GEARED for the budget speech!

SPECIAL EDITION TAX AND EXCHANGE CONTROL ALERT

CLIFFE DEKKER HOFMEYR

THE RECHARACTERISATION OF PROCEEDS IN THE CASE OF A SHARE BUYBACK

The basis of the benefit that arises pursuant to the repurchase of shares is that a dividend declared by one company to another is exempt from dividends tax. In addition, the dividend is also exempt from income tax.

It was announced as part of the Budget proposals that National Treasury may recharacterise the proceeds that are received by a shareholder that is a company in circumstances where it disposes of its shares through means of a share buyback as opposed to selling the shares outright to a third party.

This conundrum is currently arising on a daily basis where a shareholder in a company has two ways in which to dispose of the shareholding in the company, being:

- the outright sale of shares to a third party which will result in capital gains tax (now 22,4%) on the profits made; and
- the sale of the shares to the company in which the shares are held through means of a specific repurchase of shares, which will result in an exempt dividend if the purchase price is not funded out of contributed tax capital.

The basis of the benefit that arises pursuant to the repurchase of shares is that a dividend declared by one company to another is exempt from dividends tax. In addition, the dividend is also exempt from income tax. To the extent that shares are thus repurchased by a company in circumstances where:

- the shares are repurchased through means of a specific share buyback of shares; and
- the purchase price is not funded out of share capital (contributed tax capital), but out of reserves, the purchase price is not only exempt in the hands of the seller company, but also not subject to dividends tax.

In the Budget proposals it is indicated that one of the schemes that is used to avoid the tax consequences of share disposals "involves the company buying back the shares from the seller company and issuing new shares to the buyer". Apart from the benefit that the seller company may derive, there is also an additional benefit to the extent that the purchaser subscribes for new shares in the company, the proceeds of which are used to fund the buyback of the shares. In particular, the share subscription will result in the contributed share capital of the company also being increased.

In the Budget proposals it is indicated that this type of transaction is in substance a share sale that should be subject to tax. The question arises whether the transactions will be recharacterised such that capital gains tax is payable even though it would, strictly speaking, be a dividend. Alternatively, it is possible that the dividend will no longer be exempt in the hands of the seller company of the shares, even though it is a company.

It should be appreciated that these type of transactions are in any event not automatically without risk. There should always be a commercial rationale why the parties embark upon a share buyback as opposed to the sale of shares, for instance in circumstances where the purchaser does not have the relevant cash to pay for the purchase price for the shares in circumstances where the company in which the shares are held may have the relevant cash resources. Great care should thus be taken in implementing share buyback transactions where the parties rely upon the fact that the proceeds are exempt in the hands of the seller company over and above the fact that no dividends tax is payable.

Emil Brincker

There should always be a commercial rationale why the parties embark upon a share buyback as opposed to the sale of shares, for instance in circumstances where the purchaser does not have the relevant cash to pay for the purchase price for the shares in circumstances where the company in which the shares are held may have the relevant cash resources.

CLIFFE DEKKER HOFMEYR

THE ANOMALY THAT DIVIDENDS ARE NOT EXEMPT WHEN DECLARED BY A REIT

Another principle of income tax is also that, should shares have been held for a continuous period of three years, the proceeds are deemed to be on capital account in terms of s9C of the Income Tax Act.

The introduction of tax legislation pertaining to Real Estate Investment Trusts (REITs) has resulted in significant development of this industry over the last few years. Apart from the fact that a REIT is not subject to capital gains tax in respect of properties that it disposed of, an additional consequence is that dividends declared by a REIT to South African shareholders are not exempt, but are in fact part of taxable income.

In circumstances where the REIT shares are held for a period in excess of three years, it seems anomalous not to allow any deduction to the trader in circumstances where the dividends were clearly taxable and were incurred as one of the purposes to generate income in the hands of the trader.

The distribution is also deductible in the hands of the REIT on the basis that a flow-through principle is essentially adopted with reference to rentals and similar income that are received by the REIT.

Another principle of income tax is also that, should shares have been held for a continuous period of three years, the proceeds are deemed to be on capital account in terms of s9C of the Income Tax Act. Section 9C of the Income Tax Act currently provides that, to the extent that any deductions have been claimed from the income of a taxpayer in respect of the shareholding during the initial three year period, these expenses must be reversed. However, in a context of REITs expenses would be incurred not only to potentially make a capital gain on the sale of the REIT shares, but also to receive taxable income in the form of dividends. An anomaly has thus arisen that expenses incurred by a shareholder in a REIT in these circumstances must be apportioned.

It has been proposed that there should not be a reversal of expenses that have been claimed as a deduction given the fact that expenditure incurred to produce taxable dividends is effectively not deductible. The assumption is thus that the expenditure would not be deductible resulting in the expenses thus not having to be recouped. It is not clear whether this approach would be sound, especially in circumstances where a trader acquired REIT shares and where it in fact deducted the purchase price associated with the acquisition of the REIT shares on the basis that both the proceeds from the sale of the REIT shares as well as the dividends would be taxable. In circumstances where the REIT shares are held for a period in excess of three years, it seems anomalous not to allow any deduction to the trader in circumstances where the dividends were clearly taxable and were incurred as one of the purposes to generate income in the hands of the trader. Careful thought will thus have to be given before it is indicated that there are no recoupment of expenses in circumstances where there is a clear case to be made for the deduction of expenses pursuant to the fact that taxable dividends have been derived.

Emil Brincker

CLIFFE DEKKER HOFMEYR

ADJUSTMENTS TO PERSONAL INCOME TAX

It is thus with great surprise that the 2016 Budget brought adjustments to the bottom three personal income tax brackets which effectively relieves the impact of inflation on lower- and middle-income earners.

Following an increase in individual tax rates in the 2015 Budget and in light of the current economic circumstances which include lower estimated tax revenues, it was highly anticipated that the Minister would announce an increase in personal income tax rates in the 2016 Budget. Expectations varied between an increase in the maximum marginal rate of tax of 1% to 4%, bringing the maximum marginal rate of tax within the 42% to 45% range.

It is thus with great surprise that the 2016 Budget introduces adjustments to the bottom three personal income tax brackets which effectively relieves the impact of inflation on lower- and middle-income earners. No amendments to the marginal tax rates were proposed.

In addition, the primary rebate has been increased to R13,500 per year for all individuals. The secondary rebate, which applies to individuals aged 65 years and older, has remained unchanged at R7,407 and the tertiary rebate (which applies in respect of individuals aged 75 years and older) has remained at R2,466 per year. The threshold below which individuals are not subject to personal income tax has been increased to R75,000 of taxable income per year for individuals below the age of 65, R116,150 for individuals aged 65 years and older, and R129,850 for individuals aged 75 years and older.

These adjustments must be considered in light of the proposal of the Government to increase the inclusion rates for capital gains tax (CGT) for individuals from 33,3% to 40%, and for companies from 66,6% to 80%.

According to the 2016 Budget Speech, the aforementioned adjustments will result in personal income tax relief of R5,5 billion.

These adjustments must be considered in light of the proposal of the Government to increase the inclusion rates for capital gains tax (CGT) for individuals from 33,3% to 40%, and for companies from 66,6% to 80%. This will effectively result in an increase in the maximum effective CGT rate for individuals from 13,7% to 16,4%, and for companies from 18,6% to 22,4%. The effective rate applicable to trusts will increase from 27,3% to 32,8%. The annual exclusion in respect of CGT will increase from R30,000 to R40,000. These CGT rates will become effective for years of assessment commencing on or after 1 March 2016.

Mareli Treurnicht

CLIFFE DEKKER HOFMEYR

SPECIAL VOLUNTARY DISCLOSURE PROGRAMME IN RESPECT OF OFFSHORE ASSETS AND INCOME

Following recent rumours that the Minister may announce an amnesty in respect of offshore assets and income, National Treasury released a media statement earlier today announcing the introduction of such a Special Voluntary Disclosure Programme (VDP).

According to the media statement, trusts will not qualify for the VDP, however, settlors, donors, deceased estates or beneficiaries of foreign discretionary trusts may participate in the VDP if they elect to have the trust's offshore assets and income deemed to be held by them.

According to the media statement, the purpose of the VDP is to give non-compliant taxpayers an opportunity to voluntarily disclose offshore assets and income. The media statement warned that, with a new global standard for the automatic exchange of information between tax authorities providing SARS with information regarding such offshore assets and income from 2017, time is running out for taxpayers who have not disclosed assets abroad. The VDP will provide both individuals and companies with an opportunity to regularise their tax and exchange control affairs through one joint process.

From a tax perspective, the VDP will apply for six months commencing from 1 October 2016 and ending on 31 March 2017. Individuals and companies will be able to apply for the VDP on the same basis as is currently provided for in Chapter 16 of the Tax Administration Act, No 28 of 2011. The existing voluntary disclosure programme will be extended to the VDP.

According to the media statement, trusts will not qualify for the VDP, however, settlors, donors, deceased estates or beneficiaries of foreign discretionary trusts may participate in the VDP if they elect to have the trust's offshore assets and income deemed to be held by them.

Persons may not apply for the VDP if they are aware of a pending audit or investigation in respect of foreign assets or foreign taxes, or if such audit or investigation has commenced. If the scope of the audit or investigation is in respect of an area other than foreign assets or foreign taxes, a person may apply for the VDP.

Amounts in respect of which SARS obtained information under the terms of an international exchange of information procedure will not be eligible for the VDP.

The relief proposed in terms of the VDP will be that:

- only 50% of the total amount used to fund the acquisition of offshore assets before 1 March 2015, if the applicant failed to comply with a tax Act administered by SARS, will be included in taxable income and subjected to normal tax;
- investment returns on the offshore assets received or accrued from 1 March 2010 onwards will be included in taxable income in full and subjected to normal tax. Investment returns prior to 1 March 2010 will be exempt from normal tax;
- interest on tax debts arising from the disclosure of amounts used to fund the acquisition of offshore assets or investment returns in respect of those offshore assets will commence only from 1 March 2010;

CLIFFE DEKKER HOFMEYR

SPECIAL VOLUNTARY DISCLOSURE PROGRAMME IN RESPECT OF OFFSHORE ASSETS AND INCOME

CONTINUED

The media statement has warned that Residents who do not make use of the VDP or voluntarily approach FinSurv may face the full force of the law and that the FinSurv is mandated, in appropriate circumstances, to recover the full amount of the contravention.

- no understatement penalties will be levied where the VDP application is successful; and
- SARS will not pursue criminal prosecution for a tax offence where the VDP application is successful.

From an exchange control (Excon) perspective, the Financial Surveillance Department of the South African Reserve Bank (FinSurv) will be offering South African Excon residents (Residents) an opportunity to regularise their Excon affairs by applying for relief under the VDP in respect of contraventions of the Exchange Control Regulations, 1961 (Excon Regulations), including in respect of the ownership of unauthorised foreign assets. Applications must be made pursuant to the provisions of Regulation 24 of the Excon Regulations.

The VDP will apply to all Residents, both individuals and entities, and in respect of Excon contraventions that occurred prior to 29 February 2016. Residents who are the subjects of current and/or pending investigations by FinSurv will not qualify for relief under the VDP. The VDP will commence on 1 October 2016 and end on 31 March 2017.

The relief proposed in terms of the VDP will be that:

- applicants may be liable for a levy based on the current market value of the unauthorised foreign assets and/or structures as at 29 February 2016. The levy will be 5% of the leviable amount if the regularised assets or the sale proceeds are repatriated to South Africa, and 10% of the leviable amount if the regularised assets are kept offshore;
- the levy must be paid from foreign-sourced funds. Where insufficient liquid foreign assets are available, an additional 2% levy will be added to the extent that local assets are used to settle the levy; and
- individuals may not deduct their R10 million foreign capital allowance or any remaining portion thereof from any leviable amount and the levy may not be reduced by fees or commissions.

Where Residents decide not to utilise the VDP they will, at the discretion of FinSurv, have to pay a settlement ranging from 10% to 40% on the current market value of their unauthorised foreign assets. The determination of the settlement amount will depend on factors which include whether the applicant elects to retain the funds abroad or repatriates the funds.

The media statement has warned that Residents who do not make use of the VDP or voluntarily approach FinSurv may face the full force of the law and that the FinSurv is mandated, in appropriate circumstances, to recover the full amount of the contravention.

Mareli Treurnicht

CLIFFE DEKKER HOFMEYR

ADJUSTMENT FOR FOREIGN GROUP LOSSES TO BE REMOVED FROM THE CFC HIGH-TAX EXEMPTION CALCULATION

This anomalous outcome is compounded by the fact that in the absence of the high-tax exemption, resident shareholders of the CFC would not have been entitled to foreign tax rebates against their proportional entitlement to the CFC's net income.

The controlled foreign company (CFC) provisions contained in s9D of the Income Tax Act were amended with effect from 1 January 2008 (applicable to foreign tax years of CFCs ending during years of assessment ending on or after that date). Provided that the 'net income' of a CFC be deemed nil if the total amount of tax payable to all spheres of government of any country other than South Africa by the CFC on its net income amounts to at least 75% of the amount of normal tax that would be payable in respect of any taxable income of the CFC had it been a resident for the relevant foreign tax year.

The objective of the amendment was to disregard CFC income if negligible South African tax was at stake once having taken South African tax rebates into consideration.

In calculating the hypothetical foreign tax of the CFC, foreign losses of the CFC or another foreign group company must be disregarded. In consequence, situations may arise where a CFC may qualify for the high-tax exemption in circumstances where no foreign tax is actually payable.

This anomalous outcome is compounded by the fact that in the absence of the high-tax exemption, resident shareholders of the CFC would not have been entitled to foreign tax rebates against their proportional entitlement to the CFC's net income.

To redress the above, it is now proposed that the adjustment for foreign group losses be removed from the calculation of the high-tax exemption.

Lisa Brunton

NARROWING THE DEFINITION OF A HYBRID DEBT INSTRUMENT

The definition of a hybrid debt instrument will be amended to exclude instruments subject to subordination arrangements.

The proposed amendment aims to exclude interest-bearing arrangements from the definition of hybrid debt instruments as contained in s8F of the Act, if these instruments become subject to a subordinary agreement. It is interesting to note that a distinction is made between instruments which are subordinated from the outset and subordination arrangements concluded after the issuance of the instrument. It also remains to be seen whether the exclusion will be a retrospective exclusion. The holders of these instruments might therefore remain subject to income tax regardless of the company's ability to service its interest expense, while the company is still able to benefit from a potential income tax deduction for the interest.

Dries Hoek

The proposed amendment aims to exclude interest bearing arrangements from the definition of hybrid debt instruments as contained in s8F of the Act, if these instruments become subject to a subordinary agreement.

CLIFFE DEKKER HOFMEYR

SHARE INCENTIVE SCHEMES

Essentially, s8C delays taxation in respect of the receipt or accrual until such time that the employee becomes entitled to the full value of the share or rights under the relevant scheme.

Section 8C of the Income Tax Act acts as an anti-avoidance mechanism that prevents employees from treating what is essentially fully taxable salary or bonus income at reduced tax rates through the use of restricted shares and other incentive schemes. Essentially, s8C delays taxation in respect of the receipt or accrual until such time that the employee becomes entitled to the full value of the share or rights under the relevant scheme. Dividends received or accrued on the underlying shares are also generally not exempt under s10(1)(k) of the Income Tax Act unless the shares are equity shares as defined.

It is now proposed that the applicable rules in the Income Tax Act be reviewed so as to treat the value received as remuneration for purposes of employees' tax.

However, schemes have been developed that circumvent the application of s8C, by effectively transferring the value of the underlying shares to the relevant employees as exempt dividends under s10(1)(k) of the Income Tax Act. This is achieved, *inter alia,* by ensuring that the underlying shares technically meet the definitional requirements of an 'equity share'. There are different permutations, and in terms of some schemes the underlying shares are repurchased or redeemed for an amount that technically constitutes a dividend. In terms of other schemes, the value is first transferred to the employee by paying dividends in terms of special dividend rights attaching to the shares, and by the time the shares ultimately vest, they no longer have any value that could be subject to tax.

It is now proposed that the applicable rules in the Income Tax Act be reviewed so as to treat the value received as remuneration for purposes of employees' tax. It is, however, not clear whether existing schemes will be affected, and taxpayers who are party to such schemes should consider that they may end up paying more tax than they may have initially anticipated.

On the positive side, it was also proposed that amendments will be made to the Income Tax Act to avoid possible double taxation in circumstances where taxpayers receive certain valuable restricted equity instruments. Technically, and in certain circumstances, the value of such restricted instruments can be included in the gross income of a taxpayer in terms of paragraph (c) of the definition of 'gross income' upon receipt, while the same amount can again be included in terms of paragraph (n) upon vesting in terms of s8C. The value of such instruments will now be excluded from paragraph (n) of the definition of 'gross income'.

Heinrich Louw

CLIFFE DEKKER HOFMEYR

INTRODUCTION OF THE ENVIRONMENTAL LEVY ON TYRES

Although Government intended for the levy to come into effect during the last quarter of 2015, its implementation date was delayed.

In the 2015 Budget proposals it was indicated that Government intended to introduce an environmental tyre levy, in addition to the environmental levies already in place. The purpose of this levy was to encourage reuse, recycling and recovery of waste in light of the fact that South Africa generates an estimated 108 million tonnes of waste each year.

In the 2016 Budget it is now proposed that the date of implementation be 1 October 2016 and that the levy will apply to all new and re-treaded pneumatic tyres.

Although Government intended for the levy to come into effect during the last quarter of 2015, its implementation date was delayed. In the 2016 Budget it is now proposed that the date of implementation be 1 October 2016 and that the levy will apply to all new and re-treaded pneumatic tyres. It will be inserted into the Customs and Excise Act and will be levied at a rate of R2.30/kg net, irrespective of the tyre's previous use and irrespective of whether the tyre was imported or manufactured locally.

The levy is payable in addition to any existing customs and excise duty payable on the import or export of such tyres. The levy will replace the current fee arrangements for tyres, as regulated by the Department of Environmental Affairs.

Louis Botha and Heinrich Louw

THE ATTENTION IS TURNING TO TRUSTS

More often than not assets are sold (at market value) to a trust in circumstances where the purchase price is left outstanding as an interest free loan.

Currently trusts are used as an important vehicle to avoid the payment of estate duty and to create an insolvency remote vehicle through means of which investments can be done. However, it is always problematic how to fund a trust as one cannot subscribe for shares in a trust such that one would, for instance, do in the case of a company. More often than not assets are sold (at market value) to a trust in circumstances where the purchase price is left outstanding as an interest free loan. In addition, no donations tax would be triggered as the assets are not included in the estate of the donor at death.

As one of the first measures to curb potential avoidance, it is indicated that assets that are transferred through means of a loan to a trust will be included in the estate of the founder at death. In addition, interest free loans to trusts will be treated as donations, not only resulting in donations tax, but also the imputation of income in the hands of the donor. Measures will also be introduced so as to avoid income splitting in circumstances where the income of a trust is, for instance, vested in spouses and children.

These measures are expected to be but the first of many that will focus on trusts and perceived avoidance. Not only are trusts taxed at the highest tax rate of 41%, but its capital gains tax rate is also now equal to 32,8%.

Emil Brincker

THE INTENTIONAL CREATION OF HYBRID DEBT INSTRUMENTS THAT RESULT IN INTEREST BEING DEEMED TO BE DIVIDENDS

Section 8F and s8FA of the Income Tax Act have been promulgated with a view to convert interest into dividends. These sections deal with a scenario where the debt instrument displays a number of equity characteristics, for instance if amounts are only payable if the assets of the issuer exceed its liabilities and/or where interest is not calculated with reference to the time value of money.

It has been announced as part of the Budget proposals that, with effect from 24 February 2016, interest will no longer be reclassified as a dividend in the case where the issuer is a non-resident.

Unfortunately a number of transactions have been implemented which make use of the intentional recharacterisation of the interest into dividends. This is especially the case if the issuer is a non-resident, in which event the non-resident issuer is then treated to have paid dividends as opposed to interest to the South African holder.

It has been announced as part of the Budget proposals that, with effect from 24 February 2016, interest will no longer be reclassified as a dividend in the case where the issuer is a non-resident. The reason is that the non-resident cannot suffer any negative tax consequences in a South African context. Not only would the dividend then be exempt, but the issuer may potentially claim an interest deduction in the country of origin. Going forward the interest will no longer be recharacterised as a dividend and will thus be taxable in the hands of the South African holder if the issuer is a non-resident of South Africa.

Emil Brincker

CLIFFE DEKKER HOFMEYR

VAT ASPECTS OF NON-EXECUTIVE DIRECTORS' FEES

As a general principle, where an amount is paid to an individual (for example a non-executive director), regarded as independent under common law but not for purposes of the Fourth Schedule to the Act.

The debate essentially turns around the concept of what is regarded as 'remuneration' for purposes of the Fourth Schedule to the Act as it pertains to independent contractors and the disconnect in the VAT Act that only deals with the concept of an independent contractor in a common law context.

The Minister proposed to review certain aspects pertaining to non-executive directors' fees, as there appears to be a disconnect, or at least a difference of interpretation between the PAYE and VAT treatment of such fees.

As a general principle, where an amount is paid to an individual (for example a non-executive director), regarded as independent under common law but not for purposes of the Fourth Schedule to the Act, the individual must levy VAT on those services supplied to their client, but only if that person is (or is required to be) registered as a vendor under the VAT Act. The aforementioned scenario rarely arises in practice though. However, PAYE at the applicable rate, must be withheld from the VAT exclusive amount charged by the individual to their client.

Where an individual is not regarded as independent under common law, the supply of services would likely fall outside the definition of an 'enterprise' and no VAT would therefore be applicable. For example, there is no VAT on a salary purely because of the proviso excluding such amounts, being 'remuneration', from the concept of an 'enterprise'. The debate essentially turns around the concept of what is regarded as 'remuneration' for purposes of the Fourth Schedule to the Act as it pertains to independent contractors and the disconnect in the VAT Act that only deals with the concept of an independent contractor in a common law context.

Although no further clarity or information is provided on the proposed investigation, it can be expected that the definition of 'enterprise' in the VAT Act will be refined to hopefully put the issue to bed as to whether VAT registration would be required for a non-executive director that is subject to PAYE under the supervision and control tests in the Fourth Schedule to the Act, but still remains independent under common law.

Ruaan van Eeden

CLIFFE DEKKER HOFMEYR

PROVIDENT FUND TRANSFER LIMITATIONS

Apart from sterilising the compulsory annuitisation upon retirement for two years, it is proposed that any transfer to another retirement fund during the interim period, would result in any future contributions made by the employee, not being exempt from the compulsory annuitisation requirements.

Following on from the two year suspension of retirement reforms only relating to the compulsory annuitisation of provident funds to 1 March 2018, the Minister tabled certain interim measures affecting the transfer of amounts out of a provident fund through an urgent Revenue Laws Amendment Bill (Bill).

Apart from sterilising the compulsory annuitisation upon retirement for two years, it is proposed that any transfer to another retirement fund during the interim period, would result in any future contributions made by the employee, not being exempt from the compulsory annuitisation requirements. This proposal will surely place funds and members of those funds in limbo for two years.

Certain concessions have been made in respect of 'forced transfers' upon the closure of a retirement fund. There could, however, be two scenarios to consider – the one being a closure of the fund itself or secondly, where the employer ceases to be an employer. For employees resigning and transferring their accumulated capital to a preservation fund, there would be no effect on the basis that no further contributions would in any event be allowed into that preservation fund.

Ruaan van Eeden

FOREIGN PENSION FUND CONTRIBUTIONS AND EXITS TO BE REVIEWED

What appears to be part of a broader retirement reform in South Africa, the Minister proposed a further review of the aspects relating to foreign pension contributions, annuities and exits from those funds.

Where an apportionment of foreign source is required, it could result in at least a portion being potentially subject to normal tax in South Africa. The ruling was, however, silent on lump sums which continues to be uncertain.

This follows hot on the heels of at least some uncertainty being taken away on the issue of Binding Private Ruling 25 on 14 November 2014, which exempted foreign pensions on the basis of the source being outside South Africa. Where an apportionment of foreign source is required, it could result in at least a portion being potentially subject to normal tax in South Africa. The ruling was, however, silent on lump sums which continues to be uncertain.

Although the issue of contributions to a foreign pension fund did not form part of the ruling, by applying basic tax principles, it follows that deductions would generally not be allowed to the extent that the eventual return is in the form of exempt income. As part of the broader reforms and reviews contemplated by the Minister, the aforementioned aspects would need to be carefully considered, as it may require similar apportionment methodology as that relating to the income itself. In addition, the application of certain Double Tax Agreements would need to be considered that specifically allow for the deduction of contributions in South Africa even though those contributions are made to foreign funds.

The Minister did, however, state that sufficient time would be required to consult with the necessary stakeholders.

Ruaan van Eeden

CLIFFE DEKKER HOFMEYR

BEPS FRONT AND CENTRE

In particular, he warned that aggressive action would be taken against taxpayers attempting tax evasion through transfer pricing and tax treaty abuses.

The Minister endorsed the work of the Davis Committee and reiterated South Africa's commitment to the work of the Organisation for Economic Cooperation and Development (OECD) and G20 on base erosion and profit shifting (BEPS). He announced that South Africa would continue to measure its tax system against internationally accepted tax trends, principles and practices, and keep pace with international initiatives to improve tax compliance and deal with problems of base erosion.

In particular, he warned that aggressive action would be taken against taxpayers attempting tax evasion through transfer pricing and tax treaty abuses. In addition, he advised that further measures would be introduced to counter the exploitation of hybrid debt instruments in alignment with Action 2 (Neutralisation of the effects of hybrid mismatches) of the OECD BEPS Action Plan.

South Africa has been a staunch supporter of the OECD in its endeavours to prevent profit shifting between jurisdictions by multinational enterprises (MNEs) attempting to evade tax in their primary jurisdictions of operation and National Treasury has already introduced domestic provisions to address base erosion and profit shifting practices that it considers prejudicial to the South African fiscus. Primary areas of concern that have been identified by SARS are hybrid debt, connected person debt, transfer pricing and acquisition debt.

2017 will see the implementation of international agreements on information sharing between tax administrations. It is envisaged that these agreements will enable tax authorities to more effectively attack illicit flows and abusive practices by MNEs and wealthy individuals.

2017 will see the implementation of international agreements on information sharing between tax administrations. It is envisaged that these agreements will enable tax authorities to more effectively attack illicit flows and abusive practices by MNEs and wealthy individuals. The Minister noted that SARS's Large Business Centre was well placed to take advantage of the imminent information sharing initiatives.

Finally in this regard, the Minister tossed a bone to taxpayers who still have undisclosed assets offshore by giving advanced notice of a special voluntary disclosure programme that will provide additional relief for a six month period commencing in October 2016. Affected taxpayers are encouraged to employ the programme to regularise their tax affairs.

Lisa Brunton

AN INCREASE IN TRANSFER DUTY – WILL IT DAMPEN THE PROPERTY MARKET?

The Minister announced that the transfer duty rate on properties above R10 million will increase from 11% to 13%.

Last year's increase in the threshold for transfer duty to R750 000 was positive, but unfortunately no further relief is provided this year for properties on the lower end of the market.

Property owners at the top end of the market will, however, be worse off. The Minister announced that the transfer duty rate on properties above R10 million will increase from 11% to 13%. Consequently a new bracket in the transfer duty table will be formed. Transfer duty in this new bracket will, with effect from 1 March 2016, be R937 500 + 13% of the value exceeding R10 million.

It can be expected that those in the lower income groups will remain encouraged to invest in their own homes and thus save, but the same sort of encouragement may not be felt by investors, especially when viewed against a backdrop of gradually increasing interest rates and a sluggish economy.

With the ever-rising electricity, food, fuel costs and other consequences of inflation, it remains to be seen how the increase will affect market confidence and the Minister's plan to achieve sustainable growth.

Yashika Govind

REVIEW OF THE EMPLOYMENT TAX INCENTIVE

Government formally introduced the employment tax incentive into law on 1 January 2014, through the promulgation of the Employment Tax Incentive Act, No 26 of 2013.

The purpose of the employment tax incentive was to reduce the cost to employers of hiring young and inexperienced youth. In other words, the employment tax incentive is essentially a cost-sharing mechanism between the private sector and Government, which operates by reducing the amount of tax that is owed by an employer through the Pay-As-You-Earn (PAYE) system.

It should, however, be noted that the employment tax incentive expires on 31 December 2016 and accordingly, the incentive will cease after 1 January 2017. Therefore, incentive amounts not deducted from PAYE as at 31 December 2016, will be forfeited.

Notwithstanding the aforementioned, SARS has made data on the employment tax incentive available and a review, as to whether to extend the period for which the incentive can be utilised, is currently under way. In the event of any delay in finalising the aforementioned review, Government may consider extending the employment tax incentive by one year.

The outcome of the review will be published and presented to Parliament by the third quarter of 2016.

Nicole Paulsen

It should, however, be noted that the employment tax incentive expires on 31 December 2016 and accordingly, the incentive will cease after 1 January 2017. Therefore, incentive amounts not deducted from PAYE as at 31 December 2016, will be forfeited.

CLIFFE DEKKER HOFMEYR

PROPOSED AMENDMENT TO THE DATE ON WHICH THE ESTIMATE FOR THE SECOND PROVISIONAL TAX PAYMENT MUST BE SUBMITTED

Certain penalties and interest will be imposed if the estimates are inaccurate or if the submission of the estimates or the payment of provisional tax is late.

By way of background, provisional tax is not a separate tax payable by certain persons, instead it is merely a method used to collect normal tax that will ultimately be payable for the year of assessment concerned, during the year. Otherwise stated, provisional tax is an advance payment of a taxpayer's normal tax liability.

Notwithstanding the above, it must be noted that currently, a provisional taxpayer is not subject to the underpayment penalty if an estimate for the second provisional tax period is submitted before the due date of the subsequent provisional tax payment.

A provisional taxpayer is generally required to make two provisional tax payments, six months into the year of assessment and at the end of the year of assessment, but has the option to make a third top-up payment after the end of the year of assessment. Provisional tax payments are calculated on estimated taxable income (which includes taxable capital gains) for the particular year of assessment.

There are certain rules that must be adhered to when making estimates of taxable income for provisional tax purposes. Certain penalties and interest will be imposed if the estimates are inaccurate or if the submission of the estimates or the payment of provisional tax is late.

In respect of the second provisional tax payment period, a provisional taxpayer is required to submit a return to the Commissioner which includes an estimate of the total taxable income that will be derived by the taxpayer in the year of assessment (second period estimate). Due to the fact that the second period estimate is made at or close to the end of the year of assessment, a tax payer is often in a position to make a relatively accurate estimate of the taxable income for the year of assessment concerned.

An underpayment penalty may be levied for the second period when the actual taxable income as finally determined is more than the taxable income estimated on the second provisional tax return. The calculation of the potential penalty depends on whether actual taxable income is more than R1 million or whether actual taxable income is equal to or less than R1 million. Such an underpayment penalty is deemed to be a percentage-based penalty imposed under Chapter 15 of the Tax Administration Act. It is further noted that the penalty may be levied even if the Commissioner has increased the estimate under paragraph 19(3) of the Income Tax Act.

Notwithstanding the above, it must be noted that currently, a provisional taxpayer is not subject to the underpayment penalty if an estimate for the second provisional tax period is submitted before the due date of the subsequent provisional tax payment. The Minister has proposed in the Budget that this window period be closed on the date of assessment of the relevant year.

The information contained in the Budget is limited. However, it appears that the proposal would limit the time between the submission of the provisional tax returns and the actual payment of the provisional tax for the second period.

More clarity will be obtained once the draft legislation has been published.

Nicole Paulsen

CLIFFE DEKKER HOFMEYR

WITHDRAWAL OF WITHHOLDING TAX ON SERVICE FEES

Section 51B of the Income Tax Act, which was meant to be effective from 1 January 2017, makes provision for a final withholding tax on services fees calculated at the rate of 15% of the amount of any service fee that is paid by any person to or for the benefit of any foreign person.

It is interesting to note that the proposal accords with Notice No 140 in Government Gazette 39650, published by SARS on 3 February 2016 in terms of s35(2) of the TAA (Notice), which lists an additional reportable arrangement that was not included in previous notices.

The withholding tax on service fees provided for in s51A-s51H of the Income Tax Act was expected to commence on 1 January 2017.

In this regard, it was envisaged that the local recipient of services would generally have to withhold 15% of the fee payable to the non-resident service provider, (subject to the application of a relevant international tax treaty).

Section 51B of the Income Tax Act, which was meant to be effective from 1 January 2017, makes provision for a final withholding tax on services fees calculated at the rate of 15% of the amount of any service fee that is paid by any person to or for the benefit of any foreign person, to the extent that an amount is regarded as having been received by or accrued to that person from a source within South Africa.

The Budget proposes the withdrawal of the withholding tax on service fees from the Income Tax Act. The reason for the concession is that the introduction of the withholding tax on service fees has resulted in uncertainty on the application of domestic tax law and taxing rights under tax treaties. Accordingly, it is proposed that the withholding tax on service fees be included in the reportable arrangements provisions in the Tax Administration Act, No 28 of 2011 (TAA).

It is interesting to note that the proposal accords with Notice No 140 in Government Gazette 39650, published by SARS on 3 February 2016 in terms of s35(2) of the TAA (Notice), which lists an additional reportable arrangement that was not included in previous notices. The Notice is largely aimed at non-resident service providers who physically provide services in South Africa to residents, (or permanent establishments of non-residents) via individual non-residents sent to South Africa.

Foreign companies and collective investment schemes

Collective Investment Schemes (CIS) are regulated in terms of the Collective Investment Schemes Control Act, No 45 of 2002 and are schemes in terms of which two or more investors pool their resources by investing in a company or trust for their joint benefit while sharing the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme.

In terms of the definition of 'person' in s1 of the Income Tax Act, each portfolio in a CIS is defined as a separate person for tax purposes. As such, CISs may hold shares in other companies, including foreign companies.

WITHDRAWAL OF WITHHOLDING TAX ON SERVICE FEES

As s9D of the Income Tax Act taxes South African owners of foreign-owned entities on amounts equal to that entity's earned income, s9D results in adverse consequences for CISs that hold shares in foreign CISs.

Section 9D of the Income Tax Act is the anti-avoidance provision aimed at preventing South African residents from excluding tainted forms of taxable income from the South African tax net through investment into controlled foreign companies (CFC). More specifically, s9D(2) of the Income Tax Act provides that an amount equal to the net income of a CFC, shall be included in the South African resident's income in the proportion of such resident's participation rights to the total participation rights in the company.

As s9D of the Income Tax Act taxes South African owners of foreign-owned entities on amounts equal to those entities earned income, s9D results in adverse consequences for CISs that hold shares in foreign CISs.

As there is uncertainty as to whether it is the local fund or the investor in the local fund that should be considered to be the holder of the participation rights in the foreign collective investment scheme, it is proposed that CISs be excluded from applying s9D of the Income Tax Act to investments made in foreign companies.

Gigi Nyanin

VENTURE CAPITAL COMPANIES

Section 12J of the Income Tax Act was introduced in 2008 to stimulate much-needed equity funding for small businesses. It provides for the formation of an investment holding, described as a Venture Capital Company (VCC). Investors subscribe for shares in the VCC and claim an income tax deduction for the subscription price incurred. The VCC must then deploy most of these subscription proceeds within three years by subscribing for shares in investee companies.

Although s12J was a very welcome addition to the Income Tax Act, it is subject to rigid requirements and anti-avoidance provisions which are difficult to manage and which, if breached, trigger terminal tax consequences. In addition, although s12J provides that there is no recoupment of the investor's tax deduction where the investor sells the shares in the VCC after 5 years, returns of capital after 5 years are not subject to the same exemption.

As a result, the VCC regime is fiscally unstable to implement and does not facilitate the normal economic drivers of a typical investment fund. It is therefore encouraging that National Treasury has heard the call to make further changes to s12J. If it is sufficiently enabling it will allow the VCC regime to fulfil the vital role of stimulating entrepreneurs in South Africa.

Mark Linington

Although s12J was a very welcome addition to the Income Tax Act, it is subject to rigid requirements and anti-avoidance provisions which are difficult to manage and which, if breached, trigger terminal tax consequences.

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