EXPLANATORY MEMORANDUM

ON THE

TAXATION LAWS AMENDMENT BILL, 2021

25 January 2022

[W.P. – '21]

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1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

1.1 REVIEWING THE NATURE OF LONG SERVICE AWARDS FOR FRINGE BENEFIT PURPOSES

[Applicable provisions: Paragraphs (*c*) and (*i*) of the definition of "gross income" and paragraph 5(2)(*b*) and new paragraphs 6(4)(*d*) and 10(2)(*e*) of the Seventh Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962) ("the Act")]

I. Background

Paragraph (i) of the definition of gross income together with paragraph 5 of the Seventh Schedule to the Act make provision for a taxable benefit to arise when an employee acquires an asset from an employer, either for no consideration or for consideration which is less than the value of the asset (generally referred to as a fringe benefit). A fringe benefit is generally referred to as any non-cash benefit granted to employees, this however specifically excludes cash payments made to employees.

On the other hand, the Act further makes provision for a taxable benefit not to arise in the hands of the employee, in the event that the fringe benefit is deemed to have no value. Consequently, paragraph 5(2)(b) of the Seventh Schedule to the Act makes provision for the granting of a long service award (which can currently be provided as an asset or non-cash benefit) to an employee as a no value fringe benefit, provided that the value of such long service award does not exceed R5 000.

II. Reasons for change

Government recognises that the current prevailing practice is for employers to grant their employees a wider range of awards (which take a variety of forms) in recognition for long service, and these long service awards can in terms of the Act be considered as non-cash benefits. These include for example the granting of gift vouchers, cash, services or the right of use of an asset owned by the employer for private purposes.

III. Proposal

In order to cater for current prevailing practices, it is proposed that the current provisions as relates to long service awards are not only limited to non-cash assets, but rather extended to apply to other reasonable awards granted for long service. In order to qualify as a no value fringe benefit, all the current requirements in the Act should be met, for example, the number of years required to be considered a long service period together with the requirement that the value of the long service award should not exceed R5 000 would still apply.

IV. Effective date

The amendments will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

1.2 CURBING ABUSE IN THE EMPLOYMENT TAX INCENTIVE

[Applicable provisions: Definition of "employee" in section 1 of the Employment Tax Incentive Act, 2013 (Act No. 26 of 2013) ("the ETI Act"), and definition of "qualifying employee" in terms of section 6 of the ETI Act]

I. Background

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The main aim of the programme is to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as qualifying employees) through a cost sharing mechanism with Government, by allowing the employer to reduce the amount of Pay-As-You-Earn (PAYE) they pay to the South African Revenue Service (SARS), while leaving the wage received by the qualifying employees unaffected. Consequently, section 1 of the ETI Act defines an employee as a natural person who works for another person and receives or is entitled to receive remuneration from that other person. In turn, section 6 of the ETI Act stipulates the conditions that need to be met for the employee to be classified as a qualifying employee for ETI purposes.

II. Reasons for change

It has come to Government's attention that some taxpayers have devised certain schemes where they claim the ETI in respect of individuals who do not work for them, therefore failing to meet the definition of "employee" as outlined in section 1(1) of the ETI Act. The nature of these schemes is to market and utilise the ETI as a means of facilitating the entry of qualifying, unskilled, inexperienced, previously disadvantaged South Africans in the modern economy.

Eligible participants are recruited by a recruitment agency and employed by a participating employer for a fixed term period of 12 to 24 months. Participating employers engage with the recruitment agency to recruit eligible participants. Contracts signed by the eligible participants indicate the receipt of remuneration while 'employed' by the participating employer. Once 'employed', participants are trained by a training institution (over the 12 to 24 month period) and, in some cases, enrolled in Sector Education and Training Authority (SETA) accredited courses. The training institution is contracted by the participating employer at a cost equal to the remuneration stated in the eligible participant's contract. The remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant.

In some cases, the eligible participants are exposed to work-based exercises and activities by an independent company. The independent company is able to utilise the eligible participants for a fixed monthly fee, which similar to the remuneration, is not paid to the eligible participant. Once the training programme is completed, the eligible participant may work for the participating employer for the remainder of the 12 to 24 month period. In accordance with said scheme, the participating employer is then able to claim the ETI for the 12 to 24 month period that the eligible participant is supposedly 'employed' by the employer.

III. Proposal

The proposed clarification to the legislation is more of a confirmation of the policy position regarding the meaning of "employee" in section 1 of the ETI Act as well as the requirements needed to be met to be considered a "qualifying employee" as stipulated in section 6 of the ETI Act. In order to address the above-mentioned contraventions, it is proposed that changes be made in the ETI Act to clarify that substance over legal form will be considered when assessing an employer's ability to claim the ETI. As such, 'work' must actually be performed in terms of an

employment contract and the employee must be documented in the employer's records as envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997). Further to the above, the employee must, in lieu of services rendered, receive cash remuneration from the employer.

IV. Effective date

The amendments will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

1.3 CLARIFYING THE TIMING OF DISPOSAL RULES IN RESPECT OF AN ASSET ACQUIRED FROM A DECEASED ESTATE

[Applicable provisions: Section 1(1) new definition of "liquidation and distribution account" and section 25(3) of the Act]

I. Background

When a person dies, the Estate Duty Act, 1955 (Act No. 45 of 1955) ("the Estate Duty Act") makes provision for the assets of that person, as at the date of death, to be part of a deceased estate, before the assets are distributed to the respective heir(s). Estate Duty is then levied on the net value of a deceased estate in excess of the individual estate duty rebate of R3.5 million. If the dutiable amount of an estate does not exceed R30 million, Estate Duty is levied at a rate of 20 per cent and at a rate of 25 per cent on the dutiable amount of an estate exceeding R30 million.

The Estate Duty Act also makes provision for the Executors to step into the shoes of the deceased and administer the deceased estate, this includes the preparation and submission of the Liquidation and Distribution Account to the Master of the High Court Office, the submission of the relevant tax returns to SARS (including the payment of the estate duty to SARS). According to South African law, the relevant heir(s) of the estate have a personal right to claim delivery of the assets from the deceased estate after the finalisation of the Liquidation and Distribution Account.

II. Reasons for change

The South African law requires that the Liquidation and Distribution account lies open for inspection in the Master of the High Court's office for 21 business days. In the event that no objection is lodged against the Liquidation and Distribution account during this 21-day period, the Liquidation and Distribution Account can then be finalised. If any objections are lodged against the Liquidation and Distribution account, the law requires that the Liquidation and Distribution account remains open for inspection for another 21 business days (this 21-day period will be required until such time as no objections are raised).

At issue is a timing uncertainty around when the heirs are regarded as having acquired an asset from the estate of the deceased.

III. Proposal

In order to clarify the time of disposal of the heir's personal right to claim delivery of the deceased estate assets, it is proposed that changes be made in the legislation so that the disposal of assets by the estate occurs on the earlier of the date of an interim disposal or the date when the Liquidation and Distribution account becomes final.

IV. Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of Liquidation and Distribution accounts finalised on or after that date.

1.4 TAX TREATMENT OF THE CESSION OF THE RIGHT TO RECEIVE AN ASSEST

[Applicable provision: New section 57B of the Act]

I. Background

Paragraph (*c*) of the definition of "gross income" in section 1(1) of the Act makes provision for a taxpayer to include in gross income any amount received or accrued in respect of services rendered, to be rendered or in respect of employment or the holding of any office. In addition, the proviso to this paragraph also makes provision for any amount received or accrued for the benefit of any person in respect of services rendered or to be rendered by any other person to be deemed to have been received by or to have accrued to the other person. In turn, section 54 of the Act makes provision for donations tax to be levied on the value of any property disposed of, whether directly or indirectly, under any donation by any resident. Section 62 of the Act provides for the value of property disposed of under donations.

II. Reasons for change

It has come to Government's attention that some taxpayers have devised schemes aimed at undermining the donations tax provisions. These schemes entail a service provider (for example, an employee or independent contractor) ceding the right to receive or use an asset received from the person to whom the services are rendered or to be rendered. The right to receive or use the asset is generally ceded to a family trust before services are rendered.

In these instances, the service provider may be able to circumvent donations tax as the right to receive an asset would have been ceded to the trust before the services are rendered and a value can be attached to it. The argument is that the service provider is simply disposing of a worthless *spes* and is therefore not liable for donations tax at the time the services have been rendered and the employer transfers the asset to the cessionary. Moreover, the service provider will not be entitled to the asset and cannot be regarded as having disposed of it.

It may also be argued that the service provider is not subject to the attribution rules in section 7 of the Act or paragraphs 68 to 73 of the Eighth Schedule to the Act because the asset was not donated by the service provider, and the right to the asset was worthless. This argument is addressed by deeming the asset to have been disposed of by the service provider to the other person by way of donation for purposes of section 7 of the Act and paragraphs 68 to 73 of the Eighth Schedule to the Act.

III. Proposal

In order to address these types of schemes, it is proposed that changes be made in the Act to clarify that instances where a right to receive an asset, which asset would otherwise have been acquired in respect of services rendered or to be rendered, is disposed of, that asset will be deemed to be disposed of under a donation as envisaged in Part V of Chapter II of the Act.

IV. Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of the disposal of the right to receive an asset on or after that date.

1.5 ALLOWING MEMBERS TO USE RETIREMENT INTEREST TO ACQUIRE ANNUITIES ON RETIREMENT

[Applicable provisions: Paragraph (*b*)(ii) of the proviso to the definition of "retirement annuity fund", paragraph (ii)(*dd*) of the proviso to the definition of "pension fund", paragraph (*e*) of the definition of "pension preservation fund", paragraph (ii)(*dd*) of the proviso to the definition of "provident fund" and paragraph (*e*) of the definition of "provident preservation fund" in Section 1(1) of the Act]

I. Background

In accordance with the proviso to the definition of "retirement annuity fund", paragraph (ii)(*dd*) of the proviso to the definition of "pension fund", paragraph (*e*) of the definition of "pension preservation fund", paragraph (ii)(*dd*) of the proviso to the definition of "provident fund" and paragraph (*e*) of the definition of "provident preservation fund" in section 1(1) of the Act, any member retiring from a retirement fund is, upon retirement, allowed to receive a maximum of one third of the total value of the retirement interest as a lump-sum. The remainder of the retirement interest may be utilised to purchase or provide an annuity (including a living annuity).

The annuity can be provided by the retirement fund in one of three ways, namely, the annuity can be:

- paid directly by the retirement fund to the member,
- purchased from a South African registered insurer in the name of the fund, or
- purchased by the retirement fund from a South African registered insurer in the name of the life of the retiring member.

II. Reasons for change

If a member of a retirement fund opts to receive an annuity, the full value of the member's retirement interest following commutation is to be used to provide either of the above-mentioned annuities. Therefore, a member is prohibited from utilising the retirement interest to acquire various annuities. The above-mentioned prohibition limits flexibility in relation to the types of annuities a member can purchase with their retirement interest following commutation.

III. Proposal

In order to increase flexibility for a retiring member and maximise the retirement capital available to provide for annuities, Government proposes expanding the types of annuities a member can purchase upon retirement. For example, the full value of the member's retirement interest following commutation can therefore be utilised to purchase a combination of living and guaranteed annuities. In turn, the portion of the retirement interest utilised to purchase each type of annuity must exceed R165 000. The R165 000 threshold is required to curb the circumvention of prevailing legislation.

IV. Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of annuities purchased on or after that date.

1.6 TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER

[Applicable provisions: Paragraph (e) of the definition of "gross income", paragraph (a) of the definitions of "pension preservation fund" and "provident preservation fund", paragraph (e) of the definitions of "pension preservation fund" and "provident preservation fund" in Section 1(1) of the Act, read with paragraphs 2(1)(c) and 6A of the Second Schedule to the Act]

I. Background

Paragraph (*e*) of the definition of "gross income" in section 1(1) of the Act includes retirement fund lump sum benefits as referred to in paragraph 2(1)(*c*) of the Second Schedule to the Act in an individual's taxable income. Paragraph 2(1)(*c*) of the Second Schedule regulates the amount to be included in gross income for any year of assessment, namely, any amount transferred for the benefit of a member of a retirement fund scheme on or after normal retirement age (as defined in the rules of the fund), but before retirement date (as defined in section 1(1) of the Act), less any deductions allowed under paragraph 6A of the Second Schedule to the Act.

Paragraph 6A of the Second Schedule permits the following deductions when calculating the retirement lump sum benefit to be included in gross income:

- Transfers from a pension fund into a pension preservation fund or a retirement annuity fund or;
- Transfers from a provident fund into a pension preservation fund, a provident preservation fund or a retirement annuity fund.

II. Reasons for change

In the event that a member of a pension preservation or provident preservation fund (who has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the respective fund) makes a transfer into a similar fund, such transfer would be taxable in the individual's hands. This is due to the fact that the current wording of paragraph 2(1)(*c*) of the Second Schedule includes these transfers in gross income, while paragraph 6A of the Second Schedule fails to provide a deduction for such transfers.

As a result, any individual transfers between preservation funds where the transfer is between similar funds and the member involved has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the relevant fund will be subject to tax, this despite the fact that the policy intention is not to tax transfers from a less to a more restrictive fund, or between similar funds.

III. Proposal

Government proposes addressing this anomaly by allowing for tax-free transfers from a preservation fund into similar funds by members who have already reached normal retirement age.

IV. Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

1.7 CLARIFYING THE CALCULATION OF THE FRINGE BENEFIT IN RELATION TO EMPLOYER CONTRIBUTIONS TO A RETIREMENT FUND

[Applicable provisions: Paragraphs 2(*l*) and 12D of the Seventh Schedule to the Act]

I. Background

With effect from 1 March 2016 and in terms of paragraph 2(*l*) of the Seventh Schedule to the Act, all employer contributions to a retirement fund on behalf of employees are considered taxable fringe benefits in the employees' hands. In turn, paragraph 12D(2) of the Seventh Schedule stipulates that if the employer contributes towards a fund that consists solely of a 'defined contribution component', as defined in paragraph 12D(1) of the Seventh Schedule, the value of the fringe benefit will be the cash equivalent of that part of the contribution that pertains to that employee. Further to the above, the employer is not required to provide the employee with a contribution certificate. In contrast, paragraph 12D(3) of the Seventh Schedule determines that the value of the taxable benefit in relation to employer contributions containing a 'defined benefit component' or an 'underpin component', as defined in paragraph 12D(1) of the Seventh Schedule, is to have the value calculated in accordance with the prescribed formula. In this instance, the employer is required to provide the employee with a contribution certificate.

That said, paragraph (*b*) of the definition of 'defined contribution component' in paragraph 12D(1) of the Seventh Schedule to the Act would include a benefit or part of a benefit receivable from a pension fund, provident fund or retirement annuity fund that consists of a risk benefit provided by the fund directly or indirectly for the benefit of a member of the fund, if the risk benefit is provided solely by means of a policy of insurance.

II. Reasons for change

It has come to Government's attention that an anomaly arises in instances where a retirement fund provides both a retirement benefit in relation to the 'defined contribution component' and a self-insured risk benefit. The current wording of the Act would result in the classification of the total contribution to the said fund as a defined benefit component, subject to valuation in terms of the formula contained in paragraph 12D(3) of the Seventh Schedule to the Act as well as the issuance of a contribution certificate. This due to the fact that self-insured risk benefits are not considered a defined contribution component.

III. Proposal

In order to address this anomaly, it is proposed that changes be made in the legislation so that self-insured risk benefits are classified as a 'defined contribution component'. This would ensure that retirement funds that provide both defined contribution component retirement benefits and self-insured risk benefits can account for the fringe benefit based on the actual contribution. As a result, the value of the risk premiums under self-insured risk benefits will be determined based on the cost to the employer (i.e. the actual contribution made by the employer).

IV. Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

1.8 EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE

[Applicable provisions: Sections 2,3,4,5,6 and 11 of the Disaster Management Tax Relief Act, No. 13 of 2020 ("the Disaster Management Tax Relief Act")]

I. Background

In 2020, Parliament passed the Disaster Management Tax Relief Act, 2020 and the Disaster Management Tax Relief Administration Act, 2020, containing exceptional tax measures which formed part of the fiscal package aimed at assisting taxpayers who experienced cashflow constraints as a result of the COVID-19 pandemic and required national lockdown.

One of the exceptional tax measures included in the above-mentioned Acts was an expansion to the Employment Tax Incentive (ETI). This expansion was provided to assist employers to retain employees, thus reducing the risk of low-income earners losing their employment as a result of the lockdown.

The expanded ETI was structured as follows:

- A R750 increase to the maximum monthly amount of ETI allowable.
- Allowing the above mentioned monthly ETI claim to apply to employees not classified as "qualifying employees" in terms of the current provisions of the ETI Act for a limited period, irrespective of their date of employment (employees employed before 1 October 2013 for whom the ETI has never been claimable also qualified for the relief).
- Since the requirement for social distancing was likely to result in employees working significantly reduced hours, which would impact the monthly remuneration paid, the proposal allowed for the calculation of the ETI claim based on actual remuneration paid in that month where the employee worked less than 160 hours a month (the remuneration paid to the employee did not need to be grossed-up).
- Accelerating the ETI reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.

- As the contractual agreement entered into at the beginning of the employees employment with the employer was not altered, the extent of the ETI claimable in instances where the employee was employed for less than 160 hours a month would still be impacted by the hours employed and paid for in that month (the incentive claimable would bear the same ratio that the number of hours the employee was remunerated bears to 160 hours – the incentive needed to be grossed-down).

- The inclusion of an anti-avoidance measure aimed at limiting potential abuse where an employer claimed the incentive despite having significantly reduced the employee's wages. This anti-avoidance measure applied to wages below R2 000.

- The expansion applied for four months and was deemed to have come into operation on 1 April 2020 and ended on 31 July 2020.

II. Reasons for change

Despite the recent relaxation of the national lockdown, various businesses and employees are still negatively impacted by the COVID-19 pandemic. These negative impacts are further exacerbated by the impacts of the recent unrest in the country that destroyed businesses and infrastructure. The Government, therefore, wishes to provide additional assistance to those who continue to be adversely affected by COVID-19, as well as assisting in the process of reconstructing businesses. Moreover, this support measure is aimed at supporting employment in the most vulnerable sections of the labour market.

III. Proposal

As a result, it is proposed that the expansion of the ETI be reinstated for another limited four-month period, following the design implemented in 2020:

- A R750 increase to the maximum monthly amount of ETI allowable. Therefore, the maximum allowable values will be increased in the following manner:

- Employees are eligible under the current ETI Act from R1 000 to R1 750 in the first qualifying twelve months and from R500 to R1 250 in the second twelve qualifying months.

- Allowing a monthly ETI claim in the amount of R750 during these four months for employees from the ages of 18 to 29 who are no longer eligible for the ETI as the employer has claimed ETI in respect of those employees for 24 months, or they were in the employer's employ before 1 October 2013.

- Allowing a monthly ETI claim in the amount of R750 during these four months for employees from the ages 30 to 65 who are not eligible for the ETI due to their age.

- Formulae will apply to calculate the value of the incentive relative to remuneration received, to introduce the incentive at a positive rate for wages between R0 and R2 000 per month, at a constant value for wages between R2 000 and R4 500 per month, and a declining rate for wages between R4 500 and R6 500.

- Since the requirement for social distancing may result in employees working significantly reduced hours, coupled with businesses that are being reconstructed being unable to trade as normal at the moment, both of which would impact the monthly remuneration actually paid, the proposal allows for the calculation of the ETI claim based on actual remuneration

paid in that month where the employee worked less than 160 hours a month (the remuneration paid to the employee would not need to be grossed-up).

- As the contractual agreement entered into at the beginning of the employees employment with the employer will not be altered, the extent of the ETI claimable in instances where the employee was employed for less than 160 hours a month would still be impacted by the hours employed and paid for in that month (the incentive claimable will bear the same ratio that the number of hours the employee was remunerated bears to 160 hours – the incentive would need to be grossed-down).

- The inclusion of an anti-avoidance measure aimed at limiting potential abuse where an employer claims the incentive despite having significantly reduced the employee's wages. This anti-avoidance measure will apply to wages below R2 000.

- Accelerating the ETI reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.

- To qualify for this relief, the employer must be tax compliant and registered with the South African Revenue Service (SARS) as an employer by 25 June 2021.

IV. Effective date

The measures will apply for four months and come into operation on 1 August 2021 and end on 30 November 2021.

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2. INCOME TAX: BUSINESS (GENERAL)

2.1 STRENGTHENING THE RULES DEALING WITH THE LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX

[Applicable provisions: Sections 23M of the Act]

I. Background

In 2013, the rules dealing with the limitation of interest deductions in respect of debts owed to persons not subject to tax were introduced in section 23M of the Act. These rules were effective from 1 January 2015 and apply in respect of amounts of interest incurred on or after that date. The main aim of these rules is to limit excessive interest deductions in respect of debts owed to persons not subject to tax in South Africa, if the debtor and the creditor are in a controlling relationship. In particular, these rules apply as follows:

A. Meaning of the term "interest" for purposes of these rules

Currently, for the purposes of these rules, the term "interest" means interest as defined in section 24J. This implies that these rules are only applicable to interest as defined in section 24J.

B. Deductible interest limitation: Formula calculation

When these rules were first introduced in 2013, the aggregate deduction for interest incurred in respect of a debt owed under the circumstances set out above was based on an annual limitation determined according to a formula as defined section 23M(3). In this regard, the aggregate deductions for these amounts was limited to the sum of:

- The total interest received or accrued to the debtor; and
- 40 per cent of adjusted taxable income;
- Reduced by interest incurred in respect of debts owed (other than debts to creditors in a controlling relationship).

The term '*adjusted taxable income*' was defined as taxable income of the debtor less interest received or accrued, net income included in terms of section 9D (controlled foreign company net income), and recoupments in respect of capital assets; with the addition of interest incurred and all capital allowances. In illustrative terms, '*adjusted taxable income*' included the following:

Starting point	Taxable income
Less	Interest received or accrued
	CFC net income
	Recoupments
Plus	Interest incurred
	Capital allowances

At the time, the 40 per cent deduction formula was based on the assumption of relatively low national interest rates. It was set to increase if the national repo rate exceeded 10 per cent as follows:

(40 per cent) x repo rate / 10

Interest expense in excess of the limitation was not deductible in the year of assessment, but was carried forward to the following year of assessment.

In 2014, before these rules came into effect, changes were made to the term '*adjusted taxable income*' to exclude previous years' assessed losses carried forward from the current year's adjusted taxable income. Currently, '*adjusted taxable income*' is calculated as follows:

Starting Point	Taxable Income
Less	Interest received/accrued
	CFC net income
	Recoupments
Plus	Interest incurred
	Capital allowances
	Assessed losses

Changes were also made to the 40 per cent deduction formula to more closely align it to the cost of debt financing in the market. The limitation – expressed as a percentage of the tax equivalent of "earnings before interest, taxation, depreciation and amortisation" (EBITDA) – was changed to

adjust up and downwards based on the prevailing repo rate. The formula was amended to link deductible interest expenditure to the average repo rate for the year, regardless of whether the repo rate exceeds 10 per cent. The formula became flexible so that any change to the average repo rate for the year of assessment (together with a 400-basis point addition to the average repo rate) is captured to allow for a balanced reflection of market conditions on the interest deduction limitation. To protect the fiscus and tax base in periods of high interest rates, a cap on the interest deduction limitation ratio of 60 per cent was inserted.

These changes were made to recognise taxpayer's concerns. However, Government did point out at the time – in public consultations, on page 22 of the Explanatory Memorandum to the 2014 TLAB, and on page 13 of the 2014 Response Document to the 2014 TLAB – that available data indicated that 40 per cent was too high. Given that this was based on financial accounting information from Statistics South Africa, and not micro-level tax data from SARS, it was decided to retain the 40 per cent starting point with a flexible formula, but that this would be subject to review.

C. Back-to-back loans

Currently, section 23M(2) makes provision for these rules to apply to back-to-back loans. As indicated above, the ordinary scenario of application contained in section 23M(2)(*a*) makes provision for these rules to apply to loans to a debtor from a creditor that is in a controlling relationship with that debtor.

To address the use of back-to-back lending arrangements that would avoid the application of the interest limitation rules, section 23M(2)(*b*) makes provision for these rules to apply to loans made to a debtor from a creditor that is not in a controlling relationship with that debtor if that creditor obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that debtor.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

Currently, section 23M provides no distinct treatment for REITs (defined in section 1(1) of the Act and which are subject to a specific tax regime under section 25BB of the Act).

E. Interaction between the level of tax on interest and application of section 23M rules

Currently, one of the requirements for section 23M to apply is that the amount of interest incurred is not subject to tax in the hands of the recipient. In instances where the corresponding interest income is subject to tax in the hands of the recipient, the tax rate varies from 5 per cent (if the withholding tax on interest has been reduced by a treaty) to the corporate tax rate. This means that some taxpayers are not subject to the limitation even though the interest income is taxed at very low rates.

II. Reasons for change

On 26 February 2020, Government published a discussion document titled "***Reviewing the Tax Treatment of Excessive Debt Financing, Interest Deductions and Other Financial Payments***" to conduct a review of the current rules dealing with the limitation of interest deductions in respect of debts owed to persons not subject to tax, in line with the OECD/G20 BEPS Action 4 recommendations on interest deductions. The review highlighted that the elements the current rules require consideration.

A. Meaning of the term “interest” for purposes of these rules

Relative to the OECD/G20 BEPS recommendations, the existing rules are narrow. The meaning of interest for the purposes of these rules is narrowly defined and does not consider opportunities for tax avoidance, where interest can be labelled as other types of payments to circumvent the application of these rules.

B. Deductible interest limitation: Formula calculation

As noted above, available data during 2014 showed that the 40 per cent starting point may be too high and should be subject to review.

The OECD/G20 BEPS Action 4 Report recommends that countries use a fixed ratio of earnings to limit the deduction of excessive interest deductions and other financial payments. To recognise that countries have different interest rate and risk environments, the Report recommends a corridor approach where countries consider a range of factors to assess which percentage of earnings would be most appropriate for their economies.

South Africa’s current rules are unique in that no other country uses a formula to determine the limitation as a percentage of earnings. All developed and developing countries that have such rules apply a fixed ratio of earnings. In 2014, internal analysis indicated that a ratio of 30 per cent would have been more appropriate than 40 per cent. Available data indicated that the average net interest expense / EBITDA ratios were just above 15 per cent, and this was at a time when prevailing interest rates were higher than what they are currently.

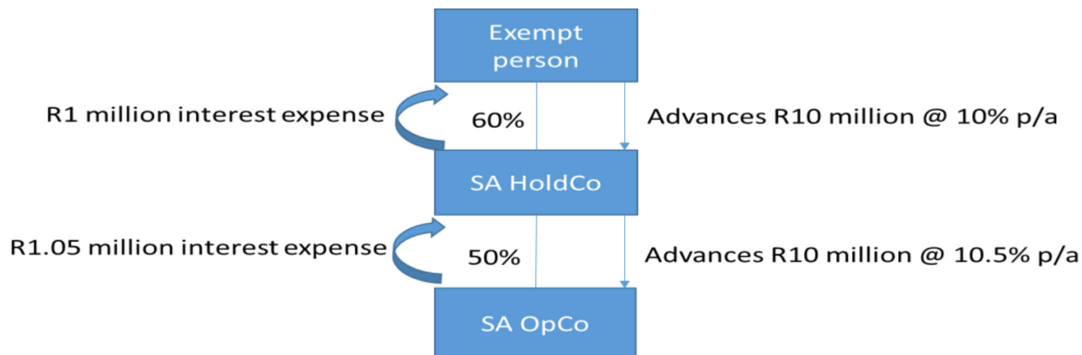
More recently, analysis using SARS micro-level data for all taxpayers shows that applying a fixed ratio of 30 per cent would be fair in that the majority of taxpayers will be able to deduct all their interest payments without restriction. In contrast to the proposal in the Discussion Document, the rules will continue to apply to interest payments between taxpayers where there is a controlling relationship (including back-to-back arrangements), rather than applying to total interest expense.

Furthermore, with the indefinite carry-forward being retained for now, no interest expense deductions will expire. While Government was considering imposing a restriction on the carry forward, it was decided that this would be too punitive in conjunction with the proposed restriction on the offset of assessed losses in determining taxable income. The stance on the ability to carry forward excess interest deductions will be reviewed after 5 years. From a policy perspective – if interest payments are considered to be excessive, allowing an indefinite carry forward is a contradiction to the policy aim. However, Government recognises that not all businesses’ investment and profit patterns follow the same time horizons and that those with longer timeframes between investing and yielding taxable profits would be worse off if a time limit was imposed.

C. Back to back loans

It has come to Government’s attention that the current rules give rise to anomalous results in the case of some back-to-back lending arrangements. The back-to-back lending arrangements of concern involve loans that are channelled between two or more tax paying companies that are ultimately owned by another company that is not subject to tax in South Africa (e.g. a resident tax-exempt entity). Under these back-to-back lending arrangements, which are often entered into by a chain of companies that are in controlling relationships with each other, the fiscus ends up bearing a much larger interest deduction as a result of the net effect of these back-to-back lending arrangements. The interest limitation rules are effectively side stepped under these arrangements as the rules apply where there is a controlling relationship and the interest incurred is not subject

to tax in the hands of the person to which it accrues. In these arrangements, a company that is subject to tax receives the interest income from the debtor and pays a slightly smaller amount in interest expense to a company that is not subject to tax on the corresponding interest income. The following, illustration sets out the concern identified:



Result

SA Hold Co:
- Net interest income: R50 000 (R1.05 million – R1 million)

SA OpCo:
- Can deduct in full interest expense of R1.05 million

The resultant effect on the fiscus is that a net R1 million interest deduction is claimed without regard for the interest limitation rules even though the interest income of R1 million is ultimately not subject to South African tax as would be the case with an exempt person.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

In general, a REIT or a controlled company is not taxed on the income it derives due to a deduction for qualifying distributions made by it. In certain instances, the deduction of a qualifying distribution may result in zero-taxable income for a REIT or controlled company.

Section 23M of the Act limits the deductibility of interest incurred in respect of loan funding advanced between any "debtor" that obtains funding, directly or indirectly, from a creditor that is in a "controlling relationship" with the debtor. At issue is that the deduction for qualifying distributions will distort their "tax EBITDA" and will result in them having a much lower "tax EBITDA" than other taxpayers.

E. Interaction between the level tax on interest and application of section 23M rules

Section 23M currently applies if two conditions are met: (i) there is a controlling relationship, and (ii) the interest is not subject to tax in the hands of the recipient. Where the recipient is subject to tax, section 23M does not apply. However, recipients are subject to a range of tax rates. The current wording in section 23M can create a perverse incentive that encourages companies to route their interest payments via countries with the lowest interest withholding tax rate (as a result of the application of tax treaties) that exceeds zero (i.e. 5 per cent). Doing so yields two benefits for a taxpayer: (i) the interest payment is not subject to 23M; and (ii) the WHT on interest at a rate of 5 per cent is more favourable than the standard rate of 15 per cent.

III. Proposal

Based on the above, Government proposes the following:

A. Meaning of the term 'interest' for purposes of these rules

It is proposed that for the purpose of these rules, the meaning of the term 'interest' should be expanded beyond the current definition of interest contained in section 24J, to include the following:

- *Payments under interest rate swap agreements*

  These agreements involve one party simply swapping one stream of interest expense (e.g. fixed rate payments) for another (e.g. variable rate payments). While the interest payments under a swap agreement are in respect of a notional amount, the original interest payments for which the contract was entered into are in respect of a debt. To the extent that such swap agreements are entered into between persons where there is a controlling relationship, the interest payments will be restricted by section 23M. Government proposes to include payments under interest rate agreements as defined in section 24K(1) of the Act in the definition of the term 'interest' for purposes of these rules. This is applicable for both payments incurred and received.

- *Finance cost element included in finance lease payments*

  The proposed amendment will limit the deduction of the finance cost element of finance lease payments to persons where there is a controlling relationship. The current tax treatment for finance leases will continue to apply, except that the finance cost element will be grouped with other interest income and payments subject to section 23M, and only in cases where there is a controlling relationship.

- *Foreign exchange differences*

  It is proposed that foreign exchange gains and losses taken into account in determining taxable income in terms of section 24I(3) and (10A) should be included in the definition of 'interest' for purposes of these rules.

- *Amounts deemed to be interest under Sharia compliant financing arrangements*

  It is proposed that any amounts deemed to be interest in terms of section 24JA will also be subject to the provisions of section 23M.

B. Deductible interest limitation: Formula calculation

It is proposed that changes be made to the deduction formula as follows:

- The deduction of interest expenditure should be limited to 30 per cent of '*adjusted taxable income*' instead of the current calculated percentage of '*adjusted taxable income*'. Therefore, part of the deduction formula in section 23M(3)(*b*), which adjusts up and downwards based on the average repo rate for the year will be deleted.

- In view of the fact that the part of the formula that refers to the average repo rate and repo rate is deleted, consequential amendments should be made in section 23M(1) to delete the definitions of '*average repo rate*' and '*repo rate*'.

C. Back-to-back loans

To curb the circumvention of the rules applicable to back-to-back loans, it is proposed that changes be made in the current provisions of section 23M(2) so that the interest limitation rules also apply in two additional instances where a debtor incurs an amount of interest owed to a creditor that (i) forms part of the same group of companies as that debtor; and (ii) is in a controlling relationship with that debtor and the interest is taxable in the hands of the immediate creditor, but is not fully subject to tax in the hands of the ultimate creditor, if that creditor, directly or indirectly through another creditor that is in a controlling relationship with that creditor, obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that creditor and that other creditor and would not be taxed on interest accrued.

D. Refining the amount of interest deducted for REITS: Changes to the definition of Adjustable Taxable Income

It is proposed that a change be made in the definition of '*adjusted taxable income*' in section 23M(1) to take into account a 'qualifying distribution' of a REIT. As such, calculating '*adjusted taxable income*' requires the following:

Starting Point	Taxable Income
Less	Interest received/accrued
	CFC net income
	Recoupment
Plus	Interest incurred
	Capital allowances
	Assessed losses
	Deductible 'qualifying distribution' of a REIT or controlled company

E. Interaction between the level of tax on interest and application of section 23M rules

It is proposed that changes be made in the legislation so that there is a more consistent treatment for all resident debtors paying interest, and so that the restriction is not dependant on which country the payment is routed through.

In instances where a resident debtor makes an interest payment and either the payment attracts WHT on interest at a rate of zero or it is not included in the recipient's income, the deduction for interest expense will be subject to section 23M as under the current rules.

For cases where a resident debtor makes an interest payment and the payment attracts WHT on interest at a rate higher than zero but less than the standard rate, a portion of the deduction for interest expense will be subject to section 23M.

For example, if a resident debtor pays R100 of interest to a non-resident creditor (which is in a controlling relationship with the debtor), and the relevant treaty reduces the WHT rate to 5 per cent, the debtor can fully deduct 5/15ths of the interest expense and the remaining interest amount

will be subject to the section 23M limitation. In this example, the amount subject to section 23M would be (15-5)/15 x 100, which equals R66.67.

From a review of a variety of countries, it appears that most apply interest limitation rules regardless of how the corresponding interest income is treated or whether withholding taxes apply. This appears to be the case for many countries, including the United States, Germany, India and African countries that choose to adopt the drafting guidelines published by the African Tax Administrative Forum. If Government had followed this approach, the only consideration for being subject to section 23M would be whether there is a controlling relationship or not. However, Government considers the proposed approach to be more equitable than applying the restriction regardless of how the interests is taxed in the hands of the recipient.

The Act has precedent for introducing the proposed change. The extent to which taxpayers can deduct tainted royalties depends on the rate of WHT applied. The basis is slightly different as one portion is denied, rather than limited, but this is because Government funding was often used to fund the intellectual IP that was moved offshore.

IV. Effective date

In line with the Minister of Finance's announcement of introducing a revenue neutral corporate income tax package, and to recognise the hardship companies have faced during the COVID-19 pandemic and its associated lockdowns, the amendment will come into operation on the date on which the rate of tax in respect of the taxable income of a company is first reduced after announcement by the Minister of Finance in the Annual National Budget and will apply in respect of years of assessment commencing on or after that date.

2.2 RESTRICTING THE SET-OFF OF THE BALANCE OF ASSESSED LOSSES IN DETERMINING TAXABLE INCOME

[Applicable provision: Section 20(1) of the Act]

I. Background

In determining taxable income, section 20 of the Act enables taxpayers to set off their balance of assessed losses carried forward from the preceding tax year against their income. An unutilised assessed loss balance may be carried forward to future years of assessment to be set off against future income (provided that the taxpayer's trade continues without interruption). Accordingly, taxpayers will only be liable for income tax once they have earned a taxable profit and their assessed loss balance is depleted.

The purpose of providing for the deductibility of assessed losses for corporate taxpayers is to smooth the tax burden for companies whose primary business is cyclical in nature and not in line with a standard tax year, and for start-up companies that are not profitable in the early years of trading.

Even so, there has been a global trend to restrict the use of assessed losses carried forward. In 2015, out of a group of 34 OECD and non-OECD countries, 16 countries limit carry-forward periods to between 3 and 20 years, while 8 countries limit the amount of tax losses that can be offset in any given year. The latter are restricted to a percentage of either taxable income (ranging from 50 to 80 per cent) or accumulated assessed losses (ranging from 25 to 50 per cent) per year. The Slovak Republic, for instance, uses two restrictions – assessed losses can be carried forward for 5 years and the maximum set-off against taxable income is 50 per cent of the tax base.

Restricting the use of assessed losses is not unique to OECD countries. In Brazil, revenue tax losses may be carried forward indefinitely, but may only reduce up to 30 per cent of taxable income in one tax period. Russian companies can carry forward operating tax losses indefinitely and, until the start of 2021, these could only be offset against up to 50 per cent of the annual tax base. India and China both use time limits – India has a time limit of 8 years for setting off business losses, while losses in China can be carried forward for 5 years (10 years for new / high-tech / small and medium technology enterprises). With respect to neighbouring countries, Botswana and Mozambique both restrict the time period for carrying forward assessed losses to 5 years (with the exception of mining and prospecting in Botswana).

II. Reasons for change

Over the past few years, there has been an international trend to restrict the use of assessed losses and reduce the corporate income tax rate. To improve the country's competitiveness, reduce the appeal of base erosion and profit shifting, encourage investment and promote economic growth, the Minister of Finance announced (in the 2020 Budget Review) Government's intention to restructure the corporate income tax system over the medium term by broadening the base and reducing the corporate income tax rate in a revenue neutral manner.

Restricting the use of assessed losses against taxable income provides some of the fiscal space required to lower the rate and, as a result, forms part of a corporate income tax package to broaden the base and reduce the headline corporate tax rate in an overall revenue neutral manner.

There are four reasons for pursuing this proposal as announced in the 2020 Budget Review:

- As stated, it forms part of a corporate income tax package to broaden the base and reduce the headline corporate income tax (CIT) rate in an overall revenue neutral manner. Restricting the offset of accumulated assessed losses against taxable income provides some of the fiscal space required to lower the rate.
- While allowing full loss offsets against taxable income allows for less distortions towards less risky projects and enhances the stabilisation effects of corporate income taxation, a number of other countries do not achieve perfect symmetry in their CIT regimes and have used this type of measure as a means to fund lowering CIT rates.
- CIT is the most volatile of the main tax revenue instruments and this measure will assist in smoothing CIT revenues. A minimum tax would also achieve this function, but would be more punitive in that it would apply to businesses that make a taxable loss in the current year. This proposed measure will only apply once businesses turn profitable.
- While partial loss offsets may have a negative impact on business' cash flow and investment, they can help in curtailing tax avoidance. Given the time value of money, there is less incentive to overstate losses.

The following three methods are used by various countries to restrict the use of assessed losses: (i) limiting the carry-forward periods to a set number of years; (ii) basing a restriction on a specified percentage of accumulated assessed losses that may be used to reduce taxable income; and (iii) restricting the set off of accumulated assessed losses to a specified percentage of taxable income. Some countries also combine a restriction based on a set number of years with a restriction based on either a percentage of accumulated losses or taxable income.

The time-bound limit has a large effect on both symmetry and stabilisation and has an uneven effect across businesses depending on their business models. Those with long lead times

between upfront investment and the realisation of income and profits (e.g. mining) would be worse off than those with shorter periods in a loss position.

Restricting the amount of assessed losses to be offset does not discriminate against varying business models and would affect a larger share of businesses. With respect to choosing between basing the amount on a percentage of the accumulated assessed loss itself or on taxable income, research shows that defining the offsetting restriction in relation to accumulated losses can have a more negative impact on symmetry and stabilisation compared to using taxable income as the reference point. This is because the latter allows the full balance of assessed losses to be exhausted assuming an indefinite carry forward.

Based on research and the desire to work towards an efficient corporate tax regime with a broad base and lower rate, placing a restriction on a high share of taxable income is seen as the most appropriate policy stance for South Africa to balance the effects for businesses and government. This is viewed as a reasonable approach that affects all businesses more equally, rather than restricting the number of years for carrying forward assessed losses, which would disproportionately hurt businesses with large initial investments or long lead times to profitability.

South Africa has no provision for carrying back losses (against prior year taxable income). This type of measure has been used in economic downturns and some countries have done so (many on a temporary basis) to alleviate the negative economic impact of the Covid-19 pandemic on previously profitable companies.

Research shows that, for depreciation schedules which are not too accelerated, carry-backs are an effective policy to help with symmetry and stabilisation. South Africa’s depreciation schedules are predominantly accelerated – particularly in the primary and secondary sectors where large capital investments are common, such as mining, agriculture and manufacturing. In addition, there is not sufficient fiscal space to provide businesses with this option. Most of the countries that offered temporary loss carry-backs are developed countries with more room for expansionary fiscal measures.

III. Proposal

In line with the 2020 Budget announcement, government proposes to broaden the corporate income tax base by restricting the offset of the balance of assessed losses carried forward to 80 per cent of taxable income.

The proposal extends to the balance of assessed losses at the time of implementation. This will contribute to providing the fiscal room for government to lower the corporate tax rate.

The effect of the proposed restriction is that only companies that would be in a positive taxable income position before setting off the balance of assessed losses would be affected.

The table below provides an overview of four potential combinations of taxable profit / loss positions combined with whether there is an assessed loss balance or not.

Group	Current year	Accumulated assessed loss
A	Taxable profit (before setting off assessed loss balance)	No assessed loss balance
B	Taxable profit (before setting off assessed loss balance)	Assessed loss balance
C	Taxable loss (before setting off assessed loss balance)	No assessed loss balance
D	Taxable loss (before setting off assessed loss balance)	Assessed loss balance

Those in groups A, C and D will not be affected by the proposed restriction on assessed losses. It is only companies in group B that will be potentially affected. Within Group B, if the company's accumulated assessed loss balance exceeds 80 per cent of its taxable income, the company will be required to pay corporate income tax on 20 per cent of its current-year taxable income.

The examples below illustrate how three different companies in Group B would be affected – all of which are in a positive taxable income position before offsetting any prior year losses.

Example 1

Company B1 has R500 of taxable income before offsetting accumulated losses of R1,000. The accumulated loss balance exceeds current-year taxable profit – and, by implication, is more than 80 per cent of taxable income. Company B1 will be required to pay corporate income tax on the portion of its current-year taxable income that exceeds 80 per cent of taxable income (i.e. on 20 per cent of taxable income). As a result, Company B1 will be required to pay CIT of R28 (CIT rate of 28 per cent applied to taxable income of R100). The remaining balance of the assessed loss can be carried forward to the following year of assessment. While the corporate tax liability will be increased by R28 for two years, this will be countered by a reduction in the tax liability in year 3. This shows that the proposal brings in a timing difference relative to the current legislation and there is no change in the overall tax liability (visible in the last row titled "Difference").

Example 2

Company B2 has taxable income of R500 prior to setting off assessed losses of R475. The balance constitutes 95 per cent of current-year taxable income – exceeding the proposed 80 per cent restriction. As a result, Company B2's assessed loss balance which can be set off against its taxable income will be limited to R400 (80 per cent of its taxable income), with the remaining balance of R75 carried forward to future years. Company B2 will pay CIT of R28 (CIT rate of 28 per cent applied to taxable income of R100) rather than R7 in year one, but this difference will be reversed in year 2.

Example 3

Company B3 has taxable income of R500 before offsetting the assessed loss balance. However, its assessed loss balance is R200, which is less than 80 per cent of taxable income. Company B3 will be able to use its total assessed loss balance of R200 to reduce its taxable income.

To recognise that not all companies have sufficient cash flow to face an additional tax burden in the first year they become profitable (if they still have a remaining balance of assessed losses from prior years that exceeds 80 per cent of current-year taxable income), government proposes including a de minimis threshold in the assessed loss restriction. The aim is to provide breathing room for a variety of companies that may experience cash flow challenges at different times. For example, this should provide the space for smaller companies to use available funds to grow and for new companies to use available funds to survive and ultimately grow. It could also assist in the event that companies face setbacks or cyclical events and need to rely on available cash flow to

recover. To the extent that the balance of assessed loss exceeds 80 per cent of current-year taxable income, companies will be able to set off the higher of R1 million or 80 per cent of taxable income.

Company	B1			B2		B3	
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 1	Year 2
Existing regime							
Taxable income	500	500	500	500	500	500	500
Assessed loss balance b/f	1 000	500	-	475	-	200	-
Taxable income	-	-	500	25	500	300	500
CIT @ 28%	*-*	*-*	*140*	*7*	*140*	*84*	*140*
AL balance c/f	500	-	-	-	-	-	-
Proposed regime							
Taxable income	500	500	500	500	500	500	500
80% of taxable income	400	400	400	400	400	400	400
Assessed loss balance b/f	1 000	600	200	475	75	200	-
% of taxable income	*200%*	*120%*	*40%*	*95%*	*15%*	*40%*	*0%*
Taxable income	100	100	300	100	425	300	500
CIT @ 28%	*28*	*28*	*84*	*28*	*119*	*84*	*140*
AL balance carried forward	600	200	-	75	-	-	-
Change in tax liability							
CIT pre-change (no restriction on assessed loss balance)	-	-	140	7	140	84	140
CIT post-change (restriction on assessed loss balance)	28	28	84	28	119	84	140
Difference	28	28	- 56	21	- 21	-	-

IV. Effective date

In line with the Minister of Finance’s announcement of introducing a revenue neutral corporate income tax package, and to recognise the hardship companies have faced during the COVID-19 pandemic and its associated lockdowns, the amendment will come into operation on the date on which the rate of tax in respect of the taxable income of a company is first reduced after announcement by the Minister of Finance in the Annual National Budget and will apply in respect of years of assessment commencing on or after that date.

2.3 CLARIFYING THE DEFINITION OF CONTRIBUTED TAX CAPITAL

[Applicable provision: section 1(1) of the Act – 'contributed tax capital' definition and the insertion of a further proviso to the definition]

I. Background

The concept of contributed tax capital (CTC) was introduced in the Act in 2008. The CTC of any company is a notional and ring-fenced 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 the notional tax amount so received.

II. Reasons for change

The policy rationale of this provision and the wording of the current proviso to the definition of CTC the legislation specifically requires that no holder of shares within a particular class of shares may receive CTC in excess of an amount per share derived by dividing the total CTC by the number of shares in that class immediately before that distribution.

However, it has come to Government's attention that some companies are exploiting the current provisions of the CTC by allocating CTC on the basis of an alleged 'share premium' contributed by a particular shareholder but not to all shareholders holding shares in the same class of shares.

III. Proposal

In order to curb this abuse, it is proposed that changes be made to the definition of CTC to clarify the principle that shareholders within the same class of shares should equally, in relation to their shareholding, share in the allocation of CTC as a result of a distribution.

To accommodate certain corporate actions, which structurally can be facilitated as a distribution of capital through an allocation of CTC, it is proposed that any amount transferred as an acquisition by the company of its own listed securities by way of general repurchase of that securities be specifically excluded from the anti-avoidance proposal above.

IV. Effective date

The amendments will come into effect on 1 January 2023.

2.4 LIMITING POTENTIAL FOR DOUBLE TAXATION UNDER THE HYBRID DEBT ANTI AVOIDANCE RULES

[Applicable provision: Sections 8F, 8FA and 50A of the Act]

I. Background

The Act contains specific anti-avoidance rules in section 8F and section 8FA dealing with hybrid debt instruments and hybrid interest. The general aim of these anti-avoidance rules is to curb the artificial generation of interest deductions by an issuer if the debt instrument qualifies as a hybrid debt instrument because of its equity features, or if the yield is determined not to constitute bona

fide interest and seeks to recharacterise interest labelled returns as dividends *in specie* paid in respect of a share. Consequently, the issuer may be liable for dividends tax at a rate of 20 per cent.

Section 8F focuses on the equity-like features of a debt instrument and applies when the debt instrument exhibits certain equity features that taxpayer include in their financial arrangements in order to take advantage of the equity features and would otherwise benefit from the tax deductibility of interest from interest bearing debt arrangements. The section deals with the convertibility of the debt instrument into shares, the repayment of the debt or interest on the debt instrument conditioned upon the solvency of the issuer and the period until redemption of the debt. Where the debt instrument qualifies as a hybrid debt instrument the yield is regarded as a dividend *in specie* paid in respect of a share.

On the other hand, section 8FA focuses on the nature of the yield (i.e. the interest labelled return) and requires that the yield must be determined with reference to a rate of interest, and that the rate of interest must not be dependent on the profits of the issuer for that yield to qualify as interest instead of an equity-like return (i.e. hybrid-interest). Where the yield is not determined in an acceptable manner, the yield is regarded as a dividend in specie paid in respect of a share.

II. Reasons for change

Concerns have been raised regarding the effect of the above-mentioned hybrid debt and hybrid interest anti-avoidance rules in sections 8F and 8FA. The deeming provisions, which deem any return from tainted debt instruments or any tainted returns to be dividends *in specie* in respect of a share to be declared and paid by the issuer to the person to whom the amount accrued, do not specifically deem the return to be the accrual of dividends *in specie* for the holder or recipient of the return. As a result, the return may not qualify for an interest deduction, dividends tax may be payable by the issuer if no exemption applies and the holder may be taxed on the interest. In such an instance, the anti-avoidance rules would be going too far as the return would be regarded as interest and thus also be taxable for the holder of a tainted instrument or recipient of a tainted return, leading to economic double taxation.

The above-mentioned effect goes against the policy rationale for the introduction of these rules as well as further changes made to these rules in 2016 and 2017 ensuring that interest will be classified as a dividend *in specie* and dividends tax may be levied on the deemed dividend *in specie*.

III. Proposal

It is proposed that the policy position regarding the deeming provisions in sections 8F and 8FA be refined. In order to address concerns raised, it is proposed that changes be made in the tax legislation to explicitly extend the deeming provision to apply to the holder of a tainted instrument or recipient of tainted return.

In addition, consequential amendments are proposed to refine the tax treatment of the reclassified return for purposes of withholding tax on interest in terms of the Act.

IV. Effective date

The amendments will come into operation on the date on which the Taxation Laws Amendment Act, 2021, is promulgated and applies in respect of amounts incurred or accrued on or after that date.

2.5 CLARIFYING THE MEANING OF ‘INTEREST’ UNDER THE DEBT RELIEF RULES

[Applicable provision: Section 19(8)(*f*) and paragraph 12A(6)*(g)* of the Eighth Schedule to the Act]

I. Background

The Act contains debt relief rules in section 19 and paragraph 12A of the Eighth Schedule that trigger tax consequences in respect of a waiver, cancellation, reduction or discharge of a debt owed by a taxpayer. Section 19 of the Act deals with normal tax implications in respect of a debt that was previously used to fund tax deductible expenditure, for example, operating expenses. On the other hand, paragraph 12A of the Eighth Schedule to the Act deals with capital gains tax implications in respect of a debt in respect of which a debt benefit arises.

In 2018, changes were made to the debt relief rules. The changes introduced a new concept of a ‘debt benefit’ that seeks to tax the benefit to a debtor resulting from a concession or compromise of a debt entered into with a creditor. Consequently, the concept of a ‘debt benefit’ results in a regime that triggers a recoupment in terms of section 19 or capital gain in terms of paragraph 12A of the Eighth Schedule in instances where an arrangement that is included in the definition of ‘concession or compromise’ gives rise to an economic benefit that is not equally reflected in the market value of the reduced consideration received by the creditor or the amount of the reduced debt exceeds the expenditure incurred by the debtor in respect of a transaction. Under the debt relief rules a concession or compromise encompasses arrangements where there is –

- a debt cancellation or waiver;
- a debt that is extinguished either by way of a redemption of the debt claim by the debtor or a person that is a connected person in relation to the debtor or extinguished by merger as a result of the acquisition of the debt claim by the debtor; or
- a conversion of debt into shares where a debt owed by a company is settled directly or indirectly by being converted to or exchanged for shares in that company or by applying the proceeds from shares issued by that company.

In the case of a conversion of debt into shares, the debt relief rules trigger a debt benefit that is subject to tax if the face value of the reduced amount of the debt prior to the entering into of that arrangement exceeds –

- the market value of the shares acquired by reason or as a result of the implementation of that arrangement, in the instance that the creditor held no interest in the shares in the debtor prior to the arrangement; or
- the amount by which the market value of the interest in the shares held by that creditor in that debtor company after the implementation of that arrangement exceeds the market value of the interest in the shares held by that creditor in the debtor company prior to entering into of that arrangement, in the instance that the creditor held an interest in the shares in the debtor prior to the arrangement.

However, an exclusion has been provided so that the debt forgiveness rule does not apply to a debt benefit arising from debt to share conversions to the extent the debt converted does not consist of or represent an amount owing in respect of interest incurred during any year of assessment.

II. Reasons for change

Concerns have been raised regarding the meaning of the word ‘interest’ in the debt relief rules that provide for the inclusion of the amount of debt in the form of interest incurred that is converted into shares or settled by applying the proceeds of shares in the application of debt relief rules. At issue is the fact that there is no definition of the word ‘interest’ contained in the debt relief rules.

III. Proposal

Legislative changes are made to provide clarity as to the meaning of the word “interest” for purposes of applying the debt relief rules. As a result, the meaning of the word “interest” is clarified in the legislation to mean interest as defined in section 24J of the Act.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

2.6 REFINING THE INTERACTION BETWEEN ANTI-VALUE SHIFTING RULES AND CORPORATE REORGANISATION RULES

[Applicable provision: Section 40CA of the Act]

I. Background

A. Anti-value shifting rules

The Act contains rules in section 24BA and section 40CA aimed at curbing the use of structures that shift value between taxpayers free of tax, referred to as “anti-value shifting rules”. Section 24BA applies to transactions involving asset for share exchanges and triggers a capital gain (in respect of which capital gains tax is payable) or deems a distribution of an asset *in specie* (in respect of which dividends tax will be payable) where these exchanges are not effected on a value-for-value basis. In its application, section 24BA provides that where a company acquires an asset in exchange for the issue of its shares and the market value of the asset immediately before that disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares and the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess. However, where a company acquires an asset from a person in exchange for the issue of shares and the market value of the shares immediately after that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

In turn, section 40CA prescribes a base cost for assets acquired by companies in exchange for the issue of their shares to the seller of those assets as the sum of the market value of the shares it issued and the amount of the capital gain triggered by the application of the provisions of section 24BA to ensure that there is no double taxation on the future disposal of the assets.

B. Roll over base cost rule under corporate reorganisation rules

On the other hand, the Act contains corporate reorganisation rules in Part III of Chapter II that allow for the tax neutral transfer of assets between companies that are part of the same group of companies. These corporate reorganisation rules also prescribe that qualifying asset-for-share transactions are subject to anti-value shifting rules and such transfers are subject to the roll-over base cost rules within the corporate reorganisation rules. In essence, these rules provide that asset transferred in terms of the corporate reorganisation rules are subject to the roll-over base cost rules that deem the acquirer and seller to be one and the same person for purposes of the base cost determination. These corporate reorganisation rules also prescribe those transactions that qualify for tax deferral under the corporate reorganisation rules are subject to the anti-value shifting rules that aim to ensure that all assets transferred in exchange for shares are affected on a value-for-value basis.

II. Reasons for change

The interaction between the anti-value shifting rules in sections 24BA and 40CA and the corporate reorganisation rules in Part III of Chapter II of the Act gives rise to anomalous results as the capital gain triggered under the anti-value shifting rules is only added to the base cost of an asset acquired in exchange for the issue of shares by a company in terms of section 40CA, which is outside of the corporate reorganisation rules in Part III of Chapter II of the Act. The capital gain triggered under the anti-value shifting rules in section 24BA is, however, not taken into account when the anti-value shifting rules are triggered in respect of transactions that are subject to the corporate reorganisation rules in Part III of Chapter II, as the corporate reorganisation rules only provide for rolled over base cost. As a result, a company will, on the future disposal of an asset acquired under the reorganisation rules in Part III of Chapter II, be subject to double taxation as the company is not granted an uplift of base cost in respect of the capital gain previously triggered in terms of the anti-value shifting rules in terms of section 40CA.

III. Proposal

In order to address these concerns, changes are made in the tax legislation to provide for additional base cost equal to any deemed capital gain resulting from the application of the anti-value shifting rules in section 24BA for corporate reorganization rules in Part III of Chapter II, namely, asset-for-share transactions rules in section 42, substitutive share-for-share transactions rule in section 43 and amalgamation transactions rules in section 44. In this regard, changes are made in the legislation to ensure that the additional base cost uplift in this regard, is granted immediately after an asset-for-share transaction that is subject to the anti-value shifting rules. As a consequential amendment, an additional legislative change will be made to section 41(2) of the Act to ensure that the re-organisation rules are made subject to this immediate base cost uplift.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of any acquisition of an asset on or after that date.

2.7 CLARIFYING THE RULES THAT TRIGGER ADDITIONAL CONSIDERATION IN ASSET-FOR-SHARE TRANSACTIONS WHEN A DEBT IS ASSUMED BY A COMPANY

[Applicable provision: Section 42(8) of the Act]

I. Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain asset-for-share transaction rules in section 42 that allow for the tax neutral transfer of assets when a person (transferor) disposes of an asset to a company in exchange for the issue of shares by that company to that transferor or when a transferor disposes of an asset that was acquired using debt and as part of that disposal, that debt is assumed as a consideration by a company acquiring that asset. In essence, these rules entail that an asset that is disposed of in terms of an asset-for-share transaction results in no immediate taxable income (including a capital gain) for the transferor as the disposal is deemed to have been effected for a consideration equal to the base cost or cost of that asset. However, when that asset is subsequently disposed of in terms of a transaction that falls outside the corporate reorganisation, then there will be tax consequences.

That said, the asset-for-share transaction rules dealing with the tax neutral transfer of assets when a transferor disposes of an asset that was acquired using debt and, as part of that disposal, that debt is assumed as consideration by a company acquiring that asset are subject to an anti-avoidance measure in section 42(8), that is aimed at preventing a permanent loss to the fiscus, instead of a tax deferral. This is to ensure that these rules do not allow taxpayers to benefit from a permanent loss to the fiscus resulting from the transferor ending up with shares that reflect the net asset value (i.e. market value of the asset less the debt assumed) transferred. As a result, section 42(8) provides that a proportional part of any qualifying debt that was assumed by a company as part of an asset-for-share transaction will constitute an amount received by or accrued to the transferor in respect of the disposal of any of the shares in the company acquired in terms of the asset-for-share transaction, when such shares are subsequently disposed of by the transferor. Consequently, a transferor must account for any debt assumed under an asset-for-share transaction as additional proceeds upon the disposal of the shares.

II. Reasons for change

It has come to Government's attention that the above-mentioned anti-avoidance rules that trigger additional consideration upon disposal are undermined when the shares are subsequently transferred in terms of a corporate reorganisation transaction as other applicable corporate reorganisation rules will enforce the rolled-over base cost of the previous asset-for-share transaction.

III. Proposal

In order to prevent the above-mentioned anti-avoidance rules contained in section 42(8) from being undermined, changes are made to the legislation and the anti-avoidance rules should be amended so that, going forward, the additional consideration accrues to the transferor in relation to any assumed debt immediately before any subsequent disposal of the shares acquired in terms of an asset-for-share transaction. Consequently, a transferor will irrespective of whether such a subsequent disposal of the shares is in terms of tax deferred transaction or not, be subject to tax on the additional consideration that is triggered immediate before that subsequent disposal of the shares. This immediate tax consequence is favoured and is viewed in the same light as the immediate tax consequence that taxpayers are subject to when they shift value by entering into asset-for-share transactions using the reorganisation rules that are subject to anti-value shifting rules that trigger an immediate capital gain or *in specie* dividend.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the disposal of a share on or after that date.

2.8 CLARIFYING THE EARLY DISPOSAL ANTI-AVOIDANCE RULES IN INTRA-GROUP TRANSACTIONS

[Applicable provision: Section 45(5) of the Act]

I. Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain intra-group transaction rules in section 45 that allow for tax deferral in respect of a disposal of an asset or a business as a going concern between companies that form part of the same group of companies at the end of the day of that disposal transaction. These intra-group transaction rules contain anti-avoidance measures that make provision for the early disposal rules to apply when an acquirer of an asset in terms of an intra-group transaction disposes of that asset within 18 months of such an acquisition. These early disposal anti-avoidance disposal rules reverse the deferral benefit that applied in terms of the intra-group transaction by ring-fencing so much of any capital gain, capital loss or income arising from the early disposal of an asset, as does not exceed the capital gain, capital loss or income that would have arisen on the date of intra-group transaction to ensure that such a gain, loss or income is not set-off against other gains, losses or income.

These early disposal anti-avoidance rules were introduced to curb the risk that group companies may enter into tax deferred transactions in terms of the intra-group transaction rules with the aim of minimising any adverse tax consequences of an asset disposal outside the group of companies, through offsetting any resultant tax consequences within the group. For example, a company may dispose of its asset (in respect of which a capital gain was anticipated on the date of an intra-group transaction) to a fellow group company with an assessed loss in order for that fellow group company to offset any capital gain on the disposal of that asset outside the group companies to a third party. Applying the early disposal anti-avoidance rules in the given example, the rules entail that the company that is disposing of an asset within 18 months of acquiring it in terms of a tax deferred intra-group transaction, must ring-fence the resultant tax consequences of such a disposal (i.e. the capital gain in the example provided) and not offset it against its losses, thus enforcing that tax must be paid on such capital gain.

II. Reasons for change

It has come to Government's attention that in some instances, a capital gain may have been anticipated from the disposal of an asset at the date of the intra-group transaction, yet, at the date of the early disposal of an asset (disposal of an asset within 18 months after the acquisition in terms of the intra group transaction), a capital loss arises in respect of that asset. The difference in the nature of the resultant consequences in respect of the disposal of an asset on the date of the intra-group transaction and the date of the early disposal creates ambiguity in the application of the early disposal anti-avoidance rules.

III. Proposal

In order to address this ambiguity, clarification is made to the early disposal anti-avoidance rules regarding the resultant tax consequences of an early asset disposal when the tax consequences

arising from actual early disposal differ from those anticipated on the date of the original intra-group transaction. As such, a further proviso is added to subsection 45(5) in order to provide that the ring-fencing provisions of subsection 45(5) will not apply in instances where the tax consequence arising from the actual disposal of the asset differs from the tax consequences that would have arisen had roll-over not been available on the date of the intra-group transaction.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the disposal of any asset on or after that date.

2.9 EXTENDING THE REVERSAL OF THE NIL BASE COST RULES TO APPLY ON THE SIXTH ANNIVERSARY OF AN INTRA-GROUP TRANSACTION

[Applicable provision: Section 45(3B) of the Act]

I. Background

The corporate reorganisation rules in Part III of Chapter II of the Act make provision in section 45, dealing with intra-group transactions, that allows for a tax deferral in instances where one company transfers an asset or a business as a going concern to the other company and both companies form part of the same group of companies at the end of the day of that transaction. However, these intra-group transaction rules also contain various anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers. Of particular concern is the de-grouping anti-avoidance rule and the zero base cost anti-avoidance rule.

The de-grouping anti-avoidance rule reverses any tax deferred from the original intra-group transaction in the hands of the transferee, which in effect reverses the tax benefit of that original intra-group transaction, in instances when a transferor company ceases to form part of any group of companies as the transferee company within six years of the original intra-group transaction.

On the other hand, the zero base cost anti-avoidance rule applies to transfers of assets in exchange for debt or a non-equity share issued by a fellow group company of an acquirer or company disposing of an asset in terms of an intra-group transaction. In terms of this zero base cost anti-avoidance rule, the holder of the debt or non-equity shares is deemed to have acquired the debt or non-equity shares for an amount of expenditure equal to nil.

In 2020, changes were made in section 45 of the Act to remove the potential double taxation arising in instances where an intra-group transaction is subject to the zero base cost anti-avoidance rule resulting in a zero base cost for the holder of a debt or non-equity share that facilitated or funded an intra-group transaction and then subsequently a de-grouping or deemed de-grouping occurs and the de-grouping rules also reverse the tax deferral benefits.

II. Reasons for change

Concerns have been raised that because the de-grouping anti-avoidance rule ceases to apply on the sixth anniversary of an intra-group transaction, the zero base cost anti avoidance rule should similarly be reversed on the sixth anniversary of an intra-group transaction. Further, it is counterintuitive that parties that operate within the spirit of the intra-group tax deferral rules and remain within the original group, should not be granted base cost in respect of debt and non-equity shares used to facilitate such an intra-group transaction.

III. Proposal

In order to address these concerns, changes are necessary to the intra-group transaction rules to extend the reversal of the zero base cost anti-avoidance rules and ensure that base cost is restored for holders of debt and non-equity shares used to facilitate the transfer of assets in terms of an intra-group transaction, on the sixth anniversary of that intra-group transaction.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

2.10 CLARIFYING THE INTERACTION BETWEEN EARLY DISPOSAL ANTI-AVOIDANCE RULES AND THE NIL BASE COST ANTI-AVOIDANCE RULES

[Applicable provision: Section 45(3B) of the Act]

I. Background

The intra-group transaction rules in section 45 of the Act allow for tax deferral in respect of transactions under which one company transfers an asset or a business as a going concern to the other company if both companies form part of the same group of companies at the end of the day of that transaction. These intra-group transaction rules also contain anti-avoidance measures aimed at discouraging abuse by taxpayers. The first anti-avoidance measure, namely, the de-grouping anti-avoidance rule, is triggered when a transferor company ceases to form part of any group of companies as the transferee company within six years of the original intra-group transaction. The de-grouping anti-avoidance rule reverses any tax deferred from the original intra-group transaction in the hands of the transferee, which in effect reverses the tax benefit of that original intra-group transaction.

The second anti-avoidance measure, namely, the early asset disposal anti-avoidance rule applies when a company within the same group of companies enter into tax deferred intra-group transaction with the aim of transferring assets to another company within the same group of companies that will be able to absorb any tax consequences that may result from a future disposal out of the group of companies. The early asset disposal anti-avoidance rule reverses any tax deferred in respect of any asset subsequently disposed of within 18 months of an intra-group transaction and ring-fence the arising gain, loss or taxable income.

The third anti-avoidance measure, namely, the zero base cost anti-avoidance rule applies to a holder of any debt or and non-equity share issued by a fellow group company of an acquirer or company disposing of assets in terms of an intra-group transaction if that debt or non-equity share was used to facilitate or fund that intra-group transaction. The zero base cost anti-avoidance rule deems the holder of such debt or non-equity share to have acquired the debt or non-equity share for an amount of expenditure equal to zero. This anti-avoidance rule is aimed at limiting the use of debt or non-equity shares by taxpayers to transfer market value consideration for assets transferred under an intra-group transaction which could further be abused by transferring the debt or non-equity shares outside of the group by the transferor.

II. Reasons for change

In 2020, changes were made in section 45 of the Act to remove the potential double taxation arising in instances where an intra-group transaction is subject to the zero base cost anti-avoidance rule resulting in a zero base cost for the holder of a debt or non-equity share that facilitated or funded an intra-group transaction and then subsequently a de-grouping or deemed de-grouping occurs and the de-grouping rules also reverse the tax deferral benefits. Because the early asset disposal anti-avoidance rule reverses the tax deferral benefit in respect of the disposal of an asset which was acquired in terms of the intra-group transaction within 18 months of such an acquisition, it is therefore appropriate that the zero base cost anti-avoidance rule should be reversed when the early disposal anti-avoidance rule is triggered.

III. Proposal

In order to address these concerns, changes are made to the intra-group rules to give effect to the reversal of the application of the zero base cost anti-avoidance rule in instances when the early asset disposal anti-avoidance rule applies. It should be noted that the reinstatement of the base cost for any debt or non-equity share will only be provided for to the extent to which the debt and/or non-equity share facilitated or funded an asset disposed of early and in respect of which the provisions of the Act applied to reverse and ring-fence the deferred capital gain, capital loss, taxable income or assessed loss.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

2.11 REFINING THE PROVISIONS APPLICABLE TO UNBUNDLING TRANSACTIONS

[Applicable provisions: Sections 46 and 46A of the Act]

I. Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain unbundling provisions in section 46 that allow for a tax neutral transfer of shares in instances where shares of a resident company (unbundled company) that are held by another resident company (unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. As a result, in a qualifying unbundling transaction, distribution of shares is disregarded for purposes of determining the taxable income, assessed loss or net income of an unbundling company. The distribution of shares is also disregarded for Dividends Tax purposes and there is no consideration taken into account when determining reduction of contributed tax capital. These unbundling rules contain the following anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers from distributing shares on a tax neutral basis if the shareholders do not fall within the South African tax net.

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Prior to 2020, this anti-avoidance measure made provision for the roll-over relief not to apply if immediately after the distribution of shares in terms of an unbundling transaction, 20 per cent or more of the shares in the unbundled company are held by disqualified persons either alone or together with any connected persons (who is a disqualified person) in relation to that disqualified

person. The term 'disqualified persons' is defined in this regard to include a person that is regarded as a non-resident in terms of the South African tax legislation or exempt persons in terms of South African tax legislation (for example, the government of the Republic in the national, provincial or local sphere contemplated in section 10(1)(*a*), a public benefit organisation as defined in section 30, a recreational club as defined in section 30A, a mining rehabilitation company or trust contemplated in section 37A, a pension fund, a provident fund, a retirement annuity fund, a benefit fund contemplated in section 10(1)(*d*)(i) or (ii) or a person contemplated in section 10(1)(*cA*) or (*t*)).

It came to Government's attention that this anti-avoidance measure was anomalous as it was not aligned with the initial policy intent of corporate reorganisation rules and created an exemption instead of a deferral by allowing an exemption on significant shareholding as opposed to a de-minimis exemption. This anti-avoidance measure created a loophole in that the 20 per cent exclusionary rule did not apply as intended to deny roll-over relief where tax exempt or non-resident shareholders are not connected persons in relation to each other, thus effectively resulting in a tax exemption instead of a tax deferral as future disposals of shares by tax exempt or non-resident shareholders would not be subject to tax in South Africa.

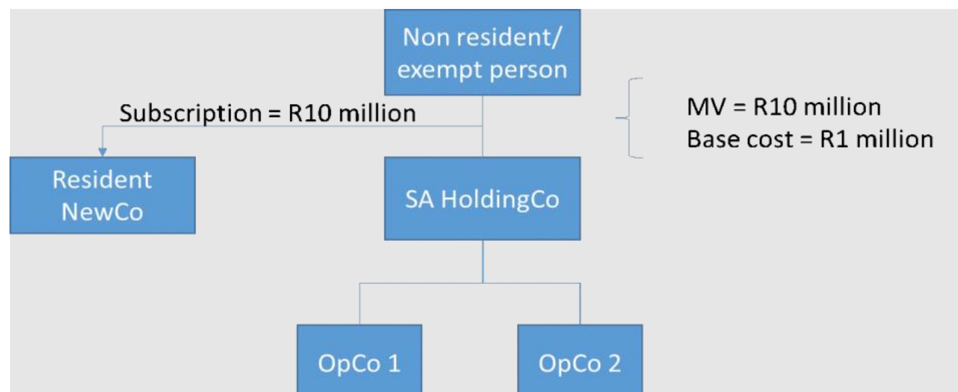
As a result, in 2020, changes were made to this anti-avoidance measure to make provision for the roll-over relief not to apply in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5 per cent of the equity shares in the unbundling company immediately before an unbundling transaction.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

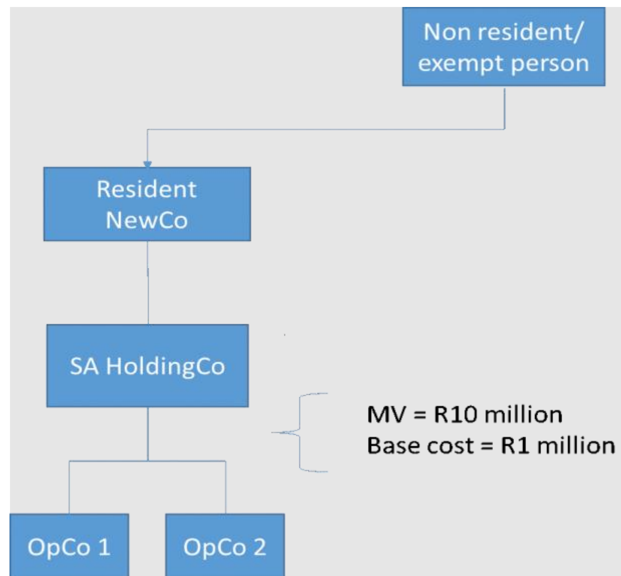
Prior to 2008, some taxpayers were abusing the roll-over relief in the unbundling transactions rules by creating for example, structures where a person that is not subject to South African tax and in particular, capital gains tax, such as a non-resident or resident tax exempt person that indirectly holds shares in high value operating companies through a South African Holding company, recapitalising the South African group to achieve an increase in the base cost of the shares held in entities within the group in order to decrease a future tax burden. This would be achieved as follows:

Example

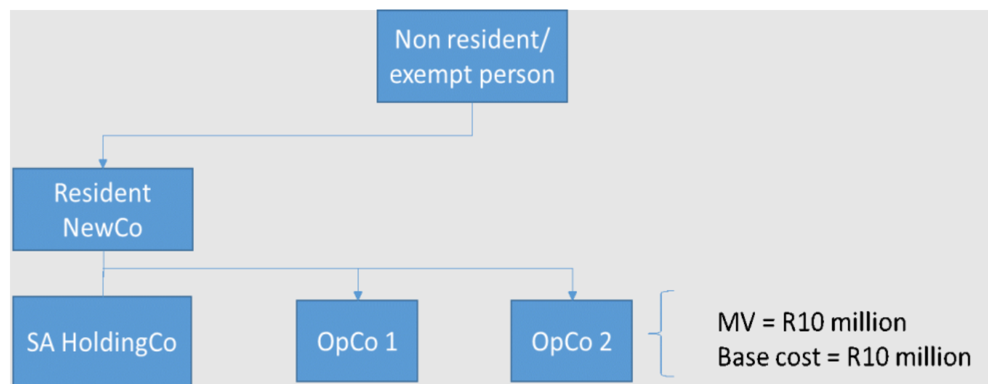
Step 1: A non-resident or resident exempt person that already holds an interest in a South African group would form a Resident NewCo by subscribing for shares in Resident NewCo for an amount reflecting the market value of the South African group that is much higher than the cumulative base cost of the shares in the South African holding company.



Step 2: Resident NewCo would use the capital to acquire the shares in the South African holding company from the non-resident or resident exempt person.



Step 3: Thereafter the South African holding company would distribute the shares it holds in the operating companies to Resident NewCo in terms of a tax deferred unbundling transaction. As a result, of applying the provisions of section 46(3) to the Resident NewCo, the base cost of the shares in the SA HoldingCo is split between the shares held in the SA HoldingCo and the operating companies without tax being paid and providing future lowered tax (for example capital gains tax) on future disposal of the shares in the operating companies.



In 2008, changes were made in the unbundling transaction rules by introducing an anti-avoidance measure in section 46A that makes provision for limitation of the base cost of shares received in terms of an unbundling transaction if the shares in the unbundling company are preceded by the disposal of shares between connected persons that are not fully taxable. As a result, upon application of this anti-avoidance measure, the base cost of the shares received in an unbundling transaction is limited. This limitation applies where a shareholder in an unbundling company acquires an unbundled company's shares within two years after the unbundling company shares were held by a connected person and the connected person was not fully subject to normal tax on disposal of the shares. Under such circumstances, the acquisition cost incurred by the first connected person for the unbundling shares in the two-year period is substituted by the base cost of the unbundling shares for the connected person with adjustment allowed for specified

deductions, ordinary revenue and capital gains of any connected person holding the unbundling shares during the two-year period.

II. Reasons for change

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Following the 2020 legislative changes, there is no tax deferral for an unbundling transaction in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5 per cent of the equity shares in the unbundling company immediately before that unbundling transaction. The 2020 changes resulted in the *pro rata* application of this anti-avoidance measure and results in a more equitable outcome in respect of unbundling transactions as only shares distributed to persons that are not disqualified persons will benefit from the roll-over relief and the rest will be subject to normal tax and dividends tax rules applicable on distribution.

That said, the *pro rata* application of these rules implies that in the case of a distribution, any taxes paid are indirectly borne by all shareholders proportionate to their equity shareholdings in the unbundling company. As a result, any shareholders that are not regarded as disqualified persons will be subject to tax on future disposals of their respective shares in the unbundled company without any recourse in the manner of an uplift of base cost in respect of the tax indirectly borne.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

It came to Government's attention that this anti-avoidance measure may be applied broadly as the current wording in the legislation may be applied to limit expenditure incurred by a taxpayer in respect of any share held in an unbundling company irrespective of how such share in the unbundling company was acquired by the taxpayer. This is of particular concern in instances that shares are not part of an unbundling transaction, a taxpayer may have acquired shares in an unbundled company from a third party that was subject to tax on the disposal of such shares. The limitation should apply only to shares acquired as part of an unbundling transaction and not limit the base cost of shares that were not acquired as part of a tainted unbundling transaction.

III. Proposal

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Changes are made to this anti-avoidance measure so that shareholders in an unbundling company that qualifies for tax deferral for an unbundling transaction should receive additional base cost that is reflective of the tax paid by the unbundling company in respect of their shares in the unbundled company, in accordance with their respective shareholding. This will, in practical terms, only benefit non-disqualified persons on future disposal of the unbundled shares as disqualified persons would in any case not be subject to tax.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

Changes are made to this anti-avoidance measure to ensure that this measure only applies to shares that are acquired by way of an unbundling and not to those shares that are acquired through either subscription or acquisition for a full consideration.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the allocation of expenditure to unbundled shares acquired on or after that date.

2.12 CLARIFYING REHYPOTHECATION OF COLLATERAL WITHIN COLLATERAL ARRANGEMENT PROVISIONS

[Applicable provision: Definition of 'collateral arrangement' in section 1(1) of the Securities Transfer Tax Act, 2007 (Act No. 25 of 2007) ("STT Act")]

I. Background

In 2015, 2016 and 2017 changes were made in the Act and the STT Act to allow for an outright transfer of listed shares or local and foreign government bonds in collateral lending arrangements. As a result, if a listed share, local or foreign government bond is transferred as collateral for an amount owed by the transferor to the transferee, there are no income tax (including capital gains tax) and securities transfer tax implications provided that identical shares or bonds are returned to the transferor by the transferee within a limited period of 24 months from the date of transfer of the collateral.

II. Reasons for change

At issue is the lack of legislated clarity regarding the rehypothecation of collateral, where the bank, broker dealer or collateral taker (transferee) intends to use collateral received through a tax-neutral collateral arrangement for subsequent trading or as security for its own borrowing.

Rehypothecation for purposes other than subsequent tax-free lending arrangements and meeting regulatory requirements undermines the very purpose of the initial tax-free provisions to support Government driven regulatory objectives post the 2008 financial crisis.

III. Proposal

It is proposed that changes be made to the legislation to clarify that any shares or bonds transferred as collateral in terms of a collateral arrangement outside of the legislated provisions and requirements will have tax consequences.

As part of the proposed amendment, legislation will be expanded to specifically list the allowable and required regulatory conduct through rehypothecation as a measure to support government's ability to identify and sanction the proper and subsequent regulatory use of the collateral received by the transferee during the 24-month time frame of collateral arrangements.

IV. Effective date

The amendments will come into operation on1 January 2023 and apply in respect of any collateral arrangements entered into on or after that date.

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

3.1 REFINING A DEDUCTION FORMULA FOR TAXABLE LONG TERM INSURER POLICYHOLDER FUNDS

[Applicable provision: Section 29A(11) of the Act]

I. Background

In 2012, changes were made to section 29A of the Act by revising the deduction formula for selling, administration and indirect expenses for long-term insurers. In general, this formula is based on taxable income divided by net economic income. For purposes of the denominator, the concept of "net economic income" is intended to reflect total taxable income without a reduction of non-includible dividends, foreign dividends and capital gains.

II. Reasons for change

At issue is that unrealised gains to be accounted for in the denominator does not refer to any level of aggregation of unrealised gains and losses and is inconsistent with dividends, foreign dividends and realised capital gains which refer to an aggregation of amounts.

III. Proposal

In order to address this anomaly, it is proposed that changes be made in the deduction formula so that unrealised gains and losses should also be aggregated for all assets allocated to the relevant policyholder fund.

IV. Effective date

The amendments will come into operation on the date of promulgation of the 2021 Taxation Laws Amendment Bill.

3.2 CLARIFYING THE TRANSFER OF LIABILITIES IN RESPECT OF INSURANCE BUSINESS BETWEEN SHORT-TERM INSURERS

[Applicable provision: Section 28 of the Act]

I. Background

In general, for regulatory purpose, under section 50 of the Insurance Act, 2017 (Act No. 18 of 2017) an insurer (other than a branch of a foreign reinsurer, Lloyd's underwriter or Lloyd's) may not, without the approval of the Prudential Authority, transfer all or any part of its assets and liabilities relating to its insurance business to another insurer. The general purpose of requiring approval is to ensure that the Prudential Authority can assess whether or not the proposed transfer could impair the financial soundness of the insurer, the insurer's controlling company or the acquirer, or impact negatively on the interests of policyholders.

However, section 28 of the Act which deals with the taxation of short-term insurers does not specifically address all the tax consequences that arise from the sale of all or a part of insurance business, which involve the transfer of all rights such as premiums receivable and obligations such

as claims to be settled under an insurance contract, in which case the general provisions of the Act apply.

As a general matter, the transaction requires the buyer to assume all outstanding liabilities with the obligation to settle any future claims as recorded in the seller's accounting records at date of transfer and have the right to all future premium's receivable under the insurance contract. In addition, the seller also transfers the rights in respect of the insurance contracts to the buyer. Lastly, for the buyer's assumption of the outstanding liabilities the seller reduces the consideration for the transaction or pays the buyer an amount equal to the value of the outstanding liabilities.

II. Reasons for change

As stated above, section 28 of the Act does not specifically address all the tax consequences that arise from the sale of all or a part of insurance business and the general provisions of the Act apply. However, the interpretation of the general provisions of the Act read with section 28 of the Act may result in inconsistent tax treatment of the insurers that are parties to the transfer of business.

III. Proposal

In order to address these concerns, it is proposed that the following changes be made in section 28 of the Act to clarify the tax treatment of transfer of liabilities as part of the transfer of short-term insurance business or short-term policies.

A. Seller's tax treatment

The outstanding claims and premiums that were recognised as liabilities for purposes of IFRS relating to claims and premiums in terms of section 28(3) of the Act may include the liabilities that are to be transferred to the buyer and were claimed as a tax deduction in the seller's tax computation in line with the provisions of section 28(3) of the Act in the previous year of assessment (prior to the year of transfer to the buyer).Thereafter, section 28(4) of the Act requires that the total of all amounts deducted from the income of a short-term insurer in respect of a year of assessment in terms of section 28(3) shall be included in the income of the short-term insurer in the following year of assessment (the year of transfer to the buyer). Given that an amount will be paid by the seller to the buyer or the consideration for the transfer of the insurance business will be reduced for the buyer to assume these liabilities, it is proposed that this amount be allowed as a deduction for the seller in terms of section 11(*a*).

B. Buyer's tax treatment

It is proposed that the liabilities relating to claims and premiums that have been assumed by the buyer constitute "gross income" in the hands of the buyer.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment ending on or after that date.

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4. INCOME TAX: BUSINESS (INCENTIVES)

4.1 EXTENSION OF THE URBAN DEVELOPMENT ZONE TAX INCENTIVE SUNSET DATE

[Applicable provision: Section 13*quat* of the Act]

I. Background

In 2003, the Urban Development Zone (UDZ) tax incentive was introduced in the Act to increase investment in 16 designated inner cities. The UDZ tax incentive was designed to encourage property investment in central business districts and to address dereliction and dilapidation, and to promote investment in urban renewal. The incentive is in the form of an accelerated depreciation allowance applicable on the value of new buildings and improvements to existing buildings in the qualifying municipalities demarcated as UDZs. When the UDZ tax incentive was introduced, it contained a sunset date of 31 March 2014. In 2013, the sunset date for the UDZ incentive was extended from 31 March 2014 to 31 March 2020.

Since its inception, there have been a number of legislative amendments to the UDZ tax incentive. In 2008, the incentive was amended to include low-cost housing and changes in the accelerated depreciation regime in view of changes in other property depreciation clauses in the Act. In 2015, changes were made to the tax incentive to allow municipalities with a population of one million to demarcate an additional UDZ area. Furthermore, where the municipality's population is below one million, the Minister of Finance may approve the demarcation of an additional UDZ area having regard to the provisions set out under subsections 13*quat*(6) and (7) of the Act.

II. Reasons for change

All tax incentives contain a sunset date which allows for a review of its effectiveness before the incentive comes to an end. The UDZ tax incentive was expected to come to an end on 31 March 2020 and before this date, a review had to be concluded to determine the future of the incentive. In the 2020 Budget Review, the Minister of Finance announced that the urban development zone incentive would be extended for one year, to 31 March 2021, while a review of the incentive was completed. However, due to the challenges posed by the Covid-19 global pandemic, a comprehensive review of the effectiveness of the UDZ tax incentive could not be concluded. In the 2021 Budget Review, the Minister of Finance announced that the incentive would be extended by a further two years beyond its current sunset date of 31 March 2021, as the review process continues.

III. Proposal

In line with the Minister's announcement in the 2021 Budget Review, it is proposed that changes be made in section 13*quat* of the Act to extend the UDZ tax incentive by another two years, to 31 March 2023. The extension of the incentive's sunset date will provide time for an extensive review of its effectiveness in achieving its objectives to be conducted.

IV. Effective date

The amendment will be deemed to have come into operation on 1 April 2021 and applies in respect of any building, part thereof or improvement that is brought into use on or after that date.

4.2 EXTENSION OF THE LEARNERSHIP TAX INCENTIVE SUNSET DATE

[Applicable provision: Section 12H of the Act]

I. Background

The learnership tax incentive, which was introduced in the Act on 1 October 2001, is a programme that supports skills intensity through the tax system. To encourage skills development and job creation, the learnership tax incentive provides employers with an additional tax deduction over and above the normal remuneration that can be deducted. The additional deduction is intended to encourage vocational training through formal learnership contracts, and provide accredited workplace training by employers. To claim the allowance, the employer, learner and an accredited training provider must enter into a formal learnership contract.

Similar to all other tax incentives, when the learnership tax incentive was introduced, it had a sunset date of 30 September 2011. In 2011, a review was conducted to assess the effectiveness of the learnership tax incentive in achieving its objectives, before the sunset date. After the review, the learnership tax incentive was extended by another five years to 30 September 2016.

In 2016, a comprehensive review was again conducted to assess the effectiveness of the learnership tax incentive in achieving its objectives. The outcome of the review indicated that there was sufficient evidence to support the continuation of the learnership tax incentive beyond its previous sunset date of 30 September 2016. However, the review also revealed that claims were not evenly spread across sectors. Sectors with high uptake were those where SETAs where perceived to administer training programmes more effectively. The review then recommended: (i) the extension of the incentive sunset date to 31 March 2022, (ii) improving the targeting of the incentive by encouraging employers to train learners in those skill categories where demand is highest, and (iii) to improve future incentive policy analysis, completion of the SARS IT180 form was made compulsory for taxpayers to claim the learnership tax incentive.

II. Reasons for change

The learnership tax incentive has a current sunset date of 31 March 2022. The effectiveness of the incentive in achieving its objectives will need to be assessed before this date to determine whether it continues. In the 2021 Budget Review, the Minister of Finance announced that the incentive would be extended by a further two years beyond its current sunset date while a review is completed.

III. Proposal

In line with the Minister’s 2021 Budget announcement, it is proposed that changes be made in section 12H of the Act to extend the learnership tax incentive by another two years, to 31 March 2024.

IV. Effective date

The amendment will come into operation on 1 April 2022 and applies in respect of learnership agreements entered into on or after that date.

4.3 REFINING THE TIMEFRAMES OF COMPLIANCE REQUIREMENTS OF INDUSTRIAL POLICY PROJECTS TAX INCENTIVE

[Applicable provision: Section 12I of the Act]

I. Background

In 2009, the Industrial Policy Projects tax incentive was introduced in section 12I (the section 12I tax incentive) to support investment in manufacturing assets that would improve the productivity of the manufacturing sector. The section 12I tax incentive is available for new industrial policy projects as well as the expansion or upgrading of existing projects. The section 12I tax incentive makes provision for an additional investment allowance for an industrial policy project as determined according to the type of investment (greenfield or brownfield) and its approval status (qualifying or preferred).

The section 12I tax incentive offers support for both capital investment and training, with qualification for the incentive based on points scoring criteria reviewed by an adjudication committee constituted in terms of section 12I(16) of the Act. The adjudication committee assesses projects for approval, and if approved, monitors these projects in terms of their compliance. Section 12I(19)(*a*) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade, Industry and Competition to extend the time periods within which approved projects must comply with the provisions of the section, by one year.

The section 12I tax incentive initially had a sunset date of 31 December 2015. In 2015, the sunset date was extended by two years to 31 December 2017. In 2017, the date was again extended by two years 3 months to 31 March 2020. This implies that approvals for new section 12I tax incentive applications officially ceased on 31 March 2020 when its latest sunset date was reached, and the tax incentive was not renewed. This notwithstanding, projects approved before 31 March 2020 still enjoy the benefits and are bound by the provisions of section 12I of the Act.

II. Reasons for change

As indicated above, in 2017, the sunset date was again extended to 31 March 2020, and no further extension was granted in this regard. However, the sunset date of 31 March 2020 fell during the Covid-19 pandemic. As a result, many beneficiaries of the section 12I tax incentive experienced the following challenges during the 2020 Covid-19 national lockdown:

- Compliance with the period of four years plus the additional one year allowed to bring qualifying assets into use in terms of subsections 12I(2) and 12I(19)(*a*).
- Delay in further acquisition of qualifying assets.
- Knock-on effect on providing skills development: practical hands-on training, which cannot be properly substituted with online classes, could not be provided. Some training required foreign or distant expert support, most of whom could not travel. Local training providers also have stringent measures in place in terms of the lockdown regulations.
- Compliance with the energy efficiency requirement was also a challenge as lower production led to lower potential energy efficiency.
- Compliance with the further requirement of more than 50 per cent of the manufacturing assets to be acquired and brought into use within 4 – 5 years in terms of 12I(7)(*c*).

This disruption is expected to last throughout 2020 and the whole of 2021. Should these compliance requirements not be met, it would lead to a withdrawal of approval for projects in terms of section 12I of the Act. This would place additional strain on the manufacturing sector in an environment where projects face severe challenges in reaching completion, and many businesses struggle to remain operational.

III. Proposal

In order to ensure that approved projects have a better chance of complying with section 12I provisions and are not adversely affected by Covid-19 and consequent restrictions on economic activity resulting in non-compliance, the following amendments are proposed in section 12I of the Act:

A. Extension of the time period that the adjudication committee can recommend to the Minister of Trade, Industry and Competition within which approved projects must comply with the provisions of section 12I of the Act

- Currently, section 12I(19)(*a*) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade, Industry and Competition to extend the time periods within which approved projects must comply with the provisions of the section, by one year.

- It is proposed that changes be made to section 12(19)(*a*) of the Act to allow for up to an additional two years to bring assets into use for approved section 12I projects negatively affected by Covid-19 and consequent disruptions and restrictions to economic activity.

- The proposed additional two years to bring assets into use is in addition to the one-year extension the Minister of Trade, Industry and Competition is currently allowed to provide, upon the recommendation of the Section 12I adjudication committee.

- The proposed extension will not provide blanket relief to all approved section 12I projects, but will be upon application by affected projects to the section 12I adjudication committee.

- After assessing these projects on a case-by-case basis, the adjudication committee should recommend to the Minister of Trade, Industry and Competition whether affected projects should be allowed:

    - An additional year or two years to bring (more than 50 per cent of) assets into use due to Covid-19 related disruptions.

B. Extension of ‘compliance period’ within which approved projects must fully comply with the provisions of section 12I of the Act

- The ‘compliance period’ in section 12I determines the period at the end of which approved projects must fully comply with all provisions of the section. It also defines the period over which projects are required to produce annual progress reports to be

assessed by the adjudication committee. In turn, section 12I(1) of the Act defines the 'compliance period' as the period:

  - commencing at the beginning of the year of assessment following the year of assessment in which assets are first brought into use; and
  - ending at the end of the year of assessment three years after the year of assessment in which assets are first brought into use;

- It is proposed that if projects apply for and are approved to extend the four-year period within which to bring the qualifying assets into use, this would mean that the 'compliance period' is also increased by the extended period (by the end of which qualifying projects must adhere to all provisions of section 12I of the Act). This provides additional time within which to ensure compliance with the provisions of section 12I of the Act.
- This would not be a blanket relief and the extended 'compliance period' would not apply to all approved section 12 projects but will, upon application by affected projects, apply to projects approved for the extended compliance period to bring assets into use in terms of the recommendation of the adjudication committee in section 12I(19)(*a*).
- As a result, it is proposed that changes be made to the definition of 'compliance period' to allow for an extended period of not more than two additional years, upon application to the adjudication committee. This would cater for projects that have brought assets into use in line with section 12I, but due to Covid-19 related disruptions, may not be able to comply with all 12I requirements by the end of the compliance period. For example, skills development, energy efficiency, and other point scoring criteria as set out in the section 12I regulations.
- The proposed amendments are intended to bring relief to approved projects that have not yet brought more than 50 per cent of assets into use by the time Covid-19 related disruptions to economic activity started at the end of March 2020.

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2020.

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5. INCOME TAX: INTERNATIONAL

5.1 CLARIFYING THE CONTROLLED FOREIGN COMPANY ANTI-DIVERSIONARY RULES

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

I. Background

The Act contains anti-avoidance provisions in section 9D aimed at taxing South African residents on the net income of a controlled foreign company (CFC). As a result, an amount equal to the net income of the CFC is included in the income of a South African resident according to the resident's proportion of participation rights in that CFC.

In order to strike a balance between protecting the South African tax base and the need for South African multinational entities to be competitive, the South African CFC rules contains various exemptions of certain types of business income, for example, foreign business establishment exemption in section 9D(9)(*b*) of the Act. This exemption makes provision for CFC income to be exempt if that income is attributable to a foreign business establishment as defined in section 9D of the Act.

In order to limit tax avoidance, the foreign business establishment exemption does not apply if the CFC foreign business establishment income is regarded as diversionary foreign business income in terms of the CFC anti-diversionary rules. Diversionary foreign business income arises when a CFC engages in transactions such as a sale of goods or rendering of services to a related South African resident or purchase of goods from a related South African resident in a manner that will most likely lead to transfer pricing tax avoidance.

II. Reasons for change

It has come to Government's attention that certain taxpayers are circumventing these anti-diversionary rules by merely entering into a contract of purchase in the country of the CFC that implies that the purchase of goods took place in the country of residence of the CFC when the goods are never physically present or delivered in that country.

III. Proposal

In order to curb this abuse, it is proposed that changes be made in the anti-diversionary rules focussing on the purchase of goods by the CFCs be amended to provide clarity that when a CFC purchases those goods, these goods should be physically delivered within the country of residence of that CFC.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

5.2 CLARIFICATION OF THE INTERACTION BETWEEN THE PROVISIONS DEALING WITH A CFC CEASING TO BE A CFC AND THE PARTICIPATION EXEMPTION

[Applicable provision: Section 9H(5) of the Act]

I. Background

In 2020, changes were made in the Act to address tax avoidance opportunities that may have emerged as a result of the withdrawal of the approval requirement from the Financial Surveillance Department of South African Reserve Bank for loop structures. One of the amendments made was in relation to the participation exemption in paragraph 64B of the Eighth Schedule for gains on the disposal of shares in a non-resident company to a non-resident. Paragraph 64B was amended so that the participation exemption does not apply to the disposal of shares in a CFC to the extent the value of the assets of the CFC are derived from South African assets.

II. Reasons for change

At issue is that the amendment to the participation exemption mentioned above creates uncertainty in the application of section 9H(5) of the Act when a foreign company ceases to be CFC as a direct or indirect result of the disposal of equity shares in that CFC.

III. Proposal

It is proposed that section 9H(5) of the Act be amended so that when a portion of the resulting gain or loss resulting from a CFC ceasing to be a CFC is not disregarded in terms of paragraph 64B of the Eighth Schedule, the application of section 9H(5) of the Act is not precluded.

IV. Effective date

The amendment is deemed to have come into operation on 1 January 2021 and applies to disposals on or after that date.

5.3 CLARIFYING THE RULES DEALING WITH WITHHOLDING TAX EXEMPTION DECLARATION

[Applicable provisions: Sections 49E(2)(*b*), 64G(2)(*a*) and 64H(2)(*a*) of the Act]

I. Background

The Act contains provisions in Part IV A, Part IV B and Part VIII for withholding tax on royalties, interest and dividends respectively.

In general, withholding tax on royalties applies to royalties from a source within South Africa paid by any person whether that person is a resident or not to a foreign person. However, this withholding tax on royalties can potentially be reduced or eliminated by a tax treaty.

Similarly, a prerequisite for the imposition of withholding tax on interest is that the interest must be from a South African source. Again, the withholding tax on interest may be reduced by the application of a tax treaty.

With respect to dividends tax, a company that is a resident that declares and pays a dividend is liable for dividends tax on that dividend to the extent that the dividend consists of a distribution of an asset *in specie*. Given that the dividends tax is a tax on shareholders when dividends are paid to them, and, under normal circumstances, is withheld from their dividend payment by a withholding agent either the company paying the dividend or, where a regulated intermediary is involved, by the latter. The dividends tax imposed may also qualify for any of the exemptions or a reduced rate by the application of a tax treaty.

Currently, one of the requirements under section 49E(2)(*b*) the Act provides the release from obligation to withhold royalties, if the foreign person to or for the benefit of which the payment of the royalty is to be made has submitted, before the royalty is paid, the following to the person making payment:

- a declaration in such form as prescribed by the Commissioner that the person is exempt from withholding tax on the royalty payment if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate during

the twelve-month period preceding the date on which the royalty is paid or if the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under Chapter 3 of the Tax Administration Act, 2011 (Act No. 28 of 2011) ("TAA"); and

- a written undertaking in such form as prescribed by the Commissioner to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the royalty no longer be for the benefit of that foreign person.

With respect to withholding tax on interest, one of the requirements under section 50E(2)(*b*) the Act provides the release from obligation to withhold interest, if the foreign person to or for the benefit of which that payment of interest is to be made has, before the interest is paid, submitted to the person making the payment:

- a declaration in such form as prescribed by the Commissioner that the person is exempt from withholding tax on interest payment if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the interest is paid or the debt claim in respect of which that interest is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under Chapter 3 of the TAA or an agreement of the avoidance of double taxation, exempt from the withholding tax on interest in respect of that payment; and

- a written undertaking in such form as prescribed by the Commissioner to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the payment of the interest no longer be for the benefit of that foreign person.

II. Reasons for change

In relation to withholding tax on interest, the income tax provides that a person must not withhold at the prescribed rate an amount of interest if the foreign person receiving interest has submitted a declaration that the amount is exempt from the withholding tax on interest as a result of an applicable double tax treaty agreement. However, a similar declaration does not exist for withholding tax on royalties and dividends tax which is contrary to the intent to align the withholding tax regime. Notably, the Act provides for a reduced withholding tax rate as a result of the application of a double tax treaty agreement in all three withholding tax regimes.

III. Proposal

To address this anomaly, it is proposed that the tax legislation be amended to provide for the release from obligation to withhold if the foreign person to or for the benefit of which that payment is to be made has, before the payment is paid, submitted to the person making the payment that an agreement of the avoidance of double taxation does not grant a taxing right over royalties or dividends to South Africa.

IV. Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the payment of royalties or dividends to foreign persons on or after that date.

6. VALUE ADDED TAX

6.1 ZERO RATING OF SUPERFINE MAIZE MEAL

[Applicable Provisions: Schedule 2 Part B, read together with section 11(1)(*j*) of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) ("the VAT Act")]

I. Background

Schedule 2 Part B of the VAT Act makes provision for a list of zero-rated foodstuffs. Item 2 of Part B provides for the zero-rating of the following grades of maize meal: super maize meal; special maize meal; sifted maize meal or unsifted maize meal. In South Africa, the grading of maize products is regulated in the Agricultural Products Standards Act 119 of 1990 which the VAT Act may use for identification of products for the purposes of Schedule 2 Part B. Before 2016, the Agricultural Products Standards Act allowed for 18 grades of maize products, including the below mentioned to be sold in South Africa.

II. Reasons for change

In 2016, another grade of maize meal, namely, super fine maize meal was added to the list regulated by the Agricultural Products Standards Act, to make it 19 graded maize products. In terms of specifications provided in the regulation in terms of Agricultural Products Standards Act, both super maize meal and super fine maize meal must have a maximum fat content by mass of less than two per cent and maximum fibre content by mass of 0.8 per cent. The only difference being that for super maize meal at least 90 per cent of the fineness or granulation by mass shall pass through a 1.4 mm sieve, and less than 90 per cent shall pass a 0.3 mm sieve, whereas with super fine maize meal at least 80 per cent of the fineness or granulation by mass shall pass through a 0.3 mm sieve.

When changes were made to the list regulated by the Agricultural Products Standards Act to add super fine maize meal as another grade of maize meal to be regulated, no submissions were received requesting National Treasury to consider including it in Item 2 of Part B of Schedule 2 to the VAT Act to allow for zero rating.

III. Proposal

An analysis was conducted on this new product from a VAT perspective and a proposal is made to zero-rate superfine maize meal. It is proposed that Item 2 of Part B of Schedule 2 to the VAT Act should be updated to include super fine maize meal.

IV. Effective date

The amendments will come into operation on 1 April 2022.

6.2 VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY

[Applicable provisions: New sections 9(13), 10(29), 16(3)(o) and section 18D of the VAT Act]

I. Background

The VAT Act makes provision for the supply of residential fixed property by a VAT vendor (being a property developer) to be subject to VAT at the standard rate of 15 per cent. The property developer has to charge VAT on the sale of the residential fixed property. Depending on market conditions, residential fixed property developers are at times unable to dispose of newly built residential fixed properties for extended periods of time. In order to maintain expenses incurred in developing such fixed property, such as bank loan repayments, property developers often enter into short term temporary leases for such fixed property until a buyer can be found.

While the VAT Act recognizes the sale of residential fixed property by a property developer as a taxable supply, the leasing of residential fixed property is an exempt supply which would generally result in the VAT incurred being denied. The VAT Act requires a change in use adjustment where property developers temporarily lease residential fixed property.

Property developers are entitled to deduct input tax on the VAT costs incurred to build residential fixed property (dwellings) for sale. However, where the property developer is unable to sell the residential fixed property and enters into a lease, until a buyer is found, the property developer is currently required to make an output tax adjustment based on the *open market value* of the residential fixed property when the residential fixed property is leased for the first time. In 2010, an announcement was made in Chapter 4 of the 2010 Budget Review (Heading entitled: "VAT and residential property developers" on page 79 of the Budget Review) to investigate and determine an equitable value and rate of claw-back for property developers as the current treatment is disproportionate to the temporary rental income. As a result, changes were made to the VAT Act by inserting new section 18B, for a short period, from 10 January 2012 to 1 January 2018. This section ceased to apply on 1 January 2018.

II. Reasons for change

Concerns have been raised with regard to the inequitable value attributed to this change in use adjustment. Further, it has come to Government's attention that there seems to be confusion amongst taxpayers relating to whether the change in use adjustment results in the subsequent supply of the residential fixed property being permanently or temporarily removed from the VAT net. As such, some taxpayers interpret the legislation to imply that output tax is still payable when the residential fixed property is subsequently sold while others interpret it otherwise.

III. Proposal

In order to address these concerns, it is proposed that changes be made to the VAT Act by inserting a new section that will deal with the deemed change in use adjustment when the residential fixed property is leased for the first time, including whether that deemed change in use adjustment results in the residential fixed property exiting the VAT net or not and the subsequent supply where the residential fixed property is sold. This proposed approach is considered more equitable than the current provisions.

IV. Effective date

The amendments will come into operation on 1 April 2022.

6.3 REVIEWING THE SECTION 72 ARRANGEMENT WITH REGARD TO TELECOMMUNICATIONS SERVICES

[Applicable Provision: Section 11(2)(*y*) of the VAT Act]

I. Background

In 2019 changes were made to section 72 of the VAT Act, which deals with the SARS Commissioner's discretion to make arrangements or decisions regarding the application of the VAT Act to specific situations where the manner in which a vendor or class of vendors conducts their business leads to difficulties, anomalies or incongruities. These changes had an impact on the arrangements or decisions made before 21 July 2019. To address these concerns, in the 2020 Budget Review, government agreed to review the impact and the role of these arrangements and decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72.

One of the arrangements and decisions made in terms of section 72 of the VAT Act, which was impacted by these changes is the VAT treatment of telecommunication services. South Africa is a signatory to the International Telecommunications Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR) and to the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai (Dubai ITR) which was effective from January 2015.

II. Reasons for change

In 2020, changes were made to the VAT Act to introduce a new zero-rating provision in order to ensure that the provisions of the Dubai ITR are upheld, in line with the section 72 rulings that were previously given to taxpayers. However, in the Response Document to the 2020 TLAB, it was noted on page 61 that any further proposed amendments regarding the implementation of the Dubai ITR could be considered in the subsequent legislative cycle. Based on the above, in 2021, it is proposed that further amendments be made to the provisions dealing with telecommunications services in order to align these provisions with the Dubai ITR, but subject to certain limitations.

III. Proposal

It is proposed that further amendments be made to section 11(2)(*y*) to extend the zero-rate to all supplies between telecommunications service providers registered in the Republic and international telecommunications service providers to the extent that such services are not provided to any branch, main business or customer of the international telecommunications service provider which branch, main business or customer of the international telecommunications service provider is situated in the Republic at the time the services are rendered. In order to comply with the Dubai ITR, it is proposed that the only exception to this will be international roaming services. Since the existing rulings given by SARS to telecommunications service providers in this regard will end on 31 December 2021, it is proposed that this amendment be effective from 1 January 2022.

IV. Effective date

The amendments will come into operation on 1 January 2022.

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7. CARBON TAX ACT

7.1 CLARIFYING RENEWABLE ENERGY PREMIUM BENEFICIARIES

[Applicable provision: Section 6(2)(*c*) of the Carbon Tax Act, 2019 (Act No.15 of 2019) ("the Carbon Tax Act")]

I. Background

In terms of Section 6(2)(*c*) of the Carbon Tax Act, provision is made for electricity generators liable for the carbon tax to offset the cost of their additional renewable energy purchases against their carbon tax liability. This provision was intended to address stakeholders' concerns on possible double taxation due to the introduction of the carbon tax in addition to the "renewable Independent Power Producers tariff" already applied under the Renewable Energy Independent Power Producers Procurement Programme (REIPPPP). During the Annexure C stakeholder consultations, taxpayers were of the view that the Carbon Tax Act was ambiguous on the intended beneficiaries of this concession and requested clarity on whether renewable-based self-generation with electricity wheeling arrangements through Eskom would also be eligible to claim the renewable energy premium deduction.

II. Reasons for change

This deduction was initially limited to Eskom and its purchases under the REIPPPP but after stakeholder consultations, was expanded to include other electricity generators for purchases of renewable based electricity under either the REIPPPP or privately. To address this concern, it is proposed that only entities that are liable for the carbon tax, conduct electricity generation activities and purchase additional primary renewable energy directly either under the REIPPPP or from private independent power producers (IPPs) would be eligible to claim the tax deduction for its renewable energy purchases. For purchases under the REIPPPP or privately, this would apply where a power purchase agreement exists.

III. Proposal

It is proposed that Section 6(2)(*c*) of the Carbon Tax Act is amended to clarify that the Renewable energy premium to be deducted for purchases of additional renewable electricity is the product of the amount of RE purchased (kWh) under a power purchase agreement and the applicable rate for that technology as specified in the Renewable Energy Notice gazetted by the Minister of Finance, as follows:

- **Deduction (B) =** quantity of renewables purchased (kWh) × rate (Rand) per technology as per the Gazetted notice

Examples of eligible renewable electricity purchases under different Power Purchase Agreements

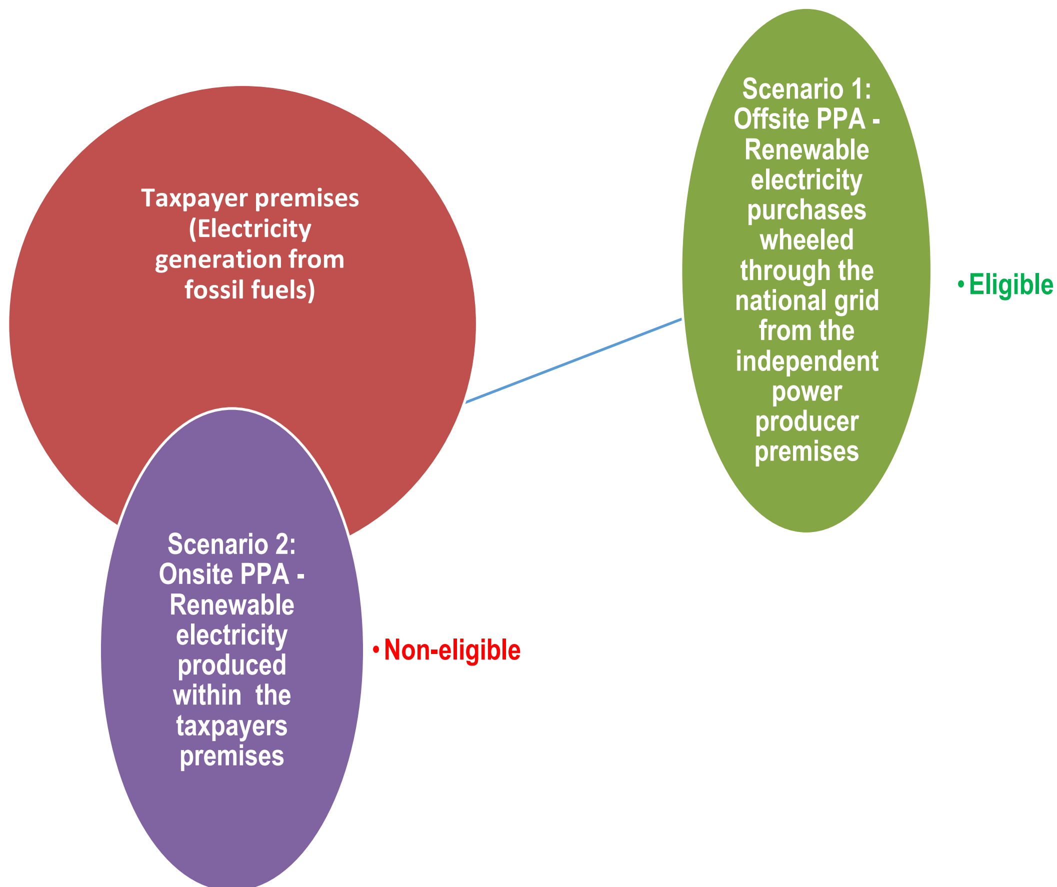

Figure 1: Power Purchase Agreements Scenarios

For purposes of Section 6(2)(c) of the Carbon Tax Act, a power purchase agreement (PPA) is a long term electricity supply agreement between a renewable power producer and electricity consumer (buyer or off taker). PPAs can exist for onsite renewable electricity purchases where there is direct supply of electricity to the buyer, and offsite electricity purchases where the producer supplies electricity to the buyer through the national grid.

There are two scenarios under which a taxpayer, who generates electricity from fossil fuels, can purchase renewable electricity from a power producer in terms of a PPA as illustrated in Figure 1 above. The different scenarios of renewable electricity purchases made by taxpayers either under onsite or offsite PPAs and the eligibility of these purchases for the renewable energy premium deduction are explained below:

- **Scenario 1:** Illustrates a case where a PPA exists between an independent power producer (IPP) and a taxpayer (electricity generated from fossil fuels), where the electricity is wheeled to the taxpayer's premises through the national grid. Because

the renewable electricity purchase is in terms of an offsite PPA where the electricity generation occurs at the IPP's premises which are removed from the taxpayer premises, the taxpayer would be eligible to claim the renewable energy premium deduction under the Carbon Tax Act.

- **Scenario 2**: Illustrates a case where the PPA exists and renewable electricity production by the IPP occurs within the premises of the taxpayer. Since renewable electricity purchases by the taxpayer is in terms of an onsite PPA, this would not be eligible for purposes of the renewable energy premium deduction under the Carbon Tax Act as it resembles self-generation for own use and would not constitute additional renewable electricity purchases.

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2021.

7.2 CLARIFYING THE SCOPE AND DEFINITION OF CARBON SEQUESTRATION

[Applicable provision: Section 6(3)/ (4) the Carbon Tax Act]

I. Background

In terms of the Carbon Tax Act, Section 4(1) and 4(2)(*a*) defines the carbon tax base that is, fuel combustion, fugitive and industrial process emissions that are determined using the Tier 3 company based emissions methodologies or the Tier 1 and 2 emission factors as per Schedule 1 of the Carbon Tax Act, respectively. The Carbon Tax Act allows taxpayers to deduct sequestered emissions as verified and certified by the Department of Forestry, Fisheries and Environment (DFFE) from their energy combustion related greenhouse gas emissions for a tax period as determined in Section 4. Sequestrated emissions cover carbon capture and storage in geological reservoirs and biological sequestration including in forests.

In November 2020, a carbon sequestration guideline entitled: *Methodological Guidelines for Quantification of Greenhouse Gas Emissions – Carbon Sequestration in the Forestry Industry* was published by the DFFE, to provide methodologies for taxpayers to use for quantifying greenhouse gas emissions sequestration by forestry plantations and harvested wood products. The emissions associated with harvests from forestland, production of harvested wood products and decomposition of the harvested wood product pool are taken into account. In the interim, the Carbon Sequestration Guideline adopts a mass flow combined with landfill approach to account for the forestry and harvested wood product related carbon flows and sequestration. The Carbon Sequestration Guidelines recommends that a 100-year accounting approach is developed for future carbon tax periods once industry specific studies are completed on suitable half-life (product decay rates) and product use period assumptions.

Government has clarified that for fuel combustion activities where carbon capture and storage (CCS) technologies are used, the nett greenhouse gas emissions (already excludes stored emissions) should be reported to the DFFE. However, for forestry plantations and wood products, the DFFE provides for emissions sequestered directly by forests and harvested wood products to be subtracted from gross fuel combustion emissions subject to approval by the DFFE.

II. Reasons for change

Since carbon capture and storage in geological reservoirs should be subtracted upfront from the reported emissions to the DFFE, changes to the scope and definition of sequestered emissions that are allowed a deduction for fuel combustion emissions determined in terms of Section 4 of the Carbon Tax Act are necessary, to avoid potential double benefits accruing to taxpayers for the same sequestered emissions. To ensure alignment with the Carbon Sequestration Guidelines of the DFFE, the scope of biological sequestration is limited to emissions sequestered in forestry plantations and harvested wood products for the pulp, paper and print activity.

Under Section 4(1) of the Carbon Tax Act, companies calculate their emissions using company specific emissions methodologies and factors. The fuel combustion emissions (E) reported to the DFFE and SARS are the same and would have already deducted the "S" amount upfront for carbon sequestration in geological reservoirs. However, emissions sequestration in forestry plantations and harvested wood products are not deducted upfront from the total fuel combustion emissions as this requires the approval of the DFFE. In terms of Section 4(2)(a), companies use the emission factors in Schedule 1 of the Carbon Tax Act to calculate their emissions. For fuel combustion emissions (E), the total emissions declared to the SARS would not include the upfront deduction for sequestration "S" in geological reservoirs, forestry plantations and harvested wood products.

III. Proposal

To address possible double benefits for the same sequestered emissions, it is proposed that sequestration in forestry plantations and harvested wood products are deductible for fuel combustion emissions (E), and the deduction for sequestration in geological reservoirs is limited to emissions determined in terms of Section 4(2)(*a*), as follows:

- For Section 4(1), only sequestration of greenhouse gases in forestry plantations and harvested wood products for pulp, paper and print would be deductible; and

- For Section 4(2)(*a*), sequestration of greenhouse gases in geological or carbon reservoirs for fuel combustion activities; and sequestration in forestry plantations and harvested wood products for the pulp, paper and print activity would be deductible.

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2021.

7.3 CORRECTION OF THE DUPLICATION OF THE AMENDMENT MADE IN SECTION 77 OF THE TAXATION LAWS AMENDMENT ACT, 2020 (ACT NO. 23 OF 2020): AMENDMENT TO SECTION 6(3) OF THE CARBON TAX ACT

[Applicable provision: Section 6(3) of the Carbon Tax Act]

I. Background

The Carbon Tax Act makes provision for a deduction of sequestrated emissions in geological reservoirs (carbon capture and storage) and biologically (eg. trees). Section 6(3) provides a definition of sequestration. In 2020, amendments were made in terms of section 77 of the Taxation Laws Amendment Act, 2020 (Act No. 23 of 2020) ("the TLAA") by inserting a new subsection 6(3)

of the Carbon Tax Act, which made provision for a cost recovery formula for use by petroleum refineries to calculate their carbon tax cost pass through deduction against carbon tax liability. Due to the regulated nature of petrol and diesel fuel prices, refineries are unable to recover their carbon tax costs as they cannot pass through the costs to the consumers hence government allowed them a partial cost recovery mechanism.

II. Reasons for change

At issue is that, after the insertion of a new sub-section 6(3) by section 77 of the of the TLAA to cater for the cost-recovery mechanism petroleum refineries, the original sub-section 6(3) in the Carbon Tax Act was not renumbered to 6(4) resulting in the creation of two different subsections 6(3) under the Carbon Tax Act. Currently, subsection 6(3) in the Carbon Tax Act refers to both the cost recovery pass through formula for petroleum refineries and the definition of 'sequestrate' to determine sequestered emissions for the carbon tax policy.

III. Proposal

In order to correct this, it is proposed that a new subsection 6(4) be inserted in the Carbon Tax Act to define 'sequestrate' while the newly created pass through cost recovery formula for the deduction of the carbon tax cost offset against the payable tax for refineries for petrol produced remains as subsection 6(3) in the Carbon Tax Act.

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2020.

7.4 CLARIFYING THE CARBON BUDGET ALLOWANCE

[Applicable provision: Section 12 of the Carbon Tax Act]

I. Background

The DFFE has gazetted the extension of the voluntary carbon budget system, which became effective from 1 January 2021 and ends on 31 December 2022, and the piloting of new methodologies for determining company-level carbon budgets. Section 12(1) of the Carbon Tax Act permits a taxpayer to claim a carbon budget allowance of five per cent if they participate in the carbon budget system during or before the tax period.

II. Reasons for change

To address any ambiguity due to the new voluntary carbon budget system, it is proposed that reference to "before the tax period" be replaced with the specific timeframe for the carbon budget as outlined in the new departmental legislation.

III. Proposal

It is proposed that a specific timeframe when the voluntary carbon budget tax free allowance will apply for taxpayers be included in the Carbon Tax Act i.e. 1 January 2021 to 31 December 2022, as determined by the DFFE.

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2021.

7.5 ALIGNING SCHEDULE 2 EMISSIONS ACTIVITIES AND THRESHOLDS WITH THE GREENHOUSE GAS EMISSION REPORTING REGULATIONS OF THE DFFE

[Applicable provision: Schedule 2 of the Carbon Tax Act]

I. Background

The Carbon Tax Act came into effect on 1 of June 2019. The tax base for the carbon tax are the stationary greenhouse gas emissions (GHG) that are reported annually by taxpayers to the DFFE as required under the National Greenhouse Gas Emission Reporting Regulations. The greenhouse gas emissions are reported to the DFFE for activities aligned with the 2006 Intergovernmental Panel on Climate Change (IPCC) Guidelines. Schedule 2 of the Carbon Tax Act outlines the activities that are subject to the carbon tax and is based on Annexure 1 of the National Greenhouse Gas Emission Reporting Regulations as reported emissions are subject to the carbon tax.

II. Reasons for change

On 11 September 2020, the DFFE published the Amended National Greenhouse Gas Emission Reporting Regulations. Annexure 1 of the GHG emissions reporting regulations was amended to include changes to the activities required to report their emissions and thresholds, and the inclusion of new activities now reportable to DFFE. Amendments to Schedule 2 of the Carbon Tax Act are required to ensure alignment with the amended GHG Emissions reporting regulations.

III. Proposal

In order to align the Carbon Tax Act and the emissions reporting regulations, it is proposed that Schedule 2 of the Carbon Tax Act be amended to reflect the changes set out in the Amended National Greenhouse Gas Emission Reporting Regulations. This includes changes to the thresholds for certain activities and the inclusion of a new activity which has been added to the emissions reporting regulations.

Table 1 below lists the proposed changes to Schedule 2 of the Carbon Tax Act to align with the Amended National Greenhouse Gas Emission Reporting Regulations.

Table 1: Proposed Activity and Threshold changes in Schedule 2

Changes in Regulations	IPCC Activities and Thresholds
Change to the threshold	1A2m Brick Manufacturing: (from 4 to 1 million bricks /month) *Emissions now reportable:* • 2A4a Ceramics, 2A4b Soda Ash: (production capacity >= 50 tonnes of production a month) • 2A4d Other: (production capacity >= 20 tonnes of production a month),

Changes in Regulations	**IPCC Activities and Thresholds**
	• 2B10 Chemicals Industry Other: (production capacity >= 20 tonnes of production a month) • 2C7 Metal industry Other: (production capacity >= 50 tonnes of production a month) • 2G1B Electrical equipment: (production capacity >=50 kg/ year)
Inclusion of new Activities	1A2n Manufacture of ceramic products by firing in particular roofing tiles, tiles, stoneware or porcelain • (production capacity >= 5 tonnes/day)
Activities now reportable to DFFE	3A2i Poultry: • (threshold 40 000 places for poultry) 3C1a Biomass Burning in Forest Lands, 3C4 Direct N2O Emissions from Managed Soils, 3C5 Indirect N2O Emissions from Managed Soils • (Owning >=100 hectares of plantation) 3D1 Harvest Wood Products • Harvested Wood Products produced from timber harvested from forest owners registered for reporting GHG emissions under IPCC code 3B1a and 3B1b 5B Other: • (None)

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2021.

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8. CLAUSE BY CLAUSE

CLAUSE 1

Transfer duty Act: Amendment to section 9

The amendment clarifies that the exemption from Transfer Duty is applicable to the acquisition of capital assets or trading stock by a company in terms of the corporate re-organisation rules envisaged under subsection 9(*l*)(i) - (iii).

CLAUSE 2

Estate duty Act: Amendments to section 5

The amendment is a consequential amendment which seeks to delete a reference to subsection 3(3)(*a*)*bis* which was deleted in 2009 by section 2(1)(*b*) of the Revenue Laws Amendment Act No 60 of 2008.

CLAUSE 3

Estate duty Act: Amendments to section 13

The amendment is a consequential amendment which seeks to delete a reference to section 11(*b*)(iA) which was deleted in 2016 by section 3(1) of the Taxation Laws Amendment Act No. 15 of 2016.

CLAUSE 4

Income Tax Act: Amendments to section 1(1)

Paragraph (a): The amendment aligns the wording with the wording of paragraph (*b*) of the definition of REIT after its amendment in 2019 and 2020.

Paragraph (b): The amendment aligns the wording with an equivalent plain English wording used elsewhere in the Act. It also removes any ambiguity created by the use of the word 'jointly', which some commentators wrongly contended meant "in common ownership".

Paragraph (*c*): Definition of 'contributed tax capital' - See notes on **CLARIFYING THE DEFINITION OF CONTRIBUTED TAX CAPITAL**

Paragraph (d): See note on **REVIEWING THE NATURE OF LONG SERVICE AWARDS FOR FRINGE BENEFIT PURPOSES**

Paragraph (e): See note on **CLARIFYING THE TIMING OF DISPOSAL RULES IN RESPECT OF AN ASSET ACQUIRED FROM A DECEASED ESTATE**

Paragraphs (f); (i); (l) and (m): see note on **ALLOWING MEMBERS TO USE RETIREMENT INTEREST TO ACQUIRE ANNUITIES ON RETIREMENT**

Paragraphs (g); (h); (j) and (k)): See note on **TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER**

Clause 4(2): This sub-clause introduces the effective date for paragraph (c)

Clause 4(3): This sub-clause introduces the effective date for paragraph (d)

Clause 4(4): This sub-clause introduces the effective date for paragraph (e)

Clause 4(5): This sub-clause introduces the effective date for paragraphs (f), (i), (l) and(m)

Clause 4(6): This sub-clause introduces the effective date for paragraphs (g), (j) and (k)

CLAUSE 5

Income Tax Act: Amendments to section 7C

Paragraph (a): The amendment to subsection (1)(*b*) clarifies that the natural person referred to in section 7C(1)(*b*) is not necessarily the same natural person referred to in section 7C(1)(*a*).

Paragraph (b): This pmendment clarifies that the natural person being referred to could be either one referred to in section 7C(1)(*a*) or (*b*).

CLAUSE 6

Income Tax Act: Amendments to section 8

Subsection 19(6A) was added to the Act in 2019. The amendment includes amounts treated as being recovered in terms of subsection 19(6A) in section 8.

CLAUSE 7

Income Tax Act: Amendments to section 8E

The amendment deletes the word “security” before arrangement in paragraph *(e)* of the definition of hybrid equity instrument, as the term security arrangement is not defined.

CLAUSE 8

Income Tax Act: Amendments to section 8F

See notes on **LIMITING POTENTIAL FOR DOUBLE TAXATION UNDER THE HYBRID DEBT ANTI-AVOIDANCE RULES**

CLAUSE 9

Income Tax Act: Amendments to section 8FA

See notes on **LIMITING POTENTIAL FOR DOUBLE TAXATION UNDER THE HYBRID DEBT ANTI-AVOIDANCE RULES**

CLAUSE 10

Income Tax Act: Amendments to section 9D

Paragraph (a): The amendment seeks to give effect to the policy intention of the amendment in the Taxation Laws Amendment Act of 2020 aimed at limiting the application of the dividend exemption in loop structures. In 2020, changes were made to the CFC legislation so that a non-resident company that is a CFC include a portion of a dividend that is received or accrued from a resident company in net income. To give effect to this policy, it is proposed that changes be made in the formula used to determine the portion of a dividend that is not exempt in the hands of the non-resident CFC. In addition, proviso (*bb*) has been inserted into the section to cater for dividends tax paid at a rate of 15 per cent.

Paragraph (b): The amendment is a consequential amendment given that an exempt dividend on a listed share could also extract value from a controlled foreign company.

Paragraphs (c) and (d): See notes on **CLARIFYING THE CONTROLLED FOREIGN COMPANY ANTI-DIVERSIONARY RULES**

CLAUSE 11

Income Tax Act: Amendments to section 9H

See notes on **CLARIFICATION OF THE INTERACTION BETWEEN THE PROVISIONS DEALING WITH A CFC CEASING TO BE A CFC AND THE PARTICIPATION EXEMPTION**

CLAUSE 12

Income Tax Act: Amendments to section 12DA

In Chapter 4 of the 2020 Budget Review, Government indicated that it would undertake a review of various tax incentives in order to determine their effectiveness and eligibility for extension. It was further indicated that some tax incentives, that did not have sunset dates, would be made subject to a sunset date of 28 February 2022. This amendment to section 12DA of the Act dealing with "deduction in respect of rolling stock" clarifies the current provision with the policy intent of the incentive's remaining period of application for assets to be brought into use in the taxpayer's trade on or before the 28 February 2022.

CLAUSE 13

Income Tax Act: Amendments to section 12F

In Chapter 4 of the 2020 Budget Review, Government indicated that it would undertake a review of various tax incentives in order to determine their effectiveness and eligibility for extension. It was further indicated that some tax incentives, that did not have sunset dates, would be made subject to a sunset date of 28 February 2022. This amendment to section 12F of the Act dealing with "deduction in respect of airport and port assets" clarifies the current provision with the policy intent of the incentive's remaining period of application for assets to be brought into use in the taxpayer's trade on or before the 28 February 2022

CLAUSE 14

Income Tax Act: Amendments to section 12H

See notes on **EXTENSION OF THE LEARNERSHIP TAX INCENTIVE SUNSET DATE**

CLAUSE 15

Income Tax Act: Amendments to section 12I

See notes on **REFINING THE TIMEFRAMES OF COMPLIANCE REQUIREMENTS OF INDUSTRIAL POLICY PROJECTS TAX INCENTIVE**

CLAUSE 16

Income Tax Act: Amendments to section 13*quat*

See notes on **EXTENSION OF THE URBAN DEVELOPMENT ZONE TAX INCENTIVE SUNSET DATE**

CLAUSE 17

Income Tax Act: Amendments to section 19

Paragraph (a): The amendments delete the full stop at the end of the definition of "group of companies" and adds a semi-colon and the word "and" as the definition of "market value" was added after the definition of "group of companies" in 2018.

Paragraph (b): The amendment to subsection (8)(*b*) deletes a superfluous "or" at the end of that it.

Paragraph (c): See notes on **CLARIFYING THE MEANING OF "INTEREST" UNDER THE DEBT RELIEF RULES**

CLAUSE 18

Income Tax Act: Amendments to section 20

See notes on **RESTRICTING THE SET-OFF OF THE BALANCE OF ASSESSED LOSSES IN DETERMINING TAXABLE INCOME**

CLAUSE 19

Income Tax Act: Amendments to section 23M

See notes on **STRENGTHENING THE RULES DEALING WITH LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX**

CLAUSE 20

Income Tax Act: Amendments to section 25

See notes on **CLARIFYING THE TIMING OF DISPOSAL RULES IN RESPECT OF AN ASSET ACQUIRED FROM A DECEASED ESTATE**

CLAUSE 21

Income Tax Act: Amendments to section 28

See notes on **CLARIFYING THE TRANSFER OF LIABILITIES IN RESPECT OF INSURANCE BUSINESS BETWEEN SHORT-TERM INSURERS**

CLAUSE 22

Income Tax Act: Amendments to section 29A

Paragraph (a): The amendment seeks to update the current definition of an “insurer” as it refers to a long-term insurer as defined in the Long-term Insurance Act. The Insurance Act 18 of 2017 came into operation on 1 July 2018. Insurers that were registered under the Long-term Insurance Act are required to be licensed under the Insurance Act, 2017 and there is a two-year transitional period for this to be achieved.

Paragraph (b): See notes on **REFINING A DEDUCTION FORMULA FOR TAXABLE LONG TERM INSURER POLICYHOLDER FUNDS**

CLAUSE 23

Income Tax Act: Substitution of section 40CA

See notes on **REFINING THE INTERACTION BETWEEN ANTI-VALUE SHIFTING RULES AND CORPORATE REORGANISATION RULES**

CLAUSE 24

Income Tax Act: Amendment to section 41

See notes on **REFINING THE INTERACTION BETWEEN ANTI-VALUE SHIFTING RULES AND CORPORATE REORGANISATION RULES**

CLAUSE 25

Income Tax Act: Amendment to section 42

Paragraphs (a) – (c): The word “amount” should not have been used to refer to a countable noun. It is therefore proposed that “amount” be replaced with “number”. Besides the incorrect use of “amount” it is confusing because it has been held to mean “market value” in relation to the definition of ‘gross income’. As such, the amendments correct grammar usage in the context of the provisions.

Paragraph (d): See notes on **CLARIFYING THE RULES THAT TRIGGER ADDITIONAL CONSIDERATION IN ASSET-FOR-SHARE TRANSACTIONS WHEN A DEBT IS ASSUMED BY A COMPANY**

CLAUSE 26

Income Tax Act: Amendment to section 45

Paragraph (a): See notes on **EXTENDING THE REVERSAL OF THE NIL BASE COST RULES TO APPLY ON THE SIXTH ANNIVERSARY OF AN INTRA-GROUP TRANSACTION and CLARIFYING THE INTERACTION BETWEEN EARLY DISPOSAL ANTI-AVOIDANCE RULES AND THE NIL BASE COST ANTI-AVOIDANCE RULES**

Paragraph (b): See notes on **CLARIFYING THE EARLY DISPOSAL ANTI-AVOIDANCE RULES IN INTRA-GROUP TRANSACTIONS**

CLAUSE 27

Income Tax Act: Amendment to section 46

See notes on **REFINING THE PROVISIONS APPLICABLE TO UNBUNDLING TRANSACTIONS**

CLAUSE 28

Income Tax Act: Amendment to section 46A

See notes on **REFINING THE PROVISIONS APPLICABLE TO UNBUNDLING TRANSACTIONS**

CLAUSE 29

Income Tax Act: Amendment to section 47

Textual changes are made for easier reading of the provisions.

CLAUSE 30

Income Tax Act: Amendment to section 49E

See notes on **CLARIFYING THE RULES DEALING WITH WITHHOLDING TAX EXEMPTION DECLARATION**

CLAUSE 31

Income Tax Act: Amendments to section 50A

Paragraph (a): The amendment deletes the numeral "(1)" at the beginning of section 50A as the section contains no other subsection.

Paragraph (b): See notes on **LIMITING POTENTIAL FOR DOUBLE TAXATION UNDER THE HYBRID DEBT ANTI-AVOIDANCE RULES**

CLAUSE 32

Income Tax Act: Insertion of new section 57B

See notes on **TAX TREATMENT OF THE CESSION OF THE RIGHT TO RECEIVE AN ASSEST**

CLAUSE 33

Income Tax Act: Amendments to section 64G

See notes on **CLARIFYING THE RULES DEALING WITH WITHHOLDING TAX EXEMPTION DECLARATION**

CLAUSE 34

Income Tax Act: Amendments to section 64H

See notes on **CLARIFYING THE RULES DEALING WITH WITHHOLDING TAX EXEMPTION DECLARATION**

CLAUSE 35

Income Tax Act: Amendments to paragraph 6A of the Second Schedule to the Act

See notes on **TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER**

CLAUSE 36

Income Tax Act: Amendments to paragraph 1 of the Second Schedule to the Act

The amendment is a technical correction which seeks to ensure grammatical correctness.

CLAUSE 37

Income Tax Act: Amendments to paragraph 2 of the Second Schedule to the Act

The amendment to paragraph 2B of the Second Schedule is a technical correction which seeks to ensure that all annuity payments are catered for. It further seeks to clarify how the paragraph will be administered once in force.

CLAUSE 38

Income Tax Act: Amendments to paragraph 5 of the Fourth Schedule to the Act

The amendment is a technical correction which seeks to inset the word "of" to ensure grammatical correctness.

CLAUSE 39

Income Tax Act: Amendments to paragraph 6 of the Fourth Schedule to the Act

The amendment is a technical correction which changes "he or her" to "the employer" and seeks to be more gender neutral by improving the language used.

CLAUSE 40

Income Tax Act: Amendments to paragraph 5 of the Seventh Schedule to the Act

See notes on **REVIEWING THE NATURE OF LONG SERVICE AWARDS FOR FRINGE BENEFIT PURPOSES**

CLAUSE 41

Income Tax Act: Amendments to paragraph 6 of the Seventh Schedule to the Act

See notes on **REVIEWING THE NATURE OF LONG SERVICE AWARDS FOR FRINGE BENEFIT PURPOSES**

CLAUSE 42

Income Tax Act: Amendments to paragraph 10 of the Seventh Schedule to the Act

See notes on **REVIEWING THE NATURE OF LONG SERVICE AWARDS FOR FRINGE BENEFIT PURPOSES**

CLAUSE 43

Income Tax Act: Amendments to paragraph 12D of the Seventh Schedule to the Act

See notes on **CLARIFYING THE CALCULATION OF THE FRINGE BENEFIT IN RELATION TO EMPLOYER CONTRIBUTIONS TO A RETIREMENT FUND**

CLAUSE 44

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

Paragraph (a): The amendments delete the full stop at the end of the definition of "group of companies" and adds a semi-colon and the word "and" as the definition of "market value" was added after the definition of "group of companies" in 2018.

Paragraph (b): The amendment is a technical correction clarifying that the debt relief rules under paragraph 12A apply where there is debt benefit in respect of debt owed by a person that was used by that person to fund any expenditure in respect of assets, other than trading stock.

Paragraph (c): The amendment corrects an incorrect reference.

Paragraph (d): See notes on **CLARIFYING THE MEANING OF "INTEREST" UNDER THE DEBT RELIEF RULES**

CLAUSE 45

Income Tax Act: Amendment to paragraph 48 of the Eighth Schedule

The amendment is a technical correction which seeks to insert missing references to a special trust, the spouse of a person as well as beneficiaries of that person.

CLAUSE 46

Income Tax Act: Amendment to paragraph 49 of the Eighth Schedule

The amendment is a technical correction which seeks to insert missing references to a special trust, the spouse of a person as well as beneficiaries of the special trust.

CLAUSE 47

Income Tax Act: Substitution of the Eleventh Schedule

The Eleventh Schedule is substituted to update the list of Government Grants that are tax exempt.

CLAUSE 48

Customs and Excise Act, 1964 and Value-Added Tax Act:

The amendment is aimed at parliamentary ratification of amendments made to the Schedules under sections 48, 49, 56, 56A, 57, 60, 75(15) of the Customs Act and under section 74(3)(a) the VAT Act.

CLAUSE 49

Value-Added Tax Act: Amendment to section 2

Paragraph (a): The amendment aligns the terminology in the VAT Act with that in the Insurance Act 18 of 2017.

Paragraph (b): The amendment aligns the terminology in the VAT Act with that in the Insurance Act 18 of 2017 and replaces the reference to the Long-Term Insurance Act 1998 with a reference to the Insurance Act 18 of 2017

Paragraph (c): The amendment aligns the terminology in the VAT Act with that in the Insurance Act 18 of 2017.

CLAUSE 50

Value-Added Tax Act: Insertion of section 9(13) to the Act

See notes on **VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY**

CLAUSE 51

Value-Added Tax Act: Amendments to section 10 to the Act

See notes on **VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY**

CLAUSE 52

Value-Added Tax Act: Amendments to section 11 to the Act

See notes on **REVIEWING THE SECTION 72 ARRANGEMENT WITH REGARD TO TELECOMMUNICATIONS SERVICES**

CLAUSE 53

Value-Added Tax Act: Amendments to section 16 to the Act

See notes on **VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY**

CLAUSE 54

Value-Added Tax Act: Inserting a new section 18D to the Act

See notes on **VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY**

CLAUSE 55

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

See notes on **ZERO RATING OF SUPERFINE MAIZE MEAL**

CLAUSE 56

Securities Transfer Tax Act: Amendment of section 1

See notes on **CLARIFYING REHYPOTHECATION OF COLLATERAL WITHIN COLLATERAL ARRANGEMENT PROVISIONS**

CLAUSE 57

Securities Transfer Tax Act: Amendment of section 8

The amendment of subsection (1)(*d*) seeks to provide clarity in terms of the criteria applicable in determining whether tax is not payable in respect of a transfer of a security by a public benefit organisation.

CLAUSE 58

Employment Tax Incentive Act: Amendments to section 1

See notes on **CURBING ABUSE IN THE EMPLOYMENT TAX INCENTIVE**

CLAUSE 59

Employment Tax Incentive Act: Amendments to section 6

See notes on **CURBING ABUSE IN THE EMPLOYMENT TAX INCENTIVE**

CLAUSE 60

Taxation Laws Amendment Act, 2013: Amendments to section 13

The amendment postpones the effective date of amendments to sections 8F(3)(*b*)(ii), 8F(3)(*c*)(ii) and 8F(3)(*d*) from 1 January 2022 to 1 January 2023.

CLAUSE 61

Taxation Laws Amendment Act, 2013: Amendment to section 15

The amendment postpones the effective date of amendments to sections 8FA(3)(*b*)(ii), 8FA(3)(*c*)(ii) and 8FA(3)(*d*) from 1 January 2022 to 1 January 2023.

CLAUSE 62

Taxation Laws Amendment Act, 2013: Amendment to section 62

The amendment postpones the effective date of amendments to section 23M from 1 January 2022 to 1 January 2023.

CLAUSE 63

Carbon Tax Act: Paragraph (a) - Amendments to section 6(2)

See notes on **CLARIFYING RENEWABLE ENERGY PREMIUM BENEFICIARIES**

Carbon Tax Act: Paragraph (b) -Amendments to section 6(4)

See notes on **CLARIFYING THE SCOPE AND DEFINITION OF CARBON SEQUESTRATION**

CLAUSE 64

Carbon Tax Act: Amendments to section 12

See notes on **CLARIFYING THE CARBON BUDGET ALLOWANCE**

CLAUSE 65

Carbon Tax Act: Amendments to Schedule 2

See notes on **ALIGNING SCHEDULE 2 EMISSIONS ACTIVITIES AND THRESHOLDS WITH THE GREENHOUSE GAS EMISSION REPORTING REGULATIONS OF THE DFFE**

CLAUSE 66

Taxation Laws Amendment Act, 2019: Amendment to section 37

In 2019, an amendment was made in the Act such that the "affected transaction" definition was expanded to cover transactions between associated enterprises. After publication of the 2019 TLAB, comments were received from taxpayers that the term "associated enterprise" in the OECD model tax convention is not intended to represent a standard benchmark definition. Its incorporation into domestic law will create significant uncertainty as to when the transfer pricing rules are applicable. Furthermore, the new definition would require further elaboration and clarification of participation, control, management and enterprise. In response to these comments documented in the 2019 Response Document to the Standing Committee on Finance and Select Committee on Finance in Parliament, it was stated that SARS would provide guidance on the interpretation of the term "associated enterprise" and in order to give SARS and taxpayers more time to consider the interpretation of the term "associated enterprise". It was proposed that the effected date of this provision be postponed until the interpretation note is issued and engagements have been done between SARS and taxpayers.

The effective date is deferred to 1 January 2023 to give SARS and taxpayers enough time to engage on the interpretation note on associated enterprises.

CLAUSE 67

Disaster Management Tax Relief Act, 2020: Amendments to long title

The proposed amendment is a technical correction which seeks to extend the applicability of the Disaster Management Tax Relief Act, 2020 to the unrest experienced in July 2021.

CLAUSE 68

Disaster Management Tax Relief Act, 2020: Amendments to preamble

The proposed amendment is a technical correction which seeks to extend the applicability of the Disaster Management Tax Relief Act, 2020 to the unrest experienced in July 2021

CLAUSE 69

Disaster Management Tax Relief Act, 2020: Amendments to Section 2

See notes on **EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE**

CLAUSE 70

Disaster Management Tax Relief Act, 2020: Amendments to Section 3

See notes on **EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE**

CLAUSE 71

Disaster Management Tax Relief Act, 2020: Amendments to Section 4

See notes on **EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE**

CLAUSE 72

Disaster Management Tax Relief Act, 2020: Amendments to Section 5

See notes on **EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE**

CLAUSE 73

Disaster Management Tax Relief Act, 2020: Amendments to Section 6

See notes on **EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE**

CLAUSE 74

Disaster Management Tax Relief Act, 2020: Amendments to section 8

The proposed amendment is a technical correction which seeks to the following words “or that property was transferred” so as to clarify that the provision of this section apply to both amounts and property.

CLAUSE 75

Disaster Management Tax Relief Act, 2020: Amendments to Section 11

See notes on **EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE**

CLAUSE 76

Taxation Laws Amendment Act, 2020: Amendments to section 77

See notes on **CORRECTION OF THE DUPLICATION OF THE AMENDMENT MADE IN SECTION 77 OF THE TAXATION LAWS AMENDMENT ACT, 2020: AMENDMENT TO SECTION 6(3) OF THE CARBON TAX ACT**

CLAUSE 77

Short title and commencement