TAX & EXCHANGE CONTROL

CDH INCORPORATED

SPECIAL EDITION

ALERT BUDGET SPEECH

21 February 2024

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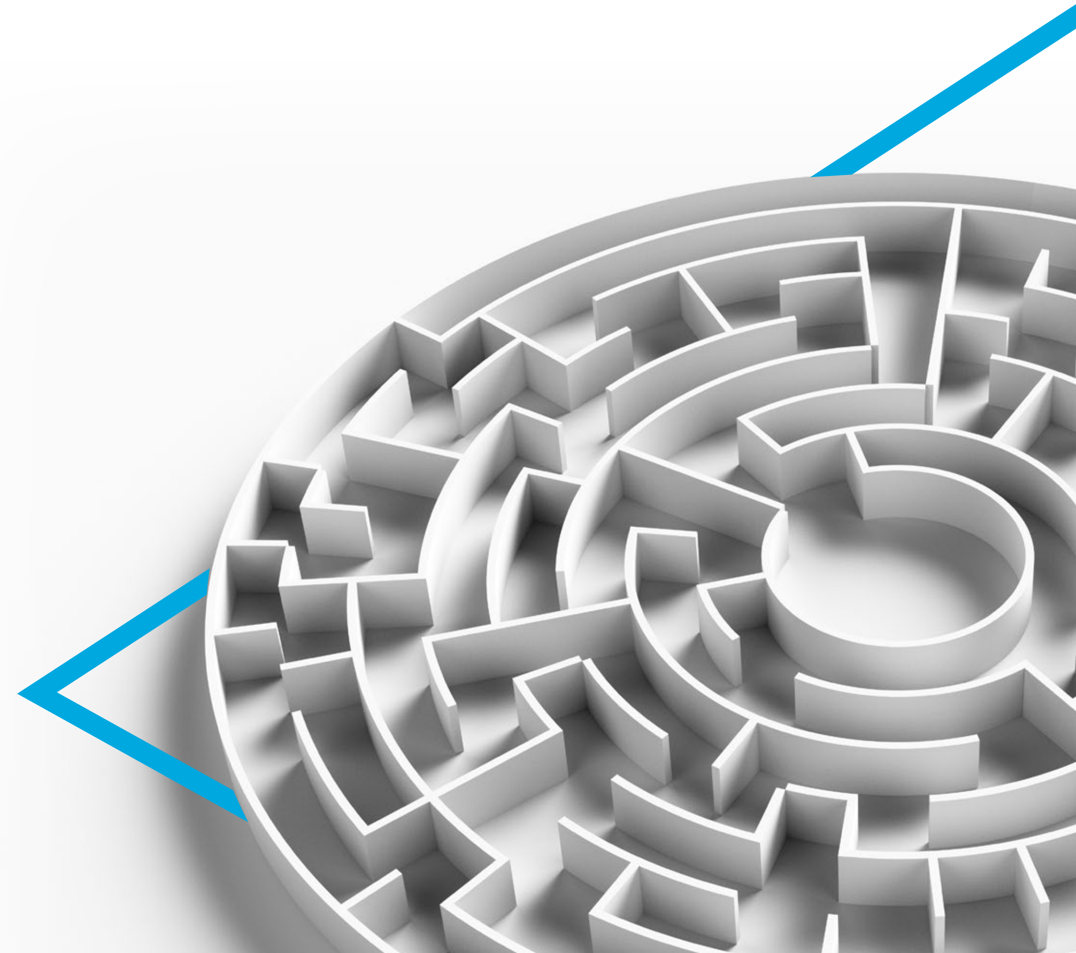

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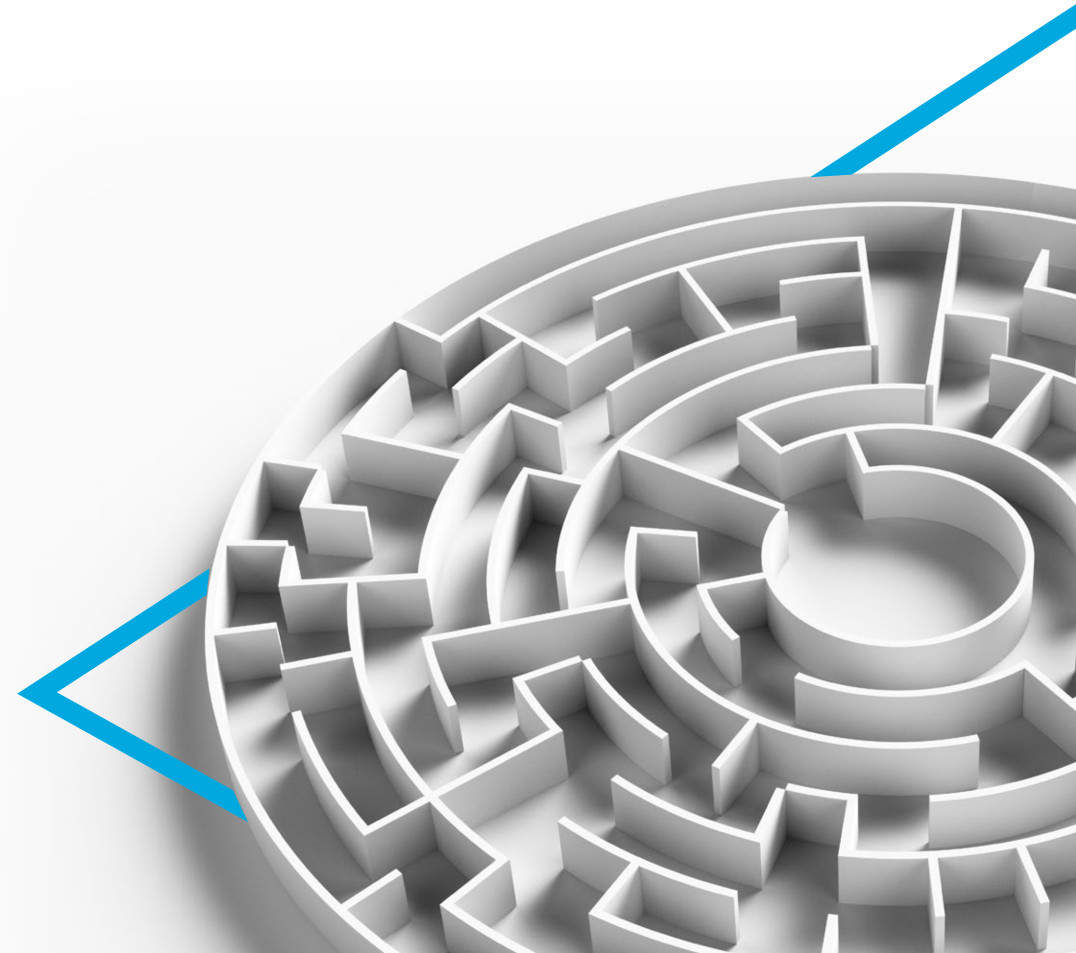

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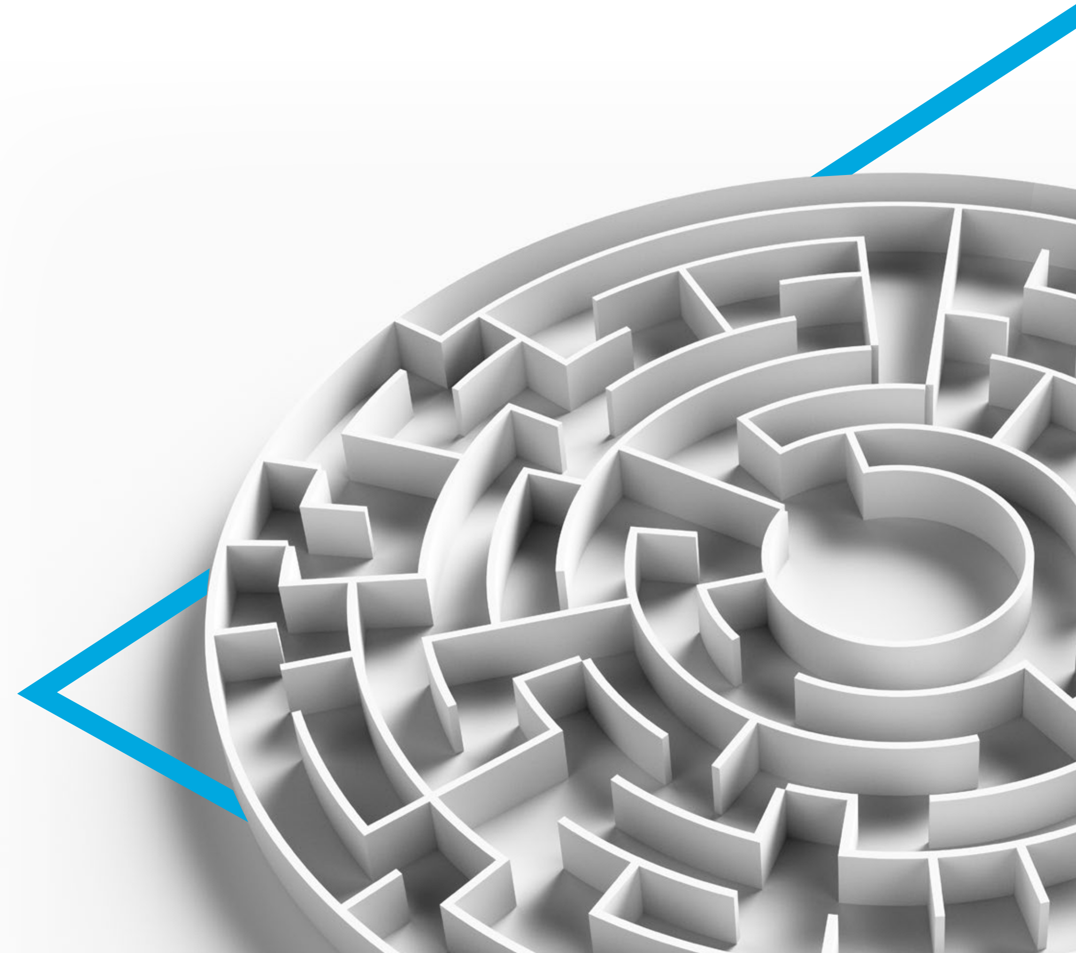
Definitions

Abbreviation	Full reference
Budget	2024 Budget
Carbon Tax Act	Carbon Tax Act 15 of 2019
Customs Act	Customs and Excise Act 91 of 1964
ITA	Income Tax Act 58 of 1962
Minister	Minister of Finance
SARS	South African Revenue Service
TAA	Tax Administration Act 28 of 2011
VAT	value-added tax
VAT Act	Value-Added Tax Act 89 of 1991



Pillar 2 has arrived in South Africa!

The release of the highly anticipated discussion document for South Africa pertaining to the implementation of Pillar 2 has not disappointed. Apart from the administrative burden on South African multi-national entities (MNEs), South Africa was one of the more than 130 countries that agreed during October 2021 to implement a minimum 15% corporate tax rate for MNEs with a global turnover in excess of €750 million. This is part of the two-pillar approach that arose out of the Base Erosion and Profit Shifting (BEPS) project of the Organisation for Economic Co-operation and Development (OECD) that aims to end "*the race to the bottom*" on tax rates that has been published as part of the efforts to tax the digital economy framework.

Even though the implementation of Pillar 2 is not limited to the digital economy as such, it is aimed to implement a minimum effective tax rate of 15% throughout the entities.

As of January 2024, 37 countries have adopted legislation to implement Pillar 2. However, the OECD has agreed that the Under Taxed Profits Rule (UTPR) can only become effective in 2025. Ironically, however, the US Congress has not yet adopted any similar legislation. Even though the Biden Administration supports the agreement, the relevant amendments have been omitted from the relevant legislation.

Those countries that have effected legislation have decided to implement same with effect from 1 January 2024. Amongst others, 18 EU members have adopted legislation to that effect, even though the EU announced infringement decisions against 9 other EU member states that have not impacted domestic legislation yet to implement Pillar 2. These countries have been given a two-month period to respond and finalise their legislation.

The starting point in determining the effective tax rate (ETR) of an MNE group is the financial statements. However, a very complex calculation needs to be done to adapt these numbers in order to ultimately determine the profits of an MNE. Adjustments to the financial accounts have been kept to a minimum and are mainly focused to address permanent differences, for instance to remove dividends and equity gains and to remove expenses that are disallowed for tax purposes. Rules have also been prescribed to address temporary differences.

Pillar 2 has arrived in South Africa! *...continued*

The OECD released a working paper on 9 January 2024 that, amongst others, indicates that the implementation of Pillar 2 will result in amongst others:

- the reduction in profit shifting by approximately half from US$698 billion to US$356 billion;
- the reduction in low-taxed profits on a worldwide basis; and
- the boosting of corporate income tax revenues by an average of US$155 billion to US$192 billion annually.

It is noted that the Pillar 2 model rules do not apply to government entities, international organisations and non-profit organisations, nor do they apply to entities that meet the definition of a pension, investment or real estate fund.

Effectively MNEs must calculate their ETR for each jurisdiction where they operate, and pay a top-up tax for the difference between their ETR per jurisdiction and the minimum 15% rate. Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the MNE, for instance South Africa, if the holding company is located in South Africa.

The minimum ETR of 15% is achieved by two main interlocking measures and using a top-down approach, namely the:

- Income Inclusion Rule (IIR); and
- UTPR.

The IIR aims to impose a top-up tax on the parent entity of a low taxed foreign subsidiary. Under the IIR, the minimum tax is paid at the level of the parent entity, in proportion to its ownership interests in those entities that have low taxed income. Generally, the IIR is applied at the level of the ultimate parent entity, and works its way down the ownership chain.

The UTPR on the other hand serves as a backstop to ensure the minimum tax is paid where the income of a subsidiary in a low taxed jurisdiction does not result in the low-taxed income being brought into account under an IIR. In such case an adjustment is made to increase the tax at the level of the subsidiary.

However, in order to retain the taxes in the jurisdiction of the parent entity (South Africa), jurisdictions can choose to implement a so-called Domestic Minimum Tax (DMT). The DMT takes precedence over the IIR and UTPR in order to ensure that the taxes that would otherwise have been paid overseas are collected in the territory in which the profits are generated. South Africa has chosen for the tax to be levied in South Africa as opposed to the tax being levied in the country of the companies that are effectively low taxed.

The draft Global Minimum Tax Bill was released earlier today. As expected South Africa has adopted the general approach in relation to Pillar 2 on the basis that the UTPR is not immediately implemented and for South Africa to be able to collect the tax instead of the foreign low taxed jurisdiction. The thrust is thus for the taxes to be paid in South Africa as opposed to in the low taxed jurisdiction. On this basis it is estimated that more taxes will be collected at a South African level.

Emil Brincker

A few changes relating to controlled foreign companies

A controlled foreign company (CFC) is essentially a foreign company where 50% or more of its shares or voting rights are collectively held by South African residents.

A special tax regime, as set out in section 9D of the ITA, applies to CFCs and specifically the residents who hold the relevant shares or voting rights.

In terms of section 9D(2) of the ITA, the *"net income"* (or portion thereof) of a CFC is included in the income of the residents for South African income tax purposes (unless any exceptions or exemptions otherwise apply), in accordance with the resident's proportional interest.

The net income of a CFC is calculated in terms of the ITA as if that CFC were a resident.

Proposal relating to translation for hyperinflationary currencies

The net income must first be calculated in the *"functional currency"* of the CFC (usually a foreign currency) and is then translated into rand at an average exchange rate for the foreign tax year (section 9D(6)).

"Functional currency" in relation to a person is:

"[T]he currency of the primary economic environment in which the business operations of that person are conducted" and in relation to a permanent establishment of any person *"the currency of the primary economic environment in which the business operations of that permanent establishment are conducted."*

Section 24I of the ITA and Paragraph 43 of the Eighth Schedule to the ITA applies to CFCs and must in principle be used to calculate the net income of the CFC by including gains or losses on exchange items.

Chambers Global 2024 Results

Tax & Exchange Control

Chambers Global 2018–2024 ranked our Tax & Exchange Control practice in: **Band 1**: Tax.

Emil Brincker ranked by Chambers Global 2003–2024 in **Band 1**: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in Chambers Global 2022–2024 for Tax: Indirect Tax.

Stephan Spamer ranked by Chambers Global 2019–2024 in **Band 3**: Tax.

Jerome Brink ranked by Chambers Global 2024 as an "**Up & Coming**" tax lawyer.

A few changes relating to controlled foreign companies*...continued*

In this regard section 9D(2A)(k) is relevant, which provides that:

"[F]or the purposes of section 24I and paragraph 43 of the Eighth Schedule, 'local currency' of a controlled foreign company otherwise than in relation to a permanent establishment of that controlled foreign company, means the functional currency of that company".

While the analysis is somewhat technical, the upshot is that where a CFC holds an exchange item that is neither attributable to a permanent establishment inside or outside of South Africa, the local currency is the functional currency, and it effectively means that no gain or loss is determined in relation to items denominated in the functional currency (there is no exchange item).

If it is denominated in a currency other than the functional currency, exchange differences may arise.

In terms of the proviso to section 9D(6) of the ITA, any exchange item denominated in a currency other than the functional currency is deemed not to be attributable to any permanent establishment of that CFC if the functional currency is a currency of a country with an inflation rate of 100% or more for the year. In other words, a hyperinflationary currency must not be used for purposes of translation (section 9D(6)).

According to the proposals in the Budget, this principle is not currently reflected in the provisions of section 9D(2A)(k) of the ITA. It is accordingly proposed that an amendment be introduced so as to not allow the use of hyperinflationary functional currencies for translation purposes.

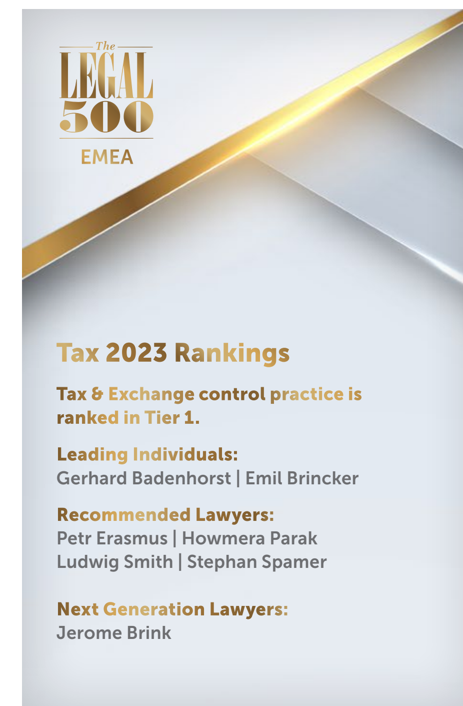
Translation of foreign taxes payable

Another proposal in respect of CFCs relates to the translation of foreign taxes payable by a CFC for purposes of ultimately determining the tax liability of the resident holder of shares or voting rights. The foreign taxes payable must be translated to rand at an average exchange rate for the year of assessment.

However, the net income of the CFC is translated to rand using the average rate for the foreign tax year of the CFC.

It has been proposed that amendments be introduced to align the years and curtail any mismatches that may result.

Heinrich Louw



Renewable energy tax incentives to be re-energised

Section 12B of the ITA deals with, amongst other things, renewable energy tax incentives. It assists companies investing in renewable energy assets with cash flow constraints through an accelerated capital depreciation allowance on qualifying assets and supporting infrastructure. Given South Africa's critical energy shortage and the global move to a greener energy mix, this tax incentive is a cornerstone of South Africa's current fiscal policy.

The Minister announced two key tax policy proposals in the Budget that will assist in clarifying certain aspects of the allowance and which will be welcomed by the industry.

Removing the distinction between energy generation thresholds eligible for the incentive

Paragraph 2 of Schedule 2 to the Electricity Regulation Act 4 of 2006 previously stated that energy systems that produced less than 1 MW of power did not need to apply for, nor hold a licence in terms of, that act. In other words, so long as the energy producing plant's capacity was below 1 MW, then it did not need to be registered. Any plant with generating capacity above 1 MW would need to follow the licensing process.

The licensing threshold for energy producing plants was also reflected in the renewable energy tax incentive in section 12B. In this context, a solar PV plant that produced less than 1 MW could be written off over a one-year period (i.e. 100% write-off in year one). Comparatively, a solar PV plant that produced more than 1 MW could only be written off over three years on a 50/30/20 basis.

However, after several calls from industry to ease red tape and open up the energy generation market, President Cyril Ramaphosa announced on 10 June 2021 that the registration threshold for self-generation facilities would be raised from 1 MW to 100 MW. On 12 August 2021 the Minister of Mineral Resources and Energy released the much-awaited exemption which raised the registration threshold for self-generation facilities from 1 MW to 100 MW.

It was previously commented that section 12B should thus be aligned with the amendments to the electricity regulations in that the 100% accelerated depreciation allowance in section 12B should not distinguish between different generation capacities of solar PV plants. In other words, given the increase in the licensing threshold for embedded power generation from 1 MW to 100 MW, one should likewise raise the thresholds in section 12B of the ITA in accordance with the amended registration thresholds, such that a larger portion of embedded solar PV projects could benefit from the incentive, thereby increasing uptake.

The renewable energy industry calls have been answered, as the Minister announced in the Budget that Government would reconsider the generation threshold in section 12B.

Renewable energy tax incentives to be re-energised*...continued*

It is hoped that the generation threshold will be removed entirely, as is the case with the current 125% temporary renewable energy incentive in section 12BA of the ITA. This will assist in ensuring South Africa's transition to renewable energy is further encouraged and will ensure fewer constraints on the unstable national grid.

Removing leasing restrictions under the section 12B allowance

Section 12B does not allow a lessor (i.e. the owner of the asset) to claim a section 12B allowance under a lease, unless one of the following requirements is met:

the lease is an "*operating lease*" as defined; or

- the lease is for at least five years and the lessee earns income under that lease.

In addition, in terms of section 23A of the ITA, a lessor is limited in claiming the section 12B allowance to the rental income earned, unless the lease is an "*operating lease*". It has been commented that these restrictions are not necessarily still fit for purpose with reference to renewable energy assets.

For example, one of the requirements of an "*operating lease*" is that the asset must be made available to be leased to the general public for a period of less than one month. From a practical and commercial perspective, many renewable energy assets cannot be leased to the general public for less than a month. For instance, it is questionable whether a hydropower plant could ever meet these requirements.

A further issue is that a finance lease type arrangement with a residential household would fall within the "*missing middle*", whereby in that scenario, no taxpayer would potentially qualify for the tax incentive.

During public consultations on section 12B's sister provision, section 12BA (the temporary increased renewable energy incentive), Government proposed applying the same treatment to finance lease arrangements as for operating leases. In this context, the distinction between finance leases and operating leases in section 12BA was removed from the final published legislation.

The Minister has now announced that similar considerations would be investigated for the permanent section 12B renewable energy allowance. This announcement is welcomed, and it is hoped that clarity, certainty and equity between commercial arrangements in this space are achieved during this process.

Jerome Brink

Don't panic, help is on the way: Incentives for electric vehicles

Climate change has been a hot topic for many years now. It is, therefore, probably understood by most (if not all) that the effects of climate change will worsen as long as greenhouse gases are added to the atmosphere. With no positive action to counteract or reduce the amount of greenhouse gas emissions, climate change extremities will worsen. As such, there is an urgent need to reduce greenhouse gas emissions and combat climate change globally.

Automotive industry and climate change in the global context

At a global level, the transport sector accounts for more than a third of greenhouse gas emissions. This has meant that the sector is amongst those that are prioritised for reducing emissions.

As such, many countries are setting pathways for reducing emissions for the various modes of transportation. In terms of road transport, policy announcements have been made by countries like the UK and political and economic blocks like the European Union (EU) for the effective ban on the sale of internal combustion energy (ICE) vehicles by 2035. Other countries have introduced carbon taxes which are set to increase over time and will contribute to achieving price parity between ICE vehicles and electric vehicles (EVs) over time.

Worldwide, incentives are playing an important role in the initial adoption of EVs and in supporting the growth of the EV manufacturing and battery industries. Other important measures being used include purchase subsidies, registration taxes, and tax rebates. Countries like Norway (1990s), the US (2008), and China (2014) were among the first to offer such measures.

Across the rest of Africa, some notable progression in EV policies have also been initiated. Morocco, for example, has introduced custom duty exemptions for EVs and VAT exemptions for importers and distributors of EVs. On the production side, EVs qualify for the standard automotive incentives, which include corporate tax exemptions for up to five years, VAT exemptions and withholding tax exemptions for dividends.

The automotive industry and climate change in South Africa

In South Africa, some studies indicate that the transport industry is South Africa's third largest source of emissions, accounting for about 11% of the total emissions. Road transport specifically, contributes 91,2% of transport emissions from the combustion of petrol and diesel.

In terms of the Green Transport Strategy (2018–2050) published by the Department of Transport, South Africa has an ambitious goal of a 5% reduction of emissions in the transport sector by 2050.

In response, South Africa's Just Energy Transition Investment Plan (JET IP, 2022) for the initial period of five years (2023–2027) identifies key areas of investment in the transport space for the transition to a greener

Don't panic, help is on the way: Incentives for electric vehicles*...continued*

economy, which includes improved and more accessible public transport, manufacturing, and EV-related charging infrastructure.

South Africa's automotive manufacturing industry

South Africa's automotive manufacturing industry contributes significantly to the South African economy; it is the fourth largest in terms of output across all manufacturing sectors and contributes materially to export revenues. In 2022, the industry contributed 2,9% to South Africa's GDP and approximately 10% to the country's manufacturing output.

As South Africa exports approximately 63% (2022) of the vehicles it produces, the country cannot

ignore global developments. The announcements by key export markets such as the EU and the UK of the effective bans on the sale of ICE vehicles by 2035, coupled with incentives aimed at increasing the uptake of EVs in these markets and a general consumer trend towards climate-friendly modes of transportation will inevitably reduce demand for many of the ICE vehicles currently produced in South Africa.

This could be catastrophic for the country's economy as the automotive industry's direct jobs account for 8% of manufacturing employment and 0,8% of total employment in South Africa. Further, the automotive industry is responsible for attracting a substantial amount of foreign investment. Between 2021 and 2022 it accounted for a total of R26,1 billion in green and brownfield investment.

In this context, it is important for South Africa to keep up with global trends and introduce policies and incentives now that will support investment in the domestic production of EVs.

Actions to drive investment in automotive manufacturing

While existing policies like the Automotive Production Development Programme (APDP) and the Automotive Investment Scheme (AIS) provide a good framework for developing EV productive capacity, including in assembly and component manufacture, additional action is required, and it needs to be implemented as soon as possible.

The Minister of Trade, Industry and Competition issued the Electric Vehicles White Paper (White Paper) in December 2023 which outlines South Africa's strategy to transition towards greater EV production and consumption in South Africa. The strategy looks to move the automotive industry from primarily producing ICE vehicles to a dual platform that includes EVs by 2035.

Don't panic, help is on the way: Incentives for electric vehicles*...continued*

The White Paper identifies 10 actions in support of the development of cost-competitive EV productive capacity in South Africa. From a tax perspective these actions include:

- the introduction of a temporary reduction on import duties for batteries in vehicles produced and sold in the domestic market, to improve cost competitiveness;
- securing or maintaining duty-free export market access for vehicles and components produced in South Africa to support the resilience of the industry; and
- leveraging research and development tax incentives to deepen domestic value addition.

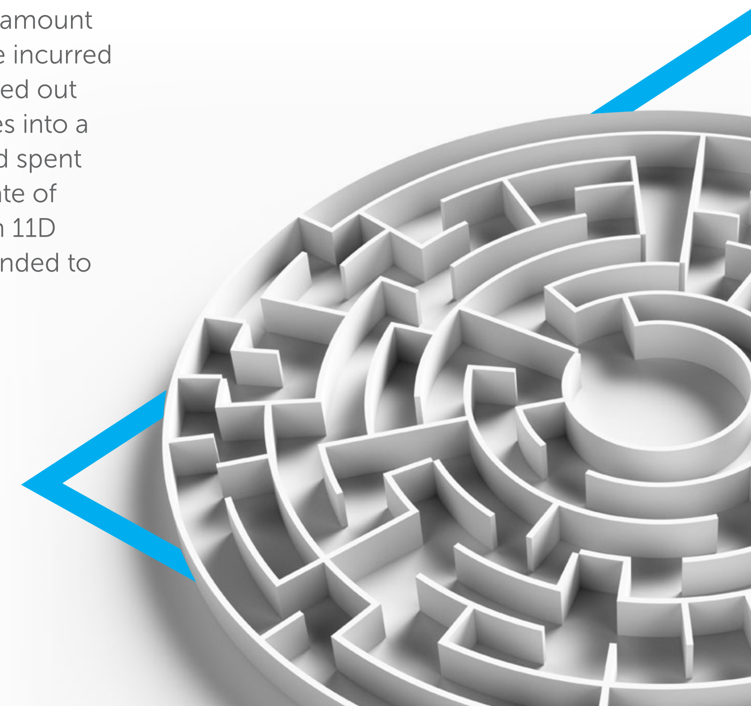
To further encourage the production of EVs in South Africa, in the Budget the Minister has proposed the introduction of an investment allowance for new investments in the production of EVs from 1 March 2026.

Research and development incentive

Research and development (R&D) is crucial for the sustainability of the automotive industry in the evolving technological space of EVs. Deepening South Africa's participation in the value chain will require technology adoption, adaptation and innovation. All these processes require ongoing investment in R&D.

The South African Government already provides a tax incentive to companies that incur expenditure related to R&D. The incentive is provided for in section 11D of the ITA and is currently based on a pre-approval system. In this context, companies intending to conduct R&D activities in South Africa need to apply to the Department of Science and Innovation for pre-approval, showing that the proposed activities will fall within the definition of R&D as set out in section 11D.

Once approved, companies can benefit from the incentive, which allows for a deduction of an amount equal to 150% of expenditure incurred by the taxpayer on R&D carried out in South Africa. This translates into a benefit of 13,5 cents per rand spent on R&D, at a corporate tax rate of 27%. Importantly, the section 11D R&D incentive has been extended to 31 December 2033.



Don't panic, help is on the way: Incentives for electric vehicles...*continued*

A new incentive focused on electric vehicles

Similar to the R&D allowance, the proposed investment allowance will permit producers to claim 150% of qualifying investment spending on EVs and hydrogen-powered vehicles in the first year.

Unfortunately, there is not a lot of guidance on how a taxpayer will qualify for the allowance or what will constitute "*qualifying investment spending*". Although the incentive is a welcome proposal, especially considering the global trends, it is notable that the allowance will only be available from 1 March 2026.

Importantly, the Minister of Trade, Industry and Competition recognised in the White Paper that the pace at which the transition to EVs needs to take place must be swift given the speed at which markets are developing. This is even more important due to the long lead times for investment decisions. It is hoped that the Minister is providing the automotive industry and potential investors with enough time to ensure that the incentive is impactful.

As noted in the Budget, the tax expenditure related to the incentive is estimated to amount to R500 million for 2026/27. With current spending pressures and there already being a deficit in revenue collection, it is essential that the incentive not only work to maintain tax revenues in the industry, but also potentially grow them in the future.

Those in the automotive manufacturing industry are therefore encouraged to take part in the consultations and discussions in anticipation of the enactment of the incentive.

Puleng Mothabeng

Further refinements to the corporate rollover relief provisions

Amalgamation transactions

The disposal of assets by a company to another company in terms of an amalgamation, conversion or merger should trigger a taxable transaction. Depending on the tax profile of the assets transferred, these disposals could trigger capital gains, other taxable gains and the recoupment of allowances previously claimed. Section 44 of the ITA enables qualifying taxpayers to transfer assets in a tax neutral manner to defer the tax consequences while not eroding the South African tax base.

The roll-over relief provisions apply to transactions falling into the following types of amalgamation transactions –

(a) A South Africa resident company disposing of its assets to another South African resident company,

(b) A foreign company disposing of its assets to a South African resident company, and

(c) A foreign company disposing of its assets to another foreign company within the same group of companies.

The intention was not that section 44 should be applied to engineer a permanent deferral of the tax consequences by transferring assets to wholly or partially income tax exempt entities or entities falling entirely outside the South African income tax net. The Minister announced that National Treasury will review the section to ensure its application is aligned with the stated intention.

Degrouping provisions

Section 45 of the ITA provides for a deferral of capital gains, taxable gains and the recoupment of allowances previously claimed for qualifying "*intra-group transactions*". Generally speaking, in order to qualify as an "*intra-group transaction*" and access the roll-over relief provisions, the purchaser and seller should form part of the same group of companies at the end of the day of the transaction.

If the purchaser ceases to form part of the same "*group of companies*" as the seller, or if the purchaser ceases to form part of the same group as the controlling group company in relation to the seller, the tax neutral treatment unwinds in the hands of the purchaser. This is commonly referred to as a "*de-grouping charge*" and is triggered if the de-grouping takes place within six years of the acquisition.

It is proposed that the de-grouping charge will be narrowed to avoid the de-grouping charge when there is a change in shareholding while purchaser and seller still remain part of another group of companies.

This should be welcomed by financiers looking to enforce their security in structures containing historic section 45 transactions.

Dries Hoek

Amendments to provisions on third-party backed shares

Both sections 8E and 8EA of the ITA are anti-avoidance provisions which effectively deem any dividends received on certain instruments to be income in the hands of the recipient unless, under certain circumstances, the shares were issued for or applied for a "*qualifying purpose*".

Section 8EA is specifically aimed at "*third-party backed shares*" where, essentially, the shares are secured by a third party. In this instance the holder of the share has an enforcement right against any person other than the issuer to, inter alia, acquire that share from the holder or make any payment in respect of that share in terms of a guarantee, indemnity or similar arrangement, as a result of any amount of any specified dividend, foreign dividend, return of capital or foreign return of capital attributable to that share not being received by, or accruing to, the holder of the share.

Section 8EA, however, does not apply if the funds derived from the issue of the share have been used for a "*qualifying purpose*". Although there are four categories under the definition of "*qualifying purpose*", one of the permitted purposes is the direct or indirect acquisition of an equity share by any person in an operating company at the time of the receipt or accrual of any dividend or foreign dividend in respect of that share. It is only if the proceeds from the issue of the shares do not fall within any of these qualifying categories, that the dividends on these shares will be classified as income.

The Budget has tabled three proposals in respect of section 8EA:

1. The "*enforcement right*" encompasses a right of the holder of a share, or any connected person in relation to that holder, to enforce the performance by another person in respect of that share. It is recognised that the definition of a "third-party backed share" does not clearly reflect the intent that either a holder or a connected person to that holder could hold that enforcement right. The definition of a "*third-party backed share*" is therefore to be amended to address this anomaly.
2. In 2023, tax amendments were made to clarify the ownership requirement for equity shares in the operating company acquired by the person receiving dividends or foreign dividends, with certain exclusions. These exclusions include a provision that the ownership requirement will not apply if that equity share was a

Amendments to provisions on third-party backed shares...*continued*

listed share, which was substituted for another listed share in terms of an arrangement that is announced and released as a corporate action on a South African regulated stock exchange. This ownership requirement exclusion will now be extended to include corporate actions relating to listed share substitutions on a recognised exchange in a country other than South Africa.

3. The ownership requirement exclusions will apply if the equity shares in the operating company are sold, and the proceeds from the sale are used to redeem the preference share within 90 days. It is recognised that further consideration is required as to whether settling dividends, foreign dividends, or accrued interest from the preference share payable also falls within the scope of allowable redemption. In this regard the proposal suggests amending the legislation to include the settlement of any such amounts in respect of the redemption of a preference share.

Howmera Parak

Amending the connected persons definition in relation to partnerships

The "*connected person*" definition contained in section 1 of the ITA is one of the most important sections that impacts income tax since various tax provisions, anti-avoidance sections in particular, are triggered if parties are connected persons. The definition encompasses various categories of persons including individuals, companies, trusts and partnerships. Arguably the "*connected person*" definition in relation to partnerships is one of the more controversial sub-definitions given its broad ambit.

Paragraph (c) to the definition defines a "*connected person*" in relation to any member of a partnership as any other member as well as any connected person in relation to any member of that partnership. In essence, all partners in a partnership are connected persons in respect of one another and are also connected to all connected persons of the other partners.

The practical effect of the above is that various provisions of the ITA relating to connected persons are triggered if and when they transact with one another or with connected persons of other partners. This is also the case in respect of partners to an *en commandite* (i.e. limited) partnership notwithstanding the number of partners and whether or not they are disclosed. Some partners may therefore be transacting with one another without being able to know whether they are "*connected persons*" in relation to each other or not.

In light of the above, the Minister has proposed that the status of connected persons in relation to partners be reviewed, in particular in the context of a "*qualifying investor*" which is especially important for determining whether a permanent establishment exists. A "*qualifying investor*", in the context of a partnership, is defined in section 1 of the ITA as, subject to certain exclusions, a member of a partnership whose liability to any creditor of the partnership is limited to that member's contribution to the partnership.

It is currently unclear how the Minister plans to amend the definition of connected persons concerning partnerships in light of the "*qualifying investor*" definition. However, there may be an intention to exempt qualifying investors due to their isolated involvement in the partnership from a risk perspective.

Keanen Naidoo and Howmera Parak

Revisions to the definition of *"value-shifting arrangement"* in the context of group reorganisation transactions

The notion of shifting value between shareholders of a company is generally a concern of revenue authorities in that, once a value shift takes place, one shareholder receives the benefit of value in the company at no or a reduced cost, while the other shareholder relinquishes value, notwithstanding there being no disposition event for tax purposes, or the transaction being deemed neutral under the ITA.

The two notable anti-avoidance provisions targeting value shifting are contained in Paragraph 11(1)(g) of the Eighth Schedule to the ITA and section 24BA of the ITA. The latter deals with exchange transactions to a company transferee whereby the exchange transaction does not take place on a value-for-value basis.

The former deals with the deemed disposition value-shifting arrangement whereby a person who enters into an arrangement that meets the definition of "*value-shifting arrangement*", as defined in Paragraph 1 of the Eighth Schedule, could trigger a capital gains tax liability, notwithstanding there being no 'active' disposal of an asset. National Treasury has proposed an amendment to this "*value-shifting arrangement*" definition.

In the context of group reorganisation transactions, the definition of "*value-shifting arrangement*" read with Paragraph 11(1)(g) makes it clear that the capital gains tax event takes place for a holder of an interest in a company if all the following conditions are met:

- there must be an existing shareholder in a company;
- there must be a change in the interest or entitlements of the existing shareholder in the company following an arrangement; and
- the market value of the existing shareholder's interest or entitlement must decrease pursuant to the event;

Revisions to the definition of "*value-shifting arrangement*" in the context of group reorganisation transactions*...continued*

If the above happens, either of the following further conditions must be met:

- the value of any existing interest in the company (held directly or indirectly) of a "connected person" (as defined in Paragraph 1 of the Income Tax Act) in relation to the existing shareholder must increase pursuant to the event; or
- a "*connected person*" in relation to the existing shareholder must acquire a direct or indirect interest in that company.

National Treasury has recognised that under the present construct of the "*value-shifting arrangement*" definition, consolidating a group of companies might lead to a scenario where the market value of a current shareholder in one entity within the group decreases while another entity's recently acquired shareholding increases, potentially triggering the value-shifting provisions. National Treasury has stated that this circumstance could arise even when:

- the transactions are considered tax-neutral under the corporate rollover relief provisions; or
- the market value of the ultimate holding company's combined direct and indirect interests in all the subsidiary companies remains unchanged.

As a result, National Treasury proposes that the definition of "*value-shifting arrangement*" be amended to exclude certain corporate rollover transactions between groups of companies or where the value of the effective interest of the connected person in question remains unchanged. It will be interesting to see what form this amendment will take with reference to the fact that section 41(2) of the ITA (being the preamble provision to the rollover relief provisions) provides that the provisions of Paragraph 11(1)(g) of the Eighth Schedule will apply notwithstanding the corporate rollover relief provisions.

Howmera Parak and Stephan Spamer

Navigating assessed losses: Where do we stand?

The assessed loss provisions contained in sections 20 and 20A of the ITA have been a focal point over the years for both individuals and companies seeking to reduce their taxable income. Originally introduced to alleviate the tax burden imposed on businesses that require high amounts of capital expenditure to start up, the assessed loss provisions have in certain circumstances been used as a tax tool to alleviate the payment of tax on the taxable income of a company or individual conducting a business.

Essentially, an assessed loss incurred by a taxpayer during a year of assessment that has not been used in that specific year of assessment, can be rolled over and set-off against their future taxable income, reducing their taxable income in future years of assessment.

Assessed loss set-offs are available to both individuals and companies, with varying restrictions detailed in the ITA applying to each type of taxpayer. While individuals are entitled to the full benefit of their assessed loss set-off, the prior updates to sections 20 and 20A introduced what is known as the 80/20 rule. This rule was specifically directed towards companies (being implemented at the same time as the reduction in the corporate tax rate to 27%) and meant that companies could only set-off their assessed losses against 80% of their taxable income or R1 million, whichever was higher, with any balance rolling over to the subsequent years of assessment.

The net result being that companies would not be able to entirely hide behind their assessed loss in order to avoid paying taxes on their taxable income. Companies would end up paying tax on at least 20% of their taxable income in any given year of assessment, albeit at the reduced rate of 27%.

One anomaly of the 80/20 rule is that it arguably failed to consider circumstances where a company would not be able to set-off the remainder of its assessed loss in the following year of assessment – e.g. where the company is in liquidation, winding-up or deregistration – until now.

The proposal in the Budget suggests amending the 80/20 rule to exempt its application to any company that finds itself in liquidation, winding-up or deregistration. This means that the entirety of a company's assessed loss can be used against its taxable income when that company is facing liquidation, winding-up or deregistration.

Although seemingly inconsequential, the proposal will bring relief to companies in financial distress and that there may be more funds to distribute to the creditors, employees and shareholders of a company with the result being that distributions are directly returned to the tax base.

Jacques Erasmus and Howmera Parak

SARS giveth and SARS taketh away

The alarmingly high unemployment rate in South Africa has given rise to several tax incentives for employers to grow their workforces. One of these is the Employment Tax Incentive (ETI) contained in the ETI Act 26 of 2013 (ETI Act). However, with new incentives come new issues, and in recent years SARS and National Treasury have clamped down on what they perceive to be abuses of the ETI Act by some employers.

Specifically, two amendments to the ETI Act have occurred. The first tightened the definition of an "*employee*" in section 1 of the ETI Act, with effect from 1 March 2022 by, amongst other things, including certain record-keeping requirements for employers and ensuring that employees actively assist in carrying on or conducting the business of the employer. The second amendment brought the ETI Act within the ambit of the TAA to trigger understatement penalties in terms thereof, with this amendment coming into operation from 1 September 2022.

As announced in the Budget, National Treasury intends to support the amendments already made to the ETI Act with legislatively refined punitive measures. Given that the previous amendment to the ETI Act was aimed at triggering understatement penalties under the TAA, the refinement of further punitive measures suggests more penalties.

Implementing these punitive measures may include the ETI Act triggering additional penalties in terms of the TAA, or under the Fourth Schedule to the ITA. It may also include the introduction of a targeted penalty (over and above that already prescribed in section 5 of the ETI Act) to address perceived abuse of the ETI Act. There may also be other punitive measures not linked to penalties.

Whichever way National Treasury (and SARS) decides to go, employers claiming ETIs would be best advised to tread carefully.

That being said, the Budget did not only bring bad news for employers.

It also included the announcement of a further extension of three years for section 12H of the ITA. This provision allows employers to claim learnership tax incentives, which greatly assists in upskilling and activating the labour market in South Africa. However, under its sunset clause, it was due to expire this year. Employers will now enjoy a further three years in which to claim these incentives, which will be welcomed. During this period, Government will evaluate the merit of the provision's continued existence.

Every cloud has a silver lining, but so too does every silver lining have a cloud. The further extension of section 12H points towards a continuing need to promote job creation in a climate of persistently high unemployment. Growing the workforce ultimately depends on economic growth. Without this economic growth and increased employment, the tax base will continue to shrink, which will have further negative knock-on effects.

Nicholas Carroll

It never ends: Proposals to clarify the interaction between section 7C and transfer pricing rules in the context of low or interest-free loans

Tax advisors, like others in the legal profession, can sometimes be guilty of using jargon and "*legalese*". However, considering the amount of times that section 7C of the ITA has been amended since its introduction in 2017, saying "*7C is a problem*" might become a common phrase at a Saturday evening braai. In the Budget, National Treasury is at it again, this time proposing to clarify the interaction between sections 7C and 31 of the ITA.

The current legal position

As we have discussed in many of our previous Tax & Exchange Control Alerts, section 7C is an anti-avoidance provision aimed at preventing the tax-free transfer of wealth to trusts using low or interest-free loans, advances, or credit arrangements, including cross-border loan arrangements. The mechanism through which it prevents anti-avoidance is by stating that if the interest rate charged on loans made by individuals to trusts and certain connected-person companies is lower than the official rate of interest, the difference between the interest charged and what would have been charged at the official rate of interest, will be treated as a deemed donation. The "*official rate of interest*" is defined as:

- In the case of a rand-denominated debt, the South African repo rate plus 100 basis points.
- In the case of a foreign currency denominated debt, a rate of interest that is the equivalent of the South African repo rate applicable in that currency plus 100 basis points.

For a rand-denominated debt, the official rate of interest is currently 9,25%. To illustrate the application of the section – if a person were to advance an interest-free loan of R1 million to a South African connected person trust, the difference between the interest charged (R0) and the interest that should have been charged in terms

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It never ends: Proposals to clarify the interaction between section 7C and transfer pricing rules in the context of low or interest-free loans*...continued*

of the official rate of interest, being R92,500, is R92,500. The full amount is treated as a deemed donation in terms of section 7C.

However, section 7C(5) contains a list of exclusions to which section 7C does not apply. One of the exclusions is where the transfer pricing provisions in section 31 of the ITA apply to a cross-border loan or advance made by a South African resident to a non-resident. Section 31 applies to so-called *"affected transactions*", which are broadly defined, but for purposes of this article, it is sufficient to state that a loan advanced by a South African resident to a non-resident, where the parties are connected persons, will be an affected transaction. This would include a situation where a South African resident is a beneficiary of a foreign trust and advances a loan to that trust. Section 31 states that one must consider whether the terms of an affected transaction, including a loan, adheres to the arm's length principle.

SARS interpretation notes and debate

Given the wording of the exclusion in section 7C(5), there has always been some debate as to the interaction between sections 7C and 31 of the ITA. Some commentators have taken the view that given the wording of exclusion in section 7C(5) it was unclear whether section 7C could still apply where section 31 applied to a cross-border loan. The more commonly held view has been that if section 31 applies to a cross-border loan, section 7C does not apply. One needs to consider two SARS interpretation notes in this regard.

In SARS Interpretation Note 114 (IN114), published on 2 March 2021, an example is included of an instance where a South African resident makes an interest-free loan to a non-resident discretionary trust. Although IN114 was not intended to expressly deal with the interaction between sections 7C and 31, it provides some useful insight. In the example, SARS states that section 31 may apply on the basis that the loan to the non-resident trust is potentially an affected transaction. However, it continues to state that the South African resident should also consider the possible application of section 7C. While some interpreted the example to suggest that if section 31 applies to the loan, section 7C will not, it was not entirely definitive. The example did not address whether there would be an issue if the rate that applies in terms of section 31 were lower than the official rate of interest.

However, Interpretation Note 127 (IN127), published on 17 January 2023, seemed to clarify the issue. There, SARS uses an example where an interest-free loan is advanced by a South African resident to a non-resident discretionary trust, which is a connected person, and where the market-related (arm's length) rate is 10%. It notes that the loan is used by the trust to earn rental income of R80,000, which is vested in the South African resident donor in terms of section 7(8) of the ITA. Considering that the arm's length amount is R100,000 (10% of R1 million), a transfer pricing adjustment of

It never ends: Proposals to clarify the interaction between section 7C and transfer pricing rules in the context of low or interest-free loans *...continued*

R20,000 must be made that also constitutes a deemed donation under section 31(3). IN127 then goes on to state that considering the exclusion in section 7C(5) and that *"the affected the transaction is subject to the provisions of section 31(2) and section 31(3) ... section 7C(2) and section 7C(3) do not apply"*. Pursuant to this, it seemed clear that section 7C would not apply where section 31 applies, although one should keep in mind that SARS interpretation notes are not binding.

Budget announcement and implication

Despite the above, and while acknowledging that the intention of the exclusion in section 7C(5) is *"to avoid the possibility of an overlap or double taxation"*, it states that:

> *"[the] exclusion does not effectively address the interaction between the trust anti-avoidance measures and transfer pricing rules where the arm's length interest rate is less than the official rate on these cross-border loan arrangements. It is proposed that amendments be made to the legislation to provide clarity in this regard."*

It appears that there is a concern in the context of loans where the arm's length interest rate, determined in terms of section 31, is lower than the official rate of interest that applies where section 7C applies and that this may result in avoidance. This issue is not addressed in IN127 example, although at the time that it was published, the official rate of interest was lower than 10% (being the arm's length rate in the example). While it remains to be seen how the issue will be addressed, one can only hope that the proposed amendment will not have the effect of diluting the exclusion by stating that the official rate of interest should also apply to a cross-border loan to which section 31 applies. One should appreciate that IN127 set out detailed considerations that should be taken into account in determining an arm's length rate. It is at least arguable that if the proper application of those IN127 considerations results in justifying an arm's length rate that is lower than the official rate of interest, the official rate of interest should not apply. Although many countries currently have high interest rates compared to prior years, a foreign trust could potentially be able to borrow abroad at a lower rate than the official rate of interest.

Louis Botha

Customs and excise

Excisable products

Of relevance this year in terms of Schedule 1 Part 2A to the Customs Act are the following:

- The guideline excise tax burdens for wine, beer and spirits are 11%, 23% and 36% respectively of the weighted average retail price. Excise duties have increased more than inflation in recent years, resulting in a higher tax incidence. Government proposes to increase excise duties on alcoholic beverages by between 6,7 and 7,2% for 2024/25.
- The guideline excise tax burden as a percentage of the retail selling price of the most popular brand within each tobacco product category is currently 40%. Government proposes to increase tobacco excise duties by 4,7% for cigarettes and cigarette tobacco and by 8,2% for pipe tobacco and cigars for 2024/25.
- Government implemented an excise duty on electronic nicotine and non-nicotine delivery systems, colloquially referred to as vaping, with effect from 1 June 2023 at a flat excise duty rate of R2,90 per millilitre on both nicotine and non-nicotine solutions. Government proposes increasing these excise duties in line with expected inflation to R3,04 per millilitre for 2024/25.
- Government proposes that excise duties in the Customs Act be increased with effect from 21 February 2024 to the extent shown below:

Product:	Current rate:	Proposed rate:
Malt beer	R127,40/litre of absolute alcohol	R135,89/litre of absolute alcohol
Unfortified wine	R5,20/litre	R5,57/litre
Fortified wine	R8,77/litre	R9,40/litre
Sparkling wine	R16,64/litre	R17,83/litre
Ciders and alcoholic fruit beverages	R127,40/litre of absolute alcohol	R135,89/litre of absolute alcohol
Spirits	R257,23/litre of absolute alcohol	R274,39/litre of absolute alcohol
Cigarettes	R20,80/20 cigarettes	R21,77/20 cigarettes
HTPs sticks	R15,60/20 sticks	R16,33/20 sticks
Cigarette tobacco	R23,38/50g	R24,47/50g
Pipe tobacco	R6,96/25g	R7,53/25g
Cigars	R116,40/23g	R125,91/23g
ENDS/ENNDS	R2,90/ml	R3,04/ml

Customs and excise *...continued*

- As was the case last year, there will be no change to the excise duty on Traditional African Beer (umqhombothi) and Traditional African Beer powder.

Plastic bag levy and incandescent globe taxes

- Government proposes increasing the plastic bag levy from 28c/bag to 32c/bag from 1 April 2024.
- To encourage the uptake of more efficient lighting such as light-emitting diode bulbs and reduce electricity demand, it proposes raising the incandescent light bulb levy from R15 to R20 per light bulb from 1 April 2024.

Motor vehicle emissions tax

- Government proposes increasing the motor vehicle emissions tax rate for passenger vehicles from R132 to R146 per gram of CO2 emissions per kilometre and the tax rate for double cabs from R176 to R195 per gram of CO2 emissions per kilometre from 1 April 2024.

Fuel taxes

- The fuel levies will not be increased, resulting in R4 billion in tax forgone, partially offset by above-inflation increases in excise duties on alcohol and certain categories of tobacco products.
- The Road Accident Fund levy and the customs and excise levy will also remain unchanged.

Carbon tax

- The carbon tax increased from R159 to R190 per tonne of CO2 equivalent from 1 January 2024. The carbon fuel levy will increase to 11c/litre for petrol and 14c/litre for diesel effective from 3 April 2024, as required under the Carbon Tax Act. Effective 1 January 2024, the carbon tax cost recovery quantum for the liquid fuels sector increased from 0,66c/litre to 0,69c/litre.
- It is proposed that the density factor for calculation of the carbon fuel levy is changed from 0,75 to 0,7405kg/l for petrol and from 0,845 to 0,82kg/l for diesel. The amendments will take effect from 1 January 2024.

General

- It is proposed that items 12 and 13 of Part B of Schedule 2 of the VAT Act be amended to clarify that the zero-rating of VAT does not apply to pre-cut or prepared fruit or vegetables. Amendments to Schedule 1 Part 1 of the Customs Act may also be needed in order to align both the schedules.
- The approach to packages imported through eCommerce will be reviewed to ensure that the appropriate balance between simplicity and compliance with customs and excise requirements is being maintained.

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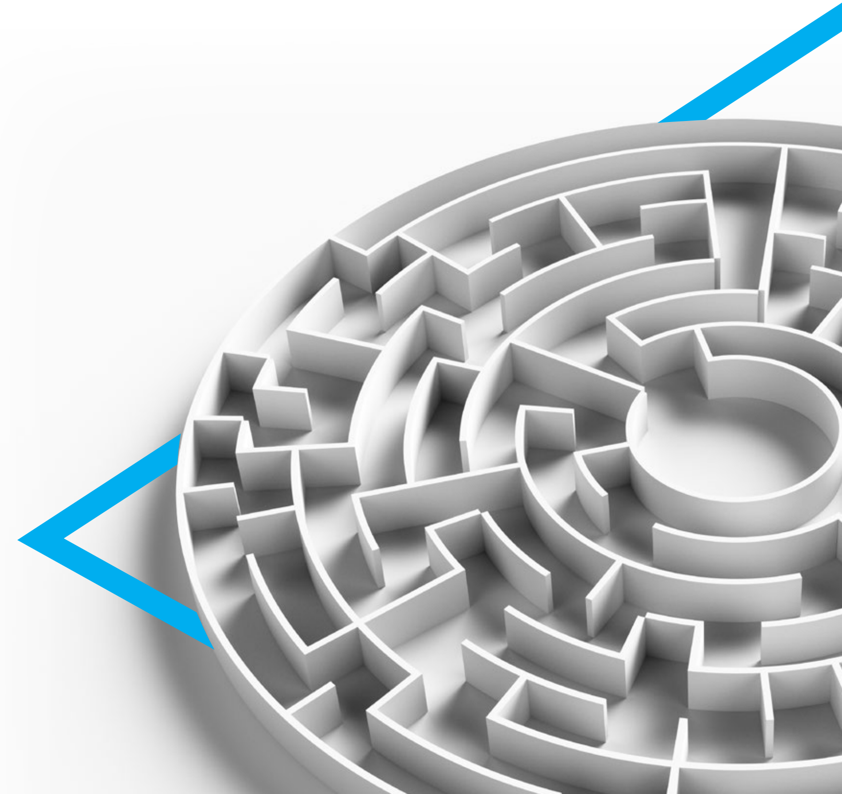
Customs and excise...*continued*

- Certain exporters face legitimate challenges in complying with the timeframe for submitting export bills of entry. It is proposed that the Customs Act be amended to enable SARS to provide, by rule, for a process by which exporters can be allowed to submit export bills of entry at a different time than what is currently provided for in the Customs Act.
- It is proposed that the Customs Act be amended to simplify the process of substituting a bill of entry in certain circumstances where the bill of entry has been passed in error or where an importer, exporter or manufacturer requested the substitution on good cause shown. A voucher of correction will no longer be required in those circumstances, and it is foreseen that the substituting bill of entry will replace the previous one.
- Every company that carries on business or has an office in South Africa must be represented by a public officer. Given that companies are automatically registered for income tax on formation, it is proposed that the one-month period within which the public officer must first be appointed be removed. A newly formed company will thus have both its directors and public officer in place on formation.

Petr Erasmus



Rate changes and the fuel sector

With effect from 2023 and following a lengthy public consultation process, the Carbon Tax Act was amended to state the exact annual carbon tax rate increases from 2023 to 2030. One of the reasons for this was to promote certainty from an investment perspective and to enable South Africa to meet its Paris Agreement commitments by gradually increasing the carbon tax rate. It therefore comes as no surprise that in the Budget it was confirmed that the carbon tax increased from R159 to R190 per tonne CO2 equivalent from 1 January 2024. Concomitantly, it was announced that the carbon fuel levy will increase to 11c/litre for petrol and 14c/litre for diesel effective from 3 April 2024.

Other important changes are:

- Effective from 1 January 2024, the carbon tax cost recovery quantum for the liquid fuels sector increased from 0,66c/litre to 0.69c/litre. This is an important amendment given the challenges faced by this sector.
- The Budget states that to ensure alignment between the Carbon Tax Act and the Department of Forestry, Fisheries and the Environment's (DFFE) Methodological Guidelines for Quantification of Greenhouse Gas Emissions, changes to the CO2 emission factors and net calorific values for the relevant fuel types are necessary. The Budget thus proposes that Schedule 1 fuel combustion emissions factors and new fuel types be added. In this regard, it is the stationary and non-stationary emission factors in Schedule 1 that are amended for several fuel types, including aviation gasoline, diesel, heavy fuel oil, jet kerosene, liquified petroleum gas, paraffin and petrol. Some of the new fuel types to be added are acetylene, refuse-derived fuel, sawdust, waste tyres and methane rich gas. From this, it appears that as the DFFE and SARS collect data regarding emissions and gain a deeper understanding of the emissions that affect South Africa's greenhouse gas emissions, they are gradually increasing the carbon tax base.
- Furthermore, to align with the guidelines, it is proposed that the density factors for the calculation of the carbon fuel levy be changed from 0,75 to 0,7405kg/litre for petrol and from 0,845 to 0,8255kg/litre for diesel.

Louis Botha and Petr Erasmus

Carbon tax changes related to the renewable energy premium deduction and carbon offset allowance

Renewable energy premium deduction

In 2023, a tangible outcome in Eskom's unbundling process occurred when the National Transmission Company of South Africa's (NATCOM) was properly established and received all requisite regulatory approvals. As things stand, power purchase agreements concluded under the Renewable Energy Independent Power Producer Procurement Programme, would have been concluded between Eskom and the relevant independent power producer. The Budget notes that as Eskom's generation, transmission and distribution functions are separated, the power purchase agreements will be transferred to NATCOM when it commences operations. However, the carbon tax liability arising from the GHG emissions related to electricity generation activities in Schedule 2 of the Carbon Tax Act, will remain with the generation function of Eskom.

In light of this, the Budget proposes that the Carbon Tax Act be amended to allow electricity generators to continue to claim the renewable energy premium deduction for power purchase agreements ceded to NATCOM. This is a sensible and logical proposal given that it will likely ensure that electricity generators who would normally be entitled to the deduction would not be prejudiced, purely as a result of the cession of agreements to NATCOM.

Article 6(4) of Paris Agreement and carbon offsets

Recently, the Clean Development Mechanism (CDM) of the Kyoto Protocol was effectively replaced by article 6(4) of the Paris Agreement. The Budget notes that under the Carbon Tax Act, offsets generated from approved projects developed under the CDM are eligible for use by taxpayers for purposes of the carbon tax allowance. This is dealt with in the Carbon Offset Regulations. Given the transition, decisions taken under the Paris Agreement in November 2022 set out the process for transitioning activities from the CDM to the article 6(4) mechanism. About 48 CDM projects are eligible for transition to the article 6(4) mechanism.

To ensure alignment with the new article 6(4) mechanism and the transition of eligible CDM project activities, National Treasury in consultation with the DFFE and the Department of Mineral Resources and Energy will consider including a new mechanism as an eligible carbon offset standard. This is also to facilitate the transition of existing CDM projects. This will necessitate a further amendment to the Carbon Offset Regulations and the Budget indicates that the draft amended regulations will likely be published in 2024. This is an important amendment in order to facilitate the growth in South Africa's carbon offset market and to incentivize the establishment of article 6(4) projects in South Africa. It also improves the chances of international investment in this regard.

Louis Botha

2024 Budget summary: VAT

VAT treatment of rental stock paid in terms of the a national housing programme

Currently, it is clear that grants paid under a national housing programme contemplated under the Housing Act 107 of 1997, in relation to the development of low-cost housing for sale are subject to VAT at the zero-rate under section 8(23), read with section 11(2)(s), of the VAT Act. It follows that developers of low-cost housing for sale are entitled to claim input tax deductions in respect of the development costs incurred.

Section 8(23) does not stipulate or specify the type of housing programme for the provisions of section 8(23) to apply, but only that the payment must be made in terms of a national housing programme as contemplated in the Housing Act. Based on the current wording of section 8(23), it is arguable that the zero-rating of the grant, and so too, the input tax deductions in respect of the development costs incurred, will apply equally to low-cost housing developed for rent.

National Treasury has indicated that there is confusion regarding the VAT status of low-cost housing projects developed for rental, and whether grants received in respect thereof may be zero-rated in the same way as grants received for low-cost housing for sale. It is proposed that the VAT treatment of grants received for low-cost housing for rent will be clarified. No indication is, however, provided as to whether the zero-rating will be taken away from these rental developments. To the extent that the zero-rating is taken away, developers of housing for letting will not be entitled to any input tax deductions in respect of the development costs incurred. This will have the effect of significantly increasing the cost of this housing.

Providing VAT relief for non-resident lessors of parts of ships, aircraft or rolling stock required to deregister as a result of recent amendments to the VAT Act

It is proposed that amendments be made to the VAT Act to clarify that foreign lessors of parts of ships, aircraft or rolling stock who are, in terms of the 2023 amendment to proviso (xiii) of the definition of "*enterprise*", no longer required to be remain registered for VAT in South Africa, will not be required to account for deemed output tax upon deregistration as a vendor in terms of section 8(2) of the VAT Act.

Clarifying the VAT treatment of the Mudaraba Islamic financing arrangement

It is proposed that the VAT Act be amended to clarify that Mudaraba financing arrangements will fall under section 8A of the VAT Act which deals with the VAT treatment of Sharia compliant financing arrangements.

Updating the electronic services regulations

South Africa introduced legislation with effect from 1 June 2014 requiring foreign suppliers of "*electronic services*" (e-services) to register as VAT vendors in South Africa. Regulations to prescribe e-services supplied by foreign suppliers to South African consumers which are subject to VAT were first published with effect from 1 June 2014. Revised regulations to prescribe and clarify the extent of the services for the purpose of the definition of "*electronic services*", and which had the effect of significantly broadening the scope of what constituted e-services, were then published with effect from 1 April 2019.

It is proposed that further amendments will be made to the e-services regulations and the relevant provisions of the VAT Act to keep up with changes in

2024 Budget summary: VAT*...continued*

the digital economy and to ease the administrative burden. It is further proposed that the regulations be amended to be limited only to non-resident vendors supplying e-services to non-vendors or end consumers.

The regulations currently make no distinction between business-to-business (B2B) and business-to-consumer (B2C) transactions This proposal seems to indicate that previously included B2B transactions will now be excluded from the scope of the e-services regulations.

Accounting for VAT in the gambling industry

The gambling industry previously obtained a binding general ruling issued by SARS under section 72 of the VAT Act which related to the VAT accounting in respect of, *inter alia*, table games of chance. This ruling expired at the end of 2021 and the gambling industry applied for the extension of the ruling, which was then granted.

It is proposed that the current section 72 ruling issued to the gambling industry, which relates to accounting for VAT for table games of chance, be incorporated into the VAT Act.

Prescription period for input tax claims

Registered VAT vendors are entitled to claim input tax deductions on expenses incurred to the extent that such expenses are incurred for the purpose of consumption, use or supply, in the course of making taxable supplies.

The VAT Act allows for an input tax deduction to be claimed within a period of five years from, *inter alia*, the date of the tax invoice or when the vendor first became entitled to the deduction. This enables vendors to claim input tax deductions of VAT on expenses incurred in one period, in a subsequent tax period.

It is proposed that the VAT Act be amended in relation to the tax period in which past unclaimed input tax credits may be claimed and to clarify that such deductions be made in the original period in which the entitlement to that deduction arose. This may create unforeseen practical difficulties for vendors.

2024 Budget summary: VAT *...continued*

Overpayments of VAT on the importation of goods and imported services

The TAA will be amended to clarify the process that needs to be followed with regard to the claiming of the overpayment of VAT on imported goods and services.

Clarifying the VAT treatment of pre-cut fruit and vegetables

It is proposed that items 12 and 13 in part B of Schedule 2 of the VAT Act be amended in order to provide clarity that the zero-rating of VAT does not extend to pre-cut or prepared fruit or vegetables.

Clarifying the VAT treatment of supply of services to non-resident subsidiaries of companies based in South Africa

Where a foreign subsidiary company is managed and controlled in South Africa, it is a "*resident*" as defined in the ITA. A "*resident of the Republic*" as defined in the VAT Act includes a "*resident*", as defined in the ITA, which means that the foreign subsidiary falls within the ambit of a resident of South Africa as defined in the VAT Act.

Even though the foreign subsidiary has no physical or business presence in South Africa, and all its operations are carried out from a place permanently situated outside South Africa, the services supplied by the resident to the non-resident subsidiary may not be zero rated in terms of section 11(2)(l) as the services are not rendered to a non-resident. The fees are now subject to VAT at the standard rate, irrespective of the fact that the services are consumed outside South Africa where the non-resident subsidiary is located. This resulted now in unintended non-deductible VAT costs for these companies when carrying on their foreign enterprise activities. As the services supplied are consumed outside South Africa, these services should not attract VAT at the standard rate.

It is proposed that the VAT Act be amended to exclude subsidiaries from the definition of "*resident of the Republic*", which will then have the effect that the fees can be zero-rated.

Reviewing the foreign donor funded project regime

It is a requirement in terms of the VAT Act to register each foreign donor funded project separately as a branch of the implementing agency for VAT, which resulted in an administration burden for the implementing agents. In light of this, it is proposed that the registration requirements be reviewed, to ease the administration burden of implementing agencies who manages a large number of foreign donor funded projects.

Domestic reverse charge regulations

The Domestic Reverse Charge (DRC) Regulations are an anti-avoidance measure designed to counter criminal attacks on the VAT system and malpractices identified in the valuable metals industry.

To address malpractices in the second-hand gold sector, National Treasury aims to amend the DRC mechanism. The current exemption for primary producers will be removed, and the gold mining sector will be included in the definition of "*holders*" as outlined in the Mineral and Petroleum Resources Development Act 28 of 2002. Consequently, gold mines will now be subject to the DRC Regulations.

2024 Budget summary: VAT*...continued*

It further appears that all exclusions will be eliminated, meaning unintentional transactions, such as replacing gold jewellery under an insurance contract, will also be governed by the DRC Regulations.

VAT claw back on irrecoverable debts subsequently recovered

Currently the VAT Act allows an input tax deduction of the tax amount written off as irrecoverable to the extent of the face value of such debt purchased on a non-recourse basis. If the debt is recovered there is no mechanism to account for output tax again. It is proposed that the VAT Act be amended to incorporate this clawback provision.

Supplies by educational institutions to third parties

The VAT treatment of supplies provided by educational institutions to third parties (i.e. short courses) will be clarified.

Non-resident vendors with no or limited physical presence in South Africa

Where non-resident vendors are required to register for VAT in South Africa they must appoint a representative vendor who resides in South Africa and open a South African bank account. However, non-resident suppliers of electronic services were exempted from these requirements.

The proposed amendment to the TAA aims to streamline compliance for electronic service suppliers by allowing the requirement to appoint a representative vendor, but waive the option that such person must reside in South Africa. The exemption from the obligation to open a South African bank account will be retained for such electronic service suppliers.

Timing of VAT on imported services to be extended

The recipient of imported services is required to account for and pay VAT within 30 days from receiving the invoice from the supplier, or when any payment is made by the recipient for the supply, whichever is earlier. Meeting this 30-day timeframe is often impractical in many cases. Failure to comply within this timeframe has also led to the imposition of penalties and interest. To address this issue, there is a proposal to extend the time period from 30 to 60 days in terms of the TAA.

Gerhard Badenhorst, Varusha Moodaley and Tersia van Schalkwyk

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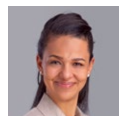

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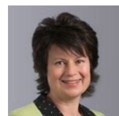

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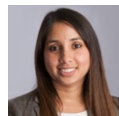

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

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.

PLEASE NOTE

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