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TAX & EXCHANGE CONTROL **ALERT**

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Looking abroad: Some possible insight into South Africa's forthcoming gambling tax

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CLIFFE DEKKER HOFMEYR

Increasing focus on environmental taxes in South Africa

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Climate change and global warming are issues that have long been debated. Predictions as far back as 1982 regarding increases in atmospheric carbon dioxide are proving true. While climate change and global warming are often seen as abstract issues, the impact on communities around the world is starting to become more prevalent. Closer to home for example, we have seen an increase in ever more severe tropical cyclones off the Mozambique channel and here in South Africa we are experiencing longer, more intense droughts.

Tax policy and tax mechanisms have often been seen as one of the ways in which governments can influence the behaviour of its citizens. This is no different in South Africa with the introduction of the sugar tax as a recent and quintessential example of such behavioural taxes. Given that the South African government continues to commit to various environmental agreements and undertakings in the relevant international forums, it is no wonder that the extent of environmental taxes continues to increase.

In fact, the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Economic Development (OECD) recently published a paper (OECD Paper) that shared some interesting statistics regarding revenue from environmentally related taxes in South Africa. For instance, as a share of GDP, South Africa has the 18th highest environmentally related tax revenue among 34 OECD and five partner economies. In 2014, environmentally related tax revenues were at 2.14% of GDP, compared to 2.0% on average among 39 countries.

In particular, the OECD Paper states that in South Africa, taxes on energy represented 93% of total environmentally related tax revenue compared to 70% on average among the 39 comparative countries. Some more specific statistics extracted from the OECD Paper include that South Africa has higher tax rates on transport fuels than on fuels used for heating and process purposes or electricity generation.

Given that environmental taxes are front and centre of mind at the moment, we discussed recent announcements made by the Minister of Finance in relation to environmental taxes in our Special Edition Budget Speech Alert issued on 20 February 2019. In particular, the long-awaited and much-anticipated carbon tax was announced as being implemented with effect from 1 June 2019, which may impact the ratio of taxes in South Africa on transport fuels compared to electricity generation and the like.

Furthermore, we discussed the proposed draft Environmental Fiscal Reform Policy Paper to be published by National Treasury during the course of this year, which will outline options to reform existing environmental taxes to broaden their coverage and strengthen 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.

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Increasing focus on environmental taxes in South Africa*...continued*

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Notwithstanding the ongoing developments regarding environmental taxes and the anticipated Environmental Fiscal Reform Policy Paper, it is worthwhile briefly considering and highlighting some of the key environmental taxes in South Africa today, with particular reference to the energy tax incentives and fossil fuel tax disincentives (as opposed to transport fuel taxes). Most businesses, from small to medium enterprises to large corporates, are impacted by these taxes in some way as indicated by the OECD Paper.

Section 12B allowance on renewable energy assets

Section 12B of the Income Tax Act, No 58 of 1962 (Act) is a very attractive tax incentive for taxpayers owning renewable energy assets and provides for an accelerated depreciation allowance for plant, machinery, implements, utensils and articles used in the production of renewable energy in the course of one's trade. In particular, s12B recognises the following renewable energy sources:

- Wind power;
- Photovoltaic (PV) solar energy;
- Concentrated solar energy;
- Hydropower to produce electricity of not more than 30 megawatts; and
- Biomass comprising organic wastes, landfill gas or plant material.

Section 12B also allows for a deduction in relation to improvements (other than repairs) to the aforesaid plant and machinery during the course of its expected life.

In short, while some renewable energy plants have an expected useful life of say, around twenty years, s12B allows one to claim an accelerated capital allowance of between one to three years (depending on the nature of the renewable energy). A very welcome tax incentive to invest in renewables indeed.

Section 12D deductions in respect of electricity transmission lines

Section 12D of the Act grants an allowance on the acquisition cost actually incurred by a taxpayer in respect of any new or unused "affected asset" which is owned by the taxpayer and is brought into use for the first time by the taxpayer and is used directly by such taxpayer for the purposes contemplated in the definition of "affected asset". An "affected asset" includes specifically any line or cable used for the transmission of electricity, as well as any earthworks or supporting structures forming part of such cables/ transmission lines. In respect of transmission lines/cables, the allowance is granted on the actual cost of acquisition or improvement or the cash cost in an arm's length transaction multiplied by 5% per annum. Taxpayers can therefore claim an allowance on electricity transmission lines, however, the key issue is often that such transmission lines are not owned by taxpayers, but rather by Eskom and hence this incentive is to some extent limited.

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Increasing focus on environmental taxes in South Africa*...continued*

The rationale behind the s12L allowance is that the incentive to be more energy efficient can effectively contribute towards a reduction in the demand for energy (especially electricity) thereby resulting in a reduction in carbon-dioxide emissions (given the fossil fuel intensive nature of energy production in South Africa).

Section 12L energy efficiency savings allowance

In simple terms, s12L of the Act allows any person registered with the South African National Energy Development Institute (SANEDI) to claim a deduction for energy-efficiency savings derived from activities performed in the carrying on of any trade, provided the relevant requirements of the section, read with the Regulations published under s12L(5) by the Minister of Finance (Regulations), are met.

The rationale behind the s12L allowance is that the incentive to be more energy efficient can effectively contribute towards a reduction in the demand for energy (especially electricity) thereby resulting in a reduction in carbon-dioxide emissions (given the fossil fuel intensive nature of energy production in South Africa). The reduced reliance by energy intensive industries on fossil fuel driven energy comes with the added benefit that there is less strain on the national grid and thus potentially less chance of load shedding for ordinary South Africans.

Section 12N – improvements to property not owned by taxpayers

Section 12N allows a lessee that makes improvements to another person's land to depreciate those improvements if the improvements are associated with the Independent Power Producer Procurement Programme administered by the Department of Energy. Furthermore, the allowance of depreciation for a lessee making improvements on another person's land is extended to include depreciation associated with s12B (eg energy renewal assets).

Section 12U additional deduction in respect of supporting infrastructure in respect of renewable energy

Large scale renewable energy projects such as wind farms and solar farms require extensive upfront capital expenditure. While s12B caters for the actual plant and machinery generating the renewable energy, it does not cover supporting infrastructure (such as roads, fences and the like) required to fully develop such projects. Section 12U of the Act was thus introduced with effect from 1 April 2016 to allow a specific deduction for expenditure incurred in respect of the aforementioned supporting infrastructure. Ordinarily such expenditure is of a capital nature and hence not deductible in terms of the general deduction formula set out in s11(a) of the Act and this additional incentive thus makes investment in large scale renewable energy projects more attractive.

Carbon tax

While there are various incentives regarding the investment in, construction of, and improvements to small and large scale renewable energy projects, one should also consider the impact of the soon-to-be introduced carbon tax.

In short, the pending 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.

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Increasing focus on environmental taxes in South Africa*...continued*

The various tax incentives pertaining to renewable energy projects, coupled with the pending introduction of the much-awaited carbon tax, provide for a very attractive proposition for taxpayers to invest in renewable energy.

The proposed headline carbon tax is R120 per ton of CO2e 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 CO2e. The aim of the tax is thus to alter behaviour towards carbon intensive industries and practices thereby reducing emissions in the medium to long term and ensuring South Africa's critical contribution to halting the effects of climate change.

Summation

Environmental taxes will become increasingly important in South Africa's tax framework and businesses and individuals alike should aim to keep abreast of the ongoing developments in this area. In particular, the various tax incentives pertaining to renewable energy projects, coupled with the pending introduction of the much-awaited carbon tax, provide for a very attractive proposition for taxpayers to invest in renewable energy. However, as indicated, there is a spider web of specific tax provisions to navigate to ensure that such investors implement their investments in an efficient manner and thus one would be well advised to consult relevant advisors prior to embarking upon such a project.

Jerome Brink

Looking abroad: Some possible insight into South Africa's forthcoming gambling tax

The COA was asked to pronounce on the tax treatment of "non-negotiable chips" issued by casinos (or other similar institutions) as a promotional tool and whether the use of such chips should be used to calculate an entity's liability for gaming duty.

In the 2019 Budget Speech, the Minister of Finance announced that draft legislation pertaining to the long-awaited gambling tax would be published for public comment in 2019. We discussed this announcement in our Special Edition Budget Speech Alert of 20 February 2019. The draft legislation will possibly be published with the draft Taxation Laws Amendment Bill in the next few months, but while we wait for the release of the draft legislation, we take the opportunity to consider some of the issues that have arisen with gambling tax in foreign jurisdictions.

Of particular interest is the recent judgment in *London Clubs Management Ltd v Revenue and Customs Commissioners* [2018] EWCA Civ 2210, a decision handed down by the United Kingdom's Court of Appeal, Civil Division (COA). In this case, the COA was asked to pronounce on the tax treatment of "non-negotiable chips" issued by casinos (or other similar institutions) as a promotional tool, and whether the use of such chips should be used to calculate an entity's liability for gaming duty, as referred to in the United Kingdom's Finance Act 1997 (FA).

Gambling tax in the United Kingdom

The FA regulates gambling tax in the United Kingdom (UK). The COA indicated that the provisions of the FA apply to equal chance gaming and casino games in which the chances are equally favourable to all participants.

As stated in the COA's judgment, in terms of s10(2) of the FA, the amount of gambling tax that is chargeable is calculated by applying specified tax rates to the "gross gaming yield" of the casino in the relevant accounting period. "Gross gaming yield" comprises the aggregate of the gaming receipts of the casino for the relevant period and the profits for the period if the institution qualifies as a banker as defined in the FA.

Section 11(10) of the FA provides that the aforementioned profit is the amount by which the value of the "money or money's worth of the stakes staked" exceeds the "value of the prizes provided by the banker to those taking part in such gaming".

Facts

London Clubs Management (Taxpayer) is a company that operates casinos. As a promotional tool, the Taxpayer issued selected customers with a range of means to place certain bets free of charge. The most relevant of these were non-negotiable chips. Non-negotiable chips are differentiable from cash chips as they can only be used to place bets at gaming tables and cannot be cashed in or used to pay for goods or services. If a customer places a bet with a non-negotiable chip and wins, the casino pays out the winnings in cash chips and the customer retains the non-negotiable chip. However, if the customer loses, the non-negotiable chip is retained by the casino.

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Looking abroad: Some possible insight into South Africa's forthcoming gambling tax*...continued*

In determining the value of the stakes staked for purposes of s11(10), the COA concurred with the Upper Tribunal and found that only the real-world stakes received from players, which could be included as an actual receipt in a casino's bookkeeping system, must be taken into account.

At issue in this matter was the value (if any) that should be ascribed to the non-negotiable chips in terms of s11(10) of the FA once the non-negotiable chips had been staked and lost by the customer.

After the UK's First-Tier Tribunal found in favour of the Revenue and Customs Commissioners (HMRC), the Taxpayer decided to appeal the decision to the Upper Tribunal.

On appeal, the Upper Tribunal held that the value of the stake staked was the amount that was put at risk by the player, which amount is the real amount of money or money's worth that was risked in the game and not the notional amount represented by the face value of the non-negotiable chip. The Upper Tribunal came to the conclusion that the value of the non-negotiable chips staked is nil as these chips do not represent money deposited with the casino, could not be redeemed for goods or services and could not be assigned for value.

Judgment of the UK Court of Appeal

The COA emphasised that the words contained in s11(10) of the FA were to be construed in their "real world, practical context" and not within an artificial realm of "possible or philosophical interpretations".

In determining the value of the stakes staked for purposes of s11(10), the COA concurred with the Upper Tribunal and found that only the real-world stakes received from players, which could be included as an actual receipt in a casino's bookkeeping system, must be taken into account. In this regard, it was stated that, by issuing the non-negotiable chips, the casino allows the player to bet with the casino's own money and that there is no receipt by the casino that contributes to its gross profits. Furthermore, it was found that non-negotiable chips actually constitute a contingent, non-enforceable, liability on the casino to pay out in the event that a non-negotiable chip is placed as a winning bet.

Looking abroad: Some possible insight into South Africa's forthcoming gambling tax...*continued*

One would hope that the common-sense approach followed by the COA in this matter will also be accepted by South Africa's legislature and be catered for in the draft legislation.

The value to be attributed to a non-negotiable chip must therefore be a "real-world (economic) value, objectively assessed, as opposed to a subjective value viewed from the perspective of the casino or the player". This would be the value of the stake which is put at risk by a player in a game.

> The mere fact that such a right [to place a bet] might subjectively be regarded by the holder of the [non-negotiable chip] as a valuable right, in the sense that it would enable that holder to play a game without putting money at risk, is not material to an objective valuation, in money or money's worth, of the stake staked. [...] On the other hand, the objective valuation of a stake would, in our view, have to have regard to the monetary value, if any, that could be obtained on an arm's length assignment to a third party of the right to place that stake, in the same way that it would if the [non-negotiable chip] was redeemable for cash or for goods and services.

As such, the COA found in favour of the Taxpayer by concluding that the value to be attributed to a non-negotiable chip is nil. The Revenue and Customs Commissioner's appeal was dismissed.

Comment

This UK judgment sheds light on an interesting potential issue that may be considered when drafting the proposed gambling tax legislation. One would hope that the common-sense approach followed by the COA in this matter will also be accepted by South Africa's legislature and be catered for in the draft legislation.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 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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