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SPECIAL EDITION ALERT
Budget Speech
20 February 2019

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CLIFFE DEKKER HOFMEYR

A NEW DAWN FOR DIVIDEND-STRIPPING RULES?

National Treasury amended legislation governing share buy-backs and dividend stripping in 2017 and again in 2018. The specific anti-avoidance provisions can be found in s22B of the Income Tax Act, No 58 of 1962 (IT Act), which takes aim at shares held as trading stock, and paragraph 43A to the Eight Schedule to the IT Act, which applies if the shares are held on capital account.

These provisions generally find application when corporates structure the disposal of "qualifying interests" with the desire to receive an income tax exempt dividend as opposed to taxable income or capital gains. In order to generate the income tax exempt dividend these disposals are generally structured as share buy-back transactions or dividend distributions combined with the immediate disposal of the shares.

If the exempt dividends qualify as "extraordinary dividends" these "extraordinary dividends" are reclassified as income subject to income tax at a rate of 28% or proceeds resulting in a capital gain subject to income tax at an effective rate of 22.4%.

These specific anti-avoidance provisions only find application if the corporates dispose of the shares in respect of which the "extraordinary dividends" are received within a period of 18 months of receiving such dividends.

It appears that taxpayers have identified the disposal requirement as a structuring opportunity and devised schemes in terms of which the shares are retained for at least 18 months before the shares are disposed for a nominal consideration.

The structures therefore comprise of a company declaring a substantial dividend, presumably equal to the value of the ordinary shares, followed by a share subscription in terms of which a new investor subscribes for shares in the company. At the time of the subscription the company will have a nominal equity value which enables the new investor to acquire essentially 99.99% of the ordinary shares in issue through the subscription transaction while diluting the "exiting" shareholder. The "exiting" shareholder will retain its 0.01% interest for at least 18 months before disposing the shares for a nominal consideration.

These types of abusive schemes have come to the attention of National Treasury and it is proposed that the share buy-backs and dividend stripping rules are amended with effect from 20 February 2019.

The Minister did not provide any guidance on the nature of the amendments, but taxpayers should expect a complicated provision that might have several unintended consequences.

Dries Hoek

ANOMALIES ARISING FROM VALUE-SHIFTING RULES

The Taxation Laws Amendment Act, No 22 of 2012 introduced a new s24BA into the IT Act, which deals with value mismatches involving the transfer of assets in exchange for the issue of shares.

Essentially, the section applies where the value of the asset given in consideration for the shares issued is different from what it would have been had the transaction been between independent persons acting at arm's length.

Where the market value of the asset before the disposal exceeds the market value of the shares issued, the excess is deemed to be a capital gain for the company issuing the shares. The amount of the excess must also be applied to reduce the tax cost of the shares in the hands of the subscriber.

Where the market value of the shares after issue exceeds the market value of the asset given in consideration, the excess is deemed to be a dividend in specie paid by the issuing company.

It should also be noted that s40CA of the IT Act provides that where a company has received an asset in return for the issue of shares, the company is deemed to have incurred expenditure equal to the market value of the shares immediately after the acquisition.

It is now proposed that some of the anomalies that could arise from the application of these provisions should be corrected.

Specifically, where a deemed gain has been triggered due to the application of s24BA, and s24CA deems the expenditure in respect of the asset to be equal to the market value, double taxation could occur if the asset is subsequently disposed of.

In addition, the issue of determining the market value of shares will also be addressed in the case of asset-for-share transactions in terms of s42 of the IT Act.

Where an asset is transferred in terms of an asset-for-share transaction, the deferred tax liability in respect of the asset may arguably be taken into account in determining the market value of the shares.

It is proposed that any difference in the value of the shares due to the deferred tax liability should not be subject to the provisions.

However, the seller can still declare a substantial dividend.

Heinrich Louw

DEDUCTION OF INTEREST IN RESPECT OF DEBT INCURRED FOR THE ACQUISITION OF SHARES

It has always been a contentious issue whether a purchaser of shares can claim a deduction of the interest that it incurs pursuant to monies borrowed by the purchaser in order to fund the acquisition of shares. The argument has traditionally been that the purchaser will only receive dividends in respect of the shares and these dividends are not taxable. Given the fact that the interest therefore does not generate income, the interest was traditionally disallowed as a deduction.

A number of years ago the legislature intervened by allowing the deduction of interest in respect of a debt that is used to fund the acquisition of shares in certain circumstances in terms of s24O of the IT Act. However, it is a requirement that the target company:

- must be an operating company;
- must form part of the same group of companies as the acquiror (70% equity shareholding).

The problem is that the 70% shareholding may be diluted pursuant to corporate action steps that may be implemented by the parties subsequently, for instance the introduction of a new company between the acquiror and the target company or the acquisition of a new group of companies. Provision will now be made that one can still claim the deduction to the extent that the acquiror still holds 70% on a direct or indirect basis of the target company.

Unfortunately, however, it is a requirement that the interest will only be deductible to the extent that the shares are acquired in a so-called operating company. In other words, the target company must already generate income as opposed to being a start-up company. This intention will be made clear, which limits the scope of the section to a large extent.

A number of taxpayers have also realised that the section does not benefit them that much in circumstances where the acquiror does not generate income. For instance, if a holding company acquires shares in a target company and does not have other taxable income, it is of little use to the holding company to be able to deduct interest. The relevant provisions are therefore only beneficial to the extent that it is an operating company that acquires shares in a target company as such operating company can then set off the interest that it can claim as a deduction against other income. Otherwise the ability to deduct interest is not of much use as the holding company would only generate dividends which are exempt from tax in any event.

Emil Brincker

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory & Controversy for 2018.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

Ludwig Smith has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

PERSONAL INCOME TAX RATES

Many predicted that, given the already small tax base in South Africa, the already high personal income tax rates, the significant increases in tax rates over recent years and the current state of the economy, there would be very few changes to personal income tax rates in the Budget Speech. In recent years, South Africans faced an increase in personal income tax rates (refer for example to the 45% tax bracket introduced for individuals earning R1,5 million and above), the value-added tax rate, dividend withholding tax rate and the capital gains tax inclusion rates.

During the Budget Speech the Minister proposed no changes to the personal income tax brackets (with no adjustment for inflation). In fact, it was specifically stated that, to limit the negative impact on economic growth, the Budget proposes no increase in tax rates in any category. Instead, the Minister proposes to increase tax collections by R12,8 billion by not adjusting tax brackets for inflation.

The Budget stated that tax administration problems partly explain poor revenue-collection. The proposal is to improve tax collections by restoring the efficiency of SARS. It was stated that, in the short-term, such improvements may be more effective in raising revenue than further substantial tax increases.

The primary, secondary and tertiary rebates will be increased by 1,1%, providing a small relief for inflation. The primary rebate will increase to R14,220, the secondary rebate will increase to R7,794 and the tertiary rebate will increase to R2,601.

The Minister proposes to increase the tax-free threshold for personal income taxes to R79,000 for taxpayers below the age of 65, R122,300 for taxpayers aged 65 years and older, and R136,750 for taxpayers aged 75 and older.

Mareli Treurnicht

TAX TREATMENT OF AMOUNTS RECEIVED BY OR ACCRUED TO PORTFOLIOS OF COLLECTIVE INVESTMENT SCHEMES (CIS)

In terms of s25BA of the IT Act, distributions of amounts that are not of a capital nature that are made by a CIS to unitholders within 12 months after they accrued to, or in the case of interest was received by a CIS, follow the flow-through principle and are deemed to directly accrue to unitholders on the date of distribution and are subject to tax in the hands of unitholders. The IT Act does not provide a definition of what constitutes an amount of a capital nature and one is required to have regard to the specific facts and circumstances as well as tests handed down by Courts to decide whether an amount is of a capital nature.

During the 2018 Taxation Laws Amendment Bill (TLAB) amendments were proposed to tax the profits of certain CISs as revenue instead of capital. It was stated that certain CISs are in effect generating profits from the active, frequent trading of shares and other financial instruments. Those CISs argue that the profits are of a capital nature and therefore not subject to income tax. This argument is based on the intention of long-term investors in the CIS. Government expressed its concern that there is no definition in the IT Act of what constitutes amounts of a capital nature and that reliance based on facts and circumstances and case law has resulted in different applications of the law.

Government therefore proposed the following changes during the 2018 legislative cycle:

- One year holding period-rule: distributions from CISs to unitholders derived from the disposal of financial instruments within 12 months of their acquisition were proposed to be deemed to be income of a revenue nature and to be taxable as such in the hands of the unitholders;
- First-in-first-out method: Where a CIS acquired financial instruments at various dates, the CIS would be deemed to have disposed of financial instruments acquired first. The first-in-first-out method would be used to determine the period that financial instruments were held for purposes of the one year holding period-rule; and
- Treatment of losses: deductions and allowances do not flow through to unitholders and amounts deemed to have accrued to unitholders are limited to amounts of gross income reduced by deductions allowable under s11 of the IT Act.

In the 2018 TLAB Response Document published during September 2018, Government stated that, in view of the fact that CISs are regulated by the Financial Sector Conduct Authority (FSCA), in order to avoid negative impact and unintended consequences as a result of the proposed 2018 TLAB amendment, Government and industry needs to be given more time to investigate and find solutions that may have less negative impact on the industry and holders of participatory interests before amendments are made in tax legislation. It was proposed that the legislative amendments be considered in the 2019 legislative cycle. It was further stated that Government continues to find ways to mitigate tax avoidance risks through regulation by the FSCA.

In the Budget it was reiterated that, after reviewing the public comments on the proposed 2018 TLAB amendments, Government decided that more time is required for it to work with industry in order to find solutions that will not negatively affect relevant groups. Government proposed to conduct a study in this regard for the 2019 legislative cycle.

Mareli Treurnicht

REVIEW OF VENTURE CAPITAL COMPANY REGIME

By way of background, the Venture Capital Company (VCC) tax regime was introduced into the IT Act in 2009. Section 12J of the IT Act encompasses the relevant legislation governing VCCs and provides for the formation of an investment holding company, described as a VCC, through which investors can provide equity funding to a portfolio of small and medium-sized enterprises (SMEs). More specifically, investors subscribe for shares in the VCC and claim an income tax deduction for the subscription price incurred. The VCC, in turn, invests in "qualifying companies".

Various legislative amendments to s12J have given rise to an increased participation in the asset class, evidenced by the increasing number of approved VCCs. To date, the South African Revenue Service's (SARS) website indicates that 152 companies have been approved as VCCs, while two have had their VCC status withdrawn.

Over the years, concerns have been raised by various stakeholders regarding abusive tax structures using the current VCC regime or investment structures outside the policy intent when the VCC regime was introduced. In order to address the administrative and technical issues obstructing the increased uptake of the VCC regime and to curb the targeted abusive tax structures, further amendments were made to the VCC regime in 2018, such as:

- the controlled group company test was amended and the definition of a "qualifying company" was extended to include a company which is not a controlled group company in relation to a group of companies in respect of which the VCC forms part. This amendment was made to clarify the policy intent that the controlled group company test is only to be applied within the VCC framework;
- the investment income threshold test in paragraph (f) of the definition of "qualifying company" was also amended to allow for the 20% investment income test to be applied for the first time during any year of assessment of that qualifying company that ends after the expiry of a period of 36 months from the date of acquisition of shares by the VCC in the "qualifying company" and every year of assessment after that; and
- in an attempt to close the various abusive schemes using the current VCC regime, the ability of a VCC shareholder having beneficial control through shares in a VCC or participation or voting rights in the underlying qualifying company was amended. In this regard, no person who holds a share in a VCC may hold, directly or indirectly, more than 50% of the participation rights or the voting rights in that underlying qualifying company.

The Budget is proposing that other aspects of the VCC regime will be reviewed as it has come to government's attention that some taxpayers are attempting to undermine other aspects of the regime to benefit from excessive tax deductions. While not specifically mentioned in the Budget, it is also anticipated that the next round of tax amendment bills will also include proposed amendments to clarify one or two minor issues arising subsequent to the amendments introduced with effect from 1 January 2019.

Although the exact proposals have not been released, this indicates National Treasury's view that the policy intent behind VCCs has always clearly been to create a pooling mechanism for investors to collectively channel funds into SMMEs and junior mining companies that are battling to get financing.

Gigi Nyanin

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REVIEW OF THE DEFINITION OF PERMANENT ESTABLISHMENT

The concept of a permanent establishment (PE) is a fundamental concept in international tax law as it establishes the right to tax business profits of non-resident entities in the country where business activities are carried out.

Typically, a tax treaty defines a PE using the following two general tests:

- whether the corporation has a fixed place of business within the target country, as defined under the language of a specific treaty; or
- whether the corporation operates in the target country through a dependent agent, other than a general agent of dependent status acting in the ordinary business as such, that habitually exercises the authority to conclude contracts on behalf of the corporation in the target country.

The current definition of PE in the IT Act is based on the definition developed by the Organisation for Economic Co-operation and Development (OECD). A PE is defined in paragraph 1 of Article 5 of the OECD Model Tax Convention (OECD MTC) as "a fixed place of business through which the business of an enterprise is wholly or partly carried on". As per paragraph two of Article 5, it specifically includes a place of management, a branch, an office, a factory, a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. It also includes a building site or construction or installation project which lasts for more than 12 months.

Specifically excluded from the aforementioned definition, in paragraph 4 of the OECD MTC, is "the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise" and "the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character".

Paragraph five of Article 5 of the OECD MTC goes on to provide that "...where a person – other than an agent of independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise ...".

Further, paragraph six of the same Article provides that "an enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business."

In November 2017, the OECD expanded this definition to include:

- an anti-abuse rule for PEs situated in third States;
- a principal purposes test rule; and
- the addition of a new paragraph to the Commentary on Article 5 of the OECD MTC which indicates that registration for the purposes of a value added tax or goods and services tax is, by itself, irrelevant for the purposes of the application and interpretation of the permanent establishment definition. In other words, this addition now explains that for the determination of whether there is a PE, one should not draw any inference from the treatment of a foreign enterprise for VAT/GST purposes, including from the fact that a foreign enterprise has registered for VAT/GST purposes.

When South Africa signed the OECD multilateral convention, it did not expand the PE definition and as a result, South African tax treaties continue to use the narrow definition of PE. However, the definition in the IT Act uses the expanded OECD definition given the reference to the OECD MTC definition.

The Budget proposes that the definition of PE in the IT Act be reviewed to determine whether a limitation is warranted.

Gigi Nyanin

CLIFFE DEKKER HOFMEYR

DOUBLE TAXATION RELIEF FOR SOUTH AFRICAN EMPLOYEES WORKING ABROAD

South African tax residents are taxed on their worldwide income, meaning that where such a person works abroad and is remunerated, this is caught in the South African tax net. If such a person works for a South African employer, an employee's tax withholding obligation exists for the employer regarding the income that resident earns for services rendered while physically abroad.

In the Taxation Laws Amendment Act, No 17 of 2017, amendments to s10(1)(o) will go into effect from 1 March 2020. These amendments limit the exemption available under this section to income up R1 million earned by a South African taxpayer while working abroad.

Prior to the amendment taking effect all remuneration earned by South African taxpayers that qualified for the exemption under s10(1)(o) was exempt from income tax, meaning that in certain cases, no employees' tax withholding obligation would arise. However, from 1 March 2020, where an employee earns more than R1 million in a 12-month period, employees' tax must be withheld for any further income beyond the R1 million threshold.

However, the country where the employee is deployed may also impose an employees' tax withholding obligation on the same income. Meaning that the same income would be subject to two withholding obligations, a classic example of double taxation.

The Budget therefore proposes that a provision be inserted into the IT Act, which would allow employers to reduce their amount withheld monthly for employees' tax by the amount of any foreign employee's tax withholding that applies to that income. This amendment is subject to a workshopping exercise by National Treasury and will be refined through the 2019 legislative cycle. The first workshop in this regard is scheduled to take place on 6 March 2019.

This amendment will provide vital relief for employees who work abroad, especially from a cash-flow perspective, given the increased tax burden they will face from March 2020. It also ensures that where an employee works in a country which has not concluded a double taxation agreement with South Africa, that they are not subject to double taxation.

Tsangadzaome Mukumba and Louis Botha

DOMESTIC TREASURY MANAGEMENT COMPANIES – ALIGNMENT OF TAX AND EXCON PROVISIONS

In 2013, the South African government introduced the domestic treasury management company (DTMC) regime to enable South African companies, which are registered with the Financial Surveillance Department (FSD) of the South African Reserve Bank (SARB), to expand into the rest of Africa and abroad. The DTMC regime allows South African companies to establish one subsidiary as a holding company to hold African and offshore operations, without being subject to exchange control restrictions.

When the DTMC regime came into effect on 27 February 2013, a DTMC was defined in s1 of the IT Act as a company that:

- is incorporated or deemed to be incorporated in South Africa;
- has its place of effective management in South Africa; and
- is not subject to exchange control restrictions by virtue of being registered with the FSD of the SARB.

A number of tax benefits apply to a DTMC, including the following:

- DTMCs may use their functional currency as a starting point for currency translations for tax purposes, as opposed to rands, providing relief in respect of unrealised foreign currency gains or losses. This dispensation applies to taxable income, monetary items and capital gains items; and
- the local currency of any DTMC in respect of an exchange item, not attributable to a permanent establishment outside South Africa, will be the functional currency of that DTMC in terms of s24I. Accordingly, no gains or losses should arise in respect of, inter alia, any unit of currency, any amount owing by or to that company in respect of a debt or owing by or to that company in respect of a forward exchange contract denominated in the functional currency of such company

The Budget explains that in 2017, the IT Act was amended to remove the requirement that the company be incorporated in South Africa. However, the SARB's definition in Circular 5/2013 (also dealt with in Circular 7/2013) still includes the requirement that the company must be incorporated in South Africa. As a result, the 2017 changes are not aligned with the SARB's requirements. It is proposed that the definition of "domestic treasury management company" is changed in s1 of the IT Act to reintroduce the incorporation requirement.

As a result of the above and pursuant to the proposed amendment, in order for a company to qualify as a DTMC, it will once again have to be incorporated in South Africa and be effectively managed from South Africa.

Louis Botha

PROPOSED AMENDMENTS REGARDING RETIREMENT INCOME

Below are some of the proposed amendments raised in the Budget regarding retirement income provisions in the IT Act.

Exemption relating to annuities from a provident or preservation fund

Once a member of a retirement fund retires and receives an annuity as a retirement benefit, any contributions to the retirement fund that did not qualify for a deduction when determining the member's taxable income are tax-exempt. This exemption does not apply to annuities received from a provident or provident preservation fund. To encourage annuitisation (regular payments in retirement), it is proposed that this exemption be extended to provident and provident preservation fund members who receive annuities. The exemption would apply for contributions made after 1 March 2016.

Tax treatment of bulk payments to former members of closed funds

Retirement funds are permitted to make certain extraordinary payments to their members tax free, provided that these payments are approved by the Minister of Finance in a Government Gazette notice. In 2009, the Minister of Finance issued a notice in Government Gazette No. 32005 approving retirement funds to make tax-free payments of "secret profits", "surplus calculations" and "unclaimed benefits". When the notice was issued, some deregistered retirement funds had already paid fund administrators, but the amounts were not yet paid to the affected members and/or beneficiaries. It is proposed that these payments currently held by fund administrators on behalf of deregistered retirement funds qualify as tax-free payments, provided they meet the relevant criteria.

Tax treatment of surviving spouse pensions

Members of a pension fund can deduct contributions to their retirement funds from their taxable income when determining their monthly employees' tax and annual income tax payable. Spousal pension payments received by surviving spouse are subject to employees' tax by the retirement fund. If the surviving spouse also receives a salary or other income, it is added to the spousal pension to determine his or her correct tax liability on assessment, which may result in the surviving spouse having a tax liability that exceeds the employees' tax withheld. In most cases, the surviving spouse does not foresee the additional tax liability and does not save money to settle the liability. This creates a cash flow burden and a tax debt for the surviving spouse. It is proposed that:

- Surviving spouses are provided with effective communication relating to tax and financial issues;
- The monthly spousal pension be subject to employees' tax being withheld at a specified flat rate; and
- Tax rebates should not be taken into account in the calculation of spousal pensions. Any PAYE excessively withheld as a result of this proposal will be refunded upon assessment.

Louis Botha

CONTROLLED FOREIGN COMPANY COMPARABLE TAX THRESHOLD TO BE DECREASED

The Budget noted a global downward trend in corporate taxation rates. This downward trend may lead to an unintended increase in the imputation of the net income of controlled foreign companies (CFCs) in South African shareholders' taxable income. This is despite the fact that at the inception, the CFC may have operated in a jurisdiction with rates of tax which would have met the present threshold contained in paragraph (i) of the proviso to s9D(2A)(l) of the IT Act.

Currently the proviso deems the net income of a CFC to be nil where the tax payable in the foreign jurisdiction amounts to 75% of the normal tax the company would have paid in South Africa. In the event that the so-called "high-tax" exemption applies, no income of the CFC is imputed in the hands of the South African shareholder.

The Budget proposes a reduction in the threshold to less than 75%. This would avoid the situation where a taxpayer who had set up a CFC under the assumption that the "high-tax" exemption applied, is now subject South African income tax on the basis of the change in tax policy of the foreign jurisdiction.

The Budget also notes that this reduction must be done by taking into account the risks to the tax base. This risk lies in a broader range of jurisdictions falling within the new lower threshold thereby reducing the tax base. South African taxpayers may even seek out these jurisdictions and interpose a company in a jurisdiction with favourable tax rates and trap income there, to the detriment of the South African fiscus.

Tsanga Mukumba

COMPANY LAW VS INCOME TAX LAW: AMALGAMATIONS NOW REGULARISED

One of the amendments proposed by the Budget aims to reconcile the incongruency that exists between South African company law and South African income tax law with regards to the deregistration or liquidation of companies that are involved in amalgamation transactions.

The Companies Act, No 71 of 2008 (Companies Act) makes provision for the amalgamation of companies in s113. In terms of this section, once one or more companies have amalgamated, the amalgamated companies are deemed to have been deregistered by operation of law. As such, there are no formalities that must be complied with in order for the company(s) to be deregistered.

Section 44 of the IT Act makes provision for the tax-neutral transfer of assets in an amalgamation transaction in terms of which one or more of the amalgamated companies involved in the amalgamation transaction ceases to exist after the transaction is concluded. For this provision to find application, numerous requirements must be met.

Of importance for purposes of this article is s44(13). This subsection states that the provisions of s44 will not apply to an amalgamation transaction where the amalgamated company(s) has not, within a period of 36 months after the date of the amalgamation transaction, taken the necessary steps (provided for in s41(4) of the ITA) to liquidate, wind-up or deregister itself. Section 41(4) makes provision for numerous procedures in terms of which an amalgamated company may take steps to cease its existence.

The incongruency that arises from the law as it currently stands is that s41(4) makes no provision for an amalgamated company to cease to exist by means of the company's deregistration by operation of law. As such, where a company implements an amalgamation transaction in terms of s113 and in terms of which the amalgamated companies are deregistered by operation of law, such amalgamation transaction does not qualify in terms of s41(4) of the IT Act. Consequently, the amalgamated company will not be entitled to the benefit of a tax-neutral transfer of assets provided for in s44 of the ITA.

It has been proposed that the scope of the steps prescribed in s41(4) that may be taken by an amalgamated company to ensure that the said company ceases to exist, must be extended to include the deregistration of an amalgamated company by operation of law. As such, an amalgamation in terms of s113 of the Companies Act will not preclude the amalgamated companies from benefiting from the tax-neutral position provided for in s44 of the ITA. This amendment is a welcome change as it will ensure that the Companies Act and the ITA operate in conjunction with, and in support of, each other.

Louise Kotze

VALUE-ADDED TAX

Following on the 2018 budget review in which the Minister increased the VAT rate to 15%, no further significant VAT amendments were announced.

Clearing of VAT refund backlog

In October 2018, the Minister stated in the Medium Term Budget Policy Statement that VAT refunds owing to vendors amounted to massive R41.8 billion. SARS made an effort to pay the outstanding refunds since then, which now stands at R31 billion. However, according to a SARS estimate, the outstanding refunds should be about R22 billion if uncompleted verifications and refunds withheld due to suspected fraud is taken into consideration. This effectively means that by reducing the VAT refund backlog from R41.8 billion to an acceptable R22 billion, the total expected additional revenue resulting from the increase in the VAT rate in the first year following the increase on 1 April 2018, is applied to pay outstanding VAT refunds.

Zero rated items

The list of zero-rated items will be expanded from 1 April 2019 to mitigate the effect of the rate increase on low-income households by the inclusion of white bread flour, cake flour and sanitary pads.

The proposed VAT amendments announced by the Minister are as follows:

VAT on electronic services

Revised regulations to prescribe and clarify the electronic services supplied by foreign suppliers to South African consumers which are subject to VAT were proposed in 2018, which significantly broaden the scope of 'electronic services'. However, electronic services supplied between companies in the same group are to be excluded from the scope of the regulations. In terms of the proposed definition of 'group of companies' the local recipient company must be a wholly owned subsidiary of the foreign group for the exclusion to apply. Consequently, if the local company has Black Economic Empowerment or employee incentive scheme shareholders, the exclusion will not apply.

It has been proposed that the definition of "group of companies" be amended to include companies with minority shareholders. The final regulations have not yet been published, but it is expected that they will gazetted before 1 April 2019, when they become effective.

VALUE-ADDED TAX (continued)

Transfers of long-term reinsurance policies

The provision, or transfer of ownership of a long-term insurance policy, or the provision of reinsurance in respect of a long-term insurance policy is deemed to be a financial service and is exempt from VAT.

It is proposed that the VAT Act be amended to also include the transfer of a long-term reinsurance policy in the scope of a 'financial service'. It is further proposed that certain definitions referenced in the VAT Act be aligned with the Insurance Act.

Refining of VAT corporate reorganisation rules

In line with the corporate rollover relief afforded to group companies in the IT Act, the VAT Act provides relief for group companies by deeming the supplier and the recipient for purposes of that supply or subsequent supplies, to be one and the same person. No VAT needs to be accounted for by the supplier or recipient on these supplies.

However, where a transaction takes place in terms of a s42 asset-for-share transaction, or a s45 intra-group transaction, the relief afforded by the VAT Act only applies if the transaction relates to the supply of a going concern. A transfers of fixed property between group companies may not always constitute a going concern, for example, where it is transferred in terms of a sale and lease back transaction.

This difficulty has been recognised, and it is proposed that the VAT Act be amended to clarify the VAT treatment in these instances.

VAT treatment of rental stock paid in terms of the National Housing Programme

The VAT Act will be amended to clarify the VAT treatment of payments made in line with the National Housing Programme relating to rental stock.

Reviewing s72 of the VAT Act

Section 72 of the VAT Act allows SARS in certain circumstances where 'difficulties, anomalies or incongruities' have arisen, the discretion to disregard the provisions of the VAT Act, and to make arrangements or decisions as to the application of the provisions of the VAT Act, provided that the ultimate VAT liability is not affected.

It is proposed that a constitutional review of s72 be conducted to address challenges with its application that have arisen in view of the mandatory wording of the VAT Act.

Refining the VAT treatment of foreign donor-funded projects

It is proposed that the provisions which provide relief for foreign donor funded projects be amended to clarify the criteria and the type of projects that qualify for relief, particularly where the project is sub-contracted to various contractors.

Gerhard Badenhorst and Varusha Moodaley

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory & Controversy for 2018.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

Ludwig Smith has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

EXCISABLE PRODUCTS

As is the case each year, government proposes an increase in duties and levies for excisable products.

- Tobacco and alcohol – an increase in excise duties on alcohol and tobacco products by between 7.4% and 9% in 2019/2020. Per example, the following:
  - Can of beer: increase of 12 cents to R1.74;
  - 750ml bottle of wine: increase of 22 cents to R3.15;
  - 750ml bottle of sparkling wine: increase of 84 cents to R10.16;
  - Bottle of whiskey: increase of R4.54 to R65.84;
  - Pack of 20 cigarettes: increase of R1.14 cents to R16.66;
  - Typical cigar: increase of 64 cents to R7.80; and
  - There will be no change to the excise duty on sorghum beer.

Environmental and health taxes

- Sugary beverages/Health Promotion Levy: a tax of 2.1 cents per gram is currently applied for every gram of sugar beyond the first four grams, which are levy-free. To avoid an erosion in the value of the tax due to inflation, the levy rate will increase to 2.21 cents per gram in excess of four grams of sugar per 100ml from 1 April 2019.

Fuel Taxes

- Fuel taxes will increase by 29 cents per litre for petrol and 30 cents per litre for diesel, as follows:
  - General fuel levy: Increase of 15c/litre from 3 April 2019;
  - Road Accident Fund levy: Increase of 5c/litre from 3 April 2019; and
  - The introduction of a carbon tax on fuel of 9c/litre on petrol and 10c/litre on diesel, from 5 June 2019. Diesel refunds cannot be claimed against this tax.

General

- The farming, forestry and mining industries are refunded levies paid when diesel is purchased. As this refund is intended to offset the RAF levy these users pay, but as the diesel users still receive benefits from the RAF if they experience accidents involving motor vehicles (even if the accident is off-road) it is proposed that the RAF levy diesel refund benefit for these primary production industries be limited to ensure that diesel users in these sectors equitably contribute towards their RAF indemnity.
- The carbon tax will be implemented on 1 June 2019.
- Vehicles produced locally are taxed at a higher rate than imported vehicles. To remove this anomaly, Government proposes to align the tax treatment.
- Government intends to start taxing electronic cigarettes and tobacco heating products. The National Treasury and the Department of Health will consult on the appropriate mechanisms, structure and timing of the tax.
- The fuel levy is currently imposed on petrol, diesel and biodiesel. Fossil fuels such as mineral ethanol, illuminating paraffin, aviation kerosene, liquefied petroleum gas, compressed natural gas – as well as biofuels such as bioethanol and biogas – are not subject to fuel taxation. As these fossil fuels and biofuels are not subject to RAF, but claims may be made to the RAF if vehicles using these fuels are involved in an accident, Government will review the scope and definition of fuel levy goods in the Customs and Excise Act (1964).
- SARS has compiled an excise rewrite discussion document that will be published for public comment as part of redrafting the excise duty legislative framework. The current duty-at-source system is reviewed to identify possible reforms. SARS will engage representative industry bodies and responsible Government departments on reform proposals that require refinement.

EXCISABLE PRODUCTS (continued)

- Concerns regarding duty-free shops operating within the country have been noted by government. The legislative framework governing duty-free shops will be reviewed to minimise any abuse and risks that may be occurring.
- Manufacturers and importers of alcoholic beverages must obtain compulsory tariff determinations before these beverages can be removed from the excise manufacturing warehouse or cleared for home consumption upon the first importation. Bulk wine that is removed from one excise manufacturing warehouse to another is used as an input for further manufacturing and is not the final alcoholic beverage that should be subject to the tariff determination requirement. These bulk wine removals between warehouses will therefore be exempted from the obligation.
- The 2018 Budget strengthened the fiscal marking, tracking and tracing intervention for tobacco products. Over time, the intervention will be expanded to include other excise and levy products where feasible.
- Consultations in relation to the diesel refund administration demonstrated the need for developing industry-specific provisions for each sector for a focused and effective diesel refund administration system. A proposed system will shift the basis from eligible users to eligible activities. The design of the new standalone diesel refund administration will be outlined in draft rules and notes that will be developed and published for public comment during the course of the year.
- Implementing the carbon tax requires SARS, the Department of Environmental Affairs and the Department of Energy to share client-specific information. Provisions in the Customs and Excise Act that permit information sharing with strict confidentiality will be enhanced for the purposes of carbon taxation and the associated regulation of greenhouse gas emissions and energy efficiency.
- Ad valorem taxes apply to televisions and monitors with screens larger than 45 cm, irrespective of their end use. "Smart" technology items are harder to distinguish and therefore difficult to categorise. To prevent these items from escaping ad valorem tax, it is proposed that the computer category be expanded to include any apparatus with a screen larger than 45cm.
- Ad valorem taxes on gaming consoles are currently limited to consoles that use a television screen. However, games are now displayed on many different items. It is proposed that the provisions be amended to include any external screen or surface on which gaming console images can be reproduced.
- Government will review provisions relating to duty rebates and refunds in circumstances of *vis major* (an unpreventable incident caused by a superior external force) in the Customs and Excise Act and its schedules to align them with international best practice. The review potentially follows the SCA judgment of *SARS v Encarnacao N.O.* (543/2017) [2018] ZASCA 71 (29 May 2018), in relation to rebate item 412.09 in Schedule 4 of the Customs and Excise Act, which provides guidance pertaining to what occurrences fall within *vis major* and the meaning of *'such goods did not enter into consumption'*.
- Government will consider amendments enabling the confidential disclosure of names and associated reference numbers of customs clients, as well as other information necessary to verify legitimate financial flows. The proposed amendment will align the Customs and Excise Act with the similar approach adopted in the Tax Administration Act (2011).

Additional information is available upon request.

Petr Erasmus

VARIOUS PROPOSALS REGARDING ENVIRONMENTAL TAXES

While recent presidential elections and appointments in the United States of America and Brazil breathed fresh air into the lungs of climate change denialists, in South Africa, there is still general political recognition of the negative effects of climate change. This is in line with government's ongoing commitment to the Paris Climate Agreement, which aims to keep the increase in the global average temperature to well below 2°C above pre-industrial levels.

As a result of government's undertaking to reduce greenhouse gas emissions and meet its international commitments, various specific environmental tax proposals have been announced including the announcement that carbon tax will be implemented on 1 June 2019, that the energy-efficiency savings initiative will be extended, and that the tax exemption for certified emissions reduction will be repealed. These welcome announcements should be seen within the broader review of environmental fiscal reform policy announced in the Budget. This article briefly examines some of the environmental tax proposals.

Carbon tax to be implemented on 1 June 2019

Given that it seems forever since carbon tax was first mooted in South Africa, one could be forgiven to think that it may never materialise. In particular, there have been extensive public consultations, workshops, seminars and reworkings of the proposed tax including various announcements pertaining to its proposed implementation date. However, the Minister has announced in the Budget that it will be implemented on 1 June 2019.

In short, the carbon tax will play a role in achieving the objectives set out in the National Climate Change Response Policy of 2011 (NCCRP) which focuses on the "polluter-pays principle" and aims to ensure that businesses and households take these costs into account in their production, consumption and investment decisions.

The proposed headline carbon tax is R120 per ton of $CO^{2}e$ for emissions above the tax-free thresholds. Given the above tax-free allowances this would imply an initial effective carbon tax rate range as low as R6 to R48 per ton of $CO^{2}e$. The aim of the tax is thus to reduce emissions in the medium to long term thereby ensuring South Africa's critical contribution to halting the effects of climate change.

Extension of energy-efficiency savings initiative

The energy-efficiency savings tax incentive as contemplated in s12L of the IT Act was introduced in November 2013 to offset the tax burden on industry from the introduction (or pending introduction rather) of carbon tax. In its simplest form, it provides companies with a tax deduction for energy-efficient investments, contributing to environmental goals while reducing energy costs. While the incentive was due to expire on 31 December 2019, to encourage additional investment in energy efficiency savings, government proposes to extend the incentive to 31 December 2022. During 2019, government will review the design and administration of the incentive to improve its ease of use, effectiveness and economic impact, which comes on the back of SARS issuing Interpretation Note No. 95 on 11 January 2019 pertaining to the technical application of s12L of the IT Act, read with the relevant regulations. Given the implementation of carbon tax on 1 June 2019, the energy-efficiency savings allowance will become increasingly important for carbon intensive taxpayers and the extension of the allowance should thus be welcomed.

Repeal of tax exemption for certified emissions reduction

In 2009, government introduced a tax exemption for income generated from the sale of certified emission-reduction credits. The intention was that after the introduction of carbon tax, emission-reduction credits could be used to reduce carbon tax liabilities. Given the now proposed implementation date of carbon tax on 1 June 2019, this tax exemption will be repealed from 1 June 2019 in order to avoid a double-benefit scenario, where the same emission reduction leads to both an income tax exemption and reduced carbon tax liabilities.

Holistic review of environmental fiscal reform policy

The aforementioned proposals and announcements should be seen within the context of the announcement that National Treasury will publish a draft Environmental Fiscal Reform Policy Paper in 2019, which will outline options to reform existing environmental taxes to broaden their coverage and strengthen

VARIOUS PROPOSALS REGARDING ENVIRONMENTAL TAXES (continued)

price signals. It is understood that the paper will also consider the role new taxes can play in addressing air pollution and climate change, promoting efficient water use, reducing waste and encouraging improvements in waste management. Government will also investigate a tax on "single-use" plastics including straws, caps, beverage cups and lids, and containers to curb their use and encourage recycling. It will also review the biodiversity tax incentive.

The specific announcements and proposals in the Budget pertaining to environmental taxes, including the long-awaited implementation date of carbon tax is thus a clear sign of government's steadfast commitment to the Paris Climate Agreement and environmental concerns in general.

Jerome Brink

EXPANSION OF REPORTABLE ARRANGEMENTS?

Currently taxpayers are obliged to report certain transactions which may be seen to be abusive in certain circumstances.

There are, for instance, the following:

- a company buys back shares from one or more shareholders for an aggregate amount exceeding R10 million and new shares are issued by the company within 12 months;
- the acquisition of shares in a company with an assessed loss exceeding R50 million;
- arrangements pertaining to consultancy and related services between a resident and a non-resident to the extent that the expenditure is anticipated to exceed R10 million.

However, there are still a number of offshore structures that do not need to be reported. This especially relates to the creation of foreign trusts in circumstances where the argument is that the control of the foreign trust does not vest in a South African resident. It has been announced that mandatory disclosure rules will be introduced to identify these type of structures and that they also need to be reported. Penalties will be imposed to the extent that these arrangements are not reported.

Emil Brincker

A FURTHER WIN FOR THE YOUTH

The historically high levels of unemployment among the youth in South Africa has led to the introduction of various tax incentives and benefits aimed at encouraging the employment and training of such persons. Among these is the employment tax incentive (ETI) scheme which was introduced by the Employment Tax Incentive Act, No 26 of 2013 (ETI Act).

The ETI is a temporary tax incentive aimed at encouraging employers to employ young employees between the ages of 18 and 29, as well as employees of any age in special economic zones and industries indicated by the Minister of Finance. The benefit for employers is that the ETI enables eligible employers to reduce the amount of employee's tax due by them by the ETI amount claimed.

The ETI scheme originally came into operation on 1 January 2014 and was legislated to end on 28 February 2019, after which date no further ETI credits would be claimable by any employer. A review of the ETI scheme presented the following positive outcomes:

- The employment growth rate and number of employees increased significantly in firms that claimed the ETI;
- The ETI improved employment growth rates even in firms with deteriorating employment rates, thereby demonstrating the role played by the ETI in halting job losses; and
- The retention rate of the ETI employees after the two-year eligible period has lapsed is substantial as employers are inclined to retain those employees who have gained experience and training.

Given the success of the ETI scheme, it has been proposed that the period for which the scheme applies be extended by 10 years. Employers will therefore be able to claim the ETI for qualifying employees until 28 February 2029.

A further amendment has also been proposed to cater for the effects of inflation. In this regard, it is noteworthy that the ETI is claimable in respect of employees earning income within specified income bands. From 1 March 2019, employers will be entitled to claim the maximum value of R1,000 per month for each employee earning up to R4,500, where previously this amount was R4000. The maximum monthly income earned by employees to qualify for the ETI has also increased from R6,000 to R6,500 per month.

Louise Kotze

GOVERNMENT TO INTRODUCE A GAMBLING TAX

Back in the 2011 Budget, the Minister proposed a withholding tax on gambling winnings. The Minister proposed that, with effect from April 2012, all winnings above R25,000, including pay-outs from the National Lottery, would be subject to a final withholding tax at the rate of 15%. The Minister stated that this was in line with practice in a number of other countries, including the United States of America. The aim for introducing this withholding tax on gambling winnings was to discourage excessive gambling.

In the 2012 Budget government proposed the introduction of a national gambling tax based on gross gambling revenue. The gambling tax was to be introduced with effect from 1 April 2013. The proposal at the time was for the 1% levy to fund rehabilitation and awareness raising programmes to mitigate the negative effects of excessive gambling. In the 2012 Budget the government proposed an additional 1% levy "on a uniform provincial gambling tax base. A similar base will be used to tax the national lottery".

In the 2019 Budget, the Minister announced that government intends to publish draft legislation pertaining to a gambling tax for public comment in 2019.

Mareli Treurnicht

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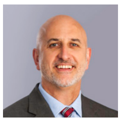

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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