TAX & EXCHANGE CONTROL

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Budget Speech

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REDUCTION IN CORPORATE INCOME TAX RATE

In the current pandemic effected economic climate, the announcement in the 2021 Budget (Budget) of the reduction in corporate income tax (CIT) from the current rate of 28% provides some relief to companies feeling the pinch of the economic downturn. CIT will be lowered to 27% for companies with years of assessment commencing on or after 1 April 2022 with a view to further CIT rate decreases over the medium term.

Whilst still high compared to the global average CIT rate of 23,6%, the reduction seeks to drive growth and encourage investment in the country. In order to implement the reduction in CIT, government intends on reducing the number of tax incentives, expenditure deductions and assessed loss offsets currently available to companies in order to broaden the CIT base. The proposals by the Minister of Finance (Minister) relating to the limitation of assessed losses and excessive interest deductions have been postponed to 2022 given the economic restrictions imposed during the pandemic.

In addition to facilitating a more competitive and attractive economic environment for investment, the reduction in CIT seeks to ensure that South African companies are able to financially recover from the economic challenges experienced during the pandemic, whilst preserving jobs and preventing further job losses.

This change should be welcomed by companies in South Africa and indirectly, it is hoped that the reduced rate will have a positive effect on wages and employment. If the current capital gains tax (CGT) inclusion rate of 80% for companies is also not increased when the CIT reduction takes effect, the effective CGT rate for companies will also be reduced. The announcement of potential further reduction in CIT may also be key in stimulating inbound investment over the next few years.

Keshen Govindsamy

CONTRIBUTED TAX CAPITAL

"*Contributed tax capital*" is defined in section 1 of the Income Tax Act 58 of 1962 (Income Tax Act) and is a key concept in differentiating between dividend distributions and capital distributions (also returns of capital) for tax purposes.

Essentially, and without considering some of the more nuanced rules, the contributed tax capital of a company, in relation to a particular class of shares, is the aggregate of all capital that has been paid or contributed to the company by the holders of that class of shares (as shareholders and not as creditors), less so much capital that has been returned to the holders of that class of shares.

Where a distribution reduces the contributed tax capital of a company, it would generally be considered a return of capital, and where it does not reduce the contributed tax capital, it would generally be considered a dividend. Where the amount is a dividend, it would in principle be subject to dividends tax (unless specifically exempt, as in the case where the beneficial holder is a South African resident company).

The definition of "*contributed tax capital*" contains an imported proviso, which effectively provides that a distribution to any particular shareholder in respect of a class of shares cannot reduce a company's contributed tax capital in respect of that class of shares by any percentage exceeding the percentage of shares that the shareholder holds in respect of that class of shares.

In the Budget it was mentioned that some companies are allocating special share premiums to specific shareholders, as opposed to all shareholders in that class.

While it appears that the Income Tax Act is clear on the principle, it is proposed that amendments be introduced to confirm that shareholders of a particular class must share equally in reductions of contributed tax capital in the case of capital distributions.

Heinrich Louw

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THE SUN SETS ON THE VENTURE CAPITAL COMPANY REGIME

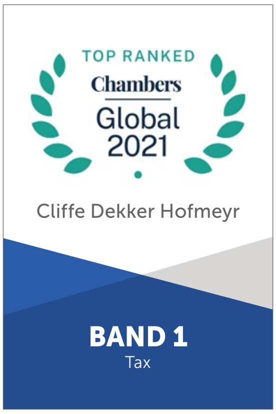
The venture capital company (VCC) tax incentive was introduced into the Income Tax Act in 2008. The regime was aimed at raising equity funding for small, medium and micro enterprises which would otherwise have struggled to attract funding due to their size and inherent risk. Investors investing in venture capital companies are allowed an upfront deduction for their investment which compared favourably to other equity investments.

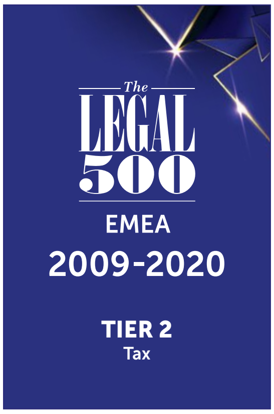
The 2008 rules contained very strict investor criteria and deductions were limited to R750,000 per tax year with individual investors also subject to a lifetime deduction limit of R2,250,000. Changes were made to the venture capital regime in 2011 to make it more attractive which resulted in natural persons and legal entities securing full deductions for investments without any monetary threshold limitation. In 2015 further changes were made to broaden the scope of the regime, which resulted in a significant uptake in the regime and making a telling investment into the economy.

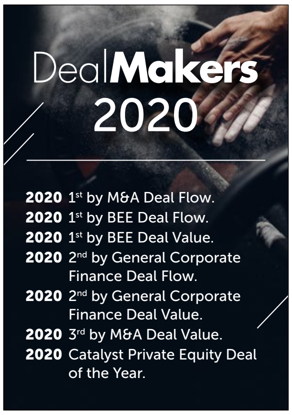
In 2019, a monetary threshold of R2,500,000 per venture capital investor was reintroduced in order to balance the benefit and perceived effectiveness of the regime.

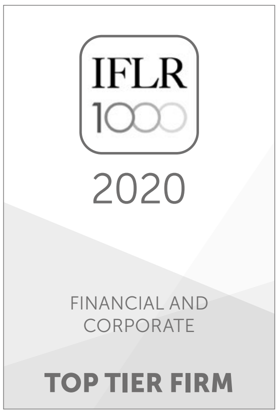
National Treasury again reviewed the VCC regime, as part of a larger process of monitoring and evaluating tax expenditures, and concluded that the incentive did not achieve its objectives. The Budget indicates that National Treasury found that the incentive raised capital for relatively low-risk investments which could have attracted funding without the incentive. Therefore, no upfront deduction will be allowed in terms of this incentive for shares acquired on or after 30 June 2021.

Dries Hoek









PROPOSED RESTRICTIONS ON THE USE OF ASSESSED LOSSES TO BE POSTPONED

In 2020, as part of National Treasury's endeavour to broaden the tax base, it was proposed that a restriction be imposed in respect of the extent to which an assessed loss carried forward by a company may be set off against the taxable income of that company in the current year of assessment (YOA). Specifically, it was proposed that the offset of the carried forward assessed loss be restricted to 80% of the taxable income of the company for that YOA, with the effect that the company would be liable to pay tax on at least 20% of its taxable income, regardless of whether the assessed loss carried forward exceeds the taxable income. This proposal was intended to come into effect on 1 January 2021.

On a similar note, in the 2021 Budget, it was reiterated that the ability to utilise assessed loss offsets would be reduced in order to facilitate the lowering of the corporate income tax rate over the medium term. It was also reaffirmed that broadening the tax base by limiting the use of assessed losses would assist the government in restructuring the corporate income tax system in a revenue-neutral manner.

However, much to the relief of corporate South Africa, it would appear that the need to assist financially distressed businesses that are suffering from the devastating effects of the COVID-19 pandemic related restrictions on economic activities has not been lost on Government.

To this end, it has been indicated that the effective date of the amendments, in respect of which the use of carried forward assessed losses will be limited, will be postponed until 2022. This postponement will no doubt be well received by many companies who have suffered significant losses as a result of the restrictions on economic activities pursuant to the national lockdown. These losses may thus be fully utilised by companies as a set off against their taxable income up until 2022 (provided the requirements of, amongst others, section 20 of the Income Tax Act are met). This postponement, coupled with the lowering of the corporate income tax rate to 27% with effect from years of assessment commencing on or after 1 April 2022 provides welcome relief.

Louise Kotze

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

Section 8F and 8FA of the Income Tax Act are anti-avoidance provisions which seek to re-characterise the taxation of interest on debt instruments issued by a company where either the debt instrument itself or the interest incurred on the debt instrument has certain equity-like features. The objective behind the section is to tax the return on the instrument in accordance with its substance (and according to what the Act deems its true nature) rather than its named form in order to avoid the deliberate manipulation of the nature of the instrument for purposes of seeking more beneficial tax implications. Stated simplistically interest on debt instruments that have equity features are required to be taxed as a return on equity (dividend) and not as interest. The existence of any qualifying equity feature in a debt instrument will, in terms of section 8F, result in the debt instrument being deemed a "*hybrid debt instrument*" whilst the existence of an equity-feature in the interest will, in terms of section 8FA, result in the interest being deemed "*hybrid interest*".

The implications of a debt instrument or interest constituting a "*hybrid debt instrument*" or "*hybrid interest*" is essentially two-fold i.e. absence the applicability of any exemption, any amount of interest incurred by the borrower company on or after the date that the debt instrument or interest becomes hybrid is:

- deemed to be a dividend in specie in respect of that share that is declared and paid by that borrower company to the lender and is taxed accordingly; and
- not permitted to be claimed as a deduction by the borrower company.

What this means is that where section 8F or 8FA are triggered, the borrower company will potentially:

- pay dividends tax on the amount of interest at the in-principle rate of 20% in terms of section 64E(1) of the Income Tax Act, if no exemption applies (for example if the lender is not a South African company); and
- will be precluded from claiming a deduction of such interest, in the ordinary course and to the extent that it was permitted to claim a deduction of interest on the debt instrument.

The Minister has contended that in its current construct, the section does not deem the interest to be a corresponding dividend in specie received by the lender. In his view, considered in the totality of the transaction, this may be overreaching as the return may still be taxable in the hands of lender as interest at the lender's applicable income tax rate. As such there could be a potential double taxation on the interest. It is proposed therefore that the Income Tax Act be amended to address this concern and to make it clear that the lender is also treated as receiving a dividend in specie. Unlike interest, the receipt of a dividend in specie by a taxpayer, is exempt from income tax in terms of section 10(1)(k) of the Income Tax Act.

On a literal interpretation of the relevant charging provisions under each section, however, it can be argued that the treatment of the interest as a deemed dividend in specie is expressly for both the borrower company and the lender. Stated verbatim, the section provides "*any amount that is incurred by a company in respect of interest on or after the date of the instrument becomes a hybrid [debt instrument/interest] is -(a) deemed to be a dividend in specie in respect of a share that is declared and paid by that company to the person to whom that amount accrued on the last day*" [our emphasis]. Notwithstanding, however, the proposed amendment for clarity on the creation of no double taxation is welcomed.

Howmera Parak and Stephan Spamer

VARIOUS REFINEMENTS TO CORPORATE REORGANISATION RULES

The corporate restructuring rules in sections 41 to 47 of the Income Tax Act are extremely useful for creating, restructuring and dismantling groups of companies. They allow for tax-neutral transfers of businesses and shares, amalgamations, unbundlings and liquidations. Each rule has specific clawback and ring-fencing provisions that can be triggered after the deal is concluded. Some of these clawback and ring-fencing periods last for 18 months, others for six years and the rest last forever. There are anomalies in the current rules, as some of these clawback and ring-fencing provisions result in double tax, while others are easily avoided by using the corporate rules in a certain sequence. The Minister has therefore proposed the following changes as discussed below.

Changes to the asset-for-share rule

A taxable gain can still be triggered under the value-shifting rule where an asset is exchanged for shares in a company under the asset-for-share rule. This can lead to double taxation as the asset-for-share rule does not allow for a corresponding increase in the base cost where the value-shifting rule has applied. It is therefore proposed that the base cost be increased in these circumstances.

An asset can be transferred to a company, partly for the delegation of certain qualifying debt and partly for the issue of shares. The transferor's full base cost for the asset carries over to the base cost of the shares, without any reduction for the amount of the debt that was delegated. However, when the shares are sold to someone that falls outside the transferor's group of companies, the transferor must add the face value of the delegated debt to its CGT proceeds. The additional CGT proceeds can be avoided if the shares are transferred again under the corporate restructuring rules, before they are sold to someone outside the transferor's group. It is proposed that the additional CGT proceeds will be carried forward until the shares are sold to someone that falls outside the transferor's group.

Changes to the intra-group transaction rule

The intra-group transaction rule provides that where an asset is transferred from one company to another company in the same group, and the transferee company sells the asset within 18 months of such transfer, the resultant gain or loss must be ring-fenced from the transferee's other gains or losses. This means that the transferee cannot set off the gain (from selling the asset) against any other capital loss or assessed loss in the hands of the transferee. This ring-fencing provision only deals with an inherent gain at the date of the intra-group transaction, combined with an actual gain at the date of sale. It is ambiguous where there is an inherent gain at the date of the intra-group transaction and an actual loss at the date of sale. It is proposed that the ring-fencing provision be amended to remove this ambiguity.

The intra-group transaction rule also provides for a clawback where the transferor company and the transferee company cease to form part of the same group of companies within 6 years. The clawback occurs in the hands of the transferee. However, if the de-grouping occurs within 18 months and the transferee company also sells the asset within 18 months, both the de-grouping clawback and the ring-fencing rule will apply, which is too punitive. It is proposed that if the de-grouping clawback has applied, the ring-fencing provision will not apply.

Where an asset is transferred on intercompany loan account under the intragroup transaction rule, the transferor is deemed to have nil base cost for the loan. The only time the nil base cost is ignored is where the loan is repaid within the group. This means that the transferor can never distribute or sell the loan receivable. This anti-avoidance provision endures indefinitely. It is proposed that this anti-avoidance provision is aligned to the period of the de-grouping clawback. It will therefore cease to apply after six years of the intragroup transaction, which should bring significant relief to affected companies. It is also proposed that this anti-avoidance provision ceases to apply where the asset is sold within 18 months of the intra-group transaction.

Changes to the unbundling rule

Where a company distributes shares in another company to its shareholders and some of the shareholders are disqualified shareholders for the purpose of the unbundling rule (such as a pension fund that holds at least 5% of the shares), the unbundling rule does not apply to that portion of the distribution. This means that the company will incur CGT on a portion of the shares distributed, which is unfair on the shareholders that did qualify for the tax relief. They indirectly pick up a portion of this CGT, by virtue of their shareholdings, without a corresponding increase in the base costs of their shares. It is proposed that their base costs be increased in these circumstances.

Mark Linington

CEASING SOUTH AFRICAN TAX RESIDENCY AND TAXATION OF RETIREMENT INTERESTS – MORE CHANGES

Following the amendments included in the recently published Taxation Laws Amendment Act 23 of 2020, which alter the rules regarding withdrawal of retirement benefits upon emigration from 1 March 2021, it was announced that other provisions dealing with retirement benefits may be amended. Specifically, the Budget identifies a potential anomaly arising in the context of a person ceasing to be a South African tax resident, but retaining her investment in a South African retirement fund and only withdrawing from the retirement fund when she passes away or retires from employment.

When an individual ceases to be a South African tax resident, retirement funds are not always subject to withdrawal tax in terms of the Income Tax Act. Section 9(2)(i) of the Income Tax Act is important in this context, which section states the following regarding the source of a lump sum, pension or annuity payable by a retirement fund:

> *"An amount is received by or accrues to a person within the Republic if that amount…constitutes a lump sum, a pension or an annuity payable by a pension fund, pension preservation fund, provident fund or provident preservation fund and the services in respect of which that amount is so received or accrues were rendered within the Republic: Provided that if the amount is received or accrues in respect of services which were rendered partly within and partly outside the Republic, only so much of that amount as bears to the total of that amount the same ratio as the period during which the services were rendered in the Republic bears to the total period during which the services were rendered must be regarded as having been received by or accrued to the person from a source within the Republic…"*

According to the Budget, the effect of section 9(2)(i) is that amounts from retirement funds are deemed to be from a South African source, even though the individual receiving the retirement benefit is no longer a South African tax resident. In the context of an individual who has emigrated, when that individual withdraws from the retirement fund, the retirement fund interest will be subject to tax in the other country as the individual will, in terms of the tax treaty between South Africa and the other country, be regarded as a tax resident in the other country. The provisions of the tax treaty between South Africa and the new resident country may result in South Africa forfeiting its taxing rights.

This appears to be the case if one considers, for example, the pension provisions in some of South Africa's double tax treaties with other countries, many of which are based on the OECD's Articles of the Model Convention with respect to Taxes on Income and on Capital (OECD Model Convention). Article 18 of the OECD Model Convention states that subject to the provisions dealing with remuneration received in respect of government service (article 19 of the OECD Model Convention), *"…pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State."*

To address the anomaly whereby South Africa risks forfeiting its taxing rights despite the deemed source rule in section 9(2)(i), government proposes changing the legislation as follows:

- When the individual ceases to be a South African tax resident, the retirement fund interest will form part of the assets that are subject to retirement withdrawal tax. In other words, the individual will be deemed to have withdrawn from the fund on the day before she ceases to be a South African tax resident.
- If the individual ceases to be a South African tax resident but leaves her investment in a South African retirement fund and only withdraws from the retirement fund when she dies or retires from employment, the retirement withdrawal tax (including the associated interest) payment will be deferred until payments are received from the retirement fund or due to retirement.
- When the individual eventually receives payments from the fund, the tax will be calculated based on the prevailing lump sum tables or in the form of an annuity.
- A tax credit will be provided for the deemed retirement withdrawal tax as calculated when the individual ceased to be a South African tax resident.

Louis Botha

PROPOSED AMENDMENTS IN RELATION TO CONTROLLED FOREIGN COMPANIES

Controlled foreign companies (CFC) are companies where more than 50% of their participation rights or voting rights are held directly or indirectly by South African residents. The CFC regime is one of the measures put in place to tax South African residents that have majority held equity investments offshore. The provisions do this through (absent the qualification of an exemption), the imputation of the "*net income*" of the CFC (in essence, the taxable income of the CFC had it been South African resident) to the South African resident shareholders, in proportion to the interest held in the CFC. The Minister has proposed two amendments relating to CFCs as discussed below.

Amendment to the anti-diversionary provisions under the foreign business establishment exemption

Section 9D(9) of the Income Tax Act provides that the "*net income*" of a CFC that is attributable to a "*foreign business establishment*" (FBE) is exempt from the CFC imputation rules. A company will qualify as having an FBE if, simplistically, it has a fully-fledged physical business operation in a foreign jurisdiction. Section 9D(9A), however, excludes certain forms of revenue streams from the FBE exemption under the "*anti-diversionary rules*" which are aimed at not permitting passive or 'tainted income' between certain transacting parties from qualifying for the FBE exemption. The South African CFC rules currently contain three sets of anti-diversionary rules, namely, CFC inbound sales, CFC outbound sales and CFC connected person services. These CFC anti-diversionary rules are aimed at ensuring that CFC activities are not utilised by South African tax residents to shift taxable income offshore through transfer mispricing.

In 2011, the diversionary rules governing the outbound sale of goods by a CFC were abolished as it was contended by National Treasury that the transfer pricing rules could be applied instead. In 2016, National Treasury reinstated the diversionary rules for CFC outbound sale of goods due to their effectiveness in preventing base erosion and profit shifting. In its current format, the 2016 diversionary rules for CFC outbound sale of goods now provide for an exemption if similar goods are purchased by the CFC, from "*unconnected persons*" to that CFC, mainly within the country in which the CFC is resident.

The Minister has stipulated that certain taxpayers are circumventing these rules by merely entering into a contract of purchase and sale that implies that the purchase of goods took place in the country of residence of the CFC, when this is not the de facto position. In order to address this tax abuse, it has been proposed that the diversionary rules be amended to close this loophole.

Clarification between Participation Exemption and provisions relating to CFC ceasing to be a CFC

Following the relaxation of exchange controls in relation to 'loop structures' in 2020 (being reinvestments made by South African residents into South Africa via an offshore structure), a change was introduced to the capital gains tax 'Participation Exemption' contained in paragraph 64B to the Eighth Schedule of the Income Tax Act in order to curtail aggressive tax planning opportunities of taxpayers. The Participation Exemption, in essence, provides that a South African resident holding a minimum of 10% of the equity shares and voting rights in a foreign company, may disregard a capital gain or capital loss realised on the transfer of shares in the foreign company if the disposal is effected at market value to a foreign person that is not a connected person to the South African resident. Under the newly inserted paragraph 64B(6), however, a South African resident transferring shares in a CFC where the value of the CFC's assets are attributable to South African assets, is precluded from qualifying for the Participation Exemption.

Separately, section 9H(3)(b) of the Income Tax Act provides for a deemed disposal of all assets of a CFC on the date that the CFC ceases to be a CFC, in the form of an "*exit charge*". This typically results in an imputed capital gain for the South African resident beneficial shareholders, unless one of the CFC exemptions apply. Section 9H(5) of the Income Tax Act, however, excludes from the ambit of these "*exit charge*" provisions, the instance where the CFC ceased to be a CFC and the Participation Exemption applied.

To address the interaction between section 9H and paragraph 64B, it is proposed that section 9H be amended so that a partial participation exemption in terms of paragraph 64B(6) would not affect the exclusion under section 9H(5).

Howmera Parak and Stephan Spamer

HIGH NET WORTH INDIVIDUALS BEWARE

Consistent with the approach of the Revenue Authorities to bolster tax enforcement, it has been decided that a dedicated unit will be established to improve compliance of individuals with wealth and complex financial arrangements. High net worth individuals are certainly to be targeted in circumstances where, for the 2020 fiscal year, 6,554 individuals reflected taxable income in excess of R5 million.

Mostly high net worth individuals make use of complex financial structures, including trust structures which may be located within South Africa and overseas. The extent of management and control of these entities will also be considered.

It has been indicated that the first group of taxpayers have been identified and they will receive their notices during April 2021.

One can expect that the enforcement conduct of SARS will be bolstered substantially and in this context an additional spending allocation of R3 billion to SARS over the medium-term has been approved.

Emil Brincker

NO BRACKET CREEP FOR INDIVIDUAL TAXPAYERS

Bracket creep is the phenomenon where a state collects increased revenue without making increases to the tax rate. Instead the state relies on inflation to bring more individual taxpayers into higher tax brackets, resulting in an increased revenue collection. While South African individual taxpayers have been spared an increase in tax rates in the recent past, this was based on the intention that bracket creep would provide the additional revenue required by the state.

The Minister has announced that the tax thresholds and seven tax brackets for individuals will be raised by 5%. The two tables below demonstrate the brackets for 2020/21 and 2021/22:

2021/2022

Taxable Income (R)	Rates of Tax (R)
R1 – R216,200	18% of taxable income
R216,201 – R337,800	R38,916 + 26% of taxable income above R216,200
R337,801 – R467,500	R70,532 + 31% of taxable income above R337,800
R467,501 – R613,600	R110,739 + 36% of taxable income above R467,500
R613,601 – R782,200	R163,335 + 39% of taxable income above R613,600
R782,201 – R1,656,600	R229,089 + 41% of taxable income above R782,200
R1,656,601 and above	R587,593 + 45% of taxable income above R1,656,600

2020/2021

Taxable Income (R)	Rates of Tax (R)
R1 – R205,900	18% of taxable income
R205,901 – R321,600	R37,062 + 26% of taxable income above R205,900
R321,601 – R445,100	R67,144 + 31% of taxable income above R321,600
R445,101 – R584,200	R105,429 + 36% of taxable income above R445,100
R584,201 – R744,800	R155,505 + 39% of taxable income above R584,200
R744,801 – R1,577,300	R218,139 + 41% of taxable income above R744,800
R1,577,301 and above	R559,464 + 45% of taxable income above R1,577,300

The primary, secondary and tertiary rebates will similarly increase by 5% to R14,958, R8,199 and R2,736 respectively. While the medical schemes tax credit will see an inflationary increase to R322 for the first two members and R224 for all subsequent members.

The increase in the tax brackets for individuals means there will be no bracket creep this year. The Budget projects that this will provide R2,2 billion worth of relief to individual taxpayers. On the other hand, the Budget projected that had the tax brackets not been raised, bracket creep would have resulted in an additional R11,2 billion in collected revenue. The bracket increase therefore brings a welcome outcome for all taxpayers in the wake of the COVID-19 pandemic.

Tsanga Mukumba

BROADER SCOPE OF AWARDS TO QUALIFY FOR LONG SERVICE AWARD BENEFIT

Assets and other non-cash benefits received by an employee from their employer by virtue of their employment constitute taxable fringe benefits for purposes of the Seventh Schedule to the Income Tax Act (Seventh Schedule). In terms of the Seventh Schedule and paragraph (i) of the definition of "*gross income*" in the Income Tax Act, the cash equivalent of the value of the taxable benefit must be included in the gross income of the employee that receives such asset or non-cash benefit.

Paragraph 5 of the Seventh Schedule provides that the cash equivalent of the value of the taxable benefit is the extent to which the value of the asset exceeds the consideration given by the employee for the asset. The value of the asset is generally its market value on the day that it is acquired by the employee. However, if the asset constitutes movable property that was acquired by the employer in order for it to dispose of the asset to the employee, or if the asset was originally held by the employer as trading stock, then the value of the asset must be taken to be the lower of the cost of the asset or its market value.

The receipt of an asset by an employee as a reward for long service by that employee is also a taxable fringe benefit as envisioned in the Seventh Schedule. However, the value to be attributed to the taxable benefit arising from the long service award (in terms of paragraph 5 of the Seventh Schedule) may be reduced to the extent that the asset is awarded to an employee by reason of the fact that the employee had been employed with the same employer for:

(1) an initial unbroken period of service of at least 15 years; or

(2) any subsequent unbroken period of service of not less than 10 years.

In such an instance, the value of the asset is to be reduced by the lesser of the cost to the employer of the asset and R5,000. As such, an asset awarded to an employee as a long service award will not be subject to tax to the extent that the value thereof is R5,000 or less.

In the Budget, it has been identified that employers are awarding long service awards in a wide variety of forms that can be considered non-cash benefits in terms of the Seventh Schedule. As such, it has been proposed that the nature of long service awards, as envisioned in paragraph 5 of the Seventh Schedule, be reviewed such that a broader variety of non-cash benefits may qualify for the reduced asset value provisions of paragraph 5. To this end, the current provisions of the Seventh Schedule will be reviewed to consider other types of awards, albeit within the same limitations as currently provided for in paragraph 5.

Louise Kotze

CURBING ABUSE IN THE EMPLOYMENT TAX INCENTIVE REGIME

Statistics South Africa (Stats SA) published the results of the Quarterly Labour Force Survey (QLFS) for the fourth quarter of 2020 on 23 February 2021. On the back of the ongoing COVID-19 global pandemic, the results unfortunately do not paint a positive picture. Some of the key findings indicate that movement was proportionately more towards individuals being unemployed than employed. In fact, there was a significant increase of 1,7 percentage points in the official unemployment rate to 32,5% which is the highest since Stats SA started publishing the QLFS in 2008.

It is against this backdrop that it is worth revisiting the purpose and rationale of the Employment Tax Incentive (ETI) that was introduced with effect from 1 January 2014 and which is aimed at encouraging employers to hire young and less experienced work seekers. The ETI was thus purposefully introduced to increase employment particularly in respect of younger individuals. Despite the recent stats, government's ongoing reviews of the efficacy of the ETI regime show positive effects on growth rates of youth employment and the absence of any significant negative effects.

The way the ETI works is quite simple. If an employer is eligible to receive the ETI in respect of a qualifying employee, the employer may reduce the total amount of employees' tax generally payable to SARS thereby incentivising organisations to employ youthful job seekers.

Importantly, in order for an organisation to potentially be able to claim the ETI it must qualify as an "*eligible employer*". In addition, the eligible employer must hire a "*qualifying employee*". "*Employee*" is specifically defined in section 1 of the Employment Tax Incentive Act 26 of 2013 (ETI Act) as a natural person:

(a) who works for another person; and

(b) who receives, or is entitled to receive remuneration, from that other person, but does not include an independent contractor.

The definition of "*employee*" in the ETI Act broadly encompasses both the labour law and tax law concepts of an employee. In addition, a "*qualifying employee*" is defined in section 6 of the ETI Act with reference to various additional requirements including that the individual is 18 to 29 years old; is in possession of a valid South African identity card, Asylum Seeker permit or identity document issued in terms of the Refugees Act; has been employed by the employer on or after 1 October 2013; earns a monthly wage of at least R2,000 (where the qualifying employee was employed for at least 160 hours in a month) and receives remuneration of less than R6,500 per month.

With all tax incentives, however, comes the potential for abuse by taxpayers that utilise the incentives for narrower means that do not fall within the initial purpose and rationale behind the incentives. It would appear the employment tax incentive regime is no different. On the back of some publications in the media, the Minister announced in the Budget that some taxpayers have devised certain schemes using training institutions to claim the ETI for students. On the face of it, it would appear that these schemes (amongst other things) could be defeating the purpose of the ETI regime which was to create real employment thereby decreasing the unemployment rate.

To counter the abuse, it has been proposed that the definition of an "*employee*" be changed in the ETI Act to specify that work must be performed in terms of an employment contract that adheres to record-keeping provisions in accordance with the Basic Conditions of Employment Act 75 of 1997 (BCEA). While the specifics relating to this amendment are only expected to emerge later this year, it is interesting to note that the BCEA contains explicit provisions setting out what particulars must be included in an employment contract including (amongst others) job descriptions, place of work, ordinary work hours, leave entitlement, and period of notice. All employers utilising the ETI regime would be well advised to monitor the proposed amendments with particular reference to the proposed amendment date being 1 March 2021.

Jerome Brink

TRUSTS: MORE ANTI-AVOIDANCE RULES

Trusts are versatile legal constructs or arrangements that are often used for tax planning purposes, *inter alia* with a view to avoid estate duty on appreciating assets. However, the line is sometimes very thin between legitimate tax planning and schemes that are, at least from a policy point of view, considered unacceptable avoidance arrangements.

The list of specific anti-avoidance rules that have been introduced in relation to trusts over the years is long. These include, most notably, the introduction of section 7C of the Income Tax Act, which effectively disincentivises the transfer of an asset to a trust by a connected person on interest-free or low-interest loan account – or simply granting interest-free or low-interest credit to a trust for purposes of acquiring an asset in that trust. The amount by which the interest is less than the official rate of interest will be treated as a donation in the hands of the creditor. In addition, no deductions or losses may be claimed in respect of a disposal of such loan.

These rules have been strengthened to also cover debtor companies whose shares are held by trusts. Specifically, the rules have also been widened to include preference share funding and not only loan funding.

It was proposed in the Budget that the rules will be widened even further. The new rules will look specifically at loan transfers between trusts. Essentially, it is possible for parties to make use of multiple trusts, and by transferring loans between such trusts, theoretically avoid the application of section 7C.

We anticipate that specific amendments will be made to section 7C to address this issue.

It was also proposed in the Budget that certain changes will be made to curb certain schemes involving the cession of rights to receive or use assets. These schemes often involve trusts (although not always).

A service provider could, in principle, arrange its affairs in such a manner so as to cede a right to receive or use an asset (such as the right to receive or use an asset from a client or employer to whom services were or are to be rendered) to a trust for no consideration (such as a family trust).

Theoretically, the service provider could avoid income tax on the basis that no value could yet be attached to the right or asset at the time of cession. The service provider could also avoid donations tax on the basis that the right has no value at the time of cession. The service provider would also not be regarded as having disposed of the asset as the service provider will not at that time be entitled to the asset yet. Value would likely only arise at some later stage.

Details as to the specific amendments have not yet been revealed but it is anticipated that they could include amendments to the definition of gross income and to the donations tax provisions.

Heinrich Louw

VALUE-ADDED TAX

Owing to the detrimental effect of the COVID-19 pandemic on business and individuals alike, it has been decided that Government will not introduce measures to increase tax revenue in the Budget. In keeping with this approach, no significant VAT amendments have been announced. We nevertheless highlight some of the more technical and minor policy amendments in this article.

Zero-rating of super fine maize meal

Section 11(1)(j) of the VAT Act provides for the zero-rating of certain foodstuffs as set out in Part B of Schedule 2 of the VAT Act.

Included in the list of zero-rated food items are certain grades of maize meal including super maize meal, special maize meal, sifted maize meal or unsifted maize meal. The grading of maize products is regulated by Agricultural Products Standards Act 119 of 1990. To align the VAT Act with the Agricultural Products Standards Act, it is proposed that Part B of Schedule 2 of the VAT Act be amended to include "*super fine maize meal*" in the list of grades of maize meal that qualify for zero rating.

Measures to address undue VAT refunds on gold

Fraudulent VAT refunds relating to gold exports have been on the increase. These malpractices generally involve the import of coins, the purchasing of zero-rated Krugerrands and illicit gold. In last year's 2020 Budget Review it was noted that these schemes and malpractices had been detected and that measures would be taken to address the problem.

It has therefore been proposed that regulations providing for a 'domestic reverse charge mechanism' for the gold industry be introduced. Under the mechanism, a vendor that acquires gold from another vendor would be required to declare and pay to SARS the VAT charged on the acquisition. It is unclear at this stage as to how the regulations will operate.

Aligning the provisions of the VAT Act with the New Insurance Act

The VAT Act provides for the VAT treatment of long term and short-term insurance. The New Insurance Act 18 of 2017 (New Insurance Act) categorises insurance policies into life policies (i.e. long-term insurance) and non-life policies (i.e. short-term insurance) and also makes provision for micro-insurance.

In order to align the provisions of the VAT Act with the New Insurance Act, it has been proposed that the VAT Act be amended to make specific provision for the VAT treatment of micro-insurance.

VAT treatment of temporary letting of residential immovable property

Property developers who develop residential properties for the purpose of sale are conducting an enterprise and the sale of each property constitutes a taxable supply by the developer. The developers are accordingly entitled to claim input tax deductions on the costs incurred to develop such properties. Where a developer is unable to find a buyer, the developer may opt to let the residential property unit temporarily to generate some cash flow until such time as a buyer can be found.

The letting of residential property as a dwelling is exempt from VAT. Consequently, the temporary letting of residential units developed for sale is regarded to be a "*change in use*" of the unit for VAT purposes. The developer is then required to make an adjustment in terms of section 18(1) of the VAT Act as a means of repaying the VAT previously claimed on the development cost.

It was recognised by the Minister of Finance in his 2010 Budget Review that the requirement that developers must account for VAT on the open market value of the units temporarily let, is disproportionate to the exempt income received by the owners of the properties and that options should be investigated to determine a more reasonable method in dealing with the temporary letting of residential properties developed for resale.

Residential property developers were then afforded temporary relief with the introduction of section 18B of the VAT Act on 10 January 2012. In terms of section 18B, no change in use adjustment was required to be performed until the expiry of a 36-month relief period which commenced from the time the property was first let, or at the time when the property was applied permanently for letting as a dwelling as contemplated by section 18B(3). It was stated in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011 that section 18B was introduced as a short-term measure to the cash flow problem faced by developers, whilst seeking a more permanent solution. Notwithstanding that no permanent solution was found to the problem faced by residential property developers, the temporary relief provided under section 18B ceased to apply on 1 January 2018. Consequently, with effect from 1 January 2018, residential property developers are once again required to perform the change in use adjustment in terms of section 18(1) on the open market value when the unit is let as a dwelling.

It is proposed that the problem facing residential property developers be considered once again and that the VAT Act be amended to resolve this matter.

Varusha Moodaley and Gerhard Badenhorst

CUSTOMS & EXCISE

EXCISABLE PRODUCTS

As is the case each year, Government proposes an increase in duties and levies for excisable products in Schedule 1 Part 2A to the Customs and Excise Act 91 of 1964 (Customs Act).

Of relevance this year are the following:

TOBACCO AND ALCOHOL (EXCLUDING TRADITIONAL AFRICAN BEER):

Specific excise duties on alcoholic beverages and tobacco products will increase by 8% from 24 February 2021. Per example, the following:

Product:	Increase:
Malt beer	14c per 340ml can
Unfortified wine	26c per 750ml bottle
Fortified wine	44c per 750ml bottle
Sparkling wine	86c per 750ml bottle
Ciders and alcoholic fruit beverages	14c per 340ml can
Spirits	R5,50 per 750ml bottle
Cigarettes	R1,39 per packet of 20
Cigarette tobacco	R1,57 per 50g
Pipe tobacco	47c per 25g
Cigars	R7,71 per 23g

The policy framework for both alcohol and tobacco will be reviewed during 2021/2022.

TRADITIONAL AFRICAN BEER:

As was the case last year, there will be no change to the excise duty on traditional African beer.

PRODUCTS COMPARABLE TO CIGARETTES:

Products comparable to cigarettes which are normally sold in packs of 10/20 sticks will be taxed accordingly, while other products will be taxed by weight. The rate (75% of the rate applied to a pack of cigarettes) is unchanged from the 2020 Budget.

These excise duties will be as follows from 24 February 2021:

Product:	Duty/increase:
Products intended for inhalation without combustion, put up for retail sale in the form of sticks	R7,05/10 sticks
Other	R880,88/kg
Other cigarette tobacco substitutes	Increase from R391,06/kg to R422,34/kg
Other pipe tobacco substitutes	Increase from R231,69/kg net to R250,22/kg net
Other	Increase from R815,63/kg to R880,88/kg

CUSTOMS & EXCISE...CONTINUED

FUEL TAXES:

Fuel taxes will increase as follows:

- General fuel levy will increase by 15 cents per litre to:
  - R3,85 per litre of petrol; and
  - R3,70 per litre of diesel.
- Road accident fund levy will increase by 11 cents with effect from 7 April 2021 to R2.18 per litre for both petrol and diesel.

CARBON TAX:

- The carbon tax rate increased by 5,2% (from R127 to R134 per tonne of carbon dioxide equivalent) from 1 January 2021.
- The levy for 2021 will increase by 1c from 7 April 2021 to:
  - 8c/litre for petrol; and
  - 9c/litre for diesel.
- Government intends to phase out the carbon budget allowance of 5% provided under the carbon tax regime.

GENERAL:

- Bio-based plastic bags:
  - Government intends to differentiate levies on fossil-based and bio-based plastic bags. Plastic bags are currently taxed at 25c/bag.
  - A reduced levy of 12,5c/bag will apply to bio-based plastic bags.
- Postponing the collection of export taxes on scrap metal:
  - Last year export tax on scrap metals was introduced in the Customs Act, which was intended to take effect from 1 March 2021.
  - Government proposes that the effective date of the export tax on scrap metals be postponed to 1 August 2021.
- Clarifying the regulation and reporting of consolidated air cargo for exports:
  - Section 6(1)(hC) of the CustomsAct authorises SARS to make rules prescribing the places where de-grouping depots may be established, to which air cargo may be removed from a transit shed before due entry for certain activities.
  - The provisions, however, do not currently contemplate the consolidation of air cargo at de-grouping depots for export.
  - It is proposed that section 6(1)(hC) be amended to regulate such instances.
- Amending the accreditation system:
  - SARS is amending the current accreditation system to more closely reflect the requirements of the SAFE Framework of Standards issued by the World Customs Organisation.
  - The Customs Act is proposed to be amended accordingly.
- Adjusting the minimum thresholds for payment of refunds and underpayments of duties:
  - Section 76(5) of the Customs Act makes provision for the minimum thresholds for the payment of refunds by SARS, which are 50 cents for goods imported by post, R5 for goods imported and R2 in the case of excisable goods.
  - In turn, section 47(1) provides for the same minimum thresholds in respect of underpayments of customs duties by taxpayers.
  - To ease the administrative burden on SARS and taxpayers, it is proposed that these minimum thresholds be increased.
- Clarifying provisions dealing with less serious offences and punishment:
  - Under section 79(1)(e) of the Customs Act, anyone who pretends to be an officer is guilty of an offence and liable on conviction to a fine or imprisonment.
  - The Customs Act does not specifically deal with the unlawful use or possession of a customs uniform as an offence.
  - It is accordingly proposed that section 79 be amended to include this as an offence.
- Progress with the review of the diesel refund administration:
  - The 2020 Budget announced the intention to refine the first draft of the diesel refund notes and rules to the Customs Act which was published for public comment in early 2020. These public consultations were postponed as a result of the COVID-19 pandemic and resultant lockdown restrictions.
  - SARS revised the draft legislation to incorporate relevant comments and technical inputs received from various stakeholders. The second draft was published on 9 February 2021 for public comment and will, where necessary, be informed by virtual industry-specific consultations during the year.

Petr Erasmus

REVIEW OF VOLUNTARY DISCLOSURE PROGRAMME – CHANGE AFOOT?

Since South Africa introduced the principle of worldwide taxation in 2001, a number of so-called "*tax amnesty*" programmes have seen the light of day. A number of these amnesty programmes were focused on encouraging South Africans to declare and regularise their offshore income and assets, including the 2003 tax amnesty and the special voluntary disclosure programme (SVDP), which was in place between 1 October 2016 and 31 October 2017. A more permanent fixture in this regard has been the voluntary disclosure programme (VDP), which came into effect on 1 October 2012 and is contained in Chapter 16, Part B of the Tax Administration Act 28 of 2011 (TAA).

Under the VDP, any default committed in respect of any tax, except customs and excise taxes, can be declared, with a successful VDP application resulting in the following tax relief being granted to the applicant:

- An agreement by SARS not to pursue criminal prosecution for tax offence arising from the default declared in the VDP application;
- Relief from understatement penalties that would have arisen from the default; and
- 100% relief in respect of an administrative non-compliance penalty that was or may be imposed under Chapter 15 of the TAA or a penalty imposed under a tax Act, except a penalty imposed for the late submission of a return. Examples of non-administrative compliance penalties are penalties relating to the underpayment of employees' tax or provisional tax.

In practice, the successful VDP applicant will therefore only need to pay the tax that becomes payable pursuant to the declaration of the default and any interest imposed in respect of such tax.

In the 2021 Budget, it was announced that the VDP provisions *"...will be reviewed in 2021 to ensure that they align with SARS' strategic objectives and the policy objectives of the VDP."* The 2021 Budget does not indicate exactly what the review will entail, but it is hoped that the review will result in certain changes being made to the VDP provisions in the TAA and that this will not spell the end of the VDP.

It is interesting to note that this announcement of the review arrives on the back of the following happening in the last 12 months:

- In June 2020, SARS facilitated a workshop with tax practitioners during which practitioners were given an opportunity to raise some of the challenges they've encountered with the VDP process and to raise their concerns, including regarding SARS' interpretation of the VDP provisions;
- On 25 August 2020, the Gauteng Division of the High Court, handed down judgment in the matter of *Purveyors South Africa Mine Services (Pty) Ltd v CSARS* [2020] ZAGPPHC (25 August 2020). In this matter, the court was called on to interpret the voluntariness requirement in section 225 of the TAA and held that in the circumstances of that case, the voluntariness requirement had not been met by the taxpayer; and
- In *Medtronic International Trading SARL v CSARS* (33400/2019) ZAGPPHC (15 February 2021), it was held that even though the VDP provisions in the TAA did not grant relief in respect of interest on the additional tax payable pursuant to the successful VDP application, it does not prohibit a successful VDP applicant from requesting the remittance of the interest. It is important to note that the judgment dealt specifically with a request for remission of interest in terms of section 39(7) of the VAT Act, pursuant to the declaration of a VAT default under the VDP.

It is hoped that the review process will provide tax practitioners and the public with a further opportunity to engage meaningfully with both SARS and National Treasury, with the result being a VDP process and legislation that gives effect to its purpose.

Louis Botha

CLIFFE DEKKER HOFMEYR

SECTION 18A TAX DEDUCTIBLE DONATIONS TO PBOs UNDER THE SPOTLIGHT

Non-profit organisations (NPOs) play a critical role in their communities and broader society by sharing in the responsibility of Government to pursue the social and developmental needs of South Africa. Certain NPOs can qualify as public benefit organisations (PBOs) which entitles them to a preferential tax regime. Most PBOs are dependent on donor funding and some of them are able to encourage such funding by being able to issue section 18A tax deductible receipts which entitles the donor to claim an income tax deduction.

In broad terms, entities that can issue section 18A tax deductible receipts include, amongst others:

- entities that are approved PBOs in terms of section 30 of the Income Tax Act and which conduct public benefit activities (PBAs) listed in Part II of the Ninth Schedule to the Income Tax Act (Activities PBOs); and
- entities that are approved PBOs in terms of section 30 of the Act and which donate funds or assets to, amongst others, Activities PBOs that conduct activities listed in Part II of the Ninth Schedule to the Income Tax Act (Conduit PBOs).

In recent years, Government has identified certain abuse within the PBO regime and has been increasingly implementing additional tax law amendments and compliance mechanisms for purposes of maintaining the sanctity of the critically important regime. For instance, the most recent Tax Administration Laws Amendment Act 24 of 2020 (TALA, 2020), introduced sanctions in the event that audit certificates (evidencing compliance with section 18A) are not adequately obtained, retained and submitted to SARS by the relevant PBOs.

Following on from this it was announced in the Budget that SARS has detected that receipts are being issued by entities that are not approved to do so. In this regard, to ensure that only valid donations are claimed and to enhance SARS' ability to pre-populate individuals' returns, it has been proposed that the information required in the section 18A tax deductible receipts be extended. Furthermore, section 18A-approved PBOs will in future need to comply with SARS third-party reporting mechanisms in respect of the receipts issued. It is clear that PBOs remain under the spotlight and PBOs would be well advised to continuously monitor and keep abreast of developments in this regard.

Jerome Brink

REVIEW OF ADVANCE TAX RULING SYSTEM TO PROMOTE TAXPAYER CERTAINTY

The purpose of the Advance Tax Ruling (ATR) system provided under the TAA, is to promote clarity, consistency and certainty regarding the interpretation and application of any tax legislation. An ATR may take the form of a Binding Private Ruling, Binding Class Ruling or Binding General Ruling issued by SARS pursuant to a taxpayer's application for a ruling made in the prescribed format and manner in relation to a proposed transaction. Essentially rulings provide certainty to taxpayer applicants regarding interpretational conundrums.

As part of its objectives in the Strategic plan 2020/21 – 2024/25, National Treasury and SARS are motivated to increase taxpayer certainty and have taken the initiative to review and improve upon the ATR system through public engagement. In accordance with SARS' statement issued on 15 January 2021, taxpayers, tax practitioners as well as professional associations were called upon to submit their comments and recommendations for improvement on the current ATR process, for consideration by SARS. The deadline for submission was 12 February 2021.

Following the Budget, taxpayers are encouraged to apply to SARS to obtain rulings in terms of the ATR system. In addition, SARS has invited public comment on the ATR process for binding rulings to assess whether it can be improved. Owing to SARS' objective, it has further been stated that legislative amendments may be required to give effect to improvements identified during the consultation process.

Members of the public should continue to engage SARS on this initiative as it should ultimately lead to improved administration of taxes. In addition, taxpayers will better understand the tax implications that will arise from their proposed transactions and have certainty in relation to the tax treatment of their affairs. Once the improvements are identified and the required legislative amendments are in place, this will hopefully eliminate the shortcomings of the ATR system and define the rights and responsibilities of SARS as well as of the taxpayer applicant.

Ursula Diale-Ali

THE PURSUIT OF DE-CARBONISATION – FURTHER PROPOSED CHANGES IN RELATION TO CARBON TAX

In 2020, South African businesses had to pay carbon tax for the very first time. Considering the relative novelty of the Carbon Tax Act 15 of 2019 (Carbon Tax Act), it is understandable that there would be some interpretive challenges and that the amendments would need to be made to assist taxpayers. According to the Budget, it is proposed that the Carbon Tax Act be amended in the following respects, amongst others:

- **Clarifying renewable energy premium beneficiaries:** Concerns have been raised that the Carbon Tax Act is unclear as to who is eligible for the renewable energy premium tax deduction. To address this concern, it is proposed that section 6(2)(c) of the Carbon Tax Act is amended to clarify that only entities that conduct electricity generation activities and purchase additional renewable energy directly under the REIPPP programme or from private independent power producers with a power purchase agreement are eligible to claim the tax deduction for their renewable energy purchases. A formula for calculating the premium is also proposed and it is proposed that the amendment is effective from 1 January 2021.
- **Aligning fugitive emissions activities under the Carbon Tax Act:** When the Carbon Tax Act was amended in 2019, IPCC Activity code 1B3 for other emissions from energy production was unintentionally excluded from section 4(2) of the Carbon Tax Act, which sets out formulae for the calculation of, amongst others, carbon tax payable as a result of fugitive emissions. To ensure alignment between sections 4(1) and 4(2) of the Carbon Tax Act, it is proposed that an additional category be included under the Carbon Tax Act to cover the IPCC doe 1B3 activities for other emissions from energy production.
- **Clarifying the definition of carbon capture and sequestration:** Amendments are proposed to prevent double benefits for the same sequestered emissions and to address concerns about the permanence of sequestered emissions in harvested wood products and the robustness of the available emissions calculation methodologies.
- **Progress on waste tyre greenhouse gas (GHG) emissions:** Currently, schedule 1 of the Carbon Tax Act is aligned with the technical guidelines of the Department of Environment, Forestry and Fisheries (DEFF), which do not include emission factors for waste tyres. The DEFF will develop appropriate emission factors for waste tyres for possible inclusion in the 2022 Budget.
- **Aligning schedule 2 emissions activities and thresholds with the GHG regulations of the DEFF:** In September 2020, the DEFF gazetted the amended National Greenhouse Gas Emission Reporting Regulations, including new activities required to report emissions and changes to emissions reporting thresholds. To ensure alignment between the activities covered under the Carbon Tax Act and the amended regulations, certain changes are proposed to schedule 2 of the Carbon Tax Act, with effect from 1 January 2021.

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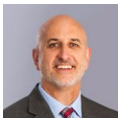

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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