdraw their benefits.

## **III. Proposal**

In order to address these concerns, it is proposed that changes be made in the Act to allow employees to transfer their benefits into a retirement annuity for later consumption. Transfers to preservation funds are not currently included in the proposal as this would create a situation where members of pension funds can transfer their benefits into preservation funds and withdraw all the benefits in a lump sum withdrawal, thereby going against preservation.

## **IV. Effective date**

The proposed amendments will come into effect on 1 March 2018 and apply in respect of years of assessment commencing on or after that date.

### **1.8. TAX EXEMPT STATUS OF PRE-MARCH 1998 BUILD UP IN PUBLIC SECTOR FUNDS**

[Applicable provisions: Paragraph 5(1)(e) and 6(1)(b)(v) of the Second Schedule to the Act]

#### **I. Background**

The Second Schedule deals with the computation of amounts derived from lump sum benefits to be included in the definition of “gross income” in section 1 of the Act. Paragraph 2(1), read together with paragraph 2A and 2C of the Second Schedule make provision for the determination of amounts to be included in gross income that arose from a lump sum benefit from a retirement fund.

In turn, paragraph 2A of the Second Schedule makes provision for the determination of amounts to be included in gross income for lump sum amounts arising from public sector

funds in terms of the prescribed formula. Paragraph 2A , read together with paragraph 5(1)(e) and 6(1)(b)(v) makes provision for withdrawal of pre-March 1998 tax free benefits if those benefits are withdrawn from a fund, and those benefits were previously transferred from a public sector fund.

## **II. Reasons for change**

Where employers, for purposes of improving economies of scale, merged or consolidated with other employers, thereby forming a different fund, the exemption applying to pre-March 1998 benefits will no longer apply as that exemption only applies on one occasion when the pre-March 1998 benefits are withdrawn from a fund, and those benefits were previously transferred from a public sector fund. This outcome does not reflect the intended policy and it results in unfair treatment in respect of the benefits from funds that are merged or consolidated.

## **III. Proposal**

In order to address this anomaly, it is proposed that changes be made 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.

## **IV. Effective date**

The proposed amendments will come into effect on 1 March 2018.

### **1.9. REMOVING THE 12-MONTH LIMITATION ON JOINING NEWLY ESTABLISHED PENSION OR PROVIDENT FUND**

[Applicable provisions: Proviso (b)(iii) of the definition for provident fund and proviso (c)(ii)(cc) of the definition of pension fund]

#### **I. Background**

The Act makes provisions in proviso (c)(ii)(cc) of the definition of “pension fund” and proviso (b)(iii) of the definition of “provident fund” in section 1 of the Act that if an employer establishes a new pension or provident fund, employees have up to 12 months to make application to join that fund. An employee who fails to make application to join within the 12 month period is not permitted to join that fund.

#### **II. Reasons for change**

The current limit of 12-month period for joining a pension or provident fund is restrictive and creates policy anomalies. The consequence of the current limit of 12-month period may be that employees can opt to be outside of the retirement saving system even though they are currently employed.

#### **III. Proposal**

In order to encourage employees to contribute towards their retirement and remove practical difficulties, it is proposed 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.

#### **IV. Effective date**

The proposed amendment will come into effect on 1 March 2018 and applies in respect of years of assessment commencing on or after that date.

### **1.10. POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019**

#### **I. Background**

In 2015, amendments were made to the Act regarding the tax treatment of provident funds in order to enhance preservation of retirement fund interests during retirement. As a result, provident funds will be treated like pension and retirement annuity funds and will be required to annuitise benefits. This implies that on retirement, members of the provident fund will be permitted to take up to a third of the retirement benefit as lump sum and annuitise at least two thirds. However, this will only be applicable for contributions made to a provident fund after the implementation date. All contributions made before the implementation date, and growth on those contributions, may still be taken as a lump sum on retirement.

The above-mentioned amendments were supposed to come into effect on 1 March 2016, however, in February 2016, Government postponed the annuitisation requirements for provident funds for two years until 1 March 2018. The postponement was done in order to provide sufficient time for the Minister of Finance to consult with interested parties, including National Economic Development and Labour Council (NEDLAC), regarding the annuitisation requirements for provident funds after the publication of the comprehensive policy document on social security, and to report back to Parliament on the outcome of those consultations no later than 31 August 2017.

#### **II. Reasons for change**

Several changes have taken place since the postponement of these amendments and the discussions on the comprehensive paper on social security are still underway in NEDLAC.

#### **III. Proposal**

In view of the above, it is proposed that the provisions relating to the annuitisation requirements for provident funds be postponed for 1 year from 1 March 2018 to 1 March 2019.

#### **IV. Effective date**

The proposed amendments will come into effect on 1 March 2019 and apply in respect of years of assessment commencing on or after that date.



## **1.11. DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

[Applicable provision: deletion of section 11(k) and insertion of new section 11F of the Act]

### **I. Background**

The deduction for employee contributions to a pension fund were historically included in section 11(k), while deductions for contributions to a retirement annuity fund were included in section 11(n). 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.

### **II. Reasons for change**

The inclusion of the deduction in section 11(k) has created technical complications, since the opening proviso states that deductions under section 11 relate to taxable income derived from the 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. The current location of the provision dealing with deductions for contributions to retirement funds under section 11(k) can also create anomalies, such as generating an assessed loss from contributions to retirement funds that are above the allowable limit when taxable capital gains are a part of the higher limit.

### **III. Proposal**

To remove the inconsistencies and anomalies that arise from the current location of the provisions that allow for a limited deduction for retirement fund contributions under section 11(k), it is proposed that a new section 11F is inserted to effect this deduction. Additionally, a new limiting criteria for the allowable deduction is proposed to avoid circumstances that can create an assessed loss.

### **IV. Effective date**

The proposed amendments will be deemed to have come into effect on 1 March 2016.

---

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

### **2.1. ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR THE BENEFIT OF MINING COMPANIES**

[Applicable provision: section 36 of the Act]

#### **I. Background**

Generally, if debt or a portion of debt is cancelled, waived, forgiven or discharged, the amount of the cancelled, waived, forgiven or discharged debt gives rise to tax implications. However, the tax implications depend on how the debt that is cancelled, waived, forgiven or discharged was utilised. The tax rules make provision for debt

forgiveness occurring under the income paradigm and debt forgiveness occurring under the capital paradigm.

#### *A. Tax implications under the income paradigm*

In the instance that the initial debt was used to finance deductible expenditure or allowance assets, the income tax rules for debt forgiveness apply. For example, if debt was used to finance tax deductible expenditure (operating expenses, for example rental expenses or employee salaries) the Act makes provision for recoupment, i.e. reversal of income tax deductions previously granted in respect of operating expenses and inclusion in the taxable income of the taxpayer that is subject to normal tax.

On the other hand, if a debt that is reduced cancelled, waived, forgiven or discharged was initially used to fund trading stock, the amount of debt that is now reduced, cancelled, waived, forgiven or discharged will first reduce the cost price of trading stock so held by the debtor (taxpayer). However, this cost price reduction will only apply to the extent to which the borrowed funds were used to acquire the trading stock that is still held by the taxpayer and only to the extent that trading stock has any remaining cost price. If the amount of debt relates to the trading stock that is no longer held by the taxpayer, or the cost price of the trading stock has already been reduced to zero for tax purposes, the amount of debt that is now reduced, cancelled, waived, forgiven or discharged is recouped under the Act, i.e. reversal of the income tax deduction previously granted in respect of that trading stock and inclusion in the taxable income of the taxpayer that is subject to normal tax.

#### *B. Tax implications under the capital paradigm*

On the other hand, the CGT rules apply where the initial debt was used to finance capital expenditure, the acquisition of capital assets or the acquisition of allowance assets (to the extent that the income rules have already applied in respect of the allowances claimed). Under the CGT rules available in paragraph 12A of the Eighth Schedule, the amount of debt that is now reduced, cancelled, waived, forgiven or discharged must first reduce the base cost of the capital or allowance assets so held by the debtor (taxpayer). However, this base cost reduction will apply only to the extent that such assets are still held by that taxpayer. This will result in a higher capital gain or reduced capital loss when the allowance asset is disposed of in the future.

Where the amount of the debt cannot be traced to the financing of any specific capital or allowance asset held by the taxpayer or the base cost of the capital or allowance asset that was acquired using this debt has been fully reduced to zero, the amount of debt that is reduced, cancelled, waived, forgiven or discharged will be applied to reduce any assessed capital losses that the taxpayer may have. After this, if the taxpayer's base cost of capital or allowance asset and assessed losses are fully reduced in accordance with the above, no capital gain will arise.

## **II. Reasons for change**

At issue is the fact that the CGT rules provided in paragraph 12A of the Eighth Schedule, that make provision for the amount of debt that is reduced, cancelled, waived, forgiven or discharged to first reduce the base cost of the capital or allowance assets so held by the taxpayer do not apply to mining companies and apply only to companies in other sectors. 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 or allowance assets differently from companies in other sectors.

Over and above the normally available deductions for operating expenses, mining companies benefit from a preferential tax treatment of their capital expenditure. Mining companies are allowed a hundred per cent upfront deduction of the capital expenditure incurred albeit that this 100 per cent upfront deduction can only be claimed against income derived from mining operations ("mining income"). Any capital expenditure incurred that exceeds the mining income of a mining company in any given year (referred to as unredeemed capital expenditure) is then ring-fenced and carried over to the subsequent years to be applied against the mining income generated by the mining company in those subsequent years. Upon disposal of any capital or allowance asset the cost of which constituted capital expenditure incurred by a mining company, the full proceeds of the disposal of that asset is in the case of certain gold mining companies deducted from capital expenditure and in any other case included in the gross income of the mining company (under paragraph (j) of the definition of "gross income"). The policy rationale for this inclusion in gross income of the full proceeds is that those assets of the mining company benefited from the preferential tax treatment of a hundred per cent upfront deduction of its cost.

On the other hand, companies in other sectors (excluding farming) do not qualify for 100 per cent upfront deduction in respect of capital expenditure. Instead, they qualify for normal capital allowances provided for in the Act. In addition, upon disposal of their capital or allowance assets, these companies are subject to CGT rules in the Act. Generally, upon disposal, the proceeds arising from the disposal of capital or allowance assets are reduced by the base cost of those assets at the time of the disposal and any capital gain arising is subject to CGT.

This difference in the tax treatment of capital or allowance assets for mining companies and capital or allowance assets for companies in other sectors results in anomalies when applying the current CGT rules provided in paragraph 12A of the Eighth Schedule for debt foregone. Unlike companies in other sectors that are allowed to use the amount of debt that is reduced, cancelled, waived, forgiven or discharged to first reduce the base cost of the capital or allowance assets that are subject to and effective capital gains rate of 22.4 per cent on disposal, mining companies will be taxed on the recoupment thereof (i.e. reversal of 100 per cent deduction previously granted in respect of the mining asset and included in the taxable income of the mining company and subject to normal tax) at normal income tax rates of 28 per cent. This is due to the fact that the current CGT rules provided in paragraph 12A of the Eighth Schedule for debt foregone are generic in their design and do not take into account whether or not an upfront allowance may have been granted in respect of capital or allowance assets the debt funded cost of which qualifies as capital expenditure incurred and the resultant tax consequences when the debt is forgiven.

### **III. Proposal**

It is proposed that specific rules dealing with debt foregone in respect of mining companies be introduced in section 36 of the Act. The intention is that these rules will only take into account the treatment of capital expenditure for mining companies in terms of section 36 when debt that financed the capital or allowance asset giving rise to the capital expenditure incurred is subsequently forgiven. In all other instances (i.e. where debt that is used to finance expenditure other than capital expenditure provided in section 36) the existing rules will apply.

Under the proposed rules, any debt that was used to fund capital expenditure as defined under section 36 that is subsequently forgiven must be treated as follows:

- a. The amount of debt that is reduced, cancelled, waived, forgiven or discharged during a year of assessment must reduce any amount of capital expenditure incurred that has not yet been deducted (i.e. the balance of the unredeemed capital expenditure of the previous year of assessment that is deemed to have been incurred in the current year as well as capital expenditure actually incurred in the current year).
- b. To the extent that the debt that is reduced, cancelled, waived, forgiven or discharged exceeds the capital expenditure incurred in previous years of assessment and the capital expenditure incurred during the year of assessment any excess amount must be treated as an amount received by or accrued by the mining company during the year of assessment that the debt that is reduced, cancelled, waived, forgiven or discharged in respect of a disposal of assets the cost of which has been included in capital expenditure incurred. As a result, the excess amount will be subject to inclusion in the gross income of the mining company in terms of paragraph (j) of the definition of gross income.

#### **IV. Effective date**

This proposed amendment will come into effect on 1 January 2018 and applies in respect of years of assessment commencing on or after that date.

### **2.2. ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR DORMANT GROUP COMPANIES**

[Applicable provisions: section 19 and paragraph 12A of the Eighth Schedule]

#### **I. Background**

The Act makes provision for the tax implications in respect of a debt that is reduced, cancelled, waived, forgiven or discharged depending on whether the debt originally funded tax deductible expenditure or capital expenditure that is not tax deductible. Section 19 of the Act deals with tax implications in respect of a debt that is reduced, cancelled, waived, forgiven or discharged and applies to a debt that was used to fund tax deductible expenditure such as operating expenses. The Act makes provision for a recoupment i.e. reversal of income tax deduction previously granted in respect of an operating expense, which is then included in the income of the debtor and subject to normal tax. On the other hand, paragraph 12A of the Eighth Schedule deals with tax implications in respect of a debt that is reduced, cancelled, waived, forgiven or discharged and applies to a debt that was used to fund a capital or an allowance asset. Paragraph 12A of the Eighth Schedule makes provision for the amount of debt that is now reduced, cancelled, waived, forgiven or discharged to first reduce the base cost of the capital or allowance assets so held by the debtor.

In turn, paragraph 12A(6)(d) of the Eighth Schedule makes provision for a group exemption in respect of debt that is reduced, cancelled, waived, forgiven or discharged between South African group companies. In particular, this subparagraph provides that the provisions of paragraph 12A do not apply to any debt owed by a person to another person where that person and that other person are companies that form part of the same group of companies as defined in section 41.

This means that where a debt between South African group companies is reduced, cancelled, waived, forgiven or discharged and that debt was used to fund capital assets, the amount of debt that is reduced, cancelled, waived, forgiven or discharged does not

result in a reduction of base cost of the capital or allowance assets held by the debtor or reduction of the capital losses of the debtor.

## **II. Reasons for change**

At issue is the fact that paragraph 12A(6)(d) of the Eighth Schedule, which makes provision for group exemption in respect of debt that is reduced, cancelled, waived, forgiven or discharged between South African groups companies is limited to apply in instances where a debt was used to fund capital or allowance asset as envisaged paragraph 12A of the Eighth Schedule and is not extended to apply to instances where a debt was used to fund operating expenditure as envisaged in section 19 of the Act. The absence of paragraph 12A(6)(d) group exemption in section 19 of the Act results in a technical impediment for groups of companies that wish to wind up the dormant companies within the same group of South African companies.

This is because when attempting to wind up a dormant company within the same group of South African companies that has an old irrecoverable debt owing to one of the group companies, any reduction, waiver, cancellation or discharge of the debt potentially results in a recoupment for the dormant company in terms of section 19 of the Act as section 19 of the Act does not contain a similar paragraph 12A(6)(d) group exemption. This creates a scenario where a dormant company within the same group of South African companies as its creditor can have recoupment as a result of a debt that is cancelled, waived, forgiven or discharged which will result in a tax liability for that dormant company that it cannot pay. As a result, it will be difficult for the dormant company to be wound up if it has a tax debt. Furthermore, it will also be difficult for SARS to collect this tax as the dormant company may no longer have assets (technically insolvent).

## **III. Proposal**

In order to bring clarity to the purpose of paragraph 12A(6)(d) group exemption and uniformity to the rules under paragraph 12A of the Eighth Schedule and section 19 of the Act in respect debt that is cancelled, waived, forgiven or discharged for dormant companies within the same group of South African companies, it is proposed that the current paragraph 12A(6)(d) group exemption should be replaced with a more targeted exclusion. In order to achieve this, it is proposed that:

- a. Paragraph 12A(6)(d) group exemption will be extended to apply to section 19; and
- b. Paragraph 12A(6)(d) of the Eighth Schedule, which makes provision for group exemption in respect of debt that is reduced, cancelled, waived, forgiven or discharged between South African groups companies will be limited to apply only to instances where the debtor is a dormant group company. Debt from non-resident group companies will, however, not be covered.

For purposes of this exclusion, a company will be regarded as being dormant if the company meets the following requirements during the year of assessment that the debt is reduced, cancelled, waived, forgiven or discharged and the preceding three years of assessment:

- a. the company has not traded;
- b. no amounts have been received or accrued to the company;
- c. no assets have been transferred to or from the company; and

d. no liability must have been incurred or assumed by the company.

Lastly, this exclusion will not apply in respect of debt that arose in respect of assets that were subsequently disposed of under the re-organisation rules.

#### **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018.

### **2.3. TAX TREATMENT OF CONVERSION OF DEBT INTO EQUITY AND ARTIFICIAL REPAYMENT OF DEBT**

[Applicable provisions: section 19, new sections 19A and B and paragraph 12A of the Eighth Schedule]

#### **I. Background**

The Act contains rules dealing with the manner in which a taxpayer must account for the benefit derived from the waiver, cancellation, reduction or discharge of a debt owed by that taxpayer. Section 19 of the Act deals with tax implications in respect of a debt that was previously used to fund tax deductible expenditure such as operating expenses. It provides, firstly, for a reduction of the cost price of trading stock still held by a person if the debt was originally used to fund the acquisition of that trading stock. Secondly, provision is made for a recoupment that is subject to normal tax if the debt was originally used to fund deductible expenditure.

Paragraph 12A of the Eighth Schedule deals with tax implications in respect of a debt that was used to fund capital or allowance assets. Provision is made, for the reduction of the base cost of the capital or allowance assets still on hand with any remaining balance then being used to reduce any assessed capital losses of the person.

The provisions above apply only to the extent to which the waiver, cancellation, reduction or discharge of a debt gives rise to a “reduction amount”, i.e. the amount, by which the debt decreases exceeds the consideration received by the creditor in return.

#### **II. Reasons for change**

##### *A. Conversion of debt into equity*

In the current economic climate, there are various mechanisms by which a debtor may settle a debt with a creditor or a creditor may relinquish a claim to have the debt repaid. One of the mechanisms is the conversion of debt owed by a company into equity in that company. This is achieved when a debt that is owed by that company to a creditor is settled by that company by using the proceeds derived from shares issued by that company to that creditor.

These types of debt conversion schemes are usually entered into in respect of loans advanced to a company by the controlling shareholder of that company. The shareholder and the company involved agree, in essence, that shares will be issued by the company to the shareholder for an aggregate amount that matches the face value of a debt owed by that company to that shareholder and that the proceeds will then be used to settle that debt. The shareholder in effect converts a debt claim against the company to equity financing. This arrangement is aimed at improving the company’s balance sheet and retaining its financial sustainability.

SARS has issued a number of binding private rulings providing relief in respect of the application of the current tax rules where a debt owed by a company to its controlling shareholder is reduced or discharged in terms of an arrangement that in effect converts that debt into equity. The conversion of debt into equity is aimed at restoring or maintaining the solvency of companies under financial distress without triggering the debt reduction rules. The shareholder/creditor desires, in effect, the outcome that would have been achieved had that shareholder originally funded the company by means of an equity contribution rather than the debt so converted.

The dispensation governing such arrangements should therefore be aimed at achieving, in broad terms, the outcome that would have been achieved had the creditor funded the company by means an equity contribution rather than by a loan. Deductions claimed by the debtor company in respect of interest incurred on debt prior to its conversion into equity should therefore at the very least be recouped to the extent to which that interest was not subject to normal tax in the hands of the creditor/shareholder.

#### *B. Abuse of artificial repayment of debt*

Since the introduction of tax rules dealing with situations where a creditor waives, cancels, reduces or discharges a debt from 1 January 2013, it has come to government's attention that creditors and debtors are entering into short-term shareholding structures that seek to circumvent tax implications triggered by the application of these rules.

These structured arrangements involve a creditor that is an unrelated creditor subscribing for shares in the debtor company. The subscription price would be equal to the total amount of the borrower's indebtedness to the creditor in spite of the market value of the shares in the borrower. This subscription price gets paid to the debtor in cash and the debtor then uses the cash to settle the capital of and the interest on the loan or debt. Soon after the payment is effected, the original shareholder of the debtor will buy the shares that the creditor. The creditor will (if at all) only be subject to CGT on a very small gain in respect of the shares in the debtor sold to the shareholder.

### **III. Proposal**

In order to assist companies in financial distress, it is proposed that definitive rules dealing with the tax treatment of conversions of debt into equity be introduced.

In addition, in order to address the abuse of artificial repayment of debt, it is proposed that the rules assisting companies in financial distress should be limited to those involving group companies.

Based on the above, the following is proposed:

#### *A. Exclusion of debt to equity conversions from the application of debt forgiveness rules*

It is proposed that the rules dealing with debt that is cancelled, waived, forgiven or discharged should not apply to a debt that is owed by a debtor to a creditor that forms part of the same group of companies (as defined in section 1 in order to include multinational groups of companies).

In order to counter abuse of the above-mentioned relief by taxpayers who simply wish to cancel, waive, forgive or discharge a debt without any tax consequences and do so with no real interest in the financial recovery of the indebted company, it is proposed that the creditor and the debtor be required to continue to form part of that same group of

companies for at least five years from the date of the conversion. This relief will apply in respect of debt governed by both section 19 of the Act and paragraph 12A of the Eighth Schedule.

However, as an added deterrent on the possible abuse of this exclusion, it is further proposed that a deemed reduction amount should be triggered for the debtor if the debtor and the creditor cease to form part of the same group of companies during the prescribed five year period.

In this regard, an amount equal to the difference between the market value of the shares previously issued by the debtor to the creditor as consideration for the reduction or settlement of the debt (determined at the time the debtor and the creditor de-group before the end of the prescribed five year period) and the amount by which the debt was reduced, will be deemed to be a reduction amount of the debtor. This deemed reduction amount must be accounted for in terms of the normal rules by the debtor as a reduction amount that arises on the date that the debtor and the creditor cease to form part of the same group of companies. The amount that will be treated as a reduction amount will, however, be reduced by any amount of interest previously incurred and deducted by the debtor and that is reflected in the amount of the debt that is reduced or settled if the creditor did not pay normal tax on its accrual of that interest. This is because this amount will be subject to a claw-back provision.

#### *B. Claw-back of interest previously incurred and deducted*

Where the conversion of debt into equity does not trigger the application of the rules dealing with the tax treatment of debt that is waived, cancelled, reduced or discharged, it is further proposed that the tax consequences should be similar to those that would have applied had the creditor/shareholder funded the company by means of an equity contribution rather than the provision of a loan, i.e. as if the loan had always been an equity investment.

As a result, any interest that was previously deducted by the borrower in respect of a debt that is subsequently converted into equity should be treated as a recoupment in the hands of the borrower to the extent to which that interest was not subject to normal tax in the hands of the company which received it or to which it accrued.

In addition, it is proposed that the amount that must be recouped must firstly be used to reduce any assessed loss of that debtor company in the year of assessment that the debt to equity conversion takes place. A third of any balance exceeding that assessed loss must be treated as a recoupment in each of the three immediately succeeding years of assessment.

Should the debtor and the creditor cease to form part of the same group of companies within the prescribed three year period, any remaining balance of the interest previously deducted by the debtor, will have to be included in the taxable income of the debtor in full in the year of assessment in which they cease to form part of the same group of companies.

#### **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018.



## **2.4. ADDRESSING CIRCUMVENTION OF ANTI-AVOIDANCE RULES DEALING WITH SHARE BUY-BACKS AND DIVIDEND STRIPPING**

[Applicable provisions: section 22B and paragraph 43A of the Eighth Schedule]

### **I. Background**

#### *A. Introduction of the concept of Share Buy-Backs*

Prior to 1999, both the Companies Act No. 61 of 1973 (“the old Companies Act”) and the Act did not cater for share buy-backs. The Companies Amendment Act No.37 of 1999 (“the 1999 Companies Amendment Act”) made provision for a company to be able to buy back its own shares. The company acquiring its own shares could, however, not transfer such shares into its own name but the shares so acquired had to be cancelled as issued shares and restored to the status of authorised shares.

#### *B. Share Buy-Backs and Secondary Tax on Companies (STC) Regime*

Together with the introduction of the concept of share buy-backs by the 1999 Companies Amendment Act, amendments were made in the Act in 1999 to address the tax consequences resulting from the above. For example, the acquisition by a company of its own shares in terms of the amendments to the Companies Act in 1999 resulted in the cancellation of the shares and a reduction of the company’s reserves (distributable or non-distributable). This, therefore, had an impact on the amount of reserves available for distribution by the company, i.e. dividends declared and consequently the STC to be collected in this regard.

As a result, proceeds of share buy-backs were included in the definition of dividend in section (1) of the Act to the extent that they are funded out of reserves that do not represent a return of capital. In turn, proceeds of share buy-backs that did not represent a return of capital were regarded as dividends and subject to STC. Furthermore, a shareholder company from which the shares are so acquired was entitled to an STC credit in respect of the portion of the selling price of the shares which constituted a dividend, provided that the dividend complied with other provisions relating to STC in the Act.

The interaction between share buy-backs and the STC regime entailed less risk to the fiscus due to the fact that: (i) STC was collected upfront at a company level and not at shareholder level; (ii) company to company dividends were not exempt from STC (other than dividends between a group of companies), but were subject to tax and qualified for STC credits if the dividends complied with other provisions in the Act; (iii) tax planning using share buy backs was limited to group companies as a group company exemption applied in this regard and group companies were allowed to declare dividends free of STC.

#### *C. Share Buy-Backs and Dividends Tax Regime*

In 2012, South Africa moved from the STC regime to the dividends tax regime. The dividends Tax regime made provision for taxation of dividends at shareholder level and it replaced the STC regime that imposed a tax liability on the company declaring a dividend. The dividends tax regime aligned the South African basis of taxation of dividends with the international norm.

Currently, the dividends tax Regime makes provision for outright exemptions from dividends tax in respect of dividends paid to certain shareholders. Most notable is the dividends tax exemption in respect of all dividends paid by a resident company to another resident company. This exemption is based on the premise that the underlying profits of resident companies should only be taxed once at company level while the after tax profits in the form of dividends should only be taxed in the hands of shareholders when these after tax profits are distributed out of resident companies (for example when after tax profits are distributed to individuals, trusts and non-resident companies).

#### *D. Dividend Stripping Rules and Dividends Tax Regime*

With the introduction of the dividends tax regime, consequential amendments were made to the Act to introduce anti-avoidance measures aimed at stopping arbitrage opportunities that may arise as a result of the dividends tax exemption in respect of dividends paid by a resident company to another resident company. As a result, rules that target avoidance schemes known as dividend stripping were introduced in section 22B of the Act and paragraph 43A of the Eighth Schedule.

Dividend stripping occurs when a resident shareholder company that is a prospective seller of the shares in a target company avoids income tax (including CGT) arising on the sale of shares in that target company by ensuring that the target company declares a dividend to that resident shareholder company prior to the sale of shares in that target company to a prospective purchaser. Such a pre-sale dividend to a resident shareholder company is exempt from dividends tax. This pre-sale dividend also decreases the value of the shares in the target company. As a result, the prospective seller extracts value from the company by effectively selling the shares through tax exempt dividends. As a consequence of this, the seller can sell the shares at a lower amount, thereby avoiding a much larger taxable capital gain.

Currently, section 22B of the Act and paragraph 43A of the Eighth Schedule attempt to discourage taxpayers from entering into these dividend stripping schemes. The anti-dividend stripping rules treat a pre-sale dividend as an amount of income or proceeds from the disposal of an asset of a shareholder company if those pre-sale dividends are indirectly funded by the prospective purchaser through a loan from or a loan guaranteed by the prospective purchaser or a connected person in relation to that prospective purchaser. This limitation that focuses on the manner in which the pre-sale dividend is funded was put in place because at the time, pre-sale dividends that were indirectly funded by the prospective purchaser were viewed as being abnormal and considered more suspicious than pre-sale dividends funded out of accumulated profits.

## **II. Reasons for change**

### *A. Interaction of Share Buy-Backs and Dividends Tax Regime*

As discussed above, when the STC regime was still in place, the interaction of share buy-backs and STC regime entailed less risk to the fiscus. However, with the introduction of dividends tax regime in 2012, Government has noticed that the interaction of share buy backs and dividends tax regime entailed more risk to the fiscus due to the following:

- a. Unlike STC, dividends tax is collected at a later stage when dividends are paid to non-SA corporate shareholders;
- b. Tax planning using share buy backs became prevalent due to the fact that company to company dividends are exempt from dividends tax; and

- c. Share buy-backs are allowed in terms of the Companies Act and the sole or main purpose of doing share buy-back arrangement may not always involve tax planning but are based on commercial rationale, e.g. mergers and acquisitions.

Several schemes have been identified where taxpayers structure their transactions using share buy backs in order to avoid tax on taxable proceeds on the sale of shares. For example, if a company shareholder sells its shares to the acquirer, the sale proceeds would be ordinarily subject to CGT or normal tax on income. In order to avoid CGT or normal tax on income, the current shareholder's shares are acquired by the company as part of a share buy back in a share buy-back transaction. In view of the fact that directors of a company have discretion to determine whether a consideration for a share buy-back can be regarded as a dividend or proceeds on the sale of shares, an election is not made to reduce contributed tax capital and a dividend is paid. The tax advantage of payment of dividends instead of proceeds on the sale of shares is that company to company dividends are exempt from dividends tax, whereas proceeds on the sale of shares are subject to CGT or normal tax on income.

#### *B. Interaction of Dividend Stripping Rules and Dividends Tax Regime*

It has come to Government's attention that the current anti-avoidance measures on dividend stripping are being undermined due to the limited scope of its application. In the first instance, the current anti-avoidance rules apply where the prospective seller, immediately prior to the disposal of the shares in the target company holds more than 50 per cent of the shares in the target company. This threshold is too high and does not adequately encapsulate the scenarios under which these dividend stripping schemes are entered into. Focus should rather be placed on the ability of a company shareholder that wishes to dispose of shares in another company to significantly influence the decision whether a dividend will be distributed in respect of those shares to achieve the desired reduction of the value of those shares. More specifically, the size of the direct or indirect interest held in that other company by that company shareholder and connected persons in relation to it that confers a significant influence to the company shareholder and this should be the focus.

Further, the focus of the current anti-dividend stripping rules on debt funding advanced/guaranteed by a prospective purchaser or a connected person in relation to a prospective purchaser is easily circumvented. This is because taxpayers have been opting to structure their sale of share transactions as share buy-backs and subscription arrangements with the pre-sale dividends either being funded by the accumulated profits of the target company or loan arrangements that are not caught under the current anti-dividend stripping rules. In particular, Government has identified schemes whereby taxpayers avoid the application of the anti-avoidance rules by raising loan funding to fund the pre-sale dividend from a third party (i.e. a person other than the prospective purchaser or a connected person in relation to the prospective purchaser), for example a loan from a bank.

### **III. Proposal**

In order to curb the use of share buy-back schemes as well as circumvention of dividend stripping rules, it is proposed that the current anti-dividend stripping rules should be broadened to take into account amongst other things the following:

- a. variations in the share buy-back schemes that taxpayers are entering into to avoid normal tax on income or CGT on the outright sale of shares;

- b. the limited scope of application of dividend stripping rules that focus only on debt funding advanced or guaranteed by a prospective purchaser or a connected person in relation to a prospective purchaser funding of the proceeds; and
- c. the limited scope of application of dividend stripping rules, i.e. the fact that they apply only where the prospective seller, immediately prior to the disposal of the shares in the target company holds more than 50 per cent of the shares in the target company.

#### *A. Dividend Stripping - Conversion Rules*

To achieve this, the current anti-dividend stripping rules covering trading stock as well as capital assets will be maintained. As with the current rules, the dividends in respect of shares that are disposed of will lose their exempt nature and will be treated as other consideration that is subject to tax depending on whether the shares were held on revenue or capital account. The anti-dividend stripping rules will also be amended to include timing rules to clarify when the tax consequences triggered by the provisions must be taken into account by the taxpayer that receives or accrues a tainted dividend.

- a. Taxation of dividends in respect of shares held as trading stock

Section 22B of the Act will continue to apply when a person that is a company disposes of shares in a target company that are held as trading stock. Where section 22B of the Act applies, any tainted dividends received by or accrued to that person will not benefit from an exemption but will be included in the income of the person in the later of the year of assessment that the shares in the target company are disposed of or the year of assessment in which the that tainted dividend is received by or accrues to the person.

- b. Taxation of dividends in respect of shares held as capital assets

Paragraph 43A of the Eighth Schedule will also continue to apply when a person disposes of shares in a target company that are held as capital assets. Where paragraph 43A of the Eighth Schedule applies, any tainted dividends received by or accrued to that person will also not benefit from the exemption but be treated as additional proceeds received by or accrued to the taxpayer in respect of the disposal by that person of the shares in the target company in the later of the year of assessment of that disposal or the year of assessment in which that tainted dividend is received by or accrues to the person.

#### *B. Application of the rules*

The rules dealing with dividend stripping will apply in the following circumstances:

- a. The person disposing of the shares in another company must be a resident company;
- b. That person (together with connected persons in relation to that person) must hold at least 50 per cent of the equity shares or voting rights in that other company or at least 20 per cent 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
- c. an otherwise exempt dividend is—
  - i. received or accrues within eighteen months prior to the disposal of the target company shares; or

- ii. received or accrues, regardless of the time of the receipt or accrual, by reason of or in consequence of the disposal of that other company's shares.

No regard will be had to how the tainted dividend is funded. This is because, taxpayers are funding the dividends in a number of ways and although the funding may in some instance be questionable, it is not the mischief that negatively affects the fiscus. The mischief is the conversion of taxable share sale consideration into exempt dividends.

#### **IV. Effective date**

The proposed amendments will be deemed to have come into effect on 19 July 2017 and apply in respect of any disposal on or after that date.

### **2.5. ADDRESSING ABUSE OF CONTRIBUTED TAX CAPITAL PROVISIONS**

[Applicable provision: section 1 of the Act - "contributed tax capital" definition and the insertion of the new section 8G of the Act]

#### **I. Background**

The concept of contributed tax capital (CTC) was introduced in the Act in 2011. CTC is a notional tax amount derived from contributions made to a company by holders of a class of shares as consideration for the issue of that class of shares by that company. It is reduced by any capital amount that is subsequently transferred back by the company to one or more shareholders of that class of shares (commonly known as a capital distribution) utilising that notional tax amount so received.

A distribution to shareholders which leads to a reduction of CTC does not constitute a dividend and is specifically excluded from the definition of "dividend" in section 1 of the Act and as a result not subject to dividends tax. That said, any transfer by a company to a shareholder, in cash or in kind, which does not constitute a return of CTC will be regarded as a dividend.

In order for a transfer from a company to a shareholder to constitute a reduction of CTC (and accordingly fall outside the dividend definition) the definition of CTC requires that the company directors (or other persons with comparable authority) determine that the transfer constitutes a transfer of CTC. This implies that a specific resolution must be taken in order for a company to return CTC to its shareholders. Without this specific company resolution, no reduction of CTC can occur and the amount transferred would constitute a dividend and be subject to dividends tax at a rate of 20 per cent.

#### **II. Reasons for change**

Government has identified structures in terms of which South African subsidiary companies with foreign parent shareholders increase their CTC and thereby avoid payment of dividends tax through capital distributions to its foreign shareholders. These capital distributions are not subject to CGT in the hands of the foreign parent shareholder if the underlying investment is not in immovable property in South Africa and therefore not within the South African CGT net.

The example of structures that have been identified whereby the concept of CTC is exploited include, but not limited to the following where CTC is either:

- a. artificially created as a means to avoid dividends tax by way of capital distribution within a group of companies; or
- b. a transaction, in substance, a share sale, is structured to create new or additional CTC.

*A. Group company structures*

In this structure, CTC is artificially created by the interposition of additional South African subsidiary companies as a means to avoid dividends tax through a capital distribution to foreign parent shareholders within a group of companies.

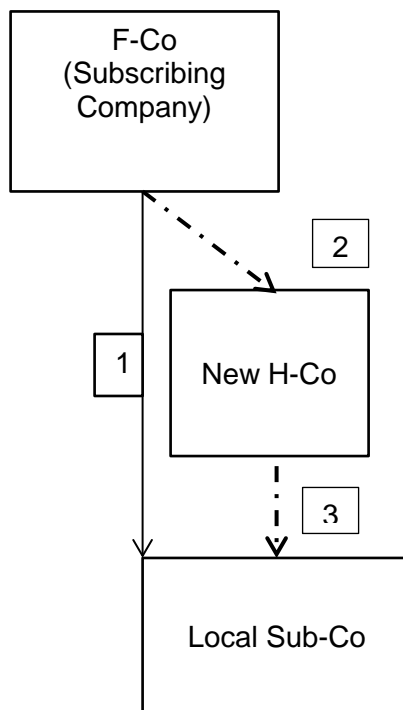
A South African subsidiary company issues shares to a foreign parent shareholding company that is part of the same group of companies as the South African subsidiary company. As consideration for the shares issued, the foreign parent company provides the South African subsidiary company with shares in another South African company that is also part of the same group of companies.

**EXAMPLE:**

Foreign parent company (F-Co) with a local subsidiary (Local S-Co) **[Note 1 on diagram below]** interposes a new intermediate holding company (H-Co) between itself and the Local S-Co on an asset-for-share basis between the F-Co and H-Co. To facilitate the transaction the H-Co is either a resident or becomes a resident after the asset-for-share transaction. H-Co issues shares to F-Co **[Note 2 on diagram below]** and receives as consideration all the shares held by F-Co in Local S-Co **[Note 3 on diagram below]**. CTC is created within H-Co equal to the market value of the shares in Local S-Co notwithstanding that Local S-Co is pregnant with reserves built up in South Africa over many years. Dividends then flow from Local S-Co to the H-Co on an exempt basis (resident to resident) and the H-Co in turn then effects a capital distribution through a reduction in the newly created CTC to the F-Co thus avoiding dividends tax.

The transaction merely reorganises ownership within the group of companies, with no or limited movement of any operational assets.

Diagram 1:



### *B. Disguised sale of shares*

The second identified structure involves a disguised sale of share transaction where instead of a standard disposal of shares between interested parties (shareholder A and possible new shareholder B), the interested parties instead enter into a structured transaction involving both shareholders and the target operational company (Op-Co).

#### **EXAMPLE:**

Shareholder B subscribes for the same class of shares in Op-Co as Shareholder A where after Op-Co then utilises the consideration received for the shares issued to shareholder B to do a share buy-back from shareholder A. By effecting the transaction as detailed above additional CTC is created in Op-Co which would not have been the case if shareholder A and B merely entered into sale transaction of the shares of Op-Co. To differentiate between those transaction with no economic real reason other than the creation of a tax benefit and legitimate transactions, the proposed anti-avoidance measure will have to be targeted.

### **III. Proposal**

It is proposed that legislation be amended to include:

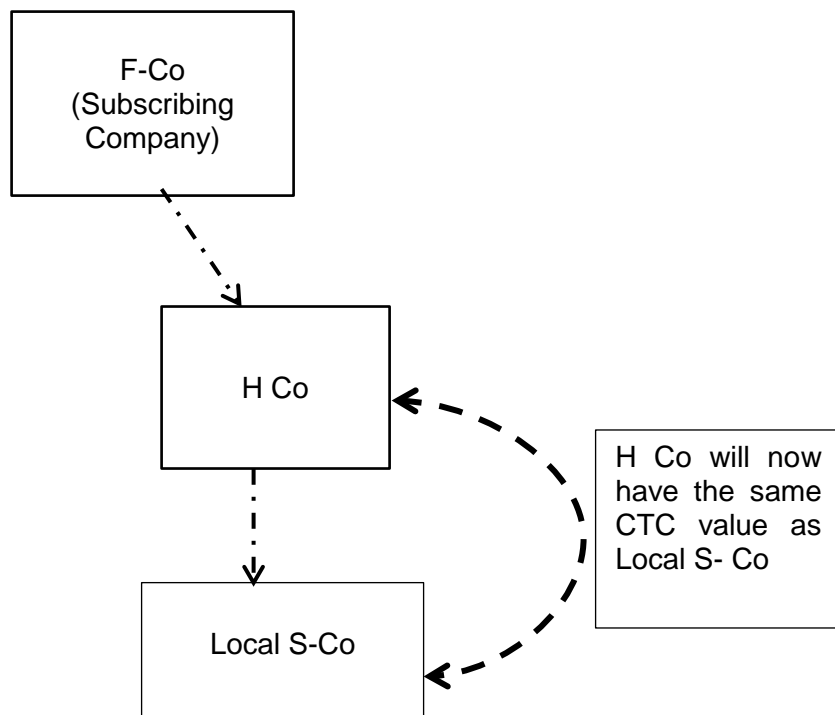
#### *A. Group company structures*

An anti-avoidance measure that adjusts the value of the consideration received for the issue of the shares by H-Co, to the extent that either

- a. that consideration consists of; or
- b. that consideration is use to directly or indirectly acquire;

shares in another company that also forms part of the same group of companies as H-Co, to be equal to the value of the CTC in Local S-Co as at the date when Local S-Co formed part of the same group of companies irrespective of whether that subscribing company formed part of that group on that date.

Diagram 2:



It is proposed that the consideration for the shares received by the issuer be deemed not to exceed the amount of the CTC available in the issuer for that same class of share immediately before the issue of the shares by the issuer.

#### IV. Effective Date

The proposed amendments will be deemed to have come into effect on 19 July 2017 and applies in respect of any share issued on or after that date.

#### 2.6. INTERACTION BETWEEN THE “*IN DUPLUM*” RULE AND THE STATUTORY TAX LEGISLATION

[Applicable provision: section 7D of the Act]

##### I. Background

###### A. Common law “*in duplum*” rule in South Africa

The “*in duplum*” rule originated from the South African common law and has been applied through South African case law for over 100 years. The main aim of the “*in duplum*” rule is to protect borrowers from exploitation by lenders that allow and, in some cases, cause interest to accumulate unabated leading borrowers into further indebtedness. In terms of the common law “*in duplum*” rule, interest charged on a debt stops to run (i.e. accrue) where the total amount of the unpaid interest equals the unpaid principal debt.

###### B. Statutory “*in duplum*” rule in South Africa



A statutory *“in duplum”* rule was later introduced into South African law in the National Credit Act No. 34 of 2005 (“NCA”) which came into effect on 1 June 2007. The statutory *“in duplum”* rule goes even further in its application as it provides for a limit on a number of costs, in addition to unpaid interest, which added together may not be more than the unpaid principal debt. These costs include initiation fees, services fees, credit insurance, default administration fees and collection costs.

The statutory *“in duplum”* rule is different from the common law *“in duplum”* rule in that the statutory *“in duplum”* rule applies to both unpaid interest and other finance related costs, whereas the common law *“in duplum”* rule only applies to unpaid interest. As a result, the statutory *“in duplum”* rule is regarded as being more onerous on credit providers and providing more protection for borrowers than the common law *“in duplum”* rule because the limit will be reached sooner given that other finance related costs that must be taken into account in respect of the statutory *“in duplum”* rule. Furthermore, the statutory *“in duplum”* rule overrides the common law *“in duplum”* rule in instances where a debt is regarded as a credit agreement governed by the NCA. However, in instances where a debt is not regarded as a credit agreement governed by the NCA, then the common law *“in duplum”* rule applies.

## **II. Reasons for change**

Taxpayers sometimes enter into loan arrangements with parties, where the lender that is advancing that loan to the borrower (who is in some manner related party to the lender) will advance the loan at a zero or low interest rate in order for the loan arrangement to be favourable to the related party by saving on interest costs. The use of these zero or low interest loans creates a loss to the fiscus as it often leads to for example:

- a. less PAYE collection where an employer grants a zero or low interest loan to an employee.
- b. avoidance of donations tax where a person transfers assets to a trust in exchange for a zero or low interest loan.
- c. possible avoidance of dividends tax where a company grants a shareholder a zero or low interest loan.

In order to counter the tax benefit as a result of the use of zero or low interest loans, the Act contains various anti-avoidance rules that deal with the taxation of a difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. These anti-avoidance provisions include the following:

- i. Section 7C of the Act which applies in respect of zero or low interest loan advanced to a trust by a connected person of that trust. The official rate of interest is used under this provision to quantify a donation that arises from advancing a zero or low interest loan to a trust.
- ii. Section 64E(4) of the Act where the official rate of interest is used to quantify a deemed dividend in respect of a zero or low interest loan made by a company to a shareholder by virtue of a share.
- iii. Seventh Schedule where the official rate of interest is used under this provision for fringe benefit determination in respect of a zero or low interest loan between an employer and employee.

It has come to Government's attention that some taxpayers are relying on the "*in duplum*" rules to circumvent the above-mentioned anti-avoidance rules. Taxpayers rely on the "*in duplum*" rules to distort the quantification of the tax benefit derived from a zero or low interest loan between connected parties, on the difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. These taxpayers claim that if a zero or low interest loan is advanced and the unpaid interest on that loan (and other costs, in the case of the statutory "*in duplum*" rule) reaches the amount of the unpaid principal debt, the "*in duplum*" rules apply to stop the interest (and other costs, in the case of the statutory "*in duplum*" rule) from running. Consequently, if the "*in duplum*" rules apply, then the application of the current anti-avoidance rules on the tax benefit on zero or low interest loans must also not be applied.

### **III. Proposal**

The above-mentioned anti-avoidance rules that deal with the tax consequences of zero or low interest loans in employer-employee relationships; shareholder-company relationships and natural connected person-trust relationships were introduced for purposes of determining the tax benefit derived from a zero or low interest loan between connected parties, on the difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. They are meant to override all instances where interest is either not levied or levied at a rate below the market value, irrespective of whether the "*in duplum*" rule applies or not. It is proposed that clarification be made in the Act so that anti-avoidance rules dealing with zero or low interest

loans should apply in spite of the application of either the statutory "*in duplum*" rule or the common law "*in duplum*" rule.

### **IV. Effective Date**

The proposed amendment will come into effect on 1 January 2018 and applies in respect of interest incurred or deemed to have been incurred on or after that date.

## **2.7. TAX IMPLICATIONS OF THE ASSUMPTION OF CONTINGENT LIABILITIES UNDER THE CORPORATE REORGANISATION RULES**

[Applicable provision: section 41 of the Act]

### **I. Background**

#### *A. Asset sales and transfers for purposes of corporate restructures*

Often in business, taxpayers sell or transfer their assets to other companies. They may choose to sell or transfer either an individual asset, a group of assets of a certain division or even an entire business as going concern to other companies. These sales or transfers of assets are not always done because the assets are no longer needed by the seller or the shareholders of the seller. The taxpayers involved in these sales and transfers of assets may, in some instances, do so for purposes of re-arranging or restructuring their own operations or the operations of other companies with which they have a common shareholder (which would make them part of the same economic unit).

Restructuring the business operations of a company or companies belonging to the same economic unit can help struggling companies to improve their financial position or even help successful companies to expand more than if they continued operating under the

same structure. Restructuring often requires that taxpayers should reallocate their existing assets, divisions or even their entire businesses between companies in the same economic unit. Such sales and transfers are disposals which trigger tax consequences for the seller.

### *B. Tax consequences of selling or transferring assets*

Ordinarily, where an asset that is being sold is trading stock, the proceeds of that sale will result in income tax consequences arising (i.e. where the sale price (after reducing it by the cost of the trading stock) is taxed at marginal rates of taxation if the taxpayer is a natural person or the corporate rate of 28 per cent if the taxpayer is a company). Where the asset that is being sold is a capital or allowance asset, CGT consequences will arise (i.e. the proceeds from the sale will be reduced by the base cost of the asset and a portion of any capital gain arising will be included in the taxable income the taxpayer and will as a result be subject to tax at the rates referred to above).

Restructuring transactions are not entered into by companies (and in particular the ultimate shareholders of the companies) to disinvest in their assets but are rather done to achieve operational efficiency and profitability. Growth in the profitability of companies would have a positive effect on the fiscus. As such, it is Government's policy to encourage and simplify corporate restructures. However, South Africa does not have a group taxation regime which would treat a group of wholly owned or majority-owned companies as a single entity for tax purposes. Under a group taxation regime, the transfer of assets within an economic unit would not trigger tax because the individual companies within the unit would be seen as one entity.

Instead of having a group taxation regime, the Act contains corporate reorganisation rules that postpone the tax consequences of taxpayers that sell or transfer their assets under specific circumstances. As a result, corporate restructures that comply with the corporate restructuring rules do not immediately trigger tax. The tax consequences are postponed until the assets are subsequently sold or transferred outside the economic unit to an unrelated third party.

## **II. Reasons for change**

For purposes of ensuring that the corporate reorganisation rules are not abused by taxpayers to facilitate the sale or transfer assets outside of the economic units without triggering tax, there is a limitation on the types of consideration (i.e. the manner in which the sale price is settled) that a purchaser can use to pay for the assets. As a starting point, selling or transferring assets in exchange for cash is viewed as an indication that a taxpayer is no longer interested in the asset and wishes to permanently dispose of it.

As a result, the corporate restructuring rules allow a seller to sell or transfer assets in exchange for equity shares in the purchaser. In some instances, the legislation also allows a purchaser to assume (i.e. take over as the debtor) some or all the debts of the seller in exchange for the assets. These instances are:

- a. where a person disposes of an asset to a company in exchange for the shares in that company in terms of section 42 of the Act;
- b. where a company disposes of all its assets to another company for purposes of merging the two companies into one company in terms of section 44 of the Act; and

- c. where a company disposes of all its assets to its shareholder(s) in anticipation of its liquidation, winding up or deregistration.

There are, however, requirements that must be met before a debt can be assumed for purposes of the corporate reorganisation rules. The debt of the seller must be older than 18 months before the sale or transfer of the assets. If the debt is not older 18 months, that debt can only be regarded as being permissible if it in the normal course of the seller's business (i.e. depending on the nature of the seller's business it would be expected that such debt would arise i.e. employee costs). The concept of debt in this regard requires that the seller must have an existing and real obligation to pay some other party and that other party must have a legal right to collect or receive the payment.

However, a seller and purchase may negotiate a selling price after considering and taking into account some of the contingent debts of the seller. Contingent debts differ from the debts that are currently allowed as permissible consideration under the corporate reorganisation rules. Unlike the debts currently catered for, contingent debts are anticipated obligations that will be confirmed only by the occurrence or non-occurrence of a future event. However, some contingent debts have a real economic impact on the sale transaction and it should be considered whether they should be provided for as acceptable consideration under the corporate reorganisation rules.

### **III. Proposal**

As indicated above, the concept of debt as it is currently contemplated under the corporate reorganisation rules and the Act as a whole refers to an existing and real obligation to pay some other party and that other party must also have a legal right to collect or receive the payment. In order to expand on this concept of debt for purposes of the corporate reorganisation rules, it is proposed that it should be clarified by way of a new definition in section 41 of the Act that the concept of debt for purposes of the corporate reorganisation rules will include contingent debt.

In addition, it should be noted that all the restrictions that are applicable to debt as it is current understood for purposes of the corporate reorganisation rules relating to the time that the debts arose (i.e. the 18-month rule discussed above), will also apply to the contingent debt contemplated above.

### **IV. Effective Date**

The proposed amendment will come into effect on the date of promulgation of Taxation Laws Amendment Act, 2017.

## **2.8. EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

[Applicable provisions: section 22 of the Act and section 1 of the Securities Transfer Tax Act No. 25 of 2007 ("STT Act")]

### **I. Background**

The Act and the STT Act provide relief in respect of an outright transfer in beneficial ownership of specific financial instruments for both collateral arrangements and lending arrangements, hereafter collectively referred to as 'securities arrangements'. As a result, there are no income tax, CGT and STT implications (where applicable) if a listed share or government bond is transferred in a securities arrangement, provided that identical

shares or bonds are returned to the borrower by the lender or to the lender by the borrower, as the case may be, within a specified limited period from the date on which the securities arrangement was entered into.

## **II. Reasons for change**

In 2016, amendments were effected in the Act and the STT Act to include listed South African government bonds as allowable financial instruments for collateral and lending arrangements. As a result, listed South African government bonds that are transferred as collateral and under securities arrangements qualify for the above-mentioned relief (where applicable).

At issue is the fact that the above-mentioned 2016 amendments only focused on tax relief for collateral and lending arrangements of listed South African government bonds and do not apply to listed foreign government bonds. This limits the potential use of listed foreign government bonds, which can be utilised as a tool to mitigate risk and to diversify risk.

## **III. Proposal**

In order to address concerns regarding the scope of tax relief collateral and lending arrangements, it is proposed that tax relief be extended to include listed foreign government bonds. As a result, listed foreign government bonds that are transferred as part of collateral and lending arrangements will qualify for the above-mentioned special tax dispensation.

## **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018 and apply in respect of collateral arrangements and lending arrangements entered into on or after that date.

### **2.9. THIRD-PARTY BACKED SHARES: AMENDMENT OF THE PROVISIONS TO COVER CERTAIN QUALIFYING PURPOSES**

[Applicable provision: section 8EA of the Act]

#### **I. Background**

The Act contains third party backed share anti-avoidance provisions in section 8EA of the Act 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 of the Act 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.

The anti-avoidance rules however do have exceptions to allow for specific third party guarantees/obligations if the application of funds derived from preference shares are used for qualifying purposes as defined in section 8EA of the Act.

#### **II. Reasons for change**

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.

Although the 2014 changes tried to address some of the concerns, however, it has come to Government's attention that the "qualifying purpose" exemption that the targeted result of the legislation has been found to be overly restrictive and as such several possible variations of asset-backed preference share transactions entered into through the ordinary course of business for qualifying purposes, other than a direct or indirect acquisition of equity shares in an operating company, has been unduly restricted.

### **III. Proposal**

In order to address concerns regarding the fact that the qualifying purpose test is too narrow, and may impede legitimate transactions, an amendment is proposed 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.

### **IV. Effective Date**

The proposed amendments will come into effect on 1 January 2018 and apply in respect of any dividends or foreign dividends received or accrued during years of assessment commencing on or after that date.

---

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

### **3.1. REFINEMENT TO THE TAXATION OF FINANCIAL ASSETS AND LIABILITIES DUE TO CHANGES IN ACCOUNTING STANDARD**

[Applicable provisions: section 24JB(1) and (2) of the Act]

#### **I. Background**

The rules for the taxation of financial assets and financial liabilities were introduced to overcome the divergence that was occurring in the income tax and accounting treatment of certain financial assets and liabilities.

To simplify compliance, this regime requires covered persons (defined in section 24JB of the Act) for tax purposes to include in, or deduct from, their income all amounts in respect of financial assets and financial liabilities that are recognised at fair value at the end of the financial year in profit or loss in the statement of comprehensive income.

In order to determine this gain or loss by the covered person, that covered person should be utilising the accounting standard dealing with the financial assets and financial liabilities, that currently is International Accounting Standard (IAS) 39 (Financial Instruments: Recognition and Measurement).

Although there are different categories of financial assets and financial liabilities according to IAS 39, the general focus of section 24JB of the Act is on financial assets and financial liabilities that IAS 39 standard requires a covered person to either hold for trading purposes or upon initial recognition designate as at fair value through profit or loss.

With respect to designation of financial assets, a company may designate a financial asset at fair value through profit or loss on initial recognition if the following criteria amongst others are met:

- a. the designation eliminates or significantly reduces a measurement recognition inconsistency sometimes referred to as an accounting mismatch.
- b. a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

Currently, section 24JB of the Act allows the exclusion of a financial asset that is a share, an endowment policy, an interest held in a portfolio of a collective investment scheme, an interest in a trust or an interest in a partnership on the premise that that financial asset is "managed and its performance is evaluated on a fair value basis" as per IAS 39. In addition, these exclusions were allowed because the covered person holds these financial assets not for trading purposes but for a long period as investments on capital account.

## **II. Reasons for change**

Given that as from 1 January 2018, banks must adopt the accounting standard called International Financial Reporting Standards (IFRS 9) which replaces IAS 39; amendments need to be made to section 24JB of the Act to ensure that it is in line with IFRS 9. In addition, although IFRS 9 in general retains the existing requirements (IAS 39 requirements) for classification and measurement of financial assets and liabilities there are certain exceptions with regards to the following:

- a. IFRS 9 only allows designation when it eliminates, or significantly reduces, an accounting mismatch.
- b. Under IFRS 9, the amount of the change in the fair value of a financial liability that is attributable to changes in the credit risk of that liability should be disclosed in the "other comprehensive income" statement.
- c. On commencement of the application of IFRS 9 certain financial instruments will be reclassified and adjustments will be reflected in retained earnings and not through profit or loss.

## **III. Proposal**

### *A. References*

It is proposed that all references to IAS 39 be changed to IFRS 9.

### *B. Changes in the designation of a financial asset*

Given that in future IFRS 9 does not allow for a designation at fair value through profit or loss for a financial asset that is managed and its performance is evaluated on a fair value basis, it is proposed that the exclusions be afforded to the covered person if the relevant financial asset is not classified as trading stock, as defined in section 1 of the Act.

#### *C. Treatment of financial liabilities under IFRS 9*

It is proposed that the amount of changes in the fair value of a financial liability that is attributable to changes in the credit risk of that financial liability reflected in the statement of “other comprehensive income” be subjected to section 24JB of the Act.

#### *D. Transitional rule*

It is proposed that if a financial asset held by or financial liability owed by a covered person at the end of the year of assessment immediately preceding the year of assessment commencing on or after 1 January 2018 would have ceased to be, or would have become subject to tax in terms of subsection (2), as the case may be, if IFRS 9 had applied on the last day of that immediately preceding year if assessment, that covered person is deemed for purposes of the Act to have—

- a. disposed of that financial asset or redeemed that financial liability; and
- b. immediately reacquired that financial asset or incurred that financial liability,

for an amount equal to the market value of that financial asset or financial liability on that day.

### **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018 and apply in respect of years of assessment commencing on or after that date.

### **3.2. EXCLUSION OF IMPAIRMENT ADJUSTMENTS FROM THE DETERMINATION OF TAXABLE INCOME**

[Applicable provision: insertion of new subsection (jA) of section 11 of the Act]

#### **I. Background**

##### *A. Summary of SARS Directive on impairment*

On 17 February 2012, SARS issued a Directive for the tax treatment of doubtful debts by banks for application from the 2011 year of assessment. This SARS Directive only applies to banks and does not apply to other financial service providers. In summary, the Directive makes provision for the following allowance percentages to be granted in terms of section 11(j) of the Act dealing with doubtful debts:

- a. 25 per cent of the incurred but not reported (IBNR) impairment provision for loans that cannot yet be identified to a specific loan;
- b. 80 per cent of portfolio specific impairment (PSI) provision for specific loans that are not yet in default; and
- c. 100 per cent of the specific impairment provision (SI) for loans that are individually



identified as impaired and are close to in default, provided a valid and accurate split can be distinguished from a PSI provision.

This Directive applies to banks as long as IAS 39 is applied by banks for accounting purposes.

#### *B. Summary of IFRS 9 (new standard replacing IAS 39) on impairment*

According to IFRS 9, it is stated that the impairment requirements relating to the accounting for an entity's expected credit losses on its financial assets and commitments to extend credit eliminate the threshold that was in IAS 39 for the recognition of credit losses. Under the impairment approach in IFRS 9 it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, an entity should always account for expected credit losses, and changes in those expected credit losses. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition and, consequently, more timely information is provided about expected credit losses.

IFRS 9 has a 'three-stage' model for impairment provisioning based on changes in credit quality since initial recognition. These stages are as follows:

- a. Stage 1: if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses (IBNR).
- b. Stage 2: recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition whether assessed on an individual or collective basis considering all reasonable and supportable information, including that which is forward-looking (PSI).
- c. Stage 3: includes financial assets that have objective evidence of impairment at the reporting date (SI).

## **II. Reasons for change**

The issue relates to the fact that the impairment requirements under IFRS 9 are determined on a significantly different basis from those under IAS 39. The key difference stems from the fact that the IAS 39 'incurred loss model' delays the recognition of credit losses until there is objective evidence of impairment. Furthermore, only past events and current conditions are considered when determining the amount of impairment (i.e. the effect of future credit loss events cannot be considered, even when they are expected). However, under the IFRS 9 'expected credit loss model', expected credit losses are recognised at each reporting period even if no actual loss events have taken place. In addition to past events and current conditions, reasonable and supportable forward-looking information that is available is considered in determining impairment. As a result of these differences, the adoption of the IFRS 9 accounting standard will result in significantly higher levels of impairments being recognised, particularly in stages 1 (IBNR) and 2 (PSI).

## **III. Proposal**

### *A. Affected parties*

In view of the fact that banks that are registered in terms of the Banks Act No. 94 of 1990, are highly regulated by the South African Reserve Bank (SARB) and are subject to stringent capital requirements, it is proposed that the following tax treatment for doubtful debts be introduced for covered persons as defined in section 24JB of the Act.

#### *B. Percentage allowed*

Based on the above, it is proposed that the following allowance be allowed in determining the taxable income of a covered person as defined in section 24JB of the Act:

- a. 25 per cent of IBNR impairment provision;
- b. 25 per cent of PSI provision; and
- c. 85 per cent of SI provision that is equal to the amount that is in default as determined by applying the criteria in paragraphs (a)(iii) to (iv) and (b) of the definition of default as defined in Regulation 67 of SARB contained in Government Gazette No. 35950 of 12 December 2012.

In applying this 25 per cent tax allowance, covered persons would apply the principles of IFRS 9 to arrive at the loss allowance as contemplated in IFRS 9 relating to impairment and the 25 per cent will be allowed as a deduction under the proposed section 11(jA). The claimed in a year of assessment must be added back to income in the following year of assessment.

#### **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018 and apply in respect of years of assessment commencing on or after that date.

### **3.3. APPLICATION OF HYBRID DEBT INSTRUMENTS RULES IN RESPECT OF COVERED PERSONS DEFINED IN SECTION 24JB**

[Applicable provision: section 24JB(1) of the Act]

#### **I. Background**

##### *A. General application of hybrid debt rules*

The Act contains anti-avoidance rules in sections 8F and 8FA of the Act aimed at curbing the use of equity instruments that are artificially disguised as debt instruments. In particular, section 8F focuses on the features of the instrument itself and section 8FA of the Act focuses on the nature of the yield of the instrument and they deal with the characterisation of any amount of interest incurred in respect of a debt instrument to be deemed as a dividend *in specie* declared and paid by the issuer if the debt instrument has specific equity-like or dividend like features. In view of the fact that these rules characterise interest as a dividend *in specie*, that interest does not qualify for a tax deduction.

##### *B. Interaction of hybrid debt rules with taxation of financial assets & financial liabilities of a covered person*

In certain instances, a covered person as defined in section 24JB of the Act may from time to time issue structured products such as credit linked notes into the market that are dependent on the covered person's solvency.

In this instance, investors buy securities from the credit link note issuer that is a covered person, and in exchange they receive a fixed or floating coupon payment over the term of the security and at maturity.

### *C. IAS 39, IFRS 9 and 24JB of the Act interaction*

In general accounting terms, hybrid debt instruments such as credit linked notes are regarded as credit derivatives. These hybrid debt instruments are in general accounted and treated as "derivatives" and therefore the gains and losses are recognised at fair value through profit or loss (FVTPL) in line with IAS 39. Even under IFRS 9, the replacement accounting standard to IAS 39, these hybrid debt instruments would generally also be accounted for at FVTPL. Currently the Act makes provision for derivatives as defined in IAS 39 of a covered person to be subject to tax under section 24JB of the Act.

## **II. Reasons for change**

If the credit linked notes issued by a covered person in terms of section 24JB of the Act are dependent on the bank's solvency, the anti-avoidance provisions of section 8F of the Act will apply to the credit linked note and will characterise any amount of interest incurred in respect of that credit linked note as a dividend *in specie*, and as a result, will not qualify for an interest deduction.

It has come to Government's attention that despite the application of the anti-avoidance provision in sections 8F and 8FA of the Act of denying a deduction of interest on the borrower's side, if the amount of interest is characterised as a dividend *in specie*, some covered persons referred to in section 24JB of the Act may still argue that they are entitled to claim a deduction of interest incurred due to the application of the provisions of section 24JB of the Act, while the counterparty is deemed to have received a dividend *in specie*.

## **III. Proposal**

In order to address the interaction between the anti-avoidance rules in sections 8F and 8FA of the Act and the provisions relating to the taxation of covered persons in section 24JB of the Act, it is proposed that the Act be amended to clarify the policy intent that the anti-avoidance rules in sections 8F and 8FA of the Act override the provisions of section 24JB of the Act. As a result, it will be confirmed that a covered person in terms of section 24JB of the Act is not eligible for an interest deduction. The amount received by a counter party of a covered person in this instance is in terms of the application of the anti-avoidance rules in sections 8F and 8FA of the Act deemed to have received a dividend *in specie*.

## **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018 and apply in respect of years of assessment commencing on or after that date.

### **3.4. AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERS DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK**

[Applicable provision: section 29A of the Act]

#### **I. Background**

In 2016, amendments were effected to section 29A of the Act to cater for the tax treatment of the long-term insurance industry as a result of the introduction of the Solvency Assessment and Management (SAM) Framework and the new Insurance Act, 2016. These changes included amongst others the introduction of the definition of “adjusted IFRS value” and the transitional rules dealing with the phasing in amount and the phasing in period.

##### *A. Definition of “adjusted IFRS value”*

The new definition of “adjusted IFRS value” both in the 2016 Taxation Laws Amendment Act No. 15 of 2016 and 2016 Explanatory Memorandum applies to both the risk policy fund and the three policyholder funds. However, unlike the 2016 Taxation Laws Amendment Act, the new definition “adjusted IFRS value” in the 2016 Explanatory Memorandum took into account all the following factors:

- a. The IFRS policy liabilities amount is net of reinsurance (gross amount of liabilities less reinsurance amount) determined in accordance with IFRS as annually reported in the audited financial statements. The IFRS policyholder liabilities amount takes into account cases where policyholder liabilities are determined and reported on a gross basis and a corresponding reinsurance asset is reflected as an asset in the annual financial statements. In this instance, IFRS policyholder liabilities will be reduced by the amount reflected as a reinsurance asset.
- b. The IFRS policy liabilities amount is also net of negative liabilities (gross amount of liabilities less all negative liabilities irrespective of whether they are disclosed as a reduction of liabilities or as an asset) determined in accordance with IFRS as annually reported in the audited financial statements.
- c. The amount of liabilities in respect of policies of the insurer net of reinsurance and negative liabilities is determined with reference to the amounts disclosed in accordance with IFRS. The amounts disclosed in accordance with IFRS should be disaggregated in order to allocate the amounts to the relevant policyholder fund or risk policy fund. After the allocation, a single net amount of liabilities in respect of all policies allocated to a fund is determined.
- d. If the determination under the three previous paragraphs results in a net “negative liability”, the amount under paragraph (a) of this definition is limited to nil. This is due to the fact that the transfer mechanism under subsection (7) operates on the assumption that the value of liabilities cannot be a number less than zero.
- e. Although the definition of “adjusted IFRS value” applies to the risk policy fund and the three policyholder funds, only the policyholder funds should include the deferred tax liabilities in respect of assets allocated to those funds in the “adjusted IFRS value”. This is due to the fact that unrealised gains on assets allocated to the

risk policy fund are not earned for the benefit of specific policyholders as in the case of policyholder funds under the trustee basis of taxation.

### *B. Definition of “phasing in amount”*

In addition, transitional rules dealing with the phasing-in amount and the phasing in period of 6 years were introduced in order to stabilise the tax collections by SARS and reduce the financial impact of certain long-term insurers due to the 2016 legislative amendments. These rules are aimed to cater for the difference in treatment of negative liabilities under the new regime (coming into effect when the Insurance Act of 2016 and SAM come into effect) and the previous rules, which applied before the coming into effect of the definition of “adjusted IFRS value”, in so far as it relates to negative liabilities.

Negative liabilities means an amount by which the expected present value of future receipts from a policy exceeds the expected present value of future claims and expenses in respect of a policy (effectively expected profit from a policy). This fixed amount representing the difference relating to policies allocated to a fund between the liabilities for tax purposes and the liabilities disclosed in the insurer’s published annual financial statements for 2016 will be phased in over a period of six years. In order to counter potential abuse of the phasing in rules, the negative liabilities as disclosed for tax and financial reporting in 2016 will be adjusted to the manner of disclosure that applied in 2015.

The amount of negative liabilities will be reduced by the negative liabilities that are recognised as an asset on the balance sheet (statement of financial position) by insurers that are in a net asset position (total negative liabilities exceeds total positive liabilities to policyholders). The reason for the exclusion is to avoid a significant negative impact on the liquidity of insurers that have a negative liability for policies allocated to a specific tax fund.

## **II. Reasons for change**

Although the 2016 tax amendments to the valuation method for long term insurers due to the introduction of SAM are explained clearly in the 2016 Explanatory Memorandum to the 2016 Taxation Laws Amendment Act (including examples), however, there are certain aspects that may still cause confusion. These aspects include the following:

### *A. Definition of “adjusted IFRS value”*

Firstly, as stated above, the new definition of “adjusted IFRS value” in the 2016 Taxation Laws Amendment Act did not take into account all the factors that were in the 2016 Explanatory Memorandum. For example, the new definition of “Adjusted IFRS value” in the 2016 Taxation Laws Amendment Act does not allow for the consistent treatment of negative liabilities on the asset or liability side on the statement of financial position (balance sheet).

In addition, according to section 29A(7) of the Act, an insurer is required to re-determine the value of liabilities in each policyholder fund and the risk policy fund within three months after the end of every year of assessment. Where the market value of the assets in the fund exceeds the value of liabilities, assets with a market value equal to the excess must be transferred from such fund to the corporate fund. Where the market value of the assets is, however, less than the value of liabilities, assets with a market value equal to the shortfall must be transferred from the corporate fund to the relevant fund. This

transfer mechanism under subsection (7) operates on the assumption that the value of liabilities cannot be a number less than zero.

*B. Definition of “phasing-in amount”*

With regard to the current definition of “*phasing in amount*”, it is not clear whether the reduction of negative liabilities by the amount of negative liabilities recognised as an asset applies if the relevant fund of the long-term insurer is in a net liability or net asset position.

**III. Proposal**

In order to address some concerns regarding the application and interpretation of the 2016 tax amendments and to align the policy rationale for the new basis of determination of the valuation of liabilities of long term insurers for tax purposes as explained in the Explanatory Memorandum to the Taxation Laws Amendment Act, 2016, it is proposed that the following amendments be made in the Act:

*A. Definition of “adjusted IFRS value”*

It is proposed that the definition of “*adjusted IFRS value*” should:

- a. be redrafted in the form of a formula that should make it easier to apply
- b. also allow for a deduction of negative liabilities (gross amount of liabilities less all negative liabilities irrespective of whether they are disclosed as a reduction of liabilities or as an asset) determined in accordance with IFRS as annually reported in the audited financial statements.
- c. not result in a “net negative” after the following deductions:
  - i. reinsurance amount
  - ii. negative liabilities
  - iii. phasing-in amount if tax value exceeds financial reporting value
  - iv. deferred acquisition costs.

*B. Definition of “phasing-in amount”*

It is proposed that the definition of “*phasing-in amount*” should be amended so that the reduction of negative liabilities recognised as an asset only be afforded to insurers that are in a ‘net asset’ position (where total negative liabilities exceeds total positive liabilities to policyholders) to avoid a significant negative impact on the liquidity of those insurers.

In addition, in view of the fact that the Insurance Act, 2016, has not yet come into operation, it is proposed that the reference to the 2016 published annual financial statements in respect of the fixed amount representing the liabilities disclosed in the insurer’s published annual statements should be changed to 2017. However, in order to counter potential abuse of the phasing-in rules, the negative liabilities as disclosed for tax and financial reporting in the proposed 2017 year will still be adjusted to the manner of disclosure that applied in 2015.

## **IV. Effective date**

The proposed amendments will come into effect on the date on which the Insurance Act 2016, comes into effect and apply in respect of years of assessment ending on or after that date.

### **3.5. TAX TREATMENT OF DEFERRED ACQUISITION COSTS BY LONG TERM INSURERS**

[Applicable provision: new paragraph (c) in section 29A(1) and new paragraph (e) in section 29A (16) of the Act]

#### **I. Background**

##### *A. General accounting treatment of Deferred Acquisition Cost (DAC)*

With regard to the business of long term insurers, DAC exists as a result of deferring acquisition costs of policies. Generally, the biggest part of acquisition costs of a policy incurred by insurers consists of commissions. Typically, long-term insurers do not typically pay commissions until the policyholder pays the insurance contract's first year premium. Furthermore, there are other acquisition costs that may be incurred before the cover period in respect of the said insurance contract between the long-term insurer and a policyholder commences.

In general, for accounting purposes, acquisition costs are recorded as an expense over the term of a policy. Therefore, DAC is treated as an asset in the published statement of financial position (balance sheet) of a long-term insurer. This means, the portion of an expense incurred is deferred and is amortised over a certain specified period.

##### *B. Current tax treatment of DAC*

Currently, the Act does not prescribe the tax treatment of DAC with regard to long-term insurers. This has led to long term insurers having different interpretations and practices of how to treat a DAC asset in determining the transfer amount as envisaged in section 29A(7) of the Act.

In practice, there are currently four alternatives that are applied by long-term insurers for tax purposes:

- a. The DAC is excluded as an asset but netted-off against gross policy liabilities.
- b. The DAC is treated as an asset and does not reduce the gross policy liabilities.
- c. The DAC asset is not taken into account and the movement in the DAC is also ignored.
- d. Instead of setting up a DAC asset, a long-term insurer creates a negative rand reserve.

#### **II. Reasons for change**

Currently, there are no specific rules dealing with the tax treatment of DAC. The application of the four different methodologies mentioned above for the treatment of DAC creates confusion and leads into inconsistencies. The introduction of the SAM, the accounting standard for insurance industry contained in IFRS 4 Phase II and the new Insurance Act necessitates that changes be made in the Act to ensure that the tax treatment of DAC by all long-term insurers is aligned.

### **III. Proposal**

In order to harmonise the tax treatment of DAC by all long-term insurers and to ensure consistent treatment of DAC, it is proposed that a prescribed tax treatment of DAC be introduced. It is assumed that the deferred acquisition costs have been allocated to the policyholder funds and the risk policy fund as the costs relate to the business conducted in those funds and as a result the following is proposed:

- a. DAC assets disclosed for financial reporting purposes must be disregarded as an asset for purposes of section 29A of the Act.
- b. Furthermore, the DAC amount should be deducted against the amount of the liabilities in respect of policies of the insurer as per the amended definition of “adjusted IFRS value”.

### **IV. Effective date**

The proposed amendments will come into effect on the date on which the Insurance Act, 2016 comes into effect and apply in respect of years of assessment ending on or after that date.

---

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

### **4.1. EXTENDING THE SCOPE OF NON-RECOUPMENT RULE FOR VENTURE CAPITAL COMPANIES**

[Applicable provision: section 12J of the Act]

#### **I. Background**

In 2008, Government introduced the Venture Capital Companies (VCC) tax regime as one of several measures to encourage the establishment and growth of Small, Medium and Micro-Enterprises (SMME) and as a tool to address job creation and inequality. Taxpayers investing in a VCC are allowed an upfront tax deduction for their investment in that VCC (whereas most equity investments are non-deductible) with a recoupment upon withdrawal if the investment is not held for a minimum period of five years.

#### **II. Reasons for change**

Similar to any other investment, investors investing in VCCs need to realise the value of their investments at some point. The investors subscribe for shares in a VCC and the VCC invests in qualifying companies and the investors have more than one option to realise the value of their VCC investment. Investors could realise the value of their investment by way of distributions from the VCC or by way of a disposal of their shares in the VCC. Distributions from the VCC could be in the form of dividends or returns of capital (reduction of CTC).

At issue is the distribution from the VCC in the form of returns of capital. It is argued that returns of capital may trigger a recoupment of the upfront income tax deductions allowed for the initial investment in the VCC, even if those returns of capital occurred after five years. This is not in line with the intention of the 2015 tax amendments that made



provision for the tax deduction not to be recouped in respect of the disposal of a share in a VCC if that share has been held by that taxpayer for a period of at least five years.

As CTC refers to a notional amount for tax purposes derived from the value of contributions made to a company as consideration for the issue of a class of shares by that company, and capital gain refers to a profit from the disposal of shares, there is no policy rationale to allow for the disparity in the treatment of recoupment of tax deduction between the disposal of a VCC share and a return of capital in respect of a VCC share.

### **III. Proposal**

In order to address the possible inconsistent treatment of recoupments of tax deductions between the disposal of a VCC share and a return of capital by way of a reduction of CTC on a VCC share it is proposed that amendments be made to the legislation to make provision for the tax deduction not to be recouped in respect of return of capital on a VCC share if that share has been held by the taxpayer for a period of at least five years. The holding period condition of five years will be the same as the holding period in respect of the disposal of a VCC share.

### **IV. Effective date**

This proposed amendment will come into effect on 1 January 2018 and applies in respect of years of assessment commencing on or after that date.

## **4.2. CLARIFYING THE SCOPE OF TAX DEDUCTIBLE DONATION STATUS FOR INTERNATIONAL DONOR FUNDING ORGANISATIONS**

[Applicable provision: section 18A(bA) of the Act]

### **I. Background**

The Act contains provisions in section 30 of the Act and the Ninth Schedule to the Act ("Ninth Schedule") which caters for exemption of public benefit organisations if they meet certain requirements as set out in the Act. In particular, section 30(1)(a) of the Act makes provision for exemption of activities listed in Part 1 of the Ninth Schedule. In turn, Part 2 of the Ninth Schedule makes provision for public benefit activities qualifying for tax deductible donations in terms of section 18A of the Act.

In 2008, changes were made in the Act to make provision for "specialised agencies" as defined in section 1 of the Diplomatic Immunities and Privileges Act No. 37 of 2001 (DIPA) to qualify for tax deductible donations in terms of section 18A of the Act.

The section 18A tax deductible donation status is not automatic for these specialised agencies operating in South Africa. Their eligibility for tax deductible donations is subject to meeting certain conditions as stipulated in sections 18A and 30 the Act.

### **II. Reasons for change**

As previously stated, the Section 18A tax deductible donation status only apply to the specialised agencies as defined in section 1 of the DIPA. It has come to Government's attention that specialised agencies referred to in section 1 of the DIPA do not include all the agencies of the United Nations (UN), which form part of the South Africa - United Nations Strategic Cooperation Framework 2013-2017 (UNSCF).

The UNSCF gives a platform for UN agencies mentioned in the framework to operate in South Africa and offer development assistance.

### **III. Proposal**

In order to encourage support of the UN agencies operating in South Africa, it is proposed that changes be made in section 18A(bA) of the Act to include the following UN agencies operating in South Africa in terms of the UNSCF, which are not included in the definition of “specialised agencies” in section 1 of the DIPA:

- a. United Nations Development Programme (UNDP);
- b. United Nations Children’s Emergency Fund (UNICEF);
- c. United Nations High Commissioner for Refugees (UNHCR);
- d. United Nations Population Fund (UNFPA);
- e. United Nations Office on Drugs and Crime (UNDC);
- f. United Nations Environmental Programme (UNEP);
- g. United Nations Entity for Gender, Equality and the Empowerment of Women (UN Women);
- h. International Organisation for Migration (IOM);
- i. Joint United Nations Programme on HIV/AIDS (UNAIDS);
- j. Office of the High Commissioner for Human Rights (OHCHR); and
- k. The United Nations Office for the Coordination of Humanitarian Affairs (OCHA).

### **IV. Effective date**

The proposed amendment will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2017.

#### **4.3. CORRECTING THE INCONSISTENT TAX TREATMENT BETWEEN CASH GRANTS AND IN-KIND GRANTS OF TRADING STOCK**

[Applicable provision: section 22 of the Act]

##### **I. Background**

In 2012, a unified system for the tax treatment of government grants was introduced. Under the unified system, government grants that are awarded to taxpayers are tax exempt in the hands of taxpayers that received them. A comprehensive list of government grants was also introduced in the Eleventh Schedule to the Act. This list is updated annually with any new government grants that are introduced so that taxpayers can have certainty when determining whether a government grant is tax exempt.

The Act allows taxpayers to make certain deductions against their income. Typically, taxpayers can deduct their operating expenses and, in some instances, taxpayers can

also claim allowances on the costs incurred by taxpayers for the creation or acquisition of business assets. However, with regards to government grants, taxpayers are not allowed to deduct operating expenses and allowances on assets if the operating expenses and the cost price of the assets are funded by government grants that are exempt. Taxpayers are denied these deductions and allowances because if they were allowed to claim them, they would be getting a double benefit (i.e. an exemption on the government grant as well as a deduction of expenses and costs that the government grant was used on).

In this regard, the following rules were introduced:

- a. If an exempt government grant is used to fund the acquisition, creation or improvement of trading stock, the cost price of the trading stock must be reduced by the amount of the exempt government grant.
- b. If an exempt government grant is used to fund the acquisition, creation or improvement of any other asset other than trading stock, the base cost of the capital asset must be reduced by the amount of the exempt government grant.
- c. If an exempt government grant is not used to fund the acquisition of an asset that is trading stock, an allowance asset or a capital asset, the taxpayer must reduce section 11 deductions otherwise allowed by the amount of the exempt government grant.
- d. In addition, if the grant exceeds the total amount of otherwise allowable deductions, the excess will be carried over into the next year.

This treatment is imposed in order to disallow any current or future deductions in respect of expenses and costs that are funded by exempt government grants. However, currently in-kind government grants (i.e. government grants in the form of goods or services as opposed to money that is then used to fund the necessary expense or acquire an asset) are excluded from this treatment.

## **II. Reasons for change**

When the unified system for the tax treatment of government grants was introduced, Government held the view that when a taxpayer receives an in-kind government grant, that taxpayer will have a zero base cost for the asset that is received. This means that the taxpayer would have no tax costs to claim allowances on for expenditure on allowance assets, capital assets or for trading stock. This view was held because under such circumstances the taxpayer would not have been liable for the payment of the acquisition costs and hence would not have incurred these expenses.

This view remains true when dealing with the in-kind government grants of allowance assets and capital assets. However, in the case of the in-kind government grants of trading stock, a market value tax cost is provided for in the Act in the instance that a taxpayer acquires trading stock without having to pay for the trading stock. This deemed cost at market value has an anomalous result when applying the rules currently governing the tax treatment of government grants. This is because, when a taxpayer receives an in-kind government grant of trading stock, that taxpayer is given an unintended double benefit because the value of the trading stock received by the taxpayer will be exempt under the current rules while the provisions dealing with the valuation of trading stock also give the taxpayer a notional tax cost for the trading stock.

This notional tax value gives the taxpayer an added benefit because this market value will reduce the sale consideration that the taxpayer will get in the future when selling the trading stock. This double benefit that a taxpayer can get when receiving an in-kind government grant goes is contrary to the tax treatment of all other government grants irrespective of the manner in which they are made available (i.e. whether in cash or in the form of an asset) and it should be aligned.

### **III. Proposal**

In order to align the resultant tax consequences of taxpayers receiving in-kind government grants of trading stock with those of all other government grants. To do this, it is proposed that the rule that provides for the market value cost price for trading stock should not apply to trading stock given to a taxpayer as a government grant. As a result of this proposal, trading stock that is given to a taxpayer in the form of a government grant will, similar to all other in-kind government grant, have a tax cost of zero.

### **IV. Effective date**

These amendments come into effect on 1 January 2018 and apply in respect of years of assessment commencing on or after that date.

#### **4.4. STRENGTHENING ANTI-AVOIDANCE MEASURES RELATED TO MINING ENVIRONMENTAL REHABILITATION FUNDS**

[Applicable provision: section 37A of the Act]

##### **I. Background**

In terms of both the Mineral and Petroleum Resource Development Act of 2002 (MPRDA) and the National Environmental Management Act of 1998 (NEMA), mining companies are obliged to make financial provision for the environmental rehabilitation of mining areas upon the closure of the mine. In 2006, changes were made in the Act to introduce a unified regime for the tax treatment of mining environmental rehabilitation funds. As a result, all cash contributions to the mining rehabilitation fund as envisaged in section 37A of the Act are tax deductible and the growth in the mining rehabilitation fund is exempt from tax.

In order to ensure that the above-mentioned tax benefit obtained in respect of the mining rehabilitation fund is utilized for its intended purpose, the new tax regime introduced a penalty system for contraventions of the provisions of section 37A of the Act. These penalty provisions include the following:

- a. if the rehabilitation fund holds impermissible investments (investments outside the list prescribed in section 37A of the Act), the person (essentially the mineral right holder or mining company) contributing towards the rehabilitation fund has to include the market value of those impermissible assets, as if that market value was fully received, as taxable income;
- b. if the rehabilitation fund makes impermissible withdrawals from the fund (e.g. used the money from the fund for activities not related to rehabilitation or closure of the mine), the market value of these withdrawals will be included in the taxable income of that rehabilitation fund; and

- c. the Commissioner may, if he/she is satisfied that the mining rehabilitation fund has contravened any of the provision of section 37A, impose an additional penalty and include an amount twice the market value of all property held in the rehabilitation fund in the income of the rehabilitation fund as taxable income or twice the market value of all property held by the mineral right holder or mining company as taxable income.

## **II. Reasons for change**

It has come to Government's attention that the funds from the mining rehabilitation fund are still withdrawn and used to fund activities not related to the rehabilitation or closure of the mine despite the current penalties contained in section 37A of the Act.

In addition, the penalty provisions provided in section 37A of the Act are difficult to enforce due to the fact that they are based on a premise of inclusion of an amount equal to the market value (or an amount equal to twice the market value, depending on the contravention) of such impermissible withdrawal or impermissible investment in the taxable income of the mining rehabilitation fund or mineral right holder or mining company. By the time SARS is aware that impermissible withdrawals or impermissible investments have taken place in the mining rehabilitation fund, it is already potentially too late and the mining rehabilitation fund or mineral right holder or mining company may no longer be operating or it may be in a loss making situation. Consequently, the mining rehabilitation fund or mineral right holder or mining company may no longer have taxable income or means to pay tax in respect of the penalty amount included in the taxable income. As a result, the impact of the penalty provisions can be circumvented or greatly reduced in this regard.

## **III. Proposal**

In order to curb the current and continued abuse, the following is proposed:

In order for the improved enforcement of the penalty provisions, it is proposed that the legislation premise of the penalties be amended to one where, during the year of assessment in which the breach occurred, 40 per cent tax rate be imposed to the market value of impermissible investment, impermissible withdrawal or a market value not exceeding twice the value of the assets in the rehabilitation fund. As a result, the following penalty provisions are proposed:

### *A. Penalty for impermissible investments*

If the rehabilitation fund holds impermissible investments (investments outside the list prescribed in section 37A of the Act), an amount equal to 40 per cent of the market value of the impermissible investment shall be deemed to be an amount of normal tax payable by the mineral right holder or mining company.

### *B. Penalty for impermissible withdrawals*

If the rehabilitation fund makes impermissible withdrawals from the fund (e.g. used the money from the fund for activities not related to rehabilitation or closure of the mine), an amount equal to the 40 per cent of the market value of these withdrawals shall be deemed to be an amount of normal tax payable by the rehabilitation fund.

### *C. Penalty for contravention of any provision of section 37A*

The Commissioner must, if he/she is satisfied that the mining rehabilitation fund has contravened any of the provision of section 37A of the Act, impose an additional penalty and an amount equal to 40 per cent of twice the market value of all property held in the rehabilitation fund shall be deemed to be normal tax payable by the mining rehabilitation fund or an amount equal to 40 per cent of twice the market value of all property held by the mineral right holder or mining company shall be deemed to be normal tax payable by mineral right holder or mining company.

#### *D. Reporting requirements*

In order for SARS to be able to verify on time if the funds from the mining rehabilitation fund are withdrawn and used to fund activities related only to the rehabilitation or closure of the mine, it is proposed that any withdrawals from the mining rehabilitation fund be included in the list of reportable arrangement in terms of section 35(2) of the Tax Administration Act No. 28 of 2011.

In view of the fact that the mining rehabilitation funds qualify for favourable tax treatment in the form of a deduction in respect of contributions to those mining rehabilitation funds and an exemption from tax in respect of the growth in the value of assets in those funds as well as that Government will have to bear the burden of ensuring that rehabilitation is done should mining rehabilitation funds be misused, it is proposed that a further reporting requirement be imposed on a mining rehabilitation fund to report to the Director-General of National Treasury. As a result, a mining rehabilitation fund will be required to report to the Director General of National Treasury, within three months after the end of any year of assessment, information comprising of (i) the total amount of contributions to the mining rehabilitation fund; (ii) the total amount of withdrawals from the mining rehabilitation fund, and (iii) the purpose for which any amount of those withdrawals were applied. In addition, the mining rehabilitation fund must, within 7 days after receiving a special request from the Director General of the National Treasury provide any information as the Director General may require.

#### **IV. Effective date**

The proposed amendments will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2017.

#### **4.5. INDUSTRIAL POLICY PROJECTS – WINDOW PERIOD EXTENSION**

[Applicable provision: Section 12I of the Act]

##### **I. Background**

Section 12I of the Act allows taxpayers an additional investment and training allowance in respect of industrial policy projects if they meet certain criteria prescribed by way of regulation. The additional investment allowance ranges from 35 per cent to 100 per cent of the cost of any new and unused manufacturing assets used for the project – depending on whether the project has qualifying or preferred status, and whether it is located in an industrial development zone (or designated special economic zone).

The additional investment allowance has specific requirements that require the asset:

- a. to be owned by the company claiming the additional allowance;
- b. to be used for the furtherance of the industrial policy project carried on by that company;

- c. to have been acquired and contracted for on or after the date of approval of the relevant project as an industrial policy project; and
- d. was brought into use within four years from the date of approval of the relevant project as an industrial policy project.

## **II. Reasons for change**

To assess the overall effectiveness of tax incentives such as 12I of the Act, Government will evaluate the relevant tax expenditure before it is considered for renewal at the end of its stipulated window period. According to subsection 12I(7)(d) of the Act, any application for approval of a project must be made before 31 December 2017.

In order to allow sufficient time for a review of the section 12I of the Act tax incentive to be completed, the window period will be extended from 31 December 2017 to 31 March 2020.

While the window period for the tax incentive will be extended, the current approval threshold of R20 billion in potential investment and training allowances will not be increased at this stage. Tax revenues are under severe pressure in a fiscally constrained environment at present. As a result, no increase in the approval threshold for the 12I programme is currently being considered. The outcome of the proposed review will determine any further legislative amendments to section 12I of the Act.

## **III. Proposal**

It is proposed that the window period for applications for industrial policy projects in terms of section 12I of the Act be extended from 31 December 2017 to 31 March 2020.

## **IV. Effective date**

The proposed amendment will be deemed to have come into effect on 31 March 2017.

---

# **5. INCOME TAX: INTERNATIONAL**

## **5.1. REFINEMENTS OF THE DOMESTIC TREASURY MANAGEMENT COMPANY REGIME QUALIFYING CRITERIA**

[Applicable provisions: definition of “domestic treasury management company” in section 1, sections 24I and 25D of the Act]

### **I. Background**

In 2013, Government introduced a domestic treasury management company regime for exchange control and tax purposes. The regime was aimed at encouraging listed South African multinational companies to relocate their treasury operations to South Africa. Under this regime, listed South African multinational companies are allowed to establish one subsidiary to manage the group treasury functions without being subject to exchange control restrictions that apply to companies incorporated in South Africa.

For tax purposes, the regime provides relief in respect of unrealised foreign currency gains and losses in that the domestic treasury management company is permitted to use its functional currency, other than the Rand, for currency translations.

In order to qualify as domestic treasury management company, a company must satisfy three criteria:

- a. must be incorporated or deemed to be incorporated by or under any law in force in South Africa;
- b. have its place of effective management in South Africa; and
- c. must not be subject to exchange control restrictions by virtue of being registered with the Financial Surveillance department of the SARB.

All the above three mentioned requirements must be satisfied for a company to qualify as a domestic treasury management company.

## **II. Reasons for change**

Experience with the domestic treasury management regime suggests that certain anomalous requirements need to be removed in order to make the domestic treasury management company regime more effective. Specifically, the requirement that a company must be incorporated in South Africa is cumbersome for companies that are incorporated offshore but wish to move their tax residency to South Africa.

A company that is incorporated offshore will still be tax resident in South Africa if it has a place of effective management in South Africa. Further, the process to move tax residency by changing the place of effective management is less cumbersome than changing the place of incorporation.

## **III. Proposal**

In view of the above, it is proposed that the requirement that a company must be incorporated or deemed to be incorporated by or under any law in force in South Africa be removed.

## **IV. Effective date**

The proposed amendment will come into effect on 1 January 2018 and will apply in respect of any year of assessment commencing on or after that date.

## **5.2. REFINEMENTS OF RULES PROHIBITING DEDUCTION OF TAINTED INTELLECTUAL PROPERTY**

[Applicable provisions: sections 9D and 23I of the Act]

### **I. Background**

Prior to 2007, the development on intellectual property was fully deductible and the payment of royalties was also fully deductible for the payor, if the payor was a South African fully taxable entity. In 2007, the Government introduced a new section 23I of the Act, which became effective on 1 January 2009. Section 23I of the Act is an anti-avoidance section that applies to expenditure incurred for the right of use of or



permission to use intellectual property and not to expenditure incurred to acquire intellectual property. Its purpose is to prevent erosion of the South African tax base resulting from assigning South African intellectual property from South Africa to foreign entities with a lower effective tax rate, followed by the licensing of that intellectual property back to fully taxable South African taxpayers.

Section 23I of the Act prohibits deductions of expenditure incurred for the use of or right of use of or permission to use tainted intellectual property or any expenses which are calculated directly or indirectly on the expenditure paid for the use or right to use of or permission to use any tainted intellectual property to the extent that the expenditure is not income in the hands of the other party or proportional amount of the net income of a controlled foreign company (CFC) that is imputed to the South African resident.

However, a partial deduction is provided for in the event where a withholding tax on royalties is applicable. For example, if a withholding tax on royalties at the rate of 10 per cent in terms of the agreement for the avoidance of double taxation applies, one third of the expenditure will be allowed to be deducted. If a withholding tax at the rate of 15 per cent on royalties applies, a deduction of one half of the expenditure is allowed. However, where an agreement for the avoidance of double taxation reduces the withholding tax rate on royalties to a rate that is below 10 per cent, the expenditure incurred will be denied.

## **II. Reasons for change**

At issue is the wide of the definition of “tainted intellectual property”. Intellectual property is regarded as a tainted intellectual property if, *inter alia*, it was discovered, devised, developed, created or produced by the end user or by a taxable person that is a connected person to the end user. Of concern is the potential wide interpretation of the word “developed” in the definition of ‘tainted intellectual property’ which if interpreted widely may be applied to modifications or improvements to existing intellectual property that was not originally developed, devised or created by the end user or a taxable person who is a connected person in relation to the end-user.

While the purpose of the provisions of section 23I of the Act is to prevent the erosion of the South African tax base, it was never intended that section 23I of the Act would be overly restrictive in nature to the extent of discouraging South African companies from using South African resources where further minor ongoing maintenance of the existing intellectual property is necessary. As a result, where a South African company acquires an intellectual property rich foreign subsidiary which is licensed worldwide and utilises South African based expertise and infrastructure within the group to enhance the intellectual property which is also licensed for use in South Africa there is a risk that the group will be exposed to the application of section 23I of the Act.

## **III. Proposal**

In view of the above, it is proposed that the rules prohibiting the deduction of tainted intellectual property will not apply where net income of a CFC is deemed to be nil due to the application of the high-tax exemption.

## **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018 and apply on amounts that are paid or payable during years of assessments commencing on or after that date.

### **5.3. EXTENDING THE APPLICATION OF CONTROLLED FOREIGN COMPANY RULES TO FOREIGN TRUSTS AND FOUNDATIONS**

[Applicable provision: section 9D and insertion of the new section 25BC of the Act]

#### **I. Background**

South African residents are subject to tax on a worldwide basis. In order to curb avoidance, the Act contains CFC rules generally aimed at preventing South African residents from shifting tainted forms of taxable income offshore by investing in CFCs. These rules make provision for the net income of a CFC to be attributed and included in the income of South African resident shareholders. A CFC is defined as a foreign company where more than 50 per cent of the participation rights in that foreign company are directly or indirectly held or more than 50 per cent of the voting rights are directly or indirectly exercised by one or more South African residents. An amount equal to the net tainted income of a CFC is attributed to and included in the taxable income of South African resident shareholders in proportion to that resident's participation right or voting rights in the CFC. A foreign company is defined as any company which is not a resident.

However, foreign entities such as foreign trusts and foreign foundations do not fall within the ambit of South African CFC rules. Foreign trusts are only taxed in South Africa if they are effectively managed in South Africa. However, vested beneficiaries who are tax resident in South Africa are subject to tax on foreign trust income as that income vests in the South African resident beneficiaries. On the other hand, foreign discretionary trust income is not taxed in the hands of the South African tax resident beneficiaries until vesting occurs.

Similarly, foreign partnerships do not fall within the scope of the South African CFC rules. However, the South African residents will still be taxed on their share of foreign partnership income. In some countries, such as France, CFC rules apply to entities such as foreign trust and partnerships.

Before the introduction of worldwide system of taxation in 2001, South Africa had Controlled Foreign Entity (CFE) rules aimed at preventing avoidance of the provisions dealing with taxation of foreign source investment income derived from a foreign country by a South African resident, by establishing offshore companies or trusts. These CFE rules deemed the investment income to have been received by or accrued to the resident from a South African source, thereby bringing it within the South African tax net. The term CFE was defined as any entity (company or trust) in which one or more residents of South Africa, individually or jointly, and whether directly or indirectly, hold more than 5 per cent of the "participation rights" or are entitled to exercise more than 50 per cent of the votes or control of a foreign entity and has its place of effective management outside South Africa. However, in the Revenue Laws Amendment Act 74 of 2002, changes were made in the Act to replace the term CFE with the term CFC. As a result, foreign trusts were excluded from application of the CFC rules.

#### **II. Reasons for change**

Government has, since 2008, been concerned that the current CFC rules do not capture foreign companies held by interposed trust or foundations. Various interventions were explored but never implemented.

In the 2015 *Budget Review* it was announced that consideration will be given to allow CFCs held by interposed trusts or foundations to be subject to tax in South Africa. Of

particular concern is the use of foreign discretionary trust or foundations in order to escape the application of CFC rules even if the participation or voting control requirements are met. This is achieved through interposing a foreign trust or foundation, in particular a discretionary trust, between South African tax residents and a foreign company, despite the fact that the foreign trust and the foreign company are part of the same group and consolidated by the South African tax resident group for financial reporting purposes under the IFRS 10.

#### *A. IFRS 10*

According to Appendix A of IFRS 10, consolidated financial statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity. IFRS 10 requires, the parent that controls one or more other entities, to present consolidated financial statements. It defines the principle of control, and establishes control as the basis for consolidation. Further, it requires a taxpayer to consolidate any entity if, for example, it has rights that give the power to direct the activities that significantly affect the subsidiary's returns.

#### *B. Base Erosion and Profit Shifting Action 3 Recommendations*

The G20/OECD base erosion and profit shifting (BEPS) Action 3, Designing Effective Controlled Foreign Companies Rules final report, recommends a broad definition of entities that fall within the scope of CFC rules if these entities earn income that raises BEPS concerns.

Action 3 final report, recommends amongst others that non-resident companies that are consolidated in the accounts of a resident company in terms of IFRS should be treated as CFC.

### **III. Proposal**

In view of the above, it is proposed that the following changes be made in the Act in order for the CFC rules to capture foreign companies that would have been held as CFCs, if no foreign trust or foreign foundation was interposed.

#### *A. Section 9D imputation*

It is proposed that:

- a. CFC rules in section 9D of the Act be adjusted so that a foreign company held through a trust or foundation that is not resident in South Africa and whose financial statements form part of the consolidated financial statements, as defined in the IFRS 10, of a group of which the parent company is resident in South Africa, is deemed to be a CFC for the purposes of section 9D of the Act.
- b. a new subparagraph (c) in the definition of participation rights in section 9D of the Act be inserted to clarify that the meaning of participation rights in this regard will be a percentage of a proportion of profits of a foreign company that was included or reflected in the consolidated financial statement of any company that is a resident.

## *B. New section 25BC of the Act*

It is proposed that:

- a. new section 25BC of the Act be inserted so that any distributions made by a foreign trust or foreign foundation, that holds shares in a foreign company would have been regarded as a CFC if no foreign trust or foreign foundation was interposed, to South African tax resident beneficiaries be deemed to be income in the hands of the South African tax resident beneficiaries and subject to normal tax in South Africa, based on the applicable tax rates.
- b. the provisions of the new section 25BC of the Act will only apply to any person, other than a company namely natural person, trust, estate of a deceased person and insolvent estate.

### **IV. Effective date**

The proposed amendments will come into effect on 1 January 2018 and apply in respect of amounts that are paid or payable on or after that date.

---

## **6. VALUE ADDED TAX**

### **6.1. CLARIFYING THE VALUE ADDED TAX TREATMENT OF LEASEHOLD IMPROVEMENTS**

[Applicable provisions: sections 8, 9, 10 and 18 of the Value Added Tax Act No. 89 of 1991 (“the VAT Act”)]

#### **I. Background**

A lessee may, during the period of a lease agreement effect improvements on the leasehold property that belongs to the lessor. These improvements may either be obligatory or voluntary. These improvements would generally refer to improvements that become permanently attached to the leasehold property.

In terms of the common law, improvements that become permanently attached to the leasehold property become the property of the lessor.

#### **II. Reasons for change**

Currently, the VAT Act does not provide guidelines in respect of the Value Added Tax (VAT) treatment of leasehold improvements effected by the lessee to the leasehold property during the period of a lease agreement. Concerns have been raised that lessee and lessor vendors are uncertain of how to treat these leasehold improvements for VAT purposes. The lack of clarity in the VAT Act has led to inconsistencies in the VAT treatment.

#### **III. Proposal**

It is proposed that the following amendments be made in the VAT Act to clarify that:

*A. Deemed Supply of goods by the Lessee*

- a. The lessee shall be deemed to have made a taxable supply of goods to the lessor to the extent that the leasehold improvements are made for no consideration. The value of this supply is deemed to be NIL in these circumstances. There is no deemed supply if the lessee, being a vendor, uses the leasehold improvements wholly for purposes of making exempt supplies.

*B. Adjustments for the lessor*

- a. Where leasehold improvements are supplied to the lessor by the lessee, as contemplated in the new section 8(29), the lessor shall be deemed to have made a taxable supply of goods in the course or furtherance of its enterprise, to the extent that the lessor, at the time of completion of the leasehold improvements, uses the fixed property otherwise than for making taxable supplies.
- b. This adjustment will ensure that the lessor is placed in the same position that it would have been in had the lessor effected the leasehold improvements itself and the use of the improvements were for the making of non-taxable supplies.
- c. The value of supply of goods in respect of the adjustment will be the higher of the open market value of the improvements or the actual cost to the lessee of effecting such improvements or the total amount as agreed upon between the lessor and the lessee. This value will be deemed to be inclusive of VAT. The lessor's output tax liability will be calculated by applying the tax fraction to the value of the supply and then further applying the percentage to which the lessor uses that property for purposes other than making taxable supplies.
- d. The time of supply for the lessor to declare an output tax shall be at the time of completion of the leasehold improvements.

*C. Connected persons*

With respect to connected persons, the normal time and value of supply rules of the VAT Act will apply with regard to the value and time of supply for leasehold improvements.

**IV. Effective date**

The proposed amendments will come into effect from 1 April 2018.

**6.2. VAT VENDOR STATUS OF MUNICIPALITIES**

[Applicable provisions: section 8 of the VAT Act]

**I. Background**

The Local Government Elections that took place on 3 August 2016 resulted in structural changes of some certain municipalities. Some municipalities were disestablished, others have merged, some have been renamed and some have changed their municipal boundaries, but continue to exist in their altered form. As a result, the affected municipalities had to either cancel their VAT registrations or apply for new VAT registrations, and possibly, transfer assets, where applicable.

## **II. Reasons for change**

The above-mentioned structural changes to certain municipalities raised a number of VAT compliance issues relating to new registrations, de-registrations or whether supplies have been made in the course of convergence / re-naming, etc. At issue is the fact that the VAT Act does not currently provide for interim measures in this regard. As a result, SARS issued a Binding General Ruling (No. 39) outlining interim measures to deal with this situation.

## **III. Proposal**

In order to address the unintended VAT consequences as a result of the structural changes to certain municipalities, it is proposed that changes be made in the VAT Act to provide interim measures in these instances, in line with the provisions of the SARS Binding General Ruling No. 39.

## **IV. Effective date**

The proposed amendments will come into effect from 1 April 2018.

### **6.3. CLARIFYING THE ZERO RATING OF INTERNATIONAL TRAVEL INSURANCE**

[Applicable provision: section 11(2)(d) of the VAT Act]

#### **I. Background**

It is common for people who travel out of the country to obtain travel insurance to cover medical risks as well as risks related to loss of luggage. In some instances, the international travel may have a domestic leg to it (such as a stop-over in another city in the Republic) before the international leg of the journey commences. In most cases, insurers charge a single premium that provides travel insurance for the entire journey and includes both the domestic portion and the international portion.

The VAT Act provides for insurance and the arranging of insurance related to international travel to be zero-rated. The provisions of section 11(2)(a) of the VAT Act in relation to passengers or goods, state that the zero-rated insurance is limited to the transport of passengers or goods:

- a. From a place outside the Republic to another place outside the Republic; or
- b. From a place in the Republic to a place in an export country; or
- c. From a place in an export country to a place in the Republic.

In relation to the transport of passengers, in terms of section 11(2)(b) of the VAT Act, the zero-rating also applies where the services comprise the transport of passengers from a place in the Republic to another place in the Republic to the extent that the transport is by air and constitutes "international travel".

In relation to the transport of goods, the zero-rating also applies where the services comprise the transport of goods from a place in the Republic to another place in the Republic to the extent that those services are supplied by the same supplier as part of the supply of services to which the scenarios stated in section 11(2)(a) of the VAT Act apply (section 11(2)(c) of the VAT Act).

## **II. Reason for change**

The zero-rating does not extend to insurance provided during the period that the insured is:

- a. Transported to and from the insured's original point of departure (e.g. while en-route to or from the airport); and
- b. Not being physically transported while on the international journey (for example, while the insured stays in a hotel).

These insurance services would currently be subject to VAT at the standard rate. Since insurers regard the single premium as being in relation to a single supply of international travel insurance, this provision creates a difficulty in practice since the premium cannot be separated into the cover for the local portion, the international portion and the period during which the insured is not physically travelling. Hence the provisions of the VAT Act relating to the zero-rated portion and the standard-rated portion cannot be applied. To assist with this practical problem, SARS issued a Binding General Ruling (No. 37) to clarify the VAT treatment of international travel insurance.

## **III. Proposal**

In order to address the practical concerns, it is proposed that the zero rating provisions in the VAT Act pertaining to travel insurance cover provided as part of an international journey be clarified.

## **IV. Effective date**

The proposed amendments will come into effect from 1 April 2018.

## **6.4. SERVICES SUPPLIED IN CONNECTION WITH CERTAIN MOVABLE PROPERTY SITUATED IN AN EXPORT COUNTRY**

[Applicable provision: section 11(2)(g)(i) of the VAT Act]

### **I. Background**

The VAT Act makes provision for services supplied that are directly in connection with movable property that is situated outside the Republic at the time that the services are rendered to be zero-rated. The term "movable property" is not defined in the VAT Act. In terms of the Companies Act, movable property is defined to include securities or shares. This implies that any services that are supplied to a resident of the Republic that are directly in connection with securities (debt securities, equity securities and participatory securities) in a foreign incorporated company that is listed on the JSE but which fall under a main register that is held in a foreign country, could be interpreted to mean the supply of services in a movable property that is situated in an export country.

### **II. Reason for change**

As previously stated, the VAT Act makes provision for the zero rating of services (fees charged) that are supplied directly in connection with movable property that is situated in an export country at the time the services are rendered. This implies that services supplied relating to securities or shares in a foreign incorporated company listed on the JSE but which fall under a main register that is held in a foreign country should be

subject to zero-rating. This creates an anomaly in the application of the VAT provisions on these services.

### **III. Proposal**

In order to address this anomaly, it is proposed that clarification be made in the VAT Act to specifically exclude debt securities, equity securities or participatory securities from the zero-rating provisions of section 11(2)(g)(i) of the VAT Act. These services will now be subject to VAT at the standard rate.

### **IV. Effective date**

The proposed amendment will come into effect from 1 April 2018.

## **6.5. GOODS SUPPLIED IN THE COURSE OF MANUFACTURING OF GOODS TEMPORARILY IMPORTED**

[Applicable provision: section 11(1)(b) of the VAT Act]

### **I. Background**

In circumstances where goods are imported under Item 470 of paragraph 8 of Schedule 1 of the VAT Act (Schedule 1), any services supplied directly in relation to the processing, repair, cleaning, reconditioning or manufacture of those goods may be zero-rated in terms of section 11(2)(g)(ii) of the VAT Act, read together with Schedule 1. In addition, section 11(1)(b) of the VAT Act makes provision for any goods supplied in the course of conducting those repairs, cleaning, reconditioning or even modification, to be zero-rated where those goods have been wrought or affixed to or consumed in the course of conducting the repairs, modification, renovation or treating.

### **II. Reason for change**

However, section 11(1)(b) of the VAT Act does not permit the zero-rating of goods that are supplied in the course of manufacturing goods entered under Item 470 (temporarily imported). There does not seem to be any policy rationale for this exclusion.

### **III. Proposal**

In order to address this anomaly, it is proposed that the VAT Act be amended to provide for the zero-rating of goods supplied in the course of manufacturing goods that were temporarily imported under Item 470 of paragraph 8 of Schedule 1 including aligning with the terminology of the said Schedule.

### **IV. Effective date**

The proposed amendment will come into effect from 1 April 2018.

---



## CLAUSE BY CLAUSE

Income Tax: Amendment to section 1

Sub-clause (a): Definition of “connected person” – The proposed amendment in subsection (1) of the proviso to the definition of “connected person” is a consequential amendment and proposes to expand the scope of the definition by including all collective investment schemes.

Sub-clause (b): Definition of “dividend” - The proposed amendment in subsection (1) in the definition of “dividend” for paragraph (iii) seeks to align the Income Tax Act reference to a subparagraph with the correct reference in the JSE Listing Requirements.

Sub-clause (c): Definition of “domestic treasury management company” – See notes on **REFINEMENTS TO DOMESTIC TREASURY MANAGEMENT COMPANY**

Sub-clause (d): Definition of “gross income” – The proposed amendment in subsection (1) in paragraph (m) is a consequential amendment and related to a 2014 amendment to section 10(1)(gl) of the Income Tax Act which resulted to the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

Sub-clause (e): Definition of “pension fund” – See notes on **TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE**

Sub-clause (f): Definition of “pension fund” - See notes on **REMOVING THE 12- MONTH LIMITATION ON JOINING NEWLY ESTABLISHED PENSION OR PROVIDENT FUND**

Sub-clause (g): Definition of “provident fund” - See notes on **TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE**

Sub-clause (h): Definition of “provident fund” – See notes on **REMOVING THE 12-MONTH LIMITATION ON JOINING NEWLY ESTABLISHED PENSION OR PROVIDENT FUND**

Sub-clause (i): Insertion of new definition of “reduction amount” - The proposed insertion in subsection (1) of the definition of a “reduction amount” is consequential to the use of “reduction amount” outside the specific provisions dealing with the reduction of debt (i.e. section 19 of the Income Tax Act and paragraph 12A of the Eighth Schedule) and thus the removal of the definition of “reduction amount” from those specific provisions.

Sub-clause (j): Definition of “retirement fund lump sum benefit” - See notes on **TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE**

Sub-clause (k) Definition of “return of capital” – The proposed amendment in paragraph (ii) of the definition of “return of capital” seeks to align the Income Tax Act reference to a subparagraph with a correct reference in the JSE Listing Requirements.

## CLAUSE 2

Income Tax: Amendment to section 5

See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

### CLAUSE 3

Income Tax: Amendment to section 6quat

The proposed amendment deletes the reference to the repealed provisions of sections 11(n) and 18 and makes reference to section 18A of the Income Tax Act.

### CLAUSE 4

Income Tax: Amendment to section 7C

Sub-clauses (a) – (e): See notes on **REFINEMENT OF MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS**

Sub-clause (f): See notes on **EXCLUDING EMPLOYEE SHARE SCHEME TRUSTS FROM MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS**

### CLAUSE 5

Income Tax: Insertion of new section 7D

See notes on **INTERACTION BETWEEN THE “IN DUPLUM” RULE AND THE STATUTORY TAX LEGISLATION**

### CLAUSE 6

Income Tax: Amendment of section 8

See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

### CLAUSE 7

Income Tax: Amendment of section 8B

The proposed amendment standardises the reference to the Companies Act in the Income Tax Act.

### CLAUSE 8

Income Tax: Amendment of section 8EA

See notes on **THIRD-PARTY BACKED SHARES: AMENDMENT OF THE PROVISIONS TO COVER CERTAIN QUALIFYING PURPOSES**

### CLAUSE 9

Income Tax: Amendment of section 8F

The proposed amendment of the opening words of paragraph (a) in subsection (2) of section 8F of the Income Tax Act were meant to apply to both paragraphs (a) and (b) of that subsection. This amendment gives effect to this.

## CLAUSE 10

Income Tax: Amendment of section 8FA

The proposed amendment of the opening words of paragraph (a) in subsection (2) of section 8F were meant to apply to both paragraphs (a) and (b) of that subsection. This amendment gives effect to this.

## CLAUSE 11

Income Tax: Insertion of new section 8G

See notes on **ADDRESSING ABUSE OF CONTRIBUTED TAX CAPITAL PROVISIONS**

## CLAUSE 12

Income Tax: Amendment of section 9C

The proposed amendment limits the current exclusion of equity shares in a REIT or controlled company as the cost of the shares has been inadvertently been excluded.

## CLAUSE 13

Income Tax: Amendment of section 9D

Sub-clause (a): Definition of “controlled foreign company” – See notes on **EXTENDING THE APPLICATION OF CONTROLLED FOREIGN COMPANY RULES TO FOREIGN TRUSTS AND FOUNDATIONS**

Sub-clause (b): The proposed addition of a further proviso to the provision of subsection (2) - See notes on **EXTENDING THE APPLICATION OF CONTROLLED FOREIGN COMPANY RULES TO FOREIGN TRUSTS AND FOUNDATIONS.**

## CLAUSE 14

Income Tax: Amendment of section 10

Sub-clause (a): The proposed amendment in subsection (1)(gC)(ii) seeks to align the tax treatment to achieve horizontal equity in respect of living or life annuities. Any annuity income that is paid by a South African Insurer in respect of a annuities to SA residents currently does not fall within the exclusionary provision under section 10(1)(gC)(ii) of the Income Tax Act. The portion of the annuity income payments received by SA residents from SA Insurers in respect of annuities relating to services rendered outside the Republic will accordingly remain exempt from tax in South Africa. As a result, two pensioners receiving the same pension for the same services rendered would not be treated equally if the pension is paid by the fund as opposed to being paid by an insurer. The amendment seeks to subject to tax the annuity income arising from foreign services rendered and that is paid by a South African Insurer to an SA resident.

Sub-clause (b): The proposed amendment in subsection (1)(gH) is a consequential amendment and related to a 2014 amendment to section 10(1)(gI) of the Income Tax Act which resulted in the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

Sub-clause (c): The proposed amendment in subsection (1)(h) for the words preceding subparagraph (i) updates wording as a matter of style and consistency.

Sub-clause (d): The proposed amendment in the proviso to subsection (1)(k)(i) for paragraph (jj) seeks to refine the current rules introduced in 2016 in order to deal adequately with some schemes where restricted shares held by employees are liquidated in return for an amount qualifying as a dividend. Also see notes on **EXCLUDING EMPLOYEE SHARE SCHEME TRUSTS FROM MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS**

Sub-clause (e): The proposed addition of paragraph (kk) in the proviso to subsection (1)(k)(i) seeks to refine the current rules introduced in 2016 in order to deal adequately with some schemes where restricted shares held by employees are liquidated in return for an amount qualifying as a dividend. Also see notes on **EXCLUDING EMPLOYEE SHARE SCHEME TRUSTS FROM MEASURES TO PREVENT TAX AVOIDANCE THROUGH THE USE OF TRUSTS**

Sub-clause (f): The proposed deletion in subsection (1)(o) of subparagraph (ii) - see notes on **REPEAL OF FOREIGN EMPLOYMENT INCOME EXEMPTION**

Sub-clause (g): The proposed amendment to the word preceding the proviso to subsection (1)(q) – see notes on **INCREASE ON THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES TO LEARNERS WITH DISABILITIES**

Sub-clause (h): The proposed insertion of subsection (1)(qA) – see notes on **INCREASE ON THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES TO LEARNERS WITH DISABILITIES**

Sub-clause (i): The proposed amendment of subsection (1)(yA)(aa) removes the requirement of consultation with the Minister of Foreign Affairs regarding the approval by the Minister of Finance in respect of tax exemption granted to international donor funding provided in terms of official development assistance agreement that is binding in terms of section 231(3) of the Constitution of the Republic of South Africa, 1996.

Sub-clause (j): The proposed deletion of subsection (1)(yA)(cc) removes the requirement to announce the tax exemption by notice in the Gazette in respect international donor funding provided in terms of an official development assistance agreement that is binding in terms of section 231(3) of the Constitution of the Republic of South Africa, 1996.

## **CLAUSE 15**

Income Tax: Amendment of section 10B

The proposed amendment is a consequential amendment and seeks to expand the provision by making it applicable to the partial exemption contemplated in subsection (3) and in respect of any portion of an annuity.

## **CLAUSE 16**

Income Tax: Amendment of section 10C

See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

## CLAUSE 17

Income Tax: Amendment of section 11

Sub-clause (a): The proposed insertion of new paragraph *(jA)* - See notes on **EXCLUSION OF IMPAIRMENT ADJUSTMENTS FROM THE DETERMINATION OF TAXABLE INCOME**

Sub-clause (b): The proposed deletion of paragraph *(k)*: See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

Sub-clause (c): The proposed amendment in paragraph *(w)* for the words proceeding subparagraph *(i)* is a consequential amendment and related to a 2014 amendment to section 10(1)*(gI)* of the Income Tax Act which resulted in the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

Sub-clause (d): The proposed amendment in paragraph *(w)(i)(aa)* is a consequential amendment and related to a 2014 amendment to section 10(1)*(gI)* of the Income Tax Act which resulted in the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

Sub-clause (e): The proposed amendment in paragraph *(w)(ii)(aa)* for item *(aa)* is a consequential amendment and related to a 2014 amendment to section 10(1)*(gI)* of the Income Tax Act which resulted in the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

## CLAUSE 18

Income Tax: Amendment of section 11A

The proposed amendment in subsection *(1)(b)* deletes referencing to the repealed provision of sections 11B of the Income Tax Act.

## CLAUSE 19

Income Tax: Insertion of section 11F

See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

## CLAUSE 20

Income Tax: Amendment of section 12B

Sub-clause (a): The proposed amendment in subsection *(2)* for the words preceding paragraph *(a)* deletes superfluous referencing.

Sub-clause (b): The proposed amendment of subsection *(3)* delete the provisions in section 12B of the Income Tax act that relate to the determination of cost of replacement assets to allow the section 8(4)*(e)* treatment to prevail over section 12B of the Income Tax Act. In 2003, the tax treatment of a recoupment in respect of an asset that is disposed of by a taxpayer but for which a replacement asset is acquired was clarified under section 8(4)*(e)* of the Income Tax Act. Under section 8(4)*(e)* of the Income Tax Act, a taxpayer can defer the inclusion of a recoupment when a depreciable asset is

replaced with another asset over (i) the same period and (ii) at the same ratio that the replacement asset is allowed to claim capital allowances in terms of the Income Tax Act. However the specific rules in section 12B of the Income Tax Act that deal with the treatment of a recoupment in respect of a disposal of an asset that is subsequently replaced were not updated.

#### **CLAUSE 21**

Income Tax: Amendment of section 12C

The proposed amendment of subsection (2) delete the provisions in section 12C of the Income Tax Act that relate to the determination of cost of replacement assets to allow the section 8(4)(e) treatment to prevail over section 12C of the Income Tax Act. In 2003, the tax treatment of a recoupment in respect of an asset that is disposed of by a taxpayer but for which a replacement asset is acquired was clarified under section 8(4)(e) of the Income Tax Act. Under section 8(4)(e) of the Income Tax Act, a taxpayer can defer the inclusion of a recoupment when a depreciable asset is replaced with another asset over (i) the same period and (ii) at the same ratio that the replacement asset is allowed to claim capital allowances in terms of the Income Tax Act. However the specific rules in section 12C of the Income Tax Act that deal with the treatment of a recoupment in respect of a disposal of an asset that is subsequently replaced were not updated.

#### **CLAUSE 22**

Income Tax: Amendment of section 12D

The proposed amendment of subsection (4) delete the provisions in section 12D of the Income Tax Act that relate to the determination of cost of replacement assets to allow the section 8(4)(e) treatment to prevail over section 12D of the Income Tax Act. In 2003, the tax treatment of a recoupment in respect of an asset that is disposed of by a taxpayer but for which a replacement asset is acquired was clarified under section 8(4)(e) of the Income Tax Act. Under section 8(4)(e) of the Income Tax Act, a taxpayer can defer the inclusion of a recoupment when a depreciable asset is replaced with another asset over (i) the same period and (ii) at the same ratio that the replacement asset is allowed to claim capital allowances in terms of the Income Tax Act. However the specific rules in section 12D of the Income Tax Act that deal with the treatment of a recoupment in respect of a disposal of an asset that is subsequently replaced were not updated.

#### **CLAUSE 23**

Income Tax: Amendment of section 12DA

The proposed amendment of subsection (3) delete the provisions in section 12DA of the Income Tax Act that relate to the determination of cost of replacement assets to allow the section 8(4)(e) treatment to prevail over section 12DA of the Income Tax Act. In 2003, the tax treatment of a recoupment in respect of an asset that is disposed of by a taxpayer but for which a replacement asset is acquired was clarified under section 8(4)(e) of the Income Tax Act. Under section 8(4)(e) of the Income Tax Act, a taxpayer can defer the inclusion of a recoupment when a depreciable asset is replaced with another asset over (i) the same period and (ii) at the same ratio that the replacement asset is allowed to claim capital allowances in terms of the Income Tax Act. However the specific rules in section 12DA of the Income Tax Act that deal with the treatment of a recoupment in respect of a disposal of an asset that is subsequently replaced were not updated.

## CLAUSE 24

Income Tax: Amendment of section 12E

Sub-clause (a): The proposed amendment of subsection (2) delete the provisions in section 12E of the Income Tax Act that relate to the determination of cost of replacement assets to allow the section 8(4)(e) treatment to prevail over section 12E of the Income Tax Act. In 2003, the tax treatment of a recoupment in respect of an asset that is disposed of by a taxpayer but for which a replacement asset is acquired was clarified under section 8(4)(e) of the Income Tax Act. Under section 8(4)(e) of the Income Tax Act, a taxpayer can defer the inclusion of a recoupment when a depreciable asset is replaced with another asset over (i) the same period and (ii) at the same ratio that the replacement asset is allowed to claim capital allowances in terms of the Income Tax Act. However the specific rules in section 12E of the Income Tax Act that deal with the treatment of a recoupment in respect of a disposal of an asset that is subsequently replaced were not updated.

Sub-clause (b): The proposed amendment in subsection (4) in paragraph (a) of the definition of “small business corporation” for the proviso to subparagraph (i) clarify the policy position that the tax benefits under the small business regime go further than the incentive on small business assets. It also makes provision for tax at the more favourable progressive tax rates. As such, the definition of a small business should not be focused on assets used by a small business.

Sub-clause (c): The proposed amendment in subsection (4) in the definition of “personal service” for paragraph (i) is aimed at curbing the abuse of the use of the definition of a “personal service” by closely related people. This is achieved by one person holding the interest in a company, co-operative or close corporation and the other connected person (such as a relative) rendering the service to the same company, co-operative or close corporation. It is proposed that the definition of a “personal service” should be expanded to cover connected persons in relation to the holder of the interest.

## CLAUSE 25

Income Tax: Amendment of section 12I

See notes on **INDUSTRIAL POLICY PROJECTS – WINDOW PERIOD EXTENSION**

## CLAUSE 26

Income Tax: Amendment of section 12J

See notes on **EXTENDING THE SCOPE OF INVESTMENTS RULES FOR VENTURE CAPITAL COMPANIES**

## CLAUSE 27

Income Tax: Amendment of section 12Q

The proposed amendment to the definition of “international shipping company” in subsection (1) removes the reference to “holds a share or shares in one or more ships” and replaces it with “operates”. The strict interpretation of the words ‘holds a share or shares’ limits the application of the international shipping exemption to a very small subset of ships brought onto our flag.

## CLAUSE 28

Income Tax: Amendment of section 12R

Sub-clause (a): The proposed amendment in the definition of “qualifying company” for paragraphs (b), (c) and (d) corrects the reference to an obsolete provision and clarifies that the trade test must be met for the commencement of the application of the provisions as it relates to special economic zones.

Sub-clause (b): The proposed amendment to subsection (5)(b) clarifies that the trade test must be met for the commencement of the application of the provisions as it relates to special economic zones.

## CLAUSE 29

Income Tax: Amendment of section 18A

See notes on **CLARIFYING THE SCOPE OF TAX DEDUCTIBLE DONATION STATUS FOR INTERNATIONAL DONOR FUNDING ORGANISATIONS**

## CLAUSE 30

Income Tax: Amendment of section 19

Sub-clause (a): The proposed deletion in subsection (1) of the definition of “reduction amount” is consequential to the use of “reduction amount” outside the specific provisions dealing with the reduction of debt (i.e. section 19 and paragraph 12A of the Eighth Schedule) and which necessitates the insertion of the definition in section (1).

Sub-clause (b): The proposed addition in subsection (8) of paragraphs (d) and (e) - See notes on **ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR DORMANT GROUP COMPANIES** and also **TAX TREATMENT OF CONVERSION OF DEBT INTO EQUITY AND ARTIFICIAL REPAYMENT OF DEBT**

## CLAUSE 31

Income Tax: Insertion of sections 19A and 19B

See notes on **TAX TREATMENT OF CONVERSION OF DEBT INTO EQUITY AND ARTIFICIAL REPAYMENT OF DEBT**

## CLAUSE 32

Income Tax: Amendment of section 22

Sub-clause (a): The proposed amendment to subsection (3A) for the words preceding paragraph (a) align the reference to the person liable for tax with the rest of the Income Tax Act by using the word “taxpayer”. In addition, as the generally accepted accounting practice or GAAP is no longer relevant for financial reporting, the following amendment is proposed that will require all taxpayers to apply the IFRS methodology set out in IAS 11 regarding construction contracts.



Sub-clause (b): The proposed amendment to subsection (4) - See notes on **CORRECTING THE INCONSISTENT TAX TREATMENT BETWEEN CASH GRANTS AND IN-KIND GRANTS OF TRADING STOCK**

Sub-clause (c): The proposed amendment to subsection (9)(a)(i) – See notes on **EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

Sub-clause (d): The proposed amendment to subsection (9)(b)(i) - See notes on **EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

Sub-clause (e): The proposed amendment to subsection (9)(c)(i) - See notes on **EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

Sub-clause (f): The proposed amendment to subsection (9)(d)(i) - See notes on **EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

### **CLAUSE 33**

Income Tax: Amendment of section 22B

See notes on **ADDRESSING CIRCUMVENTION OF ANTI-AVOIDANCE RULES DEALING WITH SHARE BUY-BACKS AND DIVIDEND STRIPPING**

### **CLAUSE 34**

Income Tax: Amendment of section 23

See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

### **CLAUSE 35**

Income Tax: Amendment of section 23B

The proposed amendment is a consequential amendment and related to a 2014 amendment to section 10(1)(g) of the Income Tax Act which resulted to the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

### **CLAUSE 36**

Income Tax: Amendment of section 23H

The proposed amendment corrects the reference to section 11D(2) of the Income Tax Act instead of section 11D(1) of the Income Tax Act.

### **CLAUSE 37**

Income Tax: Amendment of section 23I

See notes on **REFINEMENTS OF RULES PROHIBITING DEDUCTION OF TAINTED INTELLECTUAL PROPERTY**

**CLAUSE 38**

Income Tax: Amendment of section 23M

Sub-clause (a): The proposed deletion in subsection (1) of the definition of “issue” corrects a superfluous definition that is not used in the provisions of the section.

Sub-clause (b): The proposed amendment to subsection (2)(b)(ii) corrects a reference as a matter of style and consistency.

**CLAUSE 39**

Income Tax: Amendment of section 23N

Sub-clause (a): The proposed amendment of subsection (3)(b) seeks to clarify the policy position of the provision. The opening words in subsection (3) are confusing in that they purport to add a percentage to an amount, while what was intended to be added was an amount arrived at by multiplying the adjusted taxable income by a percentage. The word “immediately” is being added in subparagraph (iii) to clarify that it is the year of assessment in which the acquisition transaction took place and not any year of assessment prior to that year.

Sub-clause (b): The proposed amendment to subsection (5)(c) inserts the omitted word “property”.

**CLAUSE 40**

Income Tax: Amendment of section 23O

The proposed amendment seeks to improve better reading of the provision.

**CLAUSE 41**

Income Tax: Amendment of section 24I

The proposed amendment of the definition of “affected contract” seeks to clarify that the purpose of the concept of “affected contract” is not to tax exchange differences on a foreign exchange contract or a foreign currency option contract serving as a hedge of a future debt until the debt arises or is incurred. An affected contract can only exist until the related debt comes into being.

**CLAUSE 42**

Income Tax: Amendment of section 24J

Sub-clauses (a) – (g): The proposed amendments removes the “alternative method” as detailed in the provisions of this section given that generally accepted accounting practice or GAAP is no longer applicable.

## CLAUSE 43

Income Tax: Amendment of section 24JB

Sub-clause (a): The proposed addition in paragraph (d) of the definition of “covered person” excludes the subsidiaries of a short-term insurer and long-term insurer as defined in the Companies Act as they are not supposed to fall under the ambit of section 24JB .

Sub-clauses (b) – (f): See notes on **REFINEMENT TO THE TAXATION OF FINANCIAL ASSETS AND LIABILITIES DUE TO CHANGES IN ACCOUNTING STANDARD** and on **APPLICATION OF HYBRID DEBT INSTRUMENTS RULES IN RESPECT OF COVERED PERSONS DEFINED IN SECTION 24JB**

## CLAUSE 44

Income Tax: Amendment of section 25BB

Sub-clause (a): The proposed amendment in subsection (1) in the definition of “qualifying distribution” for the words preceding paragraph (a) corrects punctuation.

Sub-clause (b): The proposed amendment to subsection (7)(a) and (b) corrects the policy intent that a REIT or controlled company is deemed to end on the day preceding the date on which that company ceases to be either a REIT or controlled company. In this way a REIT or controlled company can still deduct the amounts in terms of section 25BB(2)(a) of the Income Tax Act.

## CLAUSE 45

Income Tax: Insertion of section 25BC

See notes on **EXTENDING THE APPLICATION OF CONTROLLED FOREIGN COMPANY (CFC) RULES TO FOREIGN TRUSTS AND FOUNDATIONS**

## CLAUSE 46

Income Tax: Amendment of section 29A

Sub-clauses (a) – (c): See notes on **AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERS DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK** and on **TAX TREATMENT OF DEFERRED ACQUISITION COSTS BY LONG-TERM INSURERS**

Sub-clause (d): See notes on **TAX TREATMENT OF DEFERRED ACQUISITION COSTS BY LONG-TERM INSURERS**

## CLAUSE 47

Income Tax: Amendment of section 35A

The proposed addition of paragraph (d) to subsection (1) aligns the tax charging provisions to the Income Tax Act.

## **CLAUSE 48**

Income Tax: Amendment of section 36

See notes on **ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR THE BENEFIT OF MINING COMPANIES**

## **CLAUSE 49**

Income Tax: Amendment of section 37A

See notes on **STRENGTHENING ANTI-AVOIDANCE MEASURES RELATED TO MINING ENVIRONMENTAL REHABILITATION FUNDS**

## **CLAUSE 50**

Income Tax: Amendment of section 41

See notes on **TAX IMPLICATIONS OF THE ASSUMPTION OF CONTINGENT LIABILITIES UNDER THE CORPORATE REORGANISATION RULES**

## **CLAUSE 51**

Income Tax: Amendment of section 42

Sub-clause (a): The proposed amendment in subsection (2)(a)(ii) is consequential on the deletion of the definition of “qualifying share” in section 9C(1) by section 12(1)(c) of the Taxation Laws Amendment Act 25 of 2015 with effect from 1 January 2016 and applies in respect of years of assessment commencing on or after that date.

Sub-clause (b): The proposed amendment in subsection (3)(a) for the words proceeding subparagraph (i). Section 25BB of the Income Tax Act stipulates that REITs are not entitled to claim certain capital allowances. This is because REITs are subject to a special tax dispensation that allows them to deduct their shareholder distributions against rental income as the shareholders bear the tax liability. The REIT is precluded from claiming allowances on its assets, which means that an anomaly arises when a REIT is party to a reorganisation transaction, because its assets would not qualify as allowance assets. This anomaly means the corporate reorganisation rules do not apply to transactions involving REITs. The proposed amendments make provision for the corporate re-organisation rules to apply in respect of an allowance asset transferred to REITs and REITs acquire that allowance asset as a capital asset.

Sub-clause (c): The proposed amendment in subsection (3)(c) for the words proceeding subparagraph (i) makes allowance for the roll-over of the section 24P allowances in respect of the future repairs of ships.

## **CLAUSE 52**

Income Tax: Amendment of section 44

Sub-clause (a): The proposed amendment in subsection (3)(a) for the words proceeding subparagraph (i). Section 25BB of the Income Tax Act stipulates that REITs are not entitled to claim certain capital allowances. This is because REITs are subject to a special tax dispensation that allows them to deduct their shareholder distributions against

rental income as the shareholders bear the tax liability. The REIT is precluded from claiming allowances on its assets, which means that an anomaly arises when a REIT is party to a reorganisation transaction, because its assets would not qualify as allowance assets. This anomaly means the corporate reorganisation rules do not apply to transactions involving REITs. The proposed amendments make provision for the corporate re-organisation rules to apply in respect of an allowance asset transferred to REITs and REITS acquire that allowance asset as a capital asset.

Sub-clause (b): The proposed amendment in subsection 44(3)(a)(ii)(bb). Section 25BB of the Income Tax Act stipulates that REITs are not entitled to claim certain capital allowances. This is because REITs are subject to a special tax dispensation that allows them to deduct their shareholder distributions against rental income as the shareholders bear the tax liability. The REIT is precluded from claiming allowances on its assets, which means that an anomaly arises when a REIT is party to a reorganisation transaction, because its assets would not qualify as allowance assets. This anomaly means the corporate reorganisation rules do not apply to transactions involving REITs. The proposed amendments make provision for the corporate re-organisation rules to apply in respect of an allowance asset transferred to REITs and REITS acquire that allowance asset as a capital asset.

Sub-clause (c): The proposed amendment in subsection (3)(b) for the words proceeding subparagraph (i) makes allowance for the roll-over of the section 24P allowances in respect of the future repairs of ships.

#### **CLAUSE 53**

Income Tax: Amendment of section 45

The proposed amendment in subsection (3)(b) for the words proceeding subparagraph (i) makes allowance for the roll-over of the section 24P allowances in respect of the future repairs of ships.

#### **CLAUSE 54**

Income Tax: Amendment of section 46

The proposed amendment is consequential on the deletion of the definition of “qualifying share” in section 9C(1) by section 12(1)(c) of the Taxation Laws Amendment Act 25 of 2015 with effect from 1 January 2016 and applies in respect of years of assessment commencing on or after that date.

#### **CLAUSE 55**

Income Tax: Amendment of section 47B

The proposed addition in subsection (2) aligns the tax charging provisions to the Income Tax Act.

#### **CLAUSE 56**

Income Tax: Amendment of section 49B

The proposed addition in subsection (1) aligns the tax charging provisions to the Income Tax Act.

#### **CLAUSE 57**

Income Tax: Amendment of section 50B

The proposed addition in subsection (1) aligns the tax charging provisions to the Income Tax Act.

#### **CLAUSE 58**

Income Tax: Amendment of section 64

The proposed addition in section 64 aligns the tax charging provisions to the Income Tax Act.

#### **CLAUSE 59**

Income Tax: Amendment of section 64D

The proposed amendment in subsection (1) in the definition of “regulated intermediary” deletes the word “or” and inserts the full stop.

#### **CLAUSE 60**

Income Tax: Amendment of section 64E

The proposed addition in section 64E aligns the tax charging provisions to the Income Tax Act.

#### **CLAUSE 61**

Income Tax: Amendment of paragraph 2 of the Second Schedule - See notes on **TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE**

#### **CLAUSE 62**

Income Tax: Amendment of paragraph 5 of the Second Schedule

Sub-clause (a): The proposed amendment in subparagraph (1)(a) See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

Sub-clause (b): The proposed amendment in subparagraph (1)(e) – See notes on **TAX EXEMPT STATUS OF PRE-MARCH 1998 BUILD UP IN PUBLIC SECTOR FUNDS**

#### **CLAUSE 63**

Income Tax: Amendment of paragraph 6 of the Second Schedule

Sub-clause (a): The proposed amendment of subparagraph (1)(b)(i) See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

Sub-clause (b): The proposed amendment of subparagraph (1)(b)(v) - See notes on **TAX EXEMPT STATUS OF PRE-MARCH 1998 BUILD UP IN PUBLIC SECTOR FUNDS**

#### **CLAUSE 64**

Income Tax: Insertion of paragraph 7 in the Second Schedule

See notes on **TRANSFERRING RETIREMENT FUND BENEFITS AFTER REACHING NORMAL RETIREMENT DATE**

#### **CLAUSE 65**

Income Tax: Amendment of paragraph 2 of the Fourth Schedule

The proposed amendment of paragraph (4)(a), (b) and (bA) See notes on **DEDUCTION IN RESPECT OF CONTRIBUTIONS TO RETIREMENT FUNDS**

#### **CLAUSE 66**

Income Tax: Amendment of paragraph 6 of the Seventh Schedule

The proposed amendment seeks to stop the unequal tax treatment in respect of a uniform granted under a right of use of any asset and special uniforms in terms of section 10(1)(nA) of the Income Tax Act as compared to the no value rule in paragraph 6(4)(a) of the Seventh Schedule. The result of which may lead to a mechanism of by-passing the special uniform requirements to qualify for the exemption from normal tax under section 10(1)(nA), by simply ensuring that ownership of the clothing does not transfer to the employee, only the right of use of such clothing.

By amending paragraph 6(4)(a), this will align the position to the special uniform position, in that non-special uniforms will not qualify for a no value taxable benefit as an asset under the Seventh Schedule, nor will an allowance for such qualify for exemption under section 10(1)(nA) of the Income Tax Act.

#### **CLAUSE 67**

Income Tax: Amendment of paragraph 12D of the Seventh Schedule

Sub-clause (a): The proposed amendment in subparagraph (1) for the definition of “fund member category factor” corrects an incorrect cross-reference.

Sub-clause (b): The proposed amendment for subparagraph (2) provides clarity on the policy intention that the contemplated benefit in that subparagraph refers to a ‘taxable benefit’.

Sub-clause (c): The proposed amendment in subparagraph (3) for the words preceding the formula provides clarity on the policy intention that the contemplated benefit in that subparagraph refers to a ‘taxable benefit’.

#### **CLAUSE 68**

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

Sub-clause (a): The proposed deletion of the definition of “reduction amount” is consequential to the use of “reduction amount” outside the specific provisions dealing with the reduction of debt (i.e. section 19 and paragraph 12A of the Eighth Schedule) and which necessitates the insertion of the definition in section (1).

Sub-clause (b): See notes on **ADDRESSING THE TAX TREATMENT OF DEBT FORGONE FOR DORMANT GROUP COMPANIES**

Sub-clause (c): See noted on **TAX TREATMENT OF CONVERSION OF DEBT INTO EQUITY AND ARTIFICIAL REPAYMENT OF DEBT**

#### **CLAUSE 69**

Income Tax: Amendment of paragraph 35A of the Eighth Schedule

The proposed amendment for subparagraph (2) corrects a grammatical error and changes the word “accrued” to “accrues”.

#### **CLAUSE 70**

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

See notes on **ADDRESSING CIRCUMVENTION OF ANTI-AVOIDANCE RULES DEALING WITH SHARE BUY-BACKS AND DIVIDEND STRIPPING**

#### **CLAUSE 71**

Income Tax: Amendment of paragraph 55 of the Eighth Schedule

The proposed amendment is a consequential amendment and related to a 2014 amendment to section 10(1)(g) of the Income Tax Act which resulted to the replacement of “severe illness” with the word “illness” since the term illness includes both concepts.

#### **CLAUSE 72**

Income Tax: Insertion of paragraph 64E of the Eighth Schedule

See notes on **CLARIFYING THE RULES RELATING TO THE TAXATION OF EMPLOYEE SHARE- BASED SCHEMES**

#### **CLAUSE 73**

Income Tax: Insertion of paragraph 80 of the Eighth Schedule

Sub-clause (a): The proposed amendment for subparagraph (2) - See notes on **CLARIFYING THE RULES RELATING TO THE TAXATION OF EMPLOYEE SHARE-BASED SCHEMES**

Sub-clause (b): The proposed deletion of subparagraph (2A) - See notes on **CLARIFYING THE RULES RELATING TO THE TAXATION OF EMPLOYEE SHARE-BASED SCHEMES**



#### CLAUSE 74

Customs and Excise Act: Amendment to certain Schedules

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

#### CLAUSE 75

Value-Added Tax Act: Amendment to section 8

Sub-clause (a): Currently, section 8(23) of the VAT Act makes provision for the Minister of Finance to issue regulations regarding the VAT treatment of supplies made in terms of the National Housing Programme as contemplated in the Housing Act, 1997. However, the Regulations were never issued. In addition, as announced in the 2017 Budget Review, the repeal of the provisions of section 8(23) is postponed by clause 20(2) of the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 22 February 2017, for a period of two years, until 1 April 2019.

Sub-clause (b): The proposed insertions of subsections (28) and (29) – See notes on **VAT VENDOR STATUS OF MUNICIPALITIES**. Also see notes on **CLARIFYING THE VALUE ADDED TAX (VAT) TREATMENT OF LEASEHOLD IMPROVEMENTS**.

#### CLAUSE 76

Value-Added Tax Act: Amendment to section 9

The proposed insertion of subsection (12) – see notes on **CLARIFYING THE VALUE ADDED TAX (VAT) TREATMENT OF LEASEHOLD IMPROVEMENTS**

#### CLAUSE 77

Value-Added Tax Act: Amendment to section 10

The proposed insertion of subsection (28) – see notes on **CLARIFYING THE VALUE ADDED TAX (VAT) TREATMENT OF LEASEHOLD IMPROVEMENTS**

#### CLAUSE 78

Value-Added Tax Act: Amendment to section 11

Sub-clause (a): The proposed amendment in subsection (1)(b) – see notes on **GOODS SUPPLIED IN THE COURSE OF MANUFACTURING OF GOODS TEMPORARILY IMPORTED**

Sub-clause (b): The proposed amendment in subsection (2)(d) – See notes on **CLARIFYING THE ZERO RATING OF INTERNATIONAL TRAVEL INSURANCE**

Sub-clause (c): The proposed amendment in subsection (2)(g)(i) – see notes on **SERVICES SUPPLIED IN CONNECTION WITH CERTAIN MOVABLE PROPERTY SITUATED IN AN EXPORT COUNTRY**

#### **CLAUSE 79**

Value-Added Tax Act: Amendment to section 13

The proposed deletion of section 13(2A) repeals the 2011 amendment with retrospective effect since the 2011 amendment was never implemented.

#### **CLAUSE 80**

Value-Added Tax Act: Amendment to section 16

The proposed amendment to section 16(3)(k) corrects referencing to the correct member of the President's cabinet.

#### **CLAUSE 81**

Value-Added Tax Act: Insertion of section 18C

See notes on **CLARIFYING THE VALUE ADDED TAX (VAT) TREATMENT OF LEASEHOLD IMPROVEMENTS**

#### **CLAUSE 82**

Value-Added Tax Act: Insertion of section 40D

The proposed insertion seeks to clarify a technical aspect. In 2015, amendments were made in the VAT ACT to abolish the zero rating of the supply of goods and services for government's national housing programme with effect from 1 April 2017. However, both the National Treasury and municipalities are not yet ready to give effect to the VAT amendments. As a result, an announcement was made in the 2017 Budget to postpone the repeal of the zero rating provision by 2 years until 1 April 2019. As a result of this extension, the proposed insertion of new section 40D seeks to ensure that past assessments that have been finalised for the periods prior to 1 April 2017 are not reopened either by SARS or the vendor. However, with regard to past assessments that have not been finalised, applications may be made to SARS to consider reviewing the assessment. However, the review of such assessment may not result in a refund paid to the vendor. Further, no new assessment may be issued by SARS in this regard.

#### **CLAUSE 83**

Value-Added Tax Act: Amendment of section 68

The proposed amendment to subsection (1) corrects referencing to the correct member of the President's cabinet.

#### **CLAUSE 84**

Value-Added Tax Act: Amendment to Schedule 2 Part B

The proposed amendment to Item 1 amends the reference to the repealed regulations and replaces it with a reference to the correct regulations.

## **CLAUSE 85**

Skills Development Levies Act: Amendment to section 3

The proposed amendment seeks to re-instate section 3 of the Skills Development Levies Act which was incorrectly deleted by section 88 of the Taxation Laws Amendment Act of 2016.

## **CLAUSE 86**

Unemployment Insurance Contribution Act: Amendment to section 4

The proposed deletion in section 4 of paragraphs *(b)* and *(d)* aligns the Unemployment Insurance Contribution Act, 2002 with the changes in the Unemployment Insurance Act, 2001 with regard to the removal of exemptions for certain types of employees.

## **CLAUSE 87**

Securities Transfer Tax Act: Amendment to subsection (1)

Sub-clause (a): The proposed amendment to subsection (1) of the definition of “collateral arrangement” – See notes on **EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

Sub-clause (b): The proposed amendment to subsection (1) of the definition of “lending arrangement” - See notes on **EXTENSION OF COLLATERAL AND SECURITIES LENDING ARRANGEMENT PROVISIONS**

## **CLAUSE 88**

Employment Tax Incentive Act: Amendment to section 4

Sub-clause (a): The proposed amendment to subsection (1)*(b)(ii)* inserts the following words “paid remuneration” and seeks to clarify a smooth practical application of the provisions of Employment Tax Incentive Act.

Sub-clause (b): The proposed addition of subsection (4) inserts the definition of “hours” and seeks to clarify a smooth practical application of the provisions Employment Tax Incentive Act.

## **CLAUSE 89**

Employment Tax Incentive Act: Amendment to section 7

The proposed amendment to subsection (1) seeks to ensure smooth practical implementation of the Employment Tax Incentive Act.

## **CLAUSE 90**

Taxation Laws Amendment Act, 2015: Amendment to section 3

The proposed amendment provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on

## **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

### **CLAUSE 91**

Taxation Laws Amendment Act, 2015: Amendment to section 150

The proposed amendment provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

### **CLAUSE 92**

Taxation Laws Amendment Act, 2015: Amendment to section 159

The proposed amendment provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

### **CLAUSE 93**

Revenue Laws Amendment Act, 2016: Amendment to section 1

Sub-clause (a): The proposed addition in subsection (1) of a proviso to the definition of “pension fund” provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

Sub-clause (b): The proposed amendment in subsection (1) of paragraph (e) of the proviso to the definition of “pension preservation fund” provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

Sub-clause (c): The proposed amendment in subsection (1) of paragraph (b) of the proviso to the definition of “provident fund” provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

Sub-clause (d): The proposed addition in subsection (1) of paragraph (e) to the definition of “provident preservation fund” provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

Sub-clause (e): The proposed amendment in subsection (1) of paragraph (b)(ii) of the proviso to the definition of “retirement annuity fund” provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

Sub-clause (f): The proposed amendment in subsection (2) provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

Sub-clause (g): The proposed amendment in subsection (3)(c) provides for the postponement of the implementation date in relation to the annuitisation requirements for provident funds - See notes on **POSTPONEMENT OF ANNUITISATION REQUIREMENT FOR PROVIDENT FUNDS TO 1 MARCH 2019.**

#### **CLAUSE 94**

Taxation Laws Amendment Act, 2016: Amendment to section 21

Sub-clause (a): The proposed amendment seeks to correct an incorrect reference in the Taxation Laws Amendment Act, 2016.

Sub-clause (b): The proposed amendment seeks to correct an incorrect reference in the Taxation Laws Amendment Act, 2016.

#### **CLAUSE 95**

Bargaining Council Tax Relief: Introduction of the Bargaining Council Tax Relief

See notes on **TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

#### **CLAUSE 96**

Bargaining Council Tax Relief: Introduction of the Bargaining Council Tax Relief

See notes on **TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

#### **CLAUSE 97**

Bargaining Council Tax Relief: Introduction of the Bargaining Council Tax Relief

See notes on **TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

#### **CLAUSE 98**

Bargaining Council Tax Relief: Introduction of the Bargaining Council Tax Relief

See notes on **TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

#### **CLAUSE 99**

Bargaining Council Tax Relief: Introduction of the Bargaining Council Tax Relief

See notes on **TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

## **CLAUSE 100**

Bargaining Council Tax Relief: Introduction of the Bargaining Council Tax Relief

See notes on **TAX RELIEF FOR BARGAINING COUNCILS REGARDING TAX NON-COMPLIANCE**

## **CLAUSE 101**

Short title and commencement