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TAX & EXCHANGE CONTROL **ALERT**

IN THIS **ISSUE**

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Proposed expanded access to living annuity funds: A liquidity measure in response to COVID-19

The Explanatory Memorandum on the Disaster Management Tax Relief Bill, 2020 (Revised Draft) (Revised EM)) states that "*the COVID-19 outbreak will have significant and potentially lasting impacts on the economy, with individuals facing the risk of cash flow problems or significant losses as the value of asset classes in which living annuitants are invested decrease*".

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Revised Draft Tax Bills – further relief measures and potential problems

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Following the President's announcement on 21 April 2020 that the initial tax relief measures proposed in response to effects of the COVID-19 pandemic would be broadened, on 1 May 2020, National Treasury published a number of documents giving effect to the announcement, specifically the following:

- The revised Draft Disaster Management Tax Relief Administration Bill, 2020 (Revised Draft Admin Bill);
- The revised Draft Disaster Management Tax Relief Bill, 2020 (Revised Draft Tax Relief Bill);
- The Explanatory Memorandum on the Disaster Management Tax Relief Bill, 2020 Revised Draft (Revised EM); and
- Memorandum of Objects of the Revised Draft Admin Bill.

We discussed what the additional proposed tax relief would broadly entail, in our Tax & Exchange Control Alert of 24 April 2020. In this article, we discuss some of the provisions in the revised draft tax bills.

Deferral of interim payments for micro businesses

In the first set of draft bills, provision was made for a qualifying micro business to defer 35% of its interim payments in terms of paragraph 11(4) of the Sixth Schedule to the Income Tax Act 58 of 1962 (Act) for a period of six months. The period ran from 1 April 2020 to 30 September 2020. The Revised Draft Admin Bill provides for a five-month period from 1 April 2020 to 31 August 2020.

Similarly, the first set of draft bills provided for a twelve-month period in which a qualifying micro business could pay 65% of its interim payments instead of an amount equal to the amount of tax calculated in terms of paragraph 11(4) of the Sixth Schedule to the Act. This period ran from 1 April 2020 to 28 February 2021. The revised Draft Admin Bill provides for a six-month period, running from 1 September 2020 to 28 February 2021.

The Revised Draft Admin Bill also provides that interim payments that have been deferred will be subject to penalties in terms of paragraph 11(6) of the Sixth Schedule and interest in terms of paragraphs 11(3) or (5) of the Sixth Schedule, if not paid when due.

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Revised Draft Tax Bills – further relief measures and potential problems

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Donations to the Solidarity Fund

As anticipated, the Revised Draft Admin Bill contains provisions that regulate the deduction of donations made to the Solidarity Fund. In terms of the Revised Draft Admin Bill, an employer may deduct from remuneration so much of a donation made by the employer on behalf of the employee to the Solidarity Fund either:

- during a period of three months commencing on or between 1 April and 1 July 2020 as does not exceed 33.33% of the monthly remuneration of the employee. The employer will then be issued a receipt as contemplated in section 18A(2) of the Act; or
- during a period of six months commencing on 1 April 2020 as does not exceed 16.66% of the monthly remuneration of the employee.

Another provision which regulates donations to the Solidarity Fund is found in the revised Draft Tax Relief Bill. The Draft Tax Relief Bill provides that if the total amount of deductions under section 18A exceeds the amount allowed to be deducted under section 18A(1)(B) of the Act, the portion of the excess attributable to payment or transfer to the Solidarity Fund must, notwithstanding section 18A(1)(B) of that Act, be allowed to be deducted up to a maximum of 10% of the taxable income of the taxpayer as calculated before allowing any deduction under this section.

The Revised EM explains that the tax-deductible limit in terms of section 18A for donations, which is currently at 10% of taxable income, will increase to 20% in respect of donations actually paid or transferred to the Solidarity Fund. There will, thus, be a limit of 10% for any qualifying donations (including donations to the Solidarity Fund) and an additional 10% solely for donations to the Solidarity Fund.

From a practical perspective it is not clear how the proposed amendment to section 18A will be reconciled with the proposed amendment to paragraph 2(4)(f) of the Fourth Schedule to the Act in all circumstances. For example, it is possible that an employee's donation to the Solidarity Fund will be taken into account for purposes of paragraph 2(4)(f) of the Fourth Schedule, but upon assessment of the employee's income tax liability, it then appears that the total amounts deducted for purposes of paragraph 2(4)(f), exceed the 20% total deduction limit set in terms of the amendment to section 18A. It is not clear what will happen in this scenario as section 18A states that donations in excess of the 20% limit will be carried over to the following year of assessment, but may have already been taken into account for purposes of paragraph 2(4)(f) of the Fourth Schedule to the Act.

COVID-19 disaster relief organisations

In terms of the Revised Draft Tax Relief Bill, it is now possible for non-profit companies and associations of persons to also apply for approval as public benefit organisations (PBOs) in terms of section 30 of the Act, which carry on COVID-19 disaster relief activities. Previously, only trusts could apply and obtain approval. It was curious as to why the previous bill

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Taxpayers should note that they have until 15 May 2020 to make submissions to National Treasury and SARS on the revised draft tax relief bills.

catered for the approval of trusts as PBOs and not companies nor associations of persons which in terms of the Act can on application be approved as PBOs. However, the proposed amendments to paragraph 2(4)(f) of the Fourth Schedule to the Act and section 18A of the Act (as discussed above) will not apply to donations made by taxpayers to such approved PBOs. To the extent that a person only makes donations to such an entity in excess of the 10% limit in section 18A, any amount of the donation which has been disallowed solely by reason of the fact that it exceeds the amount of the deduction allowable shall be carried forward and shall be deemed to be a donation actually paid or transferred in the next succeeding year of assessment.

Increase in the passive income limit for qualifying taxpayers

In the initial draft bills, a qualifying taxpayer was defined as a company, trust, partnership or individual that, amongst others, has a gross income of R50 million or less during the year of assessment ending on or after 1 April 2020 but before 1 April 2021. The proviso was that the gross income for the year of assessment does not include more than 10% income derived from interest, dividends, foreign dividends, rental from letting fixed property and any remuneration received from an employer. The Revised Draft Tax Relief Bill proposes that this limitation be amended as follows:

- the 10% limit on passive income be increased to 20%;
- passive income in this regard should be extended to include income derived from royalties and annuities; and
- passive rental income derived from the letting of fixed property should exclude rental income derived by a person whose main trading activity is the letting of fixed property.

Taxpayers should note that they have until 15 May 2020 to make submissions to National Treasury and SARS on the revised draft tax relief bills.

Aubrey Mazibuko and Louis Botha

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Proposed expanded access to living annuity funds: A liquidity measure in response to COVID-19

The Minister of Finance, in draft government notices, has proposed amending the rules regulating the draw down rate and full remaining value lump sum withdrawals from living annuity investments.

The Explanatory Memorandum on the Disaster Management Tax Relief Bill, 2020 (Revised Draft) (Revised EM)) states that *"the COVID-19 outbreak will have significant and potentially lasting impacts on the economy, with individuals facing the risk of cash flow problems or significant losses as the value of asset classes in which living annuitants are invested decrease"*.

In an effort to alleviate these cashflow constraints and risk of poor performance in what is often people's most important investment, the Minister of Finance, in draft government notices, has proposed amending the rules regulating the draw down rate and full remaining value lump sum withdrawals, from living annuity investments.

The current position

The relevant aspects of 'Living annuity' are defined in section 1 of the Income Tax Act 58 of 1962 as:

> *"a right of a member or former member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund, or his or her dependant or nominee, or any subsequent nominee, to an annuity purchased from a person or provided by that fund on or after the retirement date of that member or former member in respect of which -*
>
> *(a) the value of the annuity is determined solely by reference to the value of assets which are specified in the annuity agreement and are held for purposes of providing the annuity;*
>
> *(b) the amount of the annuity is determined in accordance with a method or formula prescribed by the Minister by notice in the Gazette;*
>
> *(c) the full remaining value of the assets contemplated in paragraph (a) may be paid as a lump sum when the value of those assets become at any time less than an amount prescribed by the Minister by notice in the Gazette;"*

The draw down rate – determining the amount of the annuity as per paragraph (b) of the above definition – is prescribed by GN290, Government Gazette 32005 of 11 March 2009 (GN290), as being between 2.5% and 17.5% of the total value of the assets referred to in paragraph (a) of the above definition. GN290 further prescribes that annuitants may only select a different draw down rate on the anniversary date of the inception of the annuity and at no other time.

Paragraph (c) of the above definition provides for the lump sum withdrawal of the full residual value of the invested assets where the value of those assets is below the threshold set in GN1164, Government Gazette 31554 of 30 October 2008 (GN1164). This threshold, where there has been a lump sum commutation, is R50,000 and R75,000 in any other case.

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Proposed expanded access to living annuity funds: A liquidity measure in response to COVID-19*...continued*

The proposed changes to the living annuity regime indeed provide relief, in that annuitants are given more options in terms of what they are permitted to withdraw, depending on their personal circumstances.

Proposed amendments

The draft government notices published by the Minister of Finance propose temporarily increasing the range of available draw down rates on living annuities to between a minimum of 0.5% and maximum of 20%, and for this to be altered freely by annuitants during this temporary period. The proposed period during which this is to be effective is from 1 May 2020 to 31 August 2020.

Annuitants whose anniversary date falls within this period may elect to make use of the relief provisions or adjust their draw down rate in the ordinary course. Should the relief provisions be made use of by such annuitants, their draw down rate will automatically revert on 1 September 2020 and they will only be able to make a further adjustment on the next anniversary date.

The draft government notices further propose adjusting the threshold for the lump sum withdrawal of the full residual value of a living annuity (as provided for in GN1164) to R125,000 in all cases. This amendment is intended to be a permanent change to the regime.

Comment

The draft government notices were published on 25 April 2020, for comment by 28 April 2020. It is unclear whether the date for comment may be extended, considering that comments on the revised draft tax relief bills, which were released on 1 May 2020, can be submitted until 15 May 2020. In any event, the final parameters of the amendments remain to be seen. Furthermore, it must be noted that these amendments only relate to investments falling within the definition of "*living annuity*" in section 1 of the Act, as set out above.

In their current form, the proposed changes to the living annuity regime indeed provide relief, in that annuitants are given more options in terms of what they are permitted to withdraw, depending on their personal circumstances. Retirees currently receiving payments from living annuities will be granted more flexibility in determining the rate at which they receive funds from their investment over the short term. It also allows annuitants to withdraw their entire investment should it fall below the threshold amount, which may provide much needed liquidity.

The amounts withdrawn under the proposed amendments continue to be taxed under the provisions of the Act, specifically the Second Schedule to the Act. The increased or decreased amount received as a result of a change in the draw down rate, will be included in such annuitant's "*gross income*" (as defined in section 1 of the Act). The amount received under a living annuity must be included in "*gross income*" under paragraph (a) of that definition and may be subject to certain deductions and exemptions.

The residual lump sum withdrawals are included in the taxpayer's "*gross income*", but under paragraph (e) of the "*gross income*" definition. The amount to be so included is determined under paragraph 2(1)(a)(iii) of the Second Schedule to the Act, subject to the relevant deductions contained in paragraphs 5 and 6 of the Second Schedule to the Act. Specific tax tables and tax rates (other than the normal marginal tax rate tables) apply to the amounts that accrue to the annuitant under these provisions.

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