The Tax Faculty

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TAX UPDATE

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Disclaimer

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NB: The information contained in the notes is specifically drafted, worded and used to illustrate only the key concepts presented, and as such is not to be regarded as a technical reference source by attendees

Reference

Contained in these notes are numerous excerpts drawn directly from the Explanatory Memorandum on the Taxation Laws Amendment Bill (EM), 2021 dated 25 January 2022. Where relevant the reference given will be as "EM" followed by the page number/s.

TAX RATES

NATURAL PERSONS

Rates of normal tax	
Retirement fund lump sum withdrawal benefits – 2021/22	
Taxable income	**Rates of tax**
R0 – R25 000	0% of taxable income
R25 001 – R660 000	18% of taxable income exceeding R25 000
R660 001 – R990 000	R114 300 + 27% of taxable income exceeding R660 000
R990 001 and above	R203 400 + 36% of taxable income exceeding R990 000

Rates of normal tax	
Retirement fund lump sum benefits and severance benefits – 2021/22	
Taxable income	**Rates of tax**
R0 – R500 000	0% of taxable income
R500 001– R700 000	18% of taxable income exceeding R500 000
R700 001 – R1 050 000	R36 000 + 27% of taxable income exceeding R700 000
R1 050 001 and above	R130 500 + 36% of taxable income exceeding R1 050 000

Annual local interest exemption for:		
	Rand	
	2023	**2022**
Persons under 65	23 800	23 800
Persons 65 and above	34 500	34 500

CGT		
	2023	**2022**
Inclusion rate	40%	40%
Annual exclusion	R40 000	R40 000
Exclusion in year of death	R300 000	R300 000
Primary residence exclusion	R2 000 000	R2 000 000

Section 12T Tax free Investment		
	Rand	
	2023	**2022**
Annual contribution	36 000	36 000
Lifetime contribution	500 000	500 000

Medical rebates		
Monthly contributions to medical schemes by the individual who paid the contributions		
	2023	**2022**
First two persons covered by those medical schemes	R347 each	R319 each
Each additional dependant	R234	R215

Section 12E Small Business Corporation

Taxable income	Rate of tax
Not exceeding R91 250	0 per cent of taxable income
Exceeding R91 250 but not exceeding R365 000	7 per cent of amount by which taxableincome exceeds R91 250
Exceeding R365 000 but not exceeding R550 000	R19 163 plus 21 per cent of amount by which taxable income exceeds R365 000
Exceeding R550 000	R58 013 plus 27 per cent of amount by which taxable income exceeds R550 000

Sixth Schedule Turnover tax

Taxable turnover	Rate of tax
Not exceeding R335 000	0 per cent of taxable turnover
Exceeding R335 000 but not exceeding R500 000	1 per cent of amount by which taxableturnover exceeds R335 000
Exceeding R500 000 but not exceeding R750 000	R1 650 plus 2 per cent of amount by whichtaxable turnover exceeds R500 000
Exceeding R750 000	R6 650 plus 3 per cent of amount by whichtaxable turnover exceeds R750 000

DETERMINATION OF THE DAILY AMOUNT IN RESPECT OF MEALS AND INCIDENTAL COSTS FOR PURPOSES OF SECTION 8(1) OF THE INCOME TAX ACT, 1962 (ACT NO. 58 OF 1962)

By virtue of the powers vested in me by section 8(1)*(a)*(ii) of the Income Tax Act, 1962 (Act No. 58 of 1962), I, Edward Christian Kieswetter, Commissioner for the South African Revenue Service, hereby determine the maximum amount for expenditure in respect of meals and incidental costs for purposes of section 8(1)*(a)*(ii)*(aa)* of the Act to be **R152 per day.**

March 2022

DETERMINATION OF THE DAILY AMOUNT IN RESPECT OF MEALS AND INCIDENTAL COSTS FOR PURPOSES OF SECTION 8(1) OF THE INCOME TAX ACT, 1962 (ACT NO. 58 OF 1962)

By virtue of the powers vested in me by section 8(1)*(c)*(ii) of the Income Tax Act, 1962 (Act No. 58 of 1962), I, Edward Christian Kieswetter, Commissioner for the South African Revenue Service, hereby determine in the Schedule hereto the amounts which shall be deemed to have been actually expended by a person in respect of meals and incidental costs for the purposes of section 8(1)*(a)*(i)*(bb)* of that Act.

The amounts determined in this notice apply in respect of years of assessment commencing on or after 1 March 2022

SCHEDULE

1. Unless the context otherwise indicates, any word or expression to which a meaning has been assigned in the Income Tax Act, 1962, bears the meaning so assigned.
2. The following amounts will be deemed to have been actually expended by a recipient to whom an allowance or advance has been granted or paid—

(a) where the accommodation, to which that allowance or advance relates, is in the Republic and that allowance or advance is paid or granted todefray—

(i) incidental costs only, an amount equal to R152 per day; or

(ii) the cost of meals and incidental costs, an amount equal to R493 per day; or

(b) where the accommodation, to which that allowance or advance relates, is outside the Outsidethe Republic' under Notice 268 published in Government Gazette No. 42258 dated Republic and that allowance or advance is paid or granted to defray the cost of meals and incidental costs, an amount per day determined in accordance with the 'Table: Daily Amount for Travel 1 March 2019.

TAX FORMULA

GROSS INCOME (Section 1-“resident”-worldwide, non-resident SA source, special inclusions)

LESS EXEMPT AMOUNTS (sections 10, 10B, 10C and 12T)

INCOME

LESS DEDUCTIONS (Sections 11 etc *but not* 11F or 18A)

LESS ASSESSED LOSS (Sections 20, 20A)

ADD AMOUNTS TO BE INCLUDED IN TAXABLE INCOME

- ALLOWANCES (taxable portion eg Travel allowance)
- TAXABLE CAPITAL GAINS (Net capital gain x 40% inclusion rate - indiv)

LESS

Section 11F (Retirement fund contributions)

Section 18A (Donations to qualifying PBO’s)

TAXABLE INCOME (**excluding qualifying lump sums*)

(multiply by tax rate in tax table)

TAX PAYABLE

Less rebates (section 6 and 6quat)

ADD Tax payable on qualifying lump sums (see lump sums tax tables)

Less medical rebates (sections 6A and 6B)

FINAL TAX PAYABLE

INDIVIDUALS

REVIEWING THE NATURE OF LONG SERVICE AWARDS FOR FRINGE BENEFIT PURPOSES

[Applicable provisions: Paragraphs (c) and (i) of the definition of "gross income" and paragraph 5(2)(b) and new paragraphs 6(4)(d) and 10(2)(e) of the Seventh Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962) ("the Act")] EM PG 5

Background

Paragraph (i) of the definition of gross income together with paragraph 5 of the Seventh Schedule to the Act make provision for a taxable benefit to arise when an employee acquires an asset from an employer, either for no consideration or for consideration which is less than the value of the asset (generally referred to as a fringe benefit). A fringe benefit is generally referred to as any non- cash benefit granted to employees, this however specifically excludes cash payments made to employees.
On the other hand, the Act further makes provision for a taxable benefit not to arise in the hands of the employee, in the event that the fringe benefit is deemed to have no value. Consequently, paragraph 5(2)(b) of the Seventh Schedule to the Act makes provision for the granting of a long service award (which can currently be provided as an asset or non-cash benefit) to an employee as a no value fringe benefit, provided that the value of such long service award does not exceed R5 000.

Reasons for change

Government recognises that the current prevailing practice is for employers to grant their employees a wider range of awards (which take a variety of forms) in recognition for long service, and these long service awards can in terms of the Act be considered as non-cash benefits. These include for example the granting of gift vouchers, cash, services or the right of use of an asset owned by the employer for private purposes.

Proposal

In order to cater for current prevailing practices, it is proposed that the current provisions as relates to long service awards are not only limited to non-cash assets, but rather extended to apply to other reasonable awards granted for long service. In order to qualify as a no value fringe benefit, all the current requirements in the Act should be met, for example, the number of years required to be considered a long service period together with the requirement that the value of the long service award should not exceed R5 000 would still apply.

Effective date

The amendments will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

TAX TREATMENT OF THE CESSION OF THE RIGHT TO RECEIVE AN ASSEST

[Applicable provision: New section 57B of the Act] EM PG 8

Background

Paragraph (c) of the definition of "gross income" in section 1(1) of the Act makes provision for a taxpayer to include in gross income any amount received or accrued in respect of services rendered, to be rendered or in respect of employment or the holding of any office. In addition, the proviso to this paragraph also makes provision for any amount received or accrued for the benefit of any person in respect of services rendered or to be rendered by any other person to be deemed to have been received by or to have accrued to the other person. In turn, section 54 of the Act makes provision for donations tax to be levied on the value of any property disposed of, whether directly or indirectly, under any donation by any resident. Section 62 of the Act provides for the value of property disposed of under donations.

Reasons for change

It has come to Government's attention that some taxpayers have devised schemes aimed at undermining the donations tax provisions. These schemes entail a service provider (for example, an employee or independent contractor) ceding the right to receive or use an asset received from the person to whom the services are rendered or to be rendered. The right to receive or use the asset is generally ceded to a family trust before services are rendered.

In these instances, the service provider may be able to circumvent donations tax as the right to receive an asset would have been ceded to the trust before the services are rendered and a value can be attached to it. The argument is that the service provider is simply disposing of a worthless spes and is therefore not liable for donations tax at the time the services have been rendered and the employer transfers the asset to the cessionary. Moreover, the service provider will not be entitled to the asset and cannot be regarded as having disposed of it.

It may also be argued that the service provider is not subject to the attribution rules in section 7 of the Act or paragraphs 68 to 73 of the Eighth Schedule to the Act because the asset was not donated by the service provider, and the right to the asset was worthless. This argument is addressed by deeming the asset to have been disposed of by the service provider to the other person by way of donation for purposes of section 7 of the Act and paragraphs 68 to 73 of the Eighth Schedule to the Act.

Proposal

In order to address these types of schemes, it is proposed that changes be made in the Act to clarify that instances where a right to receive an asset, which asset would otherwise have been acquired in respect of services rendered or to be rendered, is disposed of, that asset will be deemed to be disposed of under a donation as envisaged in Part V of Chapter II of the Act.

Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of the disposal of the right to receive an asset on or after that date.

ALLOWING MEMBERS TO USE RETIREMENT INTEREST TO ACQUIRE ANNUITIES ON RETIREMENT

[Applicable provisions: Paragraph (b)(ii) of the proviso to the definition of "retirement annuity fund", paragraph (ii)(dd) of the proviso to the definition of "pension fund", paragraph (e) of the definition of "pension preservation fund", paragraph (ii)(dd) of the proviso to the definition of "provident fund" and paragraph (e) of the definition of "provident preservation fund" in Section 1(1) of the Act] EM PG 9

Background

In accordance with the proviso to the definition of "retirement annuity fund", paragraph (ii)(dd) of the proviso to the definition of "pension fund", paragraph (e) of the definition of "pension preservation fund", paragraph (ii)(dd) of the proviso to the definition of "provident fund" and paragraph (e) of the definition of "provident preservation fund" in section 1(1) of the Act, any member retiring from a retirement fund is, upon retirement, allowed to receive a maximum of one third of the total value of the retirement interest as a lump-sum. The remainder of the retirement interest may be utilised to purchase or provide an annuity (including a living annuity).

The annuity can be provided by the retirement fund in one of three ways, namely, the annuity can be:

- paid directly by the retirement fund to the member,
- purchased from a South African registered insurer in the name of the fund, or
- purchased by the retirement fund from a South African registered insurer in the name of the life of the retiring member.

Reasons for change

If a member of a retirement fund opts to receive an annuity, the full value of the member's retirement interest following commutation is to be used to provide either of the above-mentioned annuities. Therefore, a member is prohibited from utilising the retirement interest to acquire various annuities. The above-mentioned prohibition limits flexibility in relation to the types of annuities a member can purchase with their retirement interest following commutation.

Proposal

In order to increase flexibility for a retiring member and maximise the retirement capital available to provide for annuities, Government proposes expanding the types of annuities a member can purchase upon retirement. For example, the full value of the member's retirement interest following commutation can therefore be utilised to purchase a combination of living and guaranteed annuities. In turn, the portion of the retirement interest utilised to purchase each type of annuity must exceed R165 000. The R165 000 threshold is required to curb the circumvention of prevailing legislation.

Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of annuities purchased on or after that date.

TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER

[Applicable provisions: Paragraph (e) of the definition of "gross income", paragraph (a) of the definitions of "pension preservation fund" and "provident preservation fund", paragraph (e) of the definitions of "pension preservation fund" and "provident preservation fund" in Section 1(1) of the Act, read with paragraphs 2(1)(c) and 6A of the Second Schedule to the Act] EM PG10

Background

Paragraph (e) of the definition of "gross income" in section 1(1) of the Act includes retirement fund lump sum benefits as referred to in paragraph 2(1)(c) of the Second Schedule to the Act in an individual's taxable income. Paragraph 2(1)(c) of the Second Schedule regulates the amount to be included in gross income for any year of assessment, namely, any amount transferred for the benefit of a member of a retirement fund scheme on or after normal retirement age (as defined in the rules of the fund), but before retirement date (as defined in section 1(1) of the Act), less any deductions allowed under paragraph 6A of the Second Schedule to the Act.

Paragraph 6A of the Second Schedule permits the following deductions when calculating the retirement lump sum benefit to be included in gross income:

- Transfers from a pension fund into a pension preservation fund or a retirement annuity fund or;
- Transfers from a provident fund into a pension preservation fund, a provident preservation fund or a retirement annuity fund.

Reasons for change

In the event that a member of a pension preservation or provident preservation fund (who has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the respective fund) makes a transfer into a similar fund, such transfer would be taxable in the individual's hands. This is due to the fact that the current wording of paragraph 2(1)(c) of the Second Schedule includes these transfers in gross income, while paragraph 6A of the Second Schedule fails to provide a deduction for such transfers.

As a result, any individual transfers between preservation funds where the transfer is between similar funds and the member involved has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the relevant fund will be subject to tax, this despite the fact that the policy intention is not to tax transfers from a less to a more restrictive fund, or between similar funds.

Proposal

Government proposes addressing this anomaly by allowing for tax-free transfers from a preservation fund into similar funds by members who have already reached normal retirement age.

Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

CLARIFYING THE CALCULATION OF THE FRINGE BENEFIT IN RELATION TO EMPLOYER CONTRIBUTIONS TO A RETIREMENT FUND

[Applicable provisions: Paragraphs 2(l) and 12D of the Seventh Schedule to the Act] EM PG 11

Background

With effect from 1 March 2016 and in terms of paragraph 2(l) of the Seventh Schedule to the Act, all employer contributions to a retirement fund on behalf of employees are considered taxable fringe benefits in the employees' hands. In turn, paragraph 12D(2) of the Seventh Schedule stipulates that if the employer contributes towards a fund that consists solely of a 'defined contribution component', as defined in paragraph 12D(1) of the Seventh Schedule, the value of the fringe benefit will be the cash equivalent of that part of the contribution that pertains to that employee. Further to the above, the employer is not required to provide the employee with a contribution certificate. In contrast, paragraph 12D(3) of the Seventh Schedule determines that the value of the taxable benefit in relation to employer contributions containing a 'defined benefit component' or an 'underpin component', as defined in paragraph 12D(1) of the Seventh Schedule, is to have the value calculated in accordance with the prescribed formula. In this instance, the employer is required to provide the employee with a contribution certificate.

That said, paragraph (b) of the definition of 'defined contribution component' in paragraph 12D(1) of the Seventh Schedule to the Act would include a benefit or part of a benefit receivable from a pension fund, provident fund or retirement annuity fund that consists of a risk benefit provided by the fund directly or indirectly for the benefit of a member of the fund, if the risk benefit is provided solely by means of a policy of insurance.

Reasons for change

It has come to Government's attention that an anomaly arises in instances where a retirement fund provides both a retirement benefit in relation to the 'defined contribution component' and a self-insured risk benefit. The current wording of the Act would result in the classification of the total contribution to the said fund as a defined benefit component, subject to valuation in terms of the formula contained in paragraph 12D(3) of the Seventh Schedule to the Act as well as the issuance of a contribution certificate. This due to the fact that self-insured risk benefits are not considered a defined contribution component.

Proposal

In order to address this anomaly, it is proposed that changes be made in the legislation so that self-insured risk benefits are classified as a 'defined contribution component'. This would ensure that retirement funds that provide both defined contribution component retirement benefits and self-insured risk benefits can account for the fringe benefit based on the actual contribution. As a result, the value of the risk premiums under self-insured risk benefits will be determined based on the cost to the employer (i.e. the actual contribution made by the employer).

Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

CURBING ABUSE IN THE EMPLOYMENT TAX INCENTIVE

[Applicable provisions: Definition of "employee" in section 1 of the Employment Tax Incentive Act, 2013 (Act No. 26 of 2013) ("the ETI Act"), and definition of "qualifying employee" in terms of section 6 of the ETI Act] EM PG 6

Background

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The main aim of the programme is to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as qualifying employees) through a cost sharing mechanism with Government, by allowing the employer to reduce the amount of Pay-As-You-Earn (PAYE) they pay to the South African Revenue Service (SARS), while leaving the wage received by the qualifying employees unaffected. Consequently, section 1 of the ETI Act defines an employee as a natural person who works for another person and receives or is entitled to receive remuneration from that other person. In turn, section 6 of the ETI Act stipulates the conditions that need to be met for the employee to be classified as a qualifying employee for ETI purposes.

Reasons for change

It has come to Government's attention that some taxpayers have devised certain schemes where they claim the ETI in respect of individuals who do not work for them, therefore failing to meet the definition of "employee" as outlined in section 1(1) of the ETI Act. The nature of these schemes is to market and utilise the ETI as a means of facilitating the entry of qualifying, unskilled, inexperienced, previously disadvantaged South Africans in the modern economy.

Eligible participants are recruited by a recruitment agency and employed by a participating employer for a fixed term period of 12 to 24 months. Participating employers engage with the recruitment agency to recruit eligible participants. Contracts signed by the eligible participants indicate the receipt of remuneration while 'employed' by the participating employer. Once 'employed', participants are trained by a training institution (over the 12 to 24 month period) and, in some cases, enrolled in Sector Education and Training Authority (SETA) accredited courses. The training institution is contracted by the participating employer at a cost equal to the remuneration stated in the eligible participant's contract. The remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant.

In some cases, the eligible participants are exposed to work-based exercises and activities by an independent company. The independent company is able to utilise the eligible participants for a fixed monthly fee, which similar to the remuneration, is not paid to the eligible participant. Once the training programme is completed, the eligible participant may work for the participating employer for the remainder of the 12 to 24 month period. In accordance with said scheme, the participating employer is then able to claim the ETI for the 12 to 24 month period that the eligible participant is supposedly 'employed' by the employer.

Proposal

The proposed clarification to the legislation is more of a confirmation of the policy position regarding the meaning of "employee" in section 1 of the ETI Act as well as the requirements needed to be met to be considered a "qualifying employee" as stipulated in section 6 of the ETI Act. In order to address the above-mentioned contraventions, it is proposed that changes be made in the ETI Act to clarify that substance over legal form will be considered when assessing an employer's ability to claim the ETI. As such, 'work' must actually be performed in terms of an employment contract and the employee must be documented in the employer's records as

envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997). Further to the above, the employee must, in lieu of services rendered, receive cash remuneration from the employer.

Effective date

The amendments will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

EXTENSION OF THE EXPANDED EMPLOYMENT TAX INCENTIVE AGE ELIGIBILITY CRITERIA AND AMOUNT CLAIMABLE

[Applicable provisions: Sections 2,3,4,5,6 and 11 of the Disaster Management Tax Relief Act, No. 13 of 2020 ("the Disaster Management Tax Relief Act")] EM PG 12- 14

Background

In 2020, Parliament passed the Disaster Management Tax Relief Act, 2020 and the Disaster Management Tax Relief Administration Act, 2020, containing exceptional tax measures which formed part of the fiscal package aimed at assisting taxpayers who experienced cashflow constraints as a result of the COVID-19 pandemic and required national lockdown.

One of the exceptional tax measures included in the above-mentioned Acts was an expansion to the Employment Tax Incentive (ETI). This expansion was provided to assist employers to retain employees, thus reducing the risk of low-income earners losing their employment as a result of the lockdown.

The expanded ETI was structured as follows:

- A R750 increase to the maximum monthly amount of ETI allowable.Allowing the above mentioned monthly ETI claim to apply to employees not classified as "qualifying employees" in terms of the current provisions of the ETI Act for a limited period, irrespective of their date of employment (employees employed before 1 October 2013 for whom the ETI has never been claimable also qualified for the relief).
- Since the requirement for social distancing was likely to result in employees working significantly reduced hours, which would impact the monthly remuneration paid, the proposal allowed for the calculation of the ETI claim based on actual remuneration paid in that month where the employee worked less than 160 hours a month (the remuneration paid to the employee did not need to be grossed-up).
- Accelerating the ETI reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.
- As the contractual agreement entered into at the beginning of the employees employment with the employer was not altered, the extent of the ETI claimable in instances where the employee was employed for less than 160 hours a month would still be impacted by the hours employed and paid for in that month (the incentive claimable would bear the same ratio that the number of hours the employee was remunerated bears to 160 hours – the incentive needed to be grossed-down).

- The inclusion of an anti-avoidance measure aimed at limiting potential abuse where an employer claimed the incentive despite having significantly reduced the employee's wages. This anti-avoidance measure applied to wages below R2 000.
- The expansion applied for four months and was deemed to have come into operation on 1 April 2020 and ended on 31 July 2020.

Reasons for change

Despite the recent relaxation of the national lockdown, various businesses and employees are still negatively impacted by the COVID-19 pandemic. These negative impacts are further exacerbated by the impacts of the recent unrest in the country that destroyed businesses and infrastructure. The Government, therefore, wishes to provide additional assistance to those who continue to be adversely affected by COVID-19, as well as assisting in the process of reconstructing businesses. Moreover, this support measure is aimed at supporting employment in the most vulnerable sections of the labour market.

Proposal

As a result, it is proposed that the expansion of the ETI be reinstated for another limited four- month period, following the design implemented in 2020:

- A R750 increase to the maximum monthly amount of ETI allowable. Therefore, the maximum allowable values will be increased in the following manner:
- Employees are eligible under the current ETI Act from R1 000 to R1 750 in the first qualifying twelve months and from R500 to R1 250 in the second twelve qualifying months.
- Allowing a monthly ETI claim in the amount of R750 during these four months for employees from the ages of 18 to 29 who are no longer eligible for the ETI as the employer has claimed ETI in respect of those employees for 24 months, or they were in the employer's employ before 1 October 2013.
- Allowing a monthly ETI claim in the amount of R750 during these four months for employees from the ages 30 to 65 who are not eligible for the ETI due to their age.
- Formulae will apply to calculate the value of the incentive relative to remuneration received, to introduce the incentive at a positive rate for wages between R0 and R2 000 per month, at a constant value for wages between R2 000 and R4 500 per month, and a declining rate for wages between R4 500 and R6 500.
- Since the requirement for social distancing may result in employees working significantly reduced hours, coupled with businesses that are being reconstructed being unable to trade as normal at the moment, both of which would impact the monthly remuneration actually paid, the proposal allows for the calculation of the ETI claim based on actual remuneration
- paid in that month where the employee worked less than 160 hours a month (the remuneration paid to the employee would not need to be grossed-up).
- As the contractual agreement entered into at the beginning of the employees employment with the employer will not be altered, the extent of the ETI claimable in instances where the employee was employed for less than 160 hours a month would still be impacted by the hours employed and paid for in that month (the incentive claimable will bear the same ratio that the number of hours the employee was remunerated bears to 160 hours – the incentive would need to be grossed-down).
- The inclusion of an anti-avoidance measure aimed at limiting potential abuse where an employer claims the incentive despite having significantly reduced the employee's wages. This anti-avoidance measure will apply to wages below R2 000.

- Accelerating the ETI reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.

- To qualify for this relief, the employer must be tax compliant and registered with the South African Revenue Service (SARS) as an employer by 25 June 2021.

Effective date

The measures will apply for four months and come into operation on 1 August 2021 and end on 30 November 2021.

CLARIFYING THE TIMING OF DISPOSAL RULES IN RESPECT OF AN ASSET ACQUIRED FROM A DECEASED ESTATE

[Applicable provisions: Section 1(1) new definition of "liquidation and distribution account" and section 25(3) of the Act] EM PG 7

Background

When a person dies, the Estate Duty Act, 1955 (Act No. 45 of 1955) ("the Estate Duty Act") makes provision for the assets of that person, as at the date of death, to be part of a deceased estate, before the assets are distributed to the respective heir(s). Estate Duty is then levied on the net value of a deceased estate in excess of the individual estate duty rebate of R3.5 million. If the dutiable amount of an estate does not exceed R30 million, Estate Duty is levied at a rate of 20 per cent and at a rate of 25 per cent on the dutiable amount of an estate exceeding R30 million.

The Estate Duty Act also makes provision for the Executors to step into the shoes of the deceased and administer the deceased estate, this includes the preparation and submission of the Liquidation and Distribution Account to the Master of the High Court Office, the submission of the relevant tax returns to SARS (including the payment of the estate duty to SARS). According to South African law, the relevant heir(s) of the estate have a personal right to claim delivery of the assets from the deceased estate after the finalisation of the Liquidation and Distribution Account.

Reasons for change

The South African law requires that the Liquidation and Distribution account lies open for inspection in the Master of the High Court's office for 21 business days. In the event that no objection is lodged against the Liquidation and Distribution account during this 21-day period, the Liquidation and Distribution Account can then be finalised. If any objections are lodged against the Liquidation and Distribution account, the law requires that the Liquidation and Distribution account remains open for inspection for another 21 business days (this 21-day period will be required until such time as no objections are raised).
At issue is a timing uncertainty around when the heirs are regarded as having acquired an asset from the estate of the deceased.

Proposal

In order to clarify the time of disposal of the heir's personal right to claim delivery of the deceased estate assets, it is proposed that changes be made in the legislation so that the disposal of assets by the estate occurs on the earlier of the date of an interim disposal or the date when the Liquidation and Distribution account becomes final.

Effective date

The amendment will come into operation on 1 March 2022 and apply in respect of Liquidation and Distribution accounts finalised on or after that date.

The responsibility of the employer in respect of a deceased employee

(SARS website "Estates")

The Fourth Schedule to the Income Tax Act (the Act) places various obligations on an employer in respect of the deduction or withholding of employees' tax and the administrative requirements related thereto.

What obligation rests on the employer?

Paragraph 13(2)(b) of the Fourth Schedule to the Act provides that an employer, who ceased to be an employer in relation to an employee, for example when an employee dies, is required to deliver an employees' tax certificate within 14 days of the date on which employment ceased to the former employee (or to such deceased employee's representative).

The employer must therefore deliver an employees' tax certificate within 14 days after the employee passed away. The employer is required to provide the employees' tax certificate to the executor acting as the representative taxpayer of the deceased employee.

The provisions of paragraph 14(5) of the Fourth Schedule that states the employees' tax certificate shall not be delivered until the EMP501 reconciliation was submitted to SARS is not applicable to the circumstances envisaged under paragraph 13(2)(b). An employer must therefore, in the case of an employee's death, provide the employees' tax certificate even if the reconciliation is not yet submitted.

What obligation rests on the executor?

The executor, as the representative taxpayer, is responsible to finalise the financial and tax affairs of the deceased employee efficiently and without any unnecessary delays. The executor should therefore ensure that the necessary documentation, like the employees' tax certificate is obtained from the deceased's employer.

BUSINESS

STRENGTHENING THE RULES DEALING WITH THE LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX

[Applicable provisions: Sections 23M of the Act] EM PG 14-21

Background

In 2013, the rules dealing with the limitation of interest deductions in respect of debts owed to persons not subject to tax were introduced in section 23M of the Act. These rules were effective from 1 January 2015 and apply in respect of amounts of interest incurred on or after that date. The main aim of these rules is to limit excessive interest deductions in respect of debts owed to persons not subject to tax in South Africa, if the debtor and the creditor are in a controlling relationship. In particular, these rules apply as follows:

A. Meaning of the term "interest" for purposes of these rules

Currently, for the purposes of these rules, the term "interest" means interest as defined in section 24J. This implies that these rules are only applicable to interest as defined in section 24J.

B. Deductible interest limitation: Formula calculation

When these rules were first introduced in 2013, the aggregate deduction for interest incurred in respect of a debt owed under the circumstances set out above was based on an annual limitation determined according to a formula as defined section 23M(3). In this regard, the aggregate deductions for these amounts was limited to the sum of:

- The total interest received or accrued to the debtor; and
- 40 per cent of adjusted taxable income;
- Reduced by interest incurred in respect of debts owed (other than debts to creditors in a controlling relationship).

The term 'adjusted taxable income' was defined as taxable income of the debtor less interest received or accrued, net income included in terms of section 9D (controlled foreign company net income), and recoupments in respect of capital assets; with the addition of interest incurred and all capital allowances. In illustrative terms, 'adjusted taxable income' included the following:

Starting point	Taxable income
Less	Interest received or accrued
	CFC net income
	Recoupments
Plus	Interest incurred
	Capital allowances

At the time, the 40 per cent deduction formula was based on the assumption of relatively low national interest rates. It was set to increase if the national repo rate exceeded 10 per cent as follows:
(40 per cent) x repo rate / 10

Interest expense in excess of the limitation was not deductible in the year of assessment, but was carried forward to the following year of assessment.
In 2014, before these rules came into effect, changes were made to the term 'adjusted taxable income' to exclude previous years' assessed losses carried forward from the current year's adjusted taxable income. Currently, 'adjusted taxable income' is calculated as follows:

Starting Point	Taxable Income
Less	Interest received/accrued
	CFC net income
	Recoupments
Plus	Interest incurred
	Capital allowances
	Assessed losses

Changes were also made to the 40 per cent deduction formula to more closely align it to the cost of debt financing in the market. The limitation – expressed as a percentage of the tax equivalent of "earnings before interest, taxation, depreciation and amortisation" (EBITDA) – was changed to adjust up and downwards based on the prevailing repo rate. The formula was amended to link deductible interest expenditure to the average repo rate for the year, regardless of whether the repo rate exceeds 10 per cent. The formula became flexible so that any change to the average repo rate for the year of assessment (together with a 400-basis point addition to the average repo rate) is captured to allow for a balanced reflection of market conditions on the interest deduction limitation. To protect the fiscus and tax base in periods of high interest rates, a cap on the interest deduction limitation ratio of 60 per cent was inserted.

These changes were made to recognise taxpayer's concerns. However, Government did point out at the time – in public consultations, on page 22 of the Explanatory Memorandum to the 2014 TLAB, and on page 13 of the 2014 Response Document to the 2014 TLAB – that available data indicated that 40 per cent was too high. Given that this was based on financial accounting information from Statistics South Africa, and not micro-level tax data from SARS, it was decided to retain the 40 per cent starting point with a flexible formula, but that this would be subject to review.

C. Back-to-back loans

Currently, section 23M(2) makes provision for these rules to apply to back-to-back loans. As indicated above, the ordinary scenario of application contained in section 23M(2)(a) makes provision for these rules to apply to loans to a debtor from a creditor that is in a controlling relationship with that debtor.

To address the use of back-to-back lending arrangements that would avoid the application of the interest limitation rules, section 23M(2)(b) makes provision for these rules to apply to loans made to a debtor from a creditor that is not in a controlling relationship with that debtor if that creditor obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that debtor.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

Currently, section 23M provides no distinct treatment for REITs (defined in section 1(1) of the Act and which are subject to a specific tax regime under section 25BB of the Act).

E. Interaction between the level of tax on interest and application of section 23M rules

Currently, one of the requirements for section 23M to apply is that the amount of interest incurred is not subject to tax in the hands of the recipient. In instances where the corresponding interest income is subject to tax in the hands of the recipient, the tax rate varies from 5 per cent (if the withholding tax on interest has been reduced by a treaty) to the corporate tax rate. This means that some taxpayers are not subject to the limitation even though the interest income is taxed at very low rates.

Reasons for change

On 26 February 2020, Government published a discussion document titled "***Reviewing the Tax Treatment of Excessive Debt Financing, Interest Deductions and Other Financial Payments***" to conduct a review of the current rules dealing with the limitation of interest deductions in respect of debts owed to persons not subject to tax, in line with the OECD/G20 BEPS Action 4 recommendations on interest deductions. The review highlighted that the elements the current rules require consideration.

A. Meaning of the term "interest" for purposes of these rules

Relative to the OECD/G20 BEPS recommendations, the existing rules are narrow. The meaning of interest for the purposes of these rules is narrowly defined and does not consider opportunities for tax avoidance, where interest can be labelled as other types of payments to circumvent the application of these rules.

B. Deductible interest limitation: Formula calculation

As noted above, available data during 2014 showed that the 40 per cent starting point may be too high and should be subject to review.

The OECD/G20 BEPS Action 4 Report recommends that countries use a fixed ratio of earnings to limit the deduction of excessive interest deductions and other financial payments. To recognise that countries have different interest rate and risk environments, the Report recommends a corridor approach where countries consider a range of factors to assess which percentage of earnings would be most appropriate for their economies.

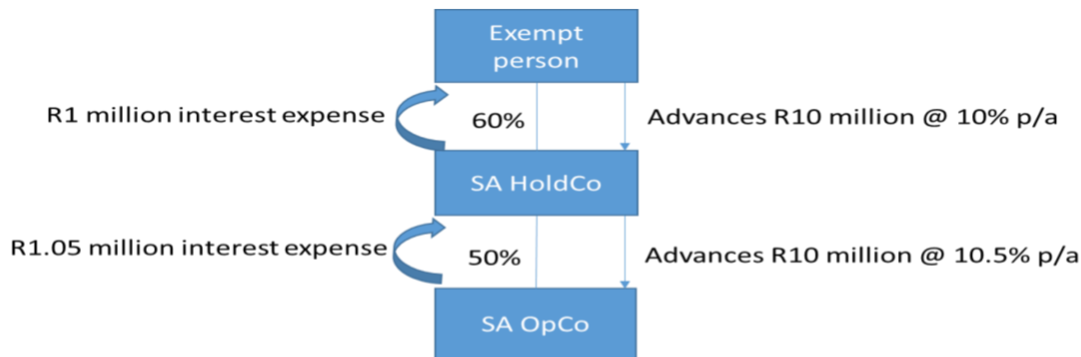
South Africa's current rules are unique in that no other country uses a formula to determine the limitation as a percentage of earnings. All developed and developing countries that have such rules apply a fixed ratio of earnings. In 2014, internal analysis indicated that a ratio of 30 per cent would have been more appropriate than 40 per cent. Available data indicated that the average net interest expense / EBITDA ratios were just above 15 per cent, and this was at a time when prevailing interest rates were higher than what they are currently.

More recently, analysis using SARS micro-level data for all taxpayers shows that applying a fixed ratio of 30 per cent would be fair in that the majority of taxpayers will be able to deduct all their interest payments without restriction. In contrast to the proposal in the Discussion Document, the rules will continue to apply to interest payments between taxpayers where there is a controlling relationship (including back-to-back arrangements), rather than applying to total interest expense.

Furthermore, with the indefinite carry-forward being retained for now, no interest expense deductions will expire. While Government was considering imposing a restriction on the carry forward, it was decided that this would be too punitive in conjunction with the proposed restriction on the offset of assessed losses in determining taxable income. The stance on the ability to carry forward excess interest deductions will be reviewed after 5 years. From a policy perspective – if interest payments are considered to be excessive, allowing an indefinite carry forward is a contradiction to the policy aim. However, Government recognises that not all businesses' investment and profit patterns follow the same time horizons and that those with longer timeframes between investing and yielding taxable profits would be worse off if a time limit was imposed.

C. Back to back loans

It has come to Government's attention that the current rules give rise to anomalous results in the case of some back-to-back lending arrangements. The back-to-back lending arrangements of concern involve loans that are channelled between two or more tax paying companies that are ultimately owned by another company that is not subject to tax in South Africa (e.g. a resident tax- exempt entity). Under these back-to-back lending arrangements, which are often entered into by a chain of companies that are in controlling relationships with each other, the fiscus ends up bearing a much larger interest deduction as a result of the net effect of these back-to-back lending arrangements. The interest limitation rules are effectively side stepped under these arrangements as the rules apply where there is a controlling relationship and the interest incurred is not subject to tax in the hands of the person to which it accrues. In these arrangements, a company that is subject to tax receives the interest income from the debtor and pays a slightly smaller amount in interest expense to a company that is not subject to tax on the corresponding interest income. The following, illustration sets out the concern identified:



Result

SA Hold Co:
- Net interest income: R50 000 (R1.05 million – R1 million)

SA OpCo:
- Can deduct in full interest expense of R1.05 million

The resultant effect on the fiscus is that a net R1 million interest deduction is claimed without regard for the interest limitation rules even though the interest income of R1 million is ultimately not subject to South African tax as would be the case with an exempt person.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

In general, a REIT or a controlled company is not taxed on the income it derives due to a deduction for qualifying distributions made by it. In certain instances, the deduction of a qualifying distribution may result in zero-taxable income for a REIT or controlled company.

Section 23M of the Act limits the deductibility of interest incurred in respect of loan funding advanced between any “debtor” that obtains funding, directly or indirectly, from a creditor that is in a “controlling relationship” with the debtor. At issue is that the deduction for qualifying distributions will distort their “tax EBITDA” and will result in them having a much lower “tax EBITDA” than other taxpayers.

E. Interaction between the level tax on interest and application of section 23M rules

Section 23M currently applies if two conditions are met

(i) there is a controlling relationship, and

(ii) the interest is not subject to tax in the hands of the recipient. Where the recipient is subject to tax, section 23M does not apply. However, recipients are subject to a range of tax rates. The current wording in section 23M can create a perverse incentive that encourages companies to route their interest payments via countries with the lowest interest withholding tax rate (as a result of the application of tax treaties) that exceeds zero (i.e. 5 per cent). Doing so yields two benefits for a taxpayer: (i) the interest payment is not subject to 23M; and (ii) the WHT on interest at a rate of 5 per cent is more favourable than the standard rate of 15 per cent.

Proposal

Based on the above, Government proposes the following:

A. *Meaning of the term 'interest' for purposes of these rules*

It is proposed that for the purpose of these rules, the meaning of the term 'interest' should be expanded beyond the current definition of interest contained in section 24J, to include the following:

- Payments under interest rate swap agreements
- These agreements involve one party simply swapping one stream of interest expense (e.g. fixed rate payments) for another (e.g. variable rate payments). While the interest payments under a swap agreement are in respect of a notional amount, the original interest payments for which the contract was entered into are in respect of a debt. To the extent that such swap agreements are entered into between persons where there is a controlling relationship, the interest payments will be restricted by section 23M. Government proposes to include payments under interest rate agreements as defined in section 24K(1) of the Act in the definition of the term 'interest' for purposes of these rules. This is applicable for both payments incurred and received.
- Finance cost element included in finance lease payments
- The proposed amendment will limit the deduction of the finance cost element of finance lease payments to persons where there is a controlling relationship. The current tax treatment for finance leases will continue to apply, except that the finance cost element will be grouped with other interest income and payments subject to section 23M, and only in cases where there is a controlling relationship.
- Foreign exchange differences
- It is proposed that foreign exchange gains and losses taken into account in determining taxable income in terms of section 24I(3) and (10A) should be included in the definition of 'interest' for purposes of these rules.
- Amounts deemed to be interest under Sharia compliant financing arrangements
- It is proposed that any amounts deemed to be interest in terms of section 24JA will also be subject to the provisions of section 23M.

B. *Deductible interest limitation: Formula calculation*

It is proposed that changes be made to the deduction formula as follows:

- The deduction of interest expenditure should be limited to 30 per cent of 'adjusted taxable income' instead of the current calculated percentage of 'adjusted taxable income'. Therefore, part of the deduction formula in section 23M(3)(b), which adjusts up and downwards based on the average repo rate for the year will be deleted.
- In view of the fact that the part of the formula that refers to the average repo rate and repo rate is deleted, consequential amendments should be made in section 23M(1) to delete the definitions of 'average repo rate' and 'repo rate'.

C. Back-to-back loans

To curb the circumvention of the rules applicable to back-to-back loans, it is proposed that changes be made in the current provisions of section 23M(2) so that the interest limitation rules also apply in two additional instances where a debtor incurs an amount of interest owed to a creditor that (i) forms part of the same group of companies as that debtor; and (ii) is in a controlling relationship with that debtor and the interest is taxable in the hands of the immediate creditor, but is not fully subject to tax in the hands of the ultimate creditor, if that creditor, directly or indirectly through another creditor that is in a controlling relationship with that creditor, obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that creditor and that other creditor and would not be taxed on interest accrued.

D. Refining the amount of interest deducted for REITS: Changes to the definition of Adjustable Taxable Income

It is proposed that a change be made in the definition of 'adjusted taxable income' in section 23M(1) to take into account a 'qualifying distribution' of a REIT. As such, calculating 'adjusted taxable income' requires the following:

Starting Point	Taxable Income
Less	Interest received/accrued
	CFC net income
	Recoupment
Plus	Interest incurred
	Capital allowances
	Assessed losses
	Deductible 'qualifying distribution' of a REITor controlled company

E. Interaction between the level of tax on interest and application of section 23M rules

It is proposed that changes be made in the legislation so that there is a more consistent treatment for all resident debtors paying interest, and so that the restriction is not dependant on which country the payment is routed through.

In instances where a resident debtor makes an interest payment and either the payment attracts WHT on interest at a rate of zero or it is not included in the recipient's income, the deduction for interest expense will be subject to section 23M as under the current rules.

For cases where a resident debtor makes an interest payment and the payment attracts WHT on interest at a rate higher than zero but less than the standard rate, a portion of the deduction for interest expense will be subject to section 23M.

For example, if a resident debtor pays R100 of interest to a non-resident creditor (which is in a controlling relationship with the debtor), and the relevant treaty reduces the WHT rate to 5 per cent, the debtor can fully deduct 5/15ths of the interest expense and the remaining interest amount will be subject to the section 23M limitation. In this example, the amount subject to section 23M would be (15-5)/15 x 100, which equals R66.67.

From a review of a variety of countries, it appears that most apply interest limitation rules regardless of how the corresponding interest income is treated or whether withholding taxes apply. This appears to be the case for many countries, including the United States, Germany, India and African countries that choose to adopt the drafting guidelines published by the African Tax Administrative Forum. If Government had followed this approach, the only consideration for being subject to section 23M would be whether there is a controlling relationship or not. However, Government considers the proposed approach to be more equitable than applying the restriction regardless of how the interests is taxed in the hands of the recipient.

The Act has precedent for introducing the proposed change. The extent to which taxpayers can deduct tainted royalties depends on the rate of WHT applied. The basis is slightly different as one portion is denied, rather than limited, but this is because Government funding was often used to fund the intellectual IP that was moved offshore.

Effective date

In line with the Minister of Finance's announcement of introducing a revenue neutral corporate income tax package, and to recognise the hardship companies have faced during the COVID-19 pandemic and its associated lockdowns, the amendment will come into operation on the date on which the rate of tax in respect of the taxable income of a company is first reduced after announcement by the Minister of Finance in the Annual National Budget and will apply in respect of years of assessment commencing on or after that date.

Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill: Section 23M comes into operation on 31 March 2023 and applies in respectof years of assessment ending on or after that date.

RESTRICTING THE SET-OFF OF THE BALANCE OF ASSESSED LOSSES IN DETERMINING TAXABLE INCOME

[Applicable provision: Section 20(1) of the Act] EM PG 21-26

Background

In determining taxable income, section 20 of the Act enables taxpayers to set off their balance of assessed losses carried forward from the preceding tax year against their income. An unutilised assessed loss balance may be carried forward to future years of assessment to be set off against future income (provided that the taxpayer's trade continues without interruption). Accordingly, taxpayers will only be liable for income tax once they have earned a taxable profit and their assessed loss balance is depleted.

The purpose of providing for the deductibility of assessed losses for corporate taxpayers is to smooth the tax burden for companies whose primary business is cyclical in nature and not in line with a standard tax year, and for start-up companies that are not profitable in the early years of trading.

Even so, there has been a global trend to restrict the use of assessed losses carried forward. In 2015, out of a group of 34 OECD and non-OECD countries, 16 countries limit carry-forward periods to between 3 and 20 years, while 8 countries limit the amount of tax losses that can be offset in any given year. The latter are restricted to a percentage of either taxable income (ranging from 50 to 80 per cent) or accumulated assessed losses (ranging from 25 to 50 per cent) per year. The Slovak Republic, for instance, uses two restrictions – assessed losses can be carried forward for 5 years and the maximum set-off against taxable income is 50 per cent of the tax base. Restricting the use of assessed losses is not unique to OECD countries. In Brazil, revenue tax losses may be carried forward indefinitely, but may only reduce up to 30 per cent of taxable income in one tax period. Russian companies can carry forward operating tax losses indefinitely and, until the start of 2021, these could only be offset against up to 50 per cent of the annual tax base. India and China both use time limits – India has a time limit of 8 years for setting off business losses, while losses in China can be carried forward for 5 years (10 years for new / high-tech / small and medium technology enterprises). With respect to neighbouring countries, Botswana and Mozambique both restrict the time period for carrying forward assessed losses to 5 years (with the exception of mining and prospecting in Botswana).

Reasons for change

Over the past few years, there has been an international trend to restrict the use of assessed losses and reduce the corporate income tax rate. To improve the country's competitiveness, reduce the appeal of base erosion and profit shifting, encourage investment and promote economic growth, the Minister of Finance announced (in the 2020 Budget Review) Government's intention to restructure the corporate income tax system over the medium term by broadening the base and reducing the corporate income tax rate in a revenue neutral manner.

Restricting the use of assessed losses against taxable income provides some of the fiscal space required to lower the rate and, as a result, forms part of a corporate income tax package to broaden the base and reduce the headline corporate tax rate in an overall revenue neutral manner.

There are four reasons for pursuing this proposal as announced in the 2020 Budget Review:

- As stated, it forms part of a corporate income tax package to broaden the base and reduce the headline corporate income tax (CIT) rate in an overall revenue neutral manner. Restricting the offset of accumulated assessed losses against taxable income provides some of the fiscal space required to lower the rate.
- While allowing full loss offsets against taxable income allows for less distortions towards less risky projects and enhances the stabilisation effects of corporate income taxation, a number of other countries do not achieve perfect symmetry in their CIT regimes and have used this type of measure as a means to fund lowering CIT rates.
- CIT is the most volatile of the main tax revenue instruments and this measure will assist in smoothing CIT revenues. A minimum tax would also achieve this function, but would be more punitive in that it would apply to businesses that make a taxable loss in the current year. This proposed measure will only apply once businesses turn profitable.
- While partial loss offsets may have a negative impact on business' cash flow and investment, they can help in curtailing tax avoidance. Given the time value of money, there is less incentive to overstate losses.

The following three methods are used by various countries to restrict the use of assessed losses:

(i) limiting the carry-forward periods to a set number of years;
(ii) basing a restriction on a specified percentage of accumulated assessed losses that may be used to reduce taxable income; and
(iii) restricting the set off of accumulated assessed losses to a specified percentage of taxable income. Some countries also combine a restriction based on a set number of years with a restriction based on either a percentage of accumulated losses or taxable income.

The time-bound limit has a large effect on both symmetry and stabilisation and has an uneven effect across businesses depending on their business models. Those with long lead times between upfront investment and the realisation of income and profits (e.g. mining) would be worse off than those with shorter periods in a loss position.

Restricting the amount of assessed losses to be offset does not discriminate against varying business models and would affect a larger share of businesses. With respect to choosing between basing the amount on a percentage of the accumulated assessed loss itself or on taxable income, research shows that defining the offsetting restriction in relation to accumulated losses can have a more negative impact on symmetry and stabilisation compared to using taxable income as the reference point. This is because the latter allows the full balance of assessed losses to be exhausted assuming an indefinite carry forward.

Based on research and the desire to work towards an efficient corporate tax regime with a broad base and lower rate, placing a restriction on a high share of taxable income is seen as the most appropriate policy stance for South Africa to balance the effects for businesses and government. This is viewed as a reasonable approach that affects all businesses more equally, rather than restricting the number of years for carrying forward assessed losses, which would disproportionately hurt businesses with large initial investments or long lead times to profitability.

South Africa has no provision for carrying back losses (against prior year taxable income). This type of measure has been used in economic downturns and some countries have done so (many on a temporary basis) to alleviate the negative economic impact of the Covid-19 pandemic on previously profitable companies.

Research shows that, for depreciation schedules which are not too accelerated, carry-backs are an effective policy to help with symmetry and stabilisation. South Africa's depreciation schedules are predominantly accelerated – particularly in the primary and secondary sectors where large capital investments are common, such as mining, agriculture and manufacturing. In addition, there is not sufficient fiscal space to provide businesses with this option. Most of the countries that offered temporary loss carry-backs are developed countries with more room for expansionary fiscal measures.

Proposal

In line with the 2020 Budget announcement, government proposes to broaden the corporate income tax base by restricting the offset of the balance of assessed losses carried forward to 80 per cent of taxable income.
The proposal extends to the balance of assessed losses at the time of implementation. This will contribute to providing the fiscal room for government to lower the corporate tax rate.
The effect of the proposed restriction is that only companies that would be in a positive taxable income position before setting off the balance of assessed losses would be affected.
The table below provides an overview of four potential combinations of taxable profit / loss positions combined with whether there is an assessed loss balance or not.

Group	Current year	Accumulated assessed loss
A	Taxable profit (before setting off assessed loss balance)	No assessed loss balance
B	Taxable profit (before setting off assessed loss balance)	Assessed loss balance
C	Taxable loss (before setting off assessed loss balance)	No assessed loss balance
D	Taxable loss (before setting off assessed loss balance)	Assessed loss balance

Those in groups A, C and D will not be affected by the proposed restriction on assessed losses. It is only companies in group B that will be potentially affected. Within Group B, if the company's accumulated assessed loss balance exceeds 80 per cent of its taxable income, the company willbe required to pay corporate income tax on 20 per cent of its current-year taxable income.

The examples below illustrate how three different companies in Group B would be affected – all of which are in a positive taxable income position before offsetting any prior year losses.

Example 1

Company B1 has R500 of taxable income before offsetting accumulated losses of R1,000. The accumulated loss balance exceeds current-year taxable profit – and, by implication, is more than80 per cent of taxable income. Company B1 will be required to pay corporate income tax on the portion of its current-year taxable income that exceeds 80 per cent of taxable income (i.e. on 20 per cent of taxable income). As a result, Company B1 will be required to pay CIT of R28 (CIT rateof 28 per cent applied to taxable income of R100). The remaining balance of the assessed loss can be carried forward to the following year of assessment. While the corporate tax liability will beincreased by R28 for two years, this will be countered by a reduction in the tax liability in year 3. This shows that the proposal brings in a timing difference relative to the current legislation and there is no change in the overall tax liability (visible in the last row titled "Difference").

Example 2

Company B2 has taxable income of R500 prior to setting off assessed losses of R475. The balance constitutes 95 per cent of current-year taxable income – exceeding the proposed 80 percent restriction. As a result, Company B2's assessed loss balance which can be set off against itstaxable income will be limited to R400 (80 per cent of its taxable income), with the remaining balance of R75 carried forward to future years. Company B2 will pay CIT of R28 (CIT rate of 28 per cent applied to taxable income of R100) rather than R7 in year one, but this difference will bereversed in year 2.

Example 3

Company B3 has taxable income of R500 before offsetting the assessed loss balance. However,its assessed loss balance is R200, which is less than 80 per cent of taxable income. Company B3will be able to use its total assessed loss balance of R200 to reduce its taxable income.

To recognise that not all companies have sufficient cash flow to face an additional tax burden in the first year they become profitable (if they still have a remaining balance of assessed losses from prior years that exceeds 80 per cent of current-year taxable income), government proposesincluding a de minimis threshold in the assessed loss restriction. The aim is to provide breathing room for a variety of companies that may experience cash flow challenges at different times. Forexample, this should provide the space for smaller companies to use available funds to grow andfor new companies to use available funds to survive and ultimately grow. It could also assist in theevent that companies face setbacks or cyclical events and need to rely on available cash flow to recover.

To the extent that the balance of assessed loss exceeds 80 per cent of current-year taxable income, companies will be able to set off the higher of R1 million or 80 per cent of taxable income.

Company	B1			B2		B3	
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 1	Year 2
Existing regime							
Taxable income	500	500	500	500	500	500	500
Assessed loss balance b/f	1 000	500	-	475	-	200	-
Taxable income	-	-	500	25	500	300	500
CIT @ 28%	-	-	*140*	*7*	*140*	*84*	*140*
AL balance c/f	500	-	-	-	-	-	-
Proposed regime							
Taxable income	500	500	500	500	500	500	500
80% of taxable income	400	400	400	400	400	400	400
Assessed loss balance b/f	1 000	600	200	475	75	200	-
% of taxable income	*200%*	*120%*	*40%*	*95%*	*15%*	*40%*	*0%*
Taxable income	100	100	300	100	425	300	500
CIT @ 28%	*28*	*28*	*84*	*28*	*119*	*84*	*140*
AL balance carried forward	600	200	-	75	-	-	-
Change in tax liability							
CIT pre-change (no restrictionon assessed loss balance)	-	-	140	7	140	84	140
CIT post-change (restriction on assessed loss balance)	28	28	84	28	119	84	140
Difference	28	28	- 56	21	- 21	-	-

Effective date

In line with the Minister of Finance’s announcement of introducing a revenue neutral corporate income tax package, and to recognise the hardship companies have faced during the COVID-19pandemic and its associated lockdowns, the amendment will come into operation on the date on which the rate of tax in respect of the taxable income of a company is first reduced after announcement by the Minister of Finance in the Annual National Budget and will apply in respectof years of assessment commencing on or after that date.

CLARIFYING THE DEFINITION OF CONTRIBUTED TAX CAPITAL

[Applicable provision: section 1(1) of the Act – 'contributed tax capital' definition and the insertion of a further proviso to the definition]
EM PG 26

Background

The concept of contributed tax capital (CTC) was introduced in the Act in 2008. The CTC of any company is a notional and ring-fenced amount derived from contributions made to a company by holders of a class of shares as consideration for the issue of that class of shares by that company. It is reduced by any capital amount that is subsequently transferred back by the company to one or more shareholders of that class of shares (commonly known as a capital distribution) utilising the notional tax amount so received.

Reasons for change

The policy rationale of this provision and the wording of the current proviso to the definition of CTC the legislation specifically requires that no holder of shares within a particular class of shares may receive CTC in excess of an amount per share derived by dividing the total CTC by the number of shares in that class immediately before that distribution.
However, it has come to Government's attention that some companies are exploiting the current provisions of the CTC by allocating CTC on the basis of an alleged 'share premium' contributed by a particular shareholder but not to all shareholders holding shares in the same class of shares.

Proposal

In order to curb this abuse, it is proposed that changes be made to the definition of CTC to clarify the principle that shareholders within the same class of shares should equally, in relation to their shareholding, share in the allocation of CTC as a result of a distribution.

To accommodate certain corporate actions, which structurally can be facilitated as a distribution of capital through an allocation of CTC, it is proposed that any amount transferred as an acquisition by the company of its own listed securities by way of general repurchase of that securities be specifically excluded from the anti-avoidance proposal above.

Effective date

The amendments will come into effect on 1 January 2023.

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

[Applicable provision: Sections 8F, 8FA and 50A of the Act] EM PG 26

Background

The Act contains specific anti-avoidance rules in section 8F and section 8FA dealing with hybrid debt instruments and hybrid interest. The general aim of these anti-avoidance rules is to curb the artificial generation of interest deductions by an issuer if the debt instrument qualifies as a hybrid debt instrument because of its equity features, or if the yield is determined not to constitute bona fide interest and seeks to recharacterise interest labelled returns as dividends in specie paid in respect of a share. Consequently, the issuer may be liable for dividends tax at a rate of 20 per cent.

Section 8F focuses on the equity-like features of a debt instrument and applies when the debt instrument exhibits certain equity features that taxpayer include in their financial arrangements in order to take advantage of the equity features and would otherwise benefit from the tax deductibility of interest from interest bearing debt arrangements. The section deals with the convertibility of the debt instrument into shares, the repayment of the debt or interest on the debt instrument conditioned upon the solvency of the issuer and the period until redemption of the debt. Where the debt instrument qualifies as a hybrid debt instrument the yield is regarded as a dividend in specie paid in respect of a share.

On the other hand, section 8FA focuses on the nature of the yield (i.e. the interest labelled return) and requires that the yield must be determined with reference to a rate of interest, and that the rate of interest must not be dependent on the profits of the issuer for that yield to qualify as interest instead of an equity-like return (i.e. hybrid-interest). Where the yield is not determined in an acceptable manner, the yield is regarded as a dividend in specie paid in respect of a share.

Reasons for change

Concerns have been raised regarding the effect of the above-mentioned hybrid debt and hybrid interest anti-avoidance rules in sections 8F and 8FA. The deeming provisions, which deem any return from tainted debt instruments or any tainted returns to be dividends in specie in respect of a share to be declared and paid by the issuer to the person to whom the amount accrued, do not specifically deem the return to be the accrual of dividends in specie for the holder or recipient of the return. As a result, the return may not qualify for an interest deduction, dividends tax may be payable by the issuer if no exemption applies and the holder may be taxed on the interest. In such an instance, the anti-avoidance rules would be going too far as the return would be regarded as interest and thus also be taxable for the holder of a tainted instrument or recipient of a tainted return, leading to economic double taxation.

The above-mentioned effect goes against the policy rationale for the introduction of these rules as well as further changes made to these rules in 2016 and 2017 ensuring that interest will be classified as a dividend in specie and dividends tax may be levied on the deemed dividend in specie.

Proposal

It is proposed that the policy position regarding the deeming provisions in sections 8F and 8FA be refined. In order to address concerns raised, it is proposed that changes be made in the tax legislation to explicitly extend the deeming provision to apply to the holder of a tainted instrument or recipient of tainted return.

In addition, consequential amendments are proposed to refine the tax treatment of the reclassified return for purposes of withholding tax on interest in terms of the Act.

Effective date

The amendments will come into operation on the date on which the Taxation Laws Amendment Act, 2021, is promulgated and applies in respect of amounts incurred or accrued on or after that date.

CLARIFYING THE MEANING OF 'INTEREST' UNDER THE DEBT RELIEF RULES

[Applicable provision: Section 19(8)(f) and paragraph 12A(6)(g) of the Eighth Schedule to the Act] EM PG 28-29

Background

The Act contains debt relief rules in section 19 and paragraph 12A of the Eighth Schedule that trigger tax consequences in respect of a waiver, cancellation, reduction or discharge of a debt owed by a taxpayer. Section 19 of the Act deals with normal tax implications in respect of a debt that was previously used to fund tax deductible expenditure, for example, operating expenses. On the other hand, paragraph 12A of the Eighth Schedule to the Act deals with capital gains tax implications in respect of a debt in respect of which a debt benefit arises.

In 2018, changes were made to the debt relief rules. The changes introduced a new concept of a 'debt benefit' that seeks to tax the benefit to a debtor resulting from a concession or compromise of a debt entered into with a creditor. Consequently, the concept of a 'debt benefit' results in a regime that triggers a recoupment in terms of section 19 or capital gain in terms of paragraph 12A of the Eighth Schedule in instances where an arrangement that is included in the definition of 'concession or compromise' gives rise to an economic benefit that is not equally reflected in the market value of the reduced consideration received by the creditor or the amount of the reduced debt exceeds the expenditure incurred by the debtor in respect of a transaction. Under the debt relief rules a concession or compromise encompasses arrangements where there is –

- a debt cancellation or waiver;
- a debt that is extinguished either by way of a redemption of the debt claim by the debtor or a person that is a connected person in relation to the debtor or extinguished by merger as a result of the acquisition of the debt claim by the debtor; or
- a conversion of debt into shares where a debt owed by a company is settled directly or indirectly by being converted to or exchanged for shares in that company or by applying the proceeds from shares issued by that company.

In the case of a conversion of debt into shares, the debt relief rules trigger a debt benefit that is subject to tax if the face value of the reduced amount of the debt prior to the entering into of that arrangement exceeds –

- the market value of the shares acquired by reason or as a result of the implementation of that arrangement, in the instance that the creditor held no interest in the shares in the debtor prior to the arrangement; or
- the amount by which the market value of the interest in the shares held by that creditor in that debtor company after the implementation of that arrangement exceeds the market value of the interest in the

shares held by that creditor in the debtor company prior to entering into of that arrangement, in the instance that the creditor held an interest in the shares in the debtor prior to the arrangement.

However, an exclusion has been provided so that the debt forgiveness rule does not apply to a debt benefit arising from debt to share conversions to the extent the debt converted does not consist of or represent an amount owing in respect of interest incurred during any year of assessment.

Reasons for change

Concerns have been raised regarding the meaning of the word 'interest' in the debt relief rules that provide for the inclusion of the amount of debt in the form of interest incurred that is converted into shares or settled by applying the proceeds of shares in the application of debt relief rules. At issue is the fact that there is no definition of the word 'interest' contained in the debt relief rules.

Proposal

Legislative changes are made to provide clarity as to the meaning of the word "interest" for purposes of applying the debt relief rules. As a result, the meaning of the word "interest" is clarified in the legislation to mean interest as defined in section 24J of the Act.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

CORPORATE RULES

REFINING THE INTERACTION BETWEEN ANTI-VALUE SHIFTING RULES AND CORPORATE REORGANISATION RULES

[Applicable provision: Section 40CA of the Act] EM PG 29-30

Background

A. Anti-value shifting rules

The Act contains rules in section 24BA and section 40CA aimed at curbing the use of structures that shift value between taxpayers free of tax, referred to as "anti-value shifting rules". Section 24BA applies to transactions involving asset for share exchanges and triggers a capital gain (in respect of which capital gains tax is payable) or deems a distribution of an asset in specie (in respect of which dividends tax will be payable) where these exchanges are not effected on a value-for-value basis. In its application, section 24BA provides that where a company acquires an asset in exchange for the issue of its shares and the market value of the asset immediately before that disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares and the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess. However, where a company acquires an asset from a person in exchange for the issue of shares and the market value of the shares immediately after that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

In turn, section 40CA prescribes a base cost for assets acquired by companies in exchange for the issue of their shares to the seller of those assets as the sum of the market value of the shares it issued and the amount of the capital gain triggered by the application of the provisions of section 24BA to ensure that there is no double taxation on the future disposal of the assets.

B. Roll over base cost rule under corporate reorganisation rules

On the other hand, the Act contains corporate reorganisation rules in Part III of Chapter II that allow for the tax neutral transfer of assets between companies that are part of the same group of companies. These corporate reorganisation rules also prescribe that qualifying asset-for-share transactions are subject to anti-value shifting rules and such transfers are subject to the roll-over base cost rules within the corporate reorganisation rules. In essence, these rules provide that asset transferred in terms of the corporate reorganisation rules are subject to the roll-over base cost rules that deem the acquirer and seller to be one and the same person for purposes of the base cost determination. These corporate reorganisation rules also prescribe those transactions that qualify for tax deferral under the corporate reorganisation rules are subject to the anti-value shifting rules that aim to ensure that all assets transferred in exchange for shares are affected on a value-for-value basis.

Reasons for change

The interaction between the anti-value shifting rules in sections 24BA and 40CA and the corporate reorganisation rules in Part III of Chapter II of the Act gives rise to anomalous results as the capital gain triggered under the anti-value shifting rules is only added to the base cost of an asset acquired in exchange for the issue of shares by a company in terms of section 40CA, which is outside of the corporate reorganisation rules in Part III of Chapter II of the Act. The capital gain triggered under the anti-value shifting rules in section 24BA is, however, not taken into account when the anti-value shifting rules are triggered in respect of transactions that are subject to the corporate reorganisation rules in Part III of Chapter II, as the corporate reorganisation rules only provide for rolled over base

cost. As a result, a company will, on the future disposal of an asset acquired under the reorganisation rules in Part III of Chapter II, be subject to double taxation as the company is not granted an uplift of base cost in respect of the capital gain previously triggered in terms of the anti-value shifting rules in terms of section 40CA.

Proposal

In order to address these concerns, changes are made in the tax legislation to provide for additional base cost equal to any deemed capital gain resulting from the application of the anti- value shifting rules in section 24BA for corporate reorganization rules in Part III of Chapter II, namely, asset-for-share transactions rules in section 42, substitutive share-for-share transactions rule in section 43 and amalgamation transactions rules in section 44. In this regard, changes are made in the legislation to ensure that the additional base cost uplift in this regard, is granted immediately after an asset-for-share transaction that is subject to the anti-value shifting rules. As a consequential amendment, an additional legislative change will be made to section 41(2) of the Act to ensure that the re-organisation rules are made subject to this immediate base cost uplift.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of any acquisition of an asset on or after that date.

CLARIFYING THE RULES THAT TRIGGER ADDITIONAL CONSIDERATION IN ASSET- FOR-SHARE TRANSACTIONS WHEN A DEBT IS ASSUMED BY A COMPANY

[Applicable provision: Section 42(8) of the Act] EM PG 31

Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain asset-for-share transaction rules in section 42 that allow for the tax neutral transfer of assets when a person (transferor) disposes of an asset to a company in exchange for the issue of shares by that company to that transferor or when a transferor disposes of an asset that was acquired using debt and as part of that disposal, that debt is assumed as a consideration by a company acquiring that asset. In essence, these rules entail that an asset that is disposed of in terms of an asset-for- share transaction results in no immediate taxable income (including a capital gain) for the transferor as the disposal is deemed to have been effected for a consideration equal to the base cost or cost of that asset. However, when that asset is subsequently disposed of in terms of a transaction that falls outside the corporate reorganisation, then there will be tax consequences.

That said, the asset-for-share transaction rules dealing with the tax neutral transfer of assets when a transferor disposes of an asset that was acquired using debt and, as part of that disposal, that debt is assumed as consideration by a company acquiring that asset are subject to an anti- avoidance measure in section 42(8), that is aimed at preventing a permanent loss to the fiscus, instead of a tax deferral. This is to ensure that these rules do not allow taxpayers to benefit from a permanent loss to the fiscus resulting from the transferor ending up with shares that reflect the net asset value (i.e. market value of the asset less the debt assumed) transferred. As a result, section 42(8) provides that a proportional part of any qualifying debt that was assumed by a company as part of an asset-for-share transaction will constitute an amount received by or accrued to the transferor in respect of the disposal of any of the shares in the company acquired in terms of the asset-for-share transaction, when such shares are subsequently disposed of by the transferor. Consequently, a transferor must account for any debt assumed under an asset-for- share transaction as additional proceeds upon the disposal of the shares.

Reasons for change

It has come to Government's attention that the above-mentioned anti-avoidance rules that trigger additional consideration upon disposal are undermined when the shares are subsequently transferred in terms of a corporate reorganisation transaction as other applicable corporate reorganisation rules will enforce the rolled-over base cost of the previous asset-for-share transaction.

Proposal

In order to prevent the above-mentioned anti-avoidance rules contained in section 42(8) from being undermined, changes are made to the legislation and the anti-avoidance rules should be amended so that, going forward, the additional consideration accrues to the transferor in relation to any assumed debt immediately before any subsequent disposal of the shares acquired in terms of an asset-for-share transaction. Consequently, a transferor will irrespective of whether such a subsequent disposal of the shares is in terms of tax deferred transaction or not, be subject to tax on the additional consideration that is triggered immediate before that subsequent disposal of the shares. This immediate tax consequence is favoured and is viewed in the same light as the immediate tax consequence that taxpayers are subject to when they shift value by entering into asset-for-share transactions using the reorganisation rules that are subject to anti-value shifting rules that trigger an immediate capital gain or in specie dividend.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the disposal of a share on or after that date.

CLARIFYING THE EARLY DISPOSAL ANTI-AVOIDANCE RULES IN INTRA-GROUP TRANSACTIONS

[Applicable provision: Section 45(5) of the Act] EM PG 32

Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain intra-group transaction rules in section 45 that allow for tax deferral in respect of a disposal of an asset or a business as a going concern between companies that form part of the same group of companies at the end of the day of that disposal transaction. These intra-group transaction rules contain anti-avoidance measures that make provision for the early disposal rules to apply when an acquirer of an asset in terms of an intra-group transaction disposes of that asset within 18 months of such an acquisition. These early disposal anti-avoidance disposal rules reverse the deferral benefit that applied in terms of the intra-group transaction by ring-fencing so much of any capital gain, capital loss or income arising from the early disposal of an asset, as does not exceed the capital gain, capital loss or income that would have arisen on the date of intra-group transaction to ensure that such a gain, loss or income is not set-off against other gains, losses or income.

These early disposal anti-avoidance rules were introduced to curb the risk that group companies may enter into tax deferred transactions in terms of the intra-group transaction rules with the aim of minimising any adverse tax consequences of an asset disposal outside the group of companies, through offsetting any resultant tax consequences within the group. For example, a company may dispose of its asset (in respect of which a capital gain was anticipated on the date of an intra- group transaction) to a fellow group company with an assessed loss in order for that fellow group company to offset any capital gain on the disposal of that asset outside the group

companies to a third party. Applying the early disposal anti-avoidance rules in the given example, the rules entail that the company that is disposing of an asset within 18 months of acquiring it in terms of a tax deferred intra-group transaction, must ring-fence the resultant tax consequences of such a disposal (i.e. the capital gain in the example provided) and not offset it against its losses, thus enforcing that tax must be paid on such capital gain.

Reasons for change

It has come to Government's attention that in some instances, a capital gain may have been anticipated from the disposal of an asset at the date of the intra-group transaction, yet, at the date of the early disposal of an asset (disposal of an asset within 18 months after the acquisition in terms of the intra group transaction), a capital loss arises in respect of that asset. The difference in the nature of the resultant consequences in respect of the disposal of an asset on the date of the intra-group transaction and the date of the early disposal creates ambiguity in the application of the early disposal anti-avoidance rules.

Proposal

In order to address this ambiguity, clarification is made to the early disposal anti-avoidance rules regarding the resultant tax consequences of an early asset disposal when the tax consequences arising from actual early disposal differ from those anticipated on the date of the original intra- group transaction. As such, a further proviso is added to subsection 45(5) in order to provide that the ring-fencing provisions of subsection 45(5) will not apply in instances where the tax consequence arising from the actual disposal of the asset differs from the tax consequences that would have arisen had roll-over not been available on the date of the intra-group transaction.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the disposal of any asset on or after that date

EXTENDING THE REVERSAL OF THE NIL BASE COST RULES TO APPLY ON THE SIXTH ANNIVERSARY OF AN INTRA-GROUP TRANSACTION

[Applicable provision: Section 45(3B) of the Act]EM PG 33

Background

The corporate reorganisation rules in Part III of Chapter II of the Act make provision in section 45, dealing with intra-group transactions, that allows for a tax deferral in instances where one company transfers an asset or a business as a going concern to the other company and both companies form part of the same group of companies at the end of the day of that transaction. However, these intra-group transaction rules also contain various anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers. Of particular concern is the de-grouping anti- avoidance rule and the zero base cost anti-avoidance rule.

The de-grouping anti-avoidance rule reverses any tax deferred from the original intra-group transaction in the hands of the transferee, which in effect reverses the tax benefit of that original intra-group transaction, in instances when a transferor company ceases to form part of any group of companies as the transferee company within six years of the original intra-group transaction.

On the other hand, the zero base cost anti-avoidance rule applies to transfers of assets in exchange for debt or a non-equity share issued by a fellow group company of an acquirer or company disposing of an asset in terms of an intra-group transaction. In terms of this zero base cost anti-avoidance rule, the holder of the debt or non-equity shares is deemed to have acquired the debt or non-equity shares for an amount of expenditure equal to nil.

In 2020, changes were made in section 45 of the Act to remove the potential double taxation arising in instances where an intra-group transaction is subject to the zero base cost anti- avoidance rule resulting in a zero base cost for the holder of a debt or non-equity share that facilitated or funded an intra-group transaction and then subsequently a de-grouping or deemed de-grouping occurs and the de-grouping rules also reverse the tax deferral benefits.

Reasons for change

Concerns have been raised that because the de-grouping anti-avoidance rule ceases to apply on the sixth anniversary of an intra-group transaction, the zero base cost anti avoidance rule should similarly be reversed on the sixth anniversary of an intra-group transaction. Further, it is counterintuitive that parties that operate within the spirit of the intra-group tax deferral rules and remain within the original group, should not be granted base cost in respect of debt and non-equity shares used to facilitate such an intra-group transaction.

Proposal

In order to address these concerns, changes are necessary to the intra-group transaction rules to extend the reversal of the zero base cost anti-avoidance rules and ensure that base cost is restored for holders of debt and non-equity shares used to facilitate the transfer of assets in terms of an intra-group transaction, on the sixth anniversary of that intra-group transaction.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

CLARIFYING THE INTERACTION BETWEEN EARLY DISPOSAL ANTI-AVOIDANCE RULES AND THE NIL BASE COST ANTI-AVOIDANCE RULES

[Applicable provision: Section 45(3B) of the Act] EM PG 34

Background

The intra-group transaction rules in section 45 of the Act allow for tax deferral in respect of transactions under which one company transfers an asset or a business as a going concern to the other company if both companies form part of the same group of companies at the end of the day of that transaction. These intra-group transaction rules also contain anti-avoidance measures aimed at discouraging abuse by taxpayers. The first anti-avoidance measure, namely, the de- grouping anti-avoidance rule, is triggered when a transferor company ceases to form part of any group of companies as the transferee company within six years of the original intra-group transaction. The de-grouping anti-avoidance rule reverses any tax deferred from the original intra- group transaction in the hands of the transferee, which in effect reverses the tax benefit of that original intra-group transaction.

The second anti-avoidance measure, namely, the early asset disposal anti-avoidance rule applies when a company within the same group of companies enter into tax deferred intra-group transaction with the aim of transferring assets to another company within the same group of companies that will be able to absorb any tax consequences that may result from a future disposal out of the group of companies. The early asset disposal anti-avoidance rule reverses any tax deferred in respect of any asset subsequently disposed of within 18 months of an intra-group transaction and ring-fence the arising gain, loss or taxable income.

The third anti-avoidance measure, namely, the zero base cost anti-avoidance rule applies to a holder of any debt or and non-equity share issued by a fellow group company of an acquirer or company disposing of assets in terms of an intra-group transaction if that debt or non-equity share was used to facilitate or fund that intra-group transaction. The zero base cost anti-avoidance rule deems the holder of such debt or non-equity share to have acquired the debt or non-equity share for an amount of expenditure equal to zero. This anti-avoidance rule is aimed at limiting the use of debt or non-equity shares by taxpayers to transfer market value consideration for assets transferred under an intra-group transaction which could further be abused by transferring the debt or non-equity shares outside of the group by the transferor.

Reasons for change

In 2020, changes were made in section 45 of the Act to remove the potential double taxation arising in instances where an intra-group transaction is subject to the zero base cost anti- avoidance rule resulting in a zero base cost for the holder of a debt or non-equity share that facilitated or funded an intra-group transaction and then subsequently a de-grouping or deemed de-grouping occurs and the de-grouping rules also reverse the tax deferral benefits. Because the early asset disposal anti-avoidance rule reverses the tax deferral benefit in respect of the disposal of an asset which was acquired in terms of the intra-group transaction within 18 months of such an acquisition, it is therefore appropriate that the zero base cost anti-avoidance rule should be reversed when the early disposal anti-avoidance rule is triggered.

Proposal

In order to address these concerns, changes are made to the intra-group rules to give effect to the reversal of the application of the zero base cost anti-avoidance rule in instances when the early asset disposal anti-avoidance rule applies. It should be noted that the reinstatement of the base cost for any debt or non-equity share will only be provided for to the extent to which the debt and/or non-equity share facilitated or funded an asset disposed of early and in respect of which the provisions of the Act applied to reverse and ring-fence the deferred capital gain, capital loss, taxable income or assessed loss.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

REFINING THE PROVISIONS APPLICABLE TO UNBUNDLING TRANSACTIONS

[Applicable provisions: Sections 46 and 46A of the Act]EM PG 35 – 39

Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain unbundling provisions in section 46 that allow for a tax neutral transfer of shares in instances where shares of a resident company (unbundled company) that are held by another resident company (unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. As a result, in a qualifying unbundling transaction, distribution of shares is disregarded for purposes of determining the taxable income, assessed loss or net income of an unbundling company. The distribution of shares is also disregarded for Dividends Tax purposes and there is no consideration taken into account when determining reduction of contributed tax capital. These unbundling rules contain the following anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers from distributing shares on a tax neutral basis if the shareholders do not fall within the South African tax net.

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Prior to 2020, this anti-avoidance measure made provision for the roll-over relief not to apply if immediately after the distribution of shares in terms of an unbundling transaction, 20 per cent or more of the shares in the unbundled company are held by disqualified persons either alone or together with any connected persons (who is a disqualified person) in relation to that disqualified person. The term ‘disqualified persons’ is defined in this regard to include a person that is regarded as a non-resident in terms of the South African tax legislation or exempt persons in terms of South African tax legislation (for example, the government of the Republic in the national, provincial or local sphere contemplated in section 10(1)(a), a public benefit organisation as defined in section 30, a recreational club as defined in section 30A, a mining rehabilitation company or trust contemplated in section 37A, a pension fund, a provident fund, a retirement annuity fund, a benefit fund contemplated in section 10(1)(d)(i) or (ii) or a person contemplated in section 10(1)(cA) or (t)).

It came to Government’s attention that this anti-avoidance measure was anomalous as it was not aligned with the initial policy intent of corporate reorganisation rules and created an exemption instead of a deferral by allowing an exemption on significant shareholding as opposed to a de- minimis exemption. This anti-avoidance measure

created a loophole in that the 20 per cent exclusionary rule did not apply as intended to deny roll-over relief where tax exempt or non- resident shareholders are not connected persons in relation to each other, thus effectively resulting in a tax exemption instead of a tax deferral as future disposals of shares by tax exempt or non-resident shareholders would not be subject to tax in South Africa.

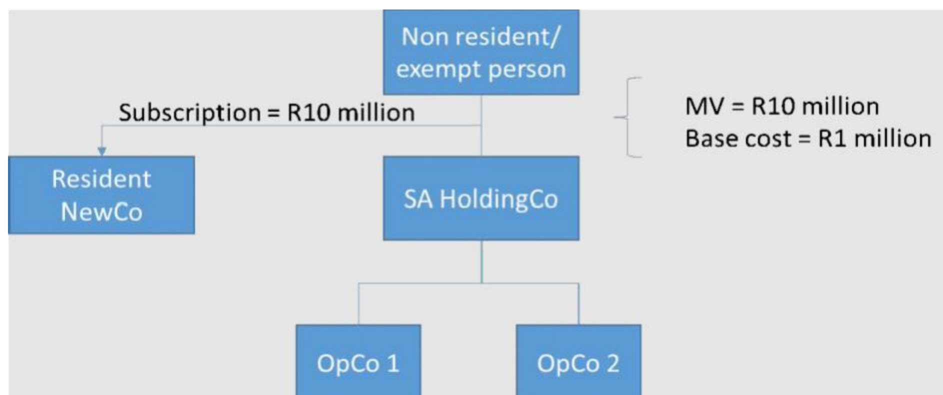
As a result, in 2020, changes were made to this anti-avoidance measure to make provision for the roll-over relief not to apply in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5 per cent of the equity shares in the unbundling company immediately before an unbundling transaction.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

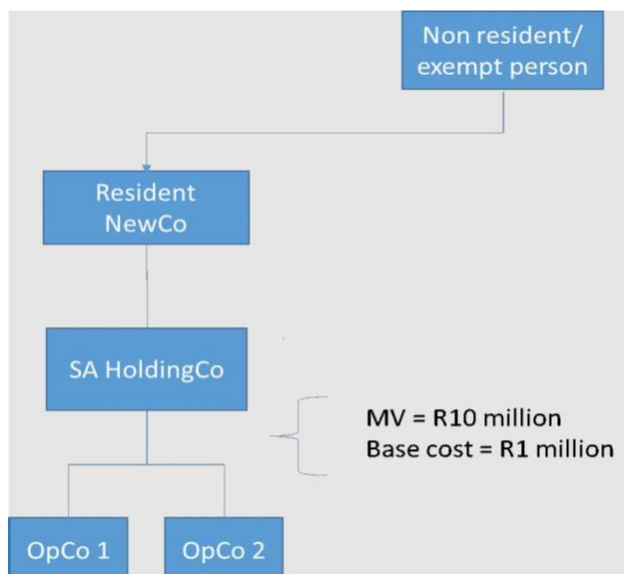
Prior to 2008, some taxpayers were abusing the roll-over relief in the unbundling transactions rules by creating for example, structures where a person that is not subject to South African tax and in particular, capital gains tax, such as a non-resident or resident tax exempt person that indirectly holds shares in high value operating companies through a South African Holding company, recapitalising the South African group to achieve an increase in the base cost of the shares held in entities within the group in order to decrease a future tax burden.
This would be achieved as follows:

Example

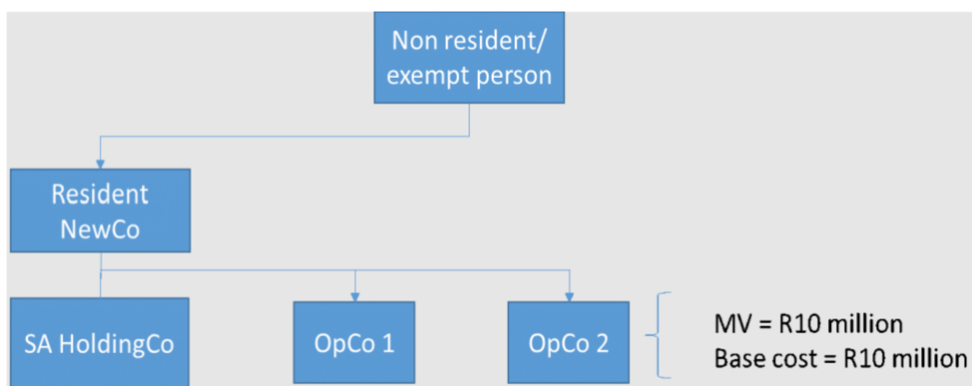
Step 1: A non-resident or resident exempt person that already holds an interest in a South African group would form a Resident NewCo by subscribing for shares in Resident NewCo for an amount reflecting the market value of the South African group that is much higher than the cumulative base cost of the shares in the South African holding company.



Step 2: Resident NewCo would use the capital to acquire the shares in the South African holdingcompany from the non-resident or resident exempt person.



Step 3: Thereafter the South African holding company would distribute the shares it holds in the operating companies to Resident NewCo in terms of a tax deferred unbundling transaction. As a result, of applying the provisions of section 46(3) to the Resident NewCo, the base cost of the shares in the SA HoldingCo is split between the shares held in the SA HoldingCo and the operatingcompanies without tax being paid and providing future lowered tax (for example capital gains tax)on future disposal of the shares in the operating companies.



In 2008, changes were made in the unbundling transaction rules by introducing an anti-avoidance measure in section 46A that makes provision for limitation of the base cost of shares received in terms of an unbundling transaction if the shares in the unbundling company are preceded by the disposal of shares between connected persons that are not fully taxable. As a result, upon application of this anti-avoidance measure, the base cost of the shares received in an unbundling transaction is limited. This limitation applies where a shareholder in an unbundling company acquires an unbundled company's shares within two years after the unbundling company shares were held by a connected person and the connected person was not fully subject to normal tax on disposal of the shares. Under such circumstances, the acquisition cost incurred by the first connected person for the unbundling shares in the two-year period is substituted by the base cost of the unbundling shares for the

connected person with adjustment allowed for specified deductions, ordinary revenue and capital gains of any connected person holding the unbundling shares during the two-year period.

Reasons for change

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Following the 2020 legislative changes, there is no tax deferral for an unbundling transaction in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5 per cent of the equity shares in the unbundling company immediately before that unbundling transaction. The 2020 changes resulted in the pro rata application of this anti-avoidance measure and results in a more equitable outcome in respect of unbundling transactions as only shares distributed to persons that are not disqualified persons will benefit from the roll-over relief and the rest will be subject to nor

That said, the pro rata application of these rules implies that in the case of a distribution, any taxes paid are indirectly borne by all shareholders proportionate to their equity shareholdings in the unbundling company. As a result, any shareholders that are not regarded as disqualified persons will be subject to tax on future disposals of their respective shares in the unbundled company without any recourse in the manner of an uplift of base cost in respect of t

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

It came to Government's attention that this anti-avoidance measure may be applied broadly as the current wording in the legislation may be applied to limit expenditure incurred by a taxpayer in respect of any share held in an unbundling company irrespective of how such share in the unbundling company was acquired by the taxpayer. This is of particular concern in instances that shares are not part of an unbundling transaction, a taxpayer may have acquired sha res in an unbundled company from a third party that was subject to tax on the disposal of such shares. The limitation should apply only to shares acquired as part of an unbundling transaction and not limit the base cost of shares that were not acquired as part of a tainted unbundling transaction.

Proposal

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Changes are made to this anti-avoidance measure so that shareholders in an unbundling company that qualifies for tax deferral for an unbundling transaction should receive additional base cost that is reflective of the tax paid by the unbundling company in respect of their shares in the unbundled company, in accordance with their respective shareholding. This will, in practical terms, only benefit non-disqualified persons on future disposal of the unbundled shares as disqualified persons would in any case not be subject to tax.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

Changes are made to this anti-avoidance measure to ensure that this measure only applies to shares that are acquired by way of an unbundling and not to those shares that are acquired through either subscription or acquisition for a full consideration.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the allocation of expenditure to unbundled shares acquired on or after that date.

TAX INCENTIVES

EXTENSION OF THE URBAN DEVELOPMENT ZONE TAX INCENTIVE SUNSET DATE

[Applicable provision: Section 13quat of the Act] EM PG 42

Background

In 2003, the Urban Development Zone (UDZ) tax incentive was introduced in the Act to increase investment in 16 designated inner cities. The UDZ tax incentive was designed to encourage property investment in central business districts and to address dereliction and dilapidation, and to promote investment in urban renewal. The incentive is in the form of an accelerated depreciation allowance applicable on the value of new buildings and improvements to existing buildings in the qualifying municipalities demarcated as UDZs. When the UDZ tax incentive was introduced, it contained a sunset date of 31 March 2014. In 2013, the sunset date for the UDZ incentive was extended from 31 March 2014 to 31 March 2020.

Since its inception, there have been a number of legislative amendments to the UDZ tax incentive. In 2008, the incentive was amended to include low-cost housing and changes in the accelerated depreciation regime in view of changes in other property depreciation clauses in the Act. In 2015, changes were made to the tax incentive to allow municipalities with a population of one million to demarcate an additional UDZ area. Furthermore, where the municipality's population is below one million, the Minister of Finance may approve the demarcation of an additional UDZ area having regard to the provisions set out under subsections 13quat(6) and (7) of the Act.

Reasons for change

All tax incentives contain a sunset date which allows for a review of its effectiveness before the incentive comes to an end. The UDZ tax incentive was expected to come to an end on 31 March 2020 and before this date, a review had to be concluded to determine the future of the incentive. In the 2020 Budget Review, the Minister of Finance announced that the urban development zone incentive would be extended for one year, to 31 March 2021, while a review of the incentive was completed. However, due to the challenges posed by the Covid-19 global pandemic, a comprehensive review of the effectiveness of the UDZ tax incentive could not be concluded. In the 2021 Budget Review, the Minister of Finance announced that the incentive would be extended by a further two years beyond its current sunset date of 31 March 2021, as the review process continues.

Proposal

In line with the Minister's announcement in the 2021 Budget Review, it is proposed that changes be made in section 13quat of the Act to extend the UDZ tax incentive by another two years, to 31 March 2023. The extension of the incentive's sunset date will provide time for an extensive review of its effectiveness in achieving its objectives to be conducted.

Effective date

The amendment will be deemed to have come into operation on 1 April 2021 and applies in respect of any building, part thereof or improvement that is brought into use on or after that date.

EXTENSION OF THE LEARNERSHIP TAX INCENTIVE SUNSET DATE

[Applicable provision: Section 12H of the Act] EM PG 43

Background

The learnership tax incentive, which was introduced in the Act on 1 October 2001, is a programme that supports skills intensity through the tax system. To encourage skills development and job creation, the learnership tax incentive provides employers with an additional tax deduction over and above the normal remuneration that can be deducted. The additional deduction is intended to encourage vocational training through formal learnership contracts, and provide accredited workplace training by employers. To claim the allowance, the employer, learner and an accredited training provider must enter into a formal learnership contract.

Similar to all other tax incentives, when the learnership tax incentive was introduced, it had a sunset date of 30 September 2011. In 2011, a review was conducted to assess the effectiveness of the learnership tax incentive in achieving its objectives, before the sunset date. After the review, the learnership tax incentive was extended by another five years to 30 September 2016.

In 2016, a comprehensive review was again conducted to assess the effectiveness of the learnership tax incentive in achieving its objectives. The outcome of the review indicated that there was sufficient evidence to support the continuation of the learnership tax incentive beyond its previous sunset date of 30 September 2016. However, the review also revealed that claims were not evenly spread across sectors. Sectors with high uptake were those where SETAs where perceived to administer training programmes more effectively. The review then recommended: (i) the extension of the incentive sunset date to 31 March 2022, (ii) improving the targeting of the incentive by encouraging employers to train learners in those skill categories where demand is highest, and (iii) to improve future incentive policy analysis, completion of the SARS IT180 form was made compulsory for taxpayers to claim the learnership tax incentive.

Reasons for change

The learnership tax incentive has a current sunset date of 31 March 2022. The effectiveness of the incentive in achieving its objectives will need to be assessed before this date to determine whether it continues. In the 2021 Budget Review, the Minister of Finance announced that the incentive would be extended by a further two years beyond its current sunset date while a review is completed.

Proposal

In line with the Minister's 2021 Budget announcement, it is proposed that changes be made in section 12H of the Act to extend the learnership tax incentive by another two years, to 31 March 2024.

Effective date

The amendment will come into operation on 1 April 2022 and applies in respect of learnership agreements entered into on or after that date.

REFINING THE TIMEFRAMES OF COMPLIANCE REQUIREMENTS OF INDUSTRIAL POLICY PROJECTS TAX INCENTIVE

[Applicable provision: Section 12I of the Act] EM PG 44-46

Background

In 2009, the Industrial Policy Projects tax incentive was introduced in section 12I (the section 12I tax incentive) to support investment in manufacturing assets that would improve the productivity of the manufacturing sector. The section 12I tax incentive is available for new industrial policy projects as well as the expansion or upgrading of existing projects. The section 12I tax incentive makes provision for an additional investment allowance for an industrial policy project as determined according to the type of investment (greenfield or brownfield) and its approval status (qualifying or preferred).

The section 12I tax incentive offers support for both capital investment and training, with qualification for the incentive based on points scoring criteria reviewed by an adjudication committee constituted in terms of section 12I(16) of the Act. The adjudication committee assesses projects for approval, and if approved, monitors these projects in terms of their compliance. Section 12I(19)(a) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade, Industry and Competition to extend the time periods within which approved projects must comply with the provisions of the section, by one year.

The section 12I tax incentive initially had a sunset date of 31 December 2015. In 2015, the sunset date was extended by two years to 31 December 2017. In 2017, the date was again extended by two years 3 months to 31 March 2020. This implies that approvals for new section 12I tax incentive applications officially ceased on 31 March 2020 when its latest sunset date was reached, and the tax incentive was not renewed. This notwithstanding, projects approved before 31 March 2020 still enjoy the benefits and are bound by the provisions of section 12I of the Act.

Reasons for change

As indicated above, in 2017, the sunset date was again extended to 31 March 2020, and no further extension was granted in this regard. However, the sunset date of 31 March 2020 fell during the Covid-19 pandemic. As a result, many beneficiaries of the section 12I tax incentive experienced the following challenges during the 2020 Covid-19 national lockdown:

Compliance with the period of four years plus the additional one year allowed to bring qualifying assets into use in terms of subsections 12I(2) and 12I(19)(a).

- Delay in further acquisition of qualifying assets.
- Knock-on effect on providing skills development: practical hands-on training, which cannot be properly substituted with online classes, could not be provided. Some training required foreign or distant expert support, most of whom could not travel. Local training providers also have stringent measures in place in terms of the lockdown regulations.
- Compliance with the energy efficiency requirement was also a challenge as lower production led to lower potential energy efficiency.

- Compliance with the further requirement of more than 50 per cent of the manufacturing assets to be acquired and brought into use within 4 – 5 years in terms of 12I(7)(c).

This disruption is expected to last throughout 2020 and the whole of 2021. Should these compliance requirements not be met, it would lead to a withdrawal of approval for projects in terms of section 12I of the Act. This would place additional strain on the manufacturing sector in an environment where projects face severe challenges in reaching completion, and many businesses struggle to remain operational.

Proposal

In order to ensure that approved projects have a better chance of complying with section 12I provisions and are not adversely affected by Covid-19 and consequent restrictions on economic activity resulting in non-compliance, the following amendments are proposed in section 12I of the Act:

1. Extension of the time period that the adjudication committee can recommend to the Minister of Trade, Industry and Competition within which approved projects must comply with the provisions of section 12I of the Act
    - Currently, section 12I(19)(a) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade, Industry and Competition to extend the time periods within which approved projects must comply with the provisions of the section, by one year.
    - It is proposed that changes be made to section 12(19)(a) of the Act to allow for up to an additional two years to bring assets into use for approved section 12I projects negatively affected by Covid-19 and consequent disruptions and restrictions to economic activity.
    - The proposed additional two years to bring assets into use is in addition to the one- year extension the Minister of Trade, Industry and Competition is currently allowed to provide, upon the recommendation of the Section 12I adjudication committee.
    - The proposed extension will not provide blanket relief to all approved section 12I projects, but will be upon application by affected projects to the section 12I adjudication committee.
    - After assessing these projects on a case-by-case basis, the adjudication committee should recommend to the Minister of Trade, Industry and Competition whether affected projects should be allowed:
        - An additional year or two years to bring (more than 50 per cent of) assets into use due to Covid-19 related disruptions.

1. Extension of 'compliance period' within which approved projects must fully comply with the provisions of section 12I of the Act
    - The 'compliance period' in section 12I determines the period at the end of which approved projects must fully comply with all provisions of the section. It also defines the period over which projects are required to produce annual progress reports to be assessed by the adjudication committee. In turn, section 12I(1) of the Act defines the 'compliance period' as the period:
        - commencing at the beginning of the year of assessment following the year of assessment in which assets are first brought into use; and
        - ending at the end of the year of assessment three years after the year of assessment in which assets are first brought into use;

- It is proposed that if projects apply for and are approved to extend the four-year period within which to bring the qualifying assets into use, this would mean that the 'compliance period' is also increased by the extended period (by the end of which qualifying projects must adhere to all provisions of section 12I of the Act). This provides additional time within which to ensure compliance with the provisions of section 12I of the Act.
- This would not be a blanket relief and the extended 'compliance period' would not apply to all approved section 12 projects but will, upon application by affected projects, apply to projects approved for the extended compliance period to bring assets into use in terms of the recommendation of the adjudication committee in section 12I(19)(a).
- As a result, it is proposed that changes be made to the definition of 'compliance period' to allow for an extended period of not more than two additional years, upon application to the adjudication committee. This would cater for projects that have brought assets into use in line with section 12I, but due to Covid-19 related disruptions, may not be able to comply with all 12I requirements by the end of the compliance period. For example, skills development, energy efficiency, and other point scoring criteria as set out in the section 12I regulations.
- The proposed amendments are intended to bring relief to approved projects that have not yet brought more than 50 per cent of assets into use by the time Covid-19 related disruptions to economic activity started at the end of March 2020.

Effective date

The amendments are deemed to have come into operation on 1 January 2020.

INTERNATIONAL

CLARIFYING THE RULES DEALING WITH WITHHOLDING TAX EXEMPTION DECLARATION

[Applicable provisions: Sections 49E(2)(b), 64G(2)(a) and 64H(2)(a) of the Act] EM PG 48-49

Background

The Act contains provisions in Part IV A, Part IV B and Part VIII for withholding tax on royalties, interest and dividends respectively.

In general, withholding tax on royalties applies to royalties from a source within South Africa paid by any person whether that person is a resident or not to a foreign person. However, this withholding tax on royalties can potentially be reduced or eliminated by a tax treaty.

Similarly, a prerequisite for the imposition of withholding tax on interest is that the interest must be from a South African source. Again, the withholding tax on interest may be reduced by the application of a tax treaty.

With respect to dividends tax, a company that is a resident that declares and pays a dividend is liable for dividends tax on that dividend to the extent that the dividend consists of a distribution of an asset in specie. Given that the dividends tax is a tax on shareholders when dividends are paid to them, and, under normal circumstances, is withheld from their dividend payment by a withholding agent either the company paying the dividend or, where a regulated intermediary is involved, by the latter. The dividends tax imposed may also qualify for any of the exemptions or a reduced rate by the application of a tax treaty.

Currently, one of the requirements under section 49E(2)(b) the Act provides the release from obligation to withhold royalties, if the foreign person to or for the benefit of which the payment of the royalty is to be made has submitted, before the royalty is paid, the following to the person making payment:

a declaration in such form as prescribed by the Commissioner that the person is exempt from withholding tax on the royalty payment if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate duringthe twelve-month period preceding the date on which the royalty is paid or if the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under Chapter 3 of the Tax Administration Act, 2011 (Act No. 28 of 2011) ("TAA"); and a written undertaking in such form as prescribed by the Commissioner to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the royalty no longer be for the benefit of that foreign person.

With respect to withholding tax on interest, one of the requirements under section 50E(2)(b) the Act provides the release from obligation to withhold interest, if the foreign person to or for the benefit of which that payment of interest is to be made has, before the interest is paid, submitted to the person making the payment:

- a declaration in such form as prescribed by the Commissioner that the person is exempt from withholding tax on interest payment if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve- month period preceding the date on which the interest is paid or the debt claim in respect of which that interest is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under Chapter 3 of the TAA or an agreement of the avoidance of double taxation, exempt from the
- a written undertaking in such form as prescribed by the Commissioner to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the payment of the interest no longer be for the benefit of that foreign person.

Reasons for change

In relation to withholding tax on interest, the income tax provides that a person must not withhold at the prescribed rate an amount of interest if the foreign person receiving interest has submitted a declaration that the amount is exempt from the withholding tax on interest as a result of an applicable double tax treaty agreement. However, a similar declaration does not exist for withholding tax on royalties and dividends tax which is contrary to the intent to align the withholding tax regime. Notably, the Act provides for a reduced withholding tax rate as a result of the application of a double tax treaty agreement in all three withholding tax regimes.

Proposal

To address this anomaly, it is proposed that the tax legislation be amended to provide for the release from obligation to withhold if the foreign person to or for the benefit of which that payment is to be made has, before the payment is paid, submitted to the person making the payment that an agreement of the avoidance of double taxation does not grant a taxing right over royalties or dividends to South Africa.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of the payment of royalties or dividends to foreign persons on or after that date

CLARIFYING THE CONTROLLED FOREIGN COMPANY ANTI-DIVERSIONARY RULES

[Applicable provision: Section 9D(9A) of the Act] EM 46

Background

The Act contains anti-avoidance provisions in section 9D aimed at taxing South African residents on the net income of a controlled foreign company (CFC). As a result, an amount equal to the net income of the CFC is included in the income of a South African resident according to the resident's proportion of participation rights in that CFC.
In order to strike a balance between protecting the South African tax base and the need for South African multinational entities to be competitive, the South African CFC rules contains various exemptions of certain types of business income, for example, foreign business establishment exemption in section 9D(9)(b) of the Act. This exemption makes provision for CFC income to be exempt if that income is attributable to a foreign business establishment as defined in section 9D of the Act.

In order to limit tax avoidance, the foreign business establishment exemption does not apply if the CFC foreign business establishment income is regarded as diversionary foreign business income in terms of the CFC anti-diversionary rules. Diversionary foreign business income arises when a CFC engages in transactions such as a sale of goods or rendering of services to a related South African resident or purchase of goods from a related South African resident in a manner that will most likely lead to transfer pricing tax avoidance.

Reasons for change

It has come to Government's attention that certain taxpayers are circumventing these anti- diversionary rules by merely entering into a contract of purchase in the country of the CFC that implies that the purchase of goods took place in the country of residence of the CFC when the goods are never physically present or delivered in that country.

Proposal

In order to curb this abuse, it is proposed that changes be made in the anti-diversionary rules focussing on the purchase of goods by the CFCs be amended to provide clarity that when a CFC purchases those goods, these goods should be physically delivered within the country of residence of that CFC.

Effective date

The amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

CLARIFICATION OF THE INTERACTION BETWEEN THE PROVISIONS DEALING WITH A CFC CEASING TO BE A CFC AND THE PARTICIPATION EXEMPTION

[Applicable provision: Section 9H(5) of the Act] EM PG 47

Background

In 2020, changes were made in the Act to address tax avoidance opportunities that may have emerged as a result of the withdrawal of the approval requirement from the Financial Surveillance Department of South African Reserve Bank for loop structures. One of the amendments made was in relation to the participation exemption in paragraph 64B of the Eighth Schedule for gains on the disposal of shares in a non-resident company to a non-resident. Paragraph 64B was amended so that the participation exemption does not apply to the disposal of shares in a CFC to the extent the value of the assets of the CFC are derived from South African assets.

Reasons for change

At issue is that the amendment to the participation exemption mentioned above creates uncertainty in the application of section 9H(5) of the Act when a foreign company ceases to be CFC as a direct or indirect result of the disposal of equity shares in that CFC.

Proposal

It is proposed that section 9H(5) of the Act be amended so that when a portion of the resulting gain or loss resulting from a CFC ceasing to be a CFC is not disregarded in terms of paragraph 64B of the Eighth Schedule, the application of section 9H(5) of the Act is not precluded.

Effective date

The amendment is deemed to have come into operation on 1 January 2021 and applies to disposals on or after that date.

VALUE ADDED TAX

ZERO RATING OF SUPERFINE MAIZE MEAL

[Applicable Provisions: Schedule 2 Part B, read together with section 11(1)(j) of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) ("the VAT Act")] EM PG 50

Background

Schedule 2 Part B of the VAT Act makes provision for a list of zero-rated foodstuffs. Item 2 of Part B provides for the zero-rating of the following grades of maize meal: super maize meal; special maize meal; sifted maize meal or unsifted maize meal. In South Africa, the grading of maize products is regulated in the Agricultural Products Standards Act 119 of 1990 which the VAT Act may use for identification of products for the purposes of Schedule 2 Part B. Before 2016, the Agricultural Products Standards Act allowed for 18 grades of maize products, including the below mentioned to be sold in South Africa.

Reasons for change

In 2016, another grade of maize meal, namely, super fine maize meal was added to the list regulated by the Agricultural Products Standards Act, to make it 19 graded maize products. In terms of specifications provided in the regulation in terms of Agricultural Products Standards Act, both super maize meal and super fine maize meal must have a maximum fat content by mass of less than two per cent and maximum fibre content by mass of 0.8 per cent. The only difference being that for super maize meal at least 90 per cent of the fineness or granulation by mass shall pass through a 1.4 mm sieve, and less than 90 per cent shall pass a 0.3 mm sieve, whereas with super fine maize meal at least 80 per cent of the fineness or granulation by mass shall pass through a 0.3 mm sieve.

When changes were made to the list regulated by the Agricultural Products Standards Act to add super fine maize meal as another grade of maize meal to be regulated, no submissions were received requesting National Treasury to consider including it in Item 2 of Part B of Schedule 2 to the VAT Act to allow for zero rating.

Proposal

An analysis was conducted on this new product from a VAT perspective and a proposal is made to zero-rate superfine maize meal. It is proposed that Item 2 of Part B of Schedule 2 to the VAT Act should be updated to include super fine maize meal.

Effective date

The amendments will come into operation on 1 April 2022.

VAT TREATMENT OF TEMPORARY LETTING OF IMMOVABLE PROPERTY

[Applicable provisions: New sections 9(13), 10(29), 16(3)(o) and section 18D of the VAT Act] EM PG 51

Background

The VAT Act makes provision for the supply of residential fixed property by a VAT vendor (being a property developer) to be subject to VAT at the standard rate of 15 per cent. The property developer has to charge VAT on the sale of the residential fixed property. Depending on market conditions, residential fixed property developers are at times unable to dispose of newly built residential fixed properties for extended periods of time. In order to maintain expenses incurred in developing such fixed property, such as bank loan repayments, property developers often enter into short term temporary leases for such fixed property until a buyer can be found.

While the VAT Act recognizes the sale of residential fixed property by a property developer as a taxable supply, the leasing of residential fixed property is an exempt supply which would generally result in the VAT incurred being denied. The VAT Act requires a change in use adjustment where property developers temporarily lease residential fixed property.

Property developers are entitled to deduct input tax on the VAT costs incurred to build residential fixed property (dwellings) for sale. However, where the property developer is unable to sell the residential fixed property and enters into a lease, until a buyer is found, the property developer is currently required to make an output tax adjustment based on the open market value of the residential fixed property when the residential fixed property is leased for the first time. In 2010, an announcement was made in Chapter 4 of the 2010 Budget Review (Heading entitled: "VAT and residential property developers" on page 79 of the Budget Review) to investigate and determine an equitable value and rate of claw-back for property developers as the current treatment is disproportionate to the temporary rental income. As a result, changes were made to the VAT Act by inserting new section 18B, for a short period, from 10 January 2012 to 1 January 2018. This section ceased to apply on 1 January 2018.

Reasons for change

Concerns have been raised with regard to the inequitable value attributed to this change in use adjustment. Further, it has come to Government's attention that there seems to be confusion amongst taxpayers relating to whether the change in use adjustment results in the subsequent supply of the residential fixed property being permanently or temporarily removed from the VAT net. As such, some taxpayers interpret the legislation to imply that output tax is still payable when the residential fixed property is subsequently sold while others interpret it otherwise.

Proposal

In order to address these concerns, it is proposed that changes be made to the VAT Act by inserting a new section that will deal with the deemed change in use adjustment when the residential fixed property is leased for the first time, including whether that deemed change in use adjustment results in the residential fixed property exiting the VAT net or not and the subsequent supply where the residential fixed property is sold. This proposed approach is considered more equitable than the current provisions.

Effective date

The amendments will come into operation on 1 April 2022.

"Temporary letting of residential property

18D. (1) For the purposes of this section-

a) **'developer'** means a vendor who continuously or regularly constructs, extends or substantially improves fixed property consisting of any dwelling or continuously or regularly constructs, extendsor substantially improves parts of that fixed property for the purpose of disposing of that fixed property after the construction, extensionor improvement; and

b) **'temporarily applied'** means the application of fixed property or a portion of a fixed property in supplying accommodation in a dwelling under an agreement or more than one agreement for letting and hiring thereof which agreement or agreements relate to a combined total period not exceeding 12 months: Provided that temporarily applied' does not include the application of fixed property in supplying accommodation in a dwelling under an agreement for the letting and hiring thereof where any such agreement is for a fixed period exceeding 12 months, in which case this section will not apply, but the provisions of section 18(1) shall apply.

(2) Notwithstanding the provisions of section 18(1), where goods being supplied consist of fixed property consisting of any dwelling and such fixed property—

(a) is developed by a vendor who is a developer wholly for the purpose of making taxable supplies or is held or applied for that purpose by that vendor; and

(b) is subsequently temporarily applied by that vendor in accordance with section 12*(c)*,

such fixed property shall be deemed to have been supplied by that vendor by way of a taxable supply for the consideration contemplated in section 10(29) and shall take place in accordance with section 9(13).

(3) Where a vendor who is a developer subsequently supplies fixed property contemplated in subsection (2)*(b)* by way of a sale within the period that the fixed property is temporarily applied, such supply shall be taxable supply in the course or furtherance of the vendor's enterprise and shall take place in accordance with section 9(3)*(d)*.

(4) Where fixed property contemplated in subsection (3) is supplied bythat vendor, the supply shall be deemed to be made for a consideration as contemplated in section 10(2).

(5) Where fixed property—

(a) contemplated in subsection (3) is supplied by that vendor within the'temporarily applied' period;

(b) is temporarily applied as contemplated in subsection (2)*(b)* and is no longer applied in supplying accommodation in a dwelling immediately after the expiry of the 'temporarily applied' period; or

(c) contemplated in the proviso to the definition of 'temporary applied'in subsection (1) is subject to the adjustment in section 18(1),

the Commissioner shall allow such vendor a deduction in terms of section 16(3)*(o)*, and the deduction so made shall be deemed for the purpose of that section to be input tax.".

(2) Subsection (1) comes into operation on 1 April 2022.

Section 18(1) Change of use adjustment

Example [1]

A property developer develops a townhouse at a cost of R1 150 000. As the townhouse was developed for sale, the developer is making a taxable supply. The developer over the course of the development would have claimed input VAT of R150 000 (R1 150 000 x 15/115).

The market value of the townhouse is R3 450 000 and the townhouse is made available for sale. Due to market conditions the townhouse does not sell. To satisfy creditors the developer is forced to temporarily let the townhouse to earn residential rental in the interim.

Effect of section 18(1) deemed supply from change of use adjustment

On the date that the townhouse is temporarily rented out the property developer would have to pay output VAT of R450 000 (R3 450 000 x 15/115).

Effect of section 18D

Section 18D only provides relief for the temporary supply of the letting of residential accommodation for a total period not exceeding 12 months. The output tax liability for the developer is eased by making the output tax adjustment on the adjusted cost and not the open market value.

In the above example, the output VAT adjustment would be made on adjusted cost of R1 150 000 and not on the market value of R3 450 000 at the date the property if first rented out.

The output VAT on the adjusted cost will be payable in the VAT period in which the lease agreement comes into effect.

Subsequent use of the property

- Disposal within the temporary letting window of 12 months:
  - Normal output VAT levied on selling price and normal time of supply rules for fixed property
  - Input VAT claimed on adjusted cost
- Property permanently used for residential rental purposes:
  - Section 18(1) change of use, output VAT levied on the open market value of the property
  - Input tax is calculated and claimed on the adjusted cost
- Property remains part of developers trading stock, and available for sale but is left vacant after the temporary 12 month letting period has expired:
  - Input VAT is claimed on the adjusted cost, in the VAT period when the property is no longer rented out

[1] (See Silke SA Income Tax Act 2022 page 1132)

REVIEWING THE SECTION 72 ARRANGEMENT WITH REGARD TO TELECOMMUNICATIONS SERVICES

[Applicable Provision: Section 11(2)(y) of the VAT Act]

Background

In 2019 changes were made to section 72 of the VAT Act, which deals with the SARS Commissioner's discretion to make arrangements or decisions regarding the application of the VAT Act to specific situations where the manner in which a vendor or class of vendors conducts their business leads to difficulties, anomalies or incongruities. These changes had an impact on the arrangements or decisions made before 21 July 2019. To address these concerns, in the 2020 Budget Review, government agreed to review the impact and the role of these arrangements and decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72.

One of the arrangements and decisions made in terms of section 72 of the VAT Act, which was impacted by these changes is the VAT treatment of telecommunication services. South Africa is a signatory to the International Telecommunications Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR) and to the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai (Dubai ITR) which was effective from January 2015.

Reasons for change

In 2020, changes were made to the VAT Act to introduce a new zero-rating provision in order to ensure that the provisions of the Dubai ITR are upheld, in line with the section 72 rulings that were previously given to taxpayers. However, in the Response Document to the 2020 TLAB, it was noted on page 61 that any further proposed amendments regarding the implementation of the Dubai ITR could be considered in the subsequent legislative cycle. Based on the above, in 2021, it is proposed that further amendments be made to the provisions dealing with telecommunications services in order to align these provisions with the Dubai ITR, but subject to certain limitations.

Proposal

It is proposed that further amendments be made to section 11(2)(y) to extend the zero-rate to all supplies between telecommunications service providers registered in the Republic and international telecommunications service providers to the extent that such services are not provided to any branch, main business or customer of the international telecommunications service provider which branch, main business or customer of the international telecommunications service provider is situated in the Republic at the time the services are rendered. In order to comply with the Dubai ITR, it is proposed that the only exception to this will be international roaming services. Since the existing rulings given by SARS to telecommunications service providers in this regard will end on 31 December 2021, it is proposed that this amendment be effective from 1 January 2022.

Effective date

The amendments will come into operation on 1 January 2022.

Case law and BGR

Peri Framework Scaffolding Engineering (Pty) Ltd v CSARS (A67/2020) (23 August 2021), the High Court of South Africa[2]

This case considered an appeal brought by the taxpayer (the appellant) which pertained to a non-compliance penalty imposed by the South African Revenue Service (SARS) for the appellant's late payment of its employees' tax obligation.

Second ground of appeal: Reasonable grounds shown for late non-compliance

In its judgment, the Tax Court found that the 10% penalty that had been imposed by SARS should not be remitted as the appellant had failed to show that reasonable grounds existed for making the late payment of the employees' tax to SARS.

Section 213 of the TAA states that if SARS is satisfied that an amount of tax was not paid as and when required under a tax Act, SARS must, in addition to any other "penalty" or interest for which a person may be liable, impose a "penalty" equal to the percentage of the amount of unpaid tax as prescribed in the tax Act.

Section 217 (3) of the TAA provides that SARS may remit a penalty imposed in terms of section 213 if SARS is satisfied that:

- the penalty has been imposed in respect of a "first incidence" of non-compliance;
- reasonable grounds for the non-compliance exist; and
- the non-compliance in issue has been remedied.

On this basis, a penalty in terms of section 213 may be remitted in circumstances where the penalty has been imposed in respect of a "first incidence" of non-compliance (i.e. where no other fixed amount or percentage based administrative penalty has been imposed during the preceding 36 months) or where exceptional circumstances exist, which rendered the taxpayer incapable of complying with the relevant obligation under the relevant tax Act. The appellant contended that it had never before been non-compliant with any of its tax related obligations (and in particular it had never been late with paying its payroll taxes) and that it had taken immediate steps to remedy its non-compliance such that payment of the employees' tax obligation was made as soon as possible. As such, the appellant argued that the 10% penalty should be remitted.

SARS, however, argued that the explanation provided by the appellant for the late payment of the employees' tax did not constitute "reasonable grounds" as required in section 217 of the TAA and that the appellant was therefore not entitled to any relief.

The High Court held that section 217(3) of the TAA makes provision for a "mechanism to come to the assistance of an aggrieved first incidence non-complying tax payer".

The High court identified one factor that SARS had failed to consider and which, in its view, could establish reasonable grounds for the appellant's non-compliance.

[2] CDH Tax and Exchange Control Alert 4 November 2021

Specifically, SARS had failed to consider the manner in which the appellant, when it realised that it would be unable to comply with the payment instruction on 3 January 2018, attempted to rectify the deficiency.

Having regard to the steps taken by the appellant to ensure that payment was made, and the fact that payment was effected on the first business day after the payment due date (with the result that SARS suffered no prejudice), and further that there was no malintent on the part of the appellant the court found that reasonable grounds existed for the penalty to be remitted. On this basis, the appellant's second ground of appeal was upheld and the 10% penalty was remitted.

Tax Court judgment of ABC Trust v Commissioner of the South African Revenue Services (IT24918)(18 March 2021),[3] the court had to determine whether the conduit principle (as it pertains to trusts) can be applied in circumstances where a beneficiary trust receives amounts from a vesting trust and in turn, vests those amounts in its beneficiaries.

Facts

The Appellant in this case was a South African resident trust –

- whose beneficiaries were also all resident in South Africa during the relevant years of assessment, being 2014, 2015 and 2016 (Relevant YOAs); and
- which was itself a beneficiary of various other South African resident vesting trusts.

In each of the Relevant YOAs, several of the vesting trusts (in respect of which the Appellant was a beneficiary) disposed of certain capital assets held by those trusts. By virtue of the fact that the Appellant was a vested beneficiary of those trusts, the Appellant became entitled to various capital gains derived from the disposal of the vesting trusts' capital assets.

During each year of assessment in which the Appellant became entitled to the specified capital gains, the trustees of the Appellant awarded (vested) the amounts that had vested in it, to its beneficiaries.
It was the Appellant's contention that no tax liability had arisen in respect of the amounts that had vested in it as the Appellant had merely acted as a "conduit pipe", such that the receipts and accruals of the amounts took place in the hands of the beneficiaries of the Appellant to whom the awards and distributions had been made. On this basis, the Appellant did not reflect any taxable capital gains in its tax returns for the Relevant YOAs.
As a result, SARS raised additional assessments for each of the Relevant YOAs, which assessed the Appellant for capital gains tax, understatement penalties and interest.

Judgment

At issue in the dispute between the Appellant and SARS was the correct treatment of the capital gains derived by the Appellant from the disposal of the capital assets by the vesting trusts and the consequent taxability of those gains in the hands of the Appellant.
In terms of section 25B(1) of the Income Tax Act 58 of 1962 (ITA), (prior to its amendment in January 2021), any amount received by (or accrued to) a person in their capacity as the trustee of a trust will be deemed to be an amount received by (or accrued to) the beneficiary of the trust to the extent that the amount has been derived for

[3] CDH Tax and Exchange Control Alert 22 April 2021

the immediate or future benefit of the said beneficiary, who must have a vested right to that amount during the relevant year of assessment. In terms of section 25B(2), the aforementioned principle applies equally in the event that the beneficiary acquires a vested right to the amount in question in the year of assessment by virtue of the exercise of a discretion by the trustees of the trust.

This principle is commonly referred to as the conduit principle and allows for the taxation of income and capital gains in the hands of the beneficiaries of a trust rather than in the trust itself (in specified circumstances
Given the broad meaning ascribed by the court to the words “any amount” in section 25B(1), it was concluded that capital gains are to be included within the ambit of section 25B(1) (as it applied in respect of the Relevant YOAs) and that to the extent that the requirements of that section were fulfilled, a capital gain may be taxed in the hands of the beneficiary of a trust rather than in the trust itself.

Taking cognisance of section 26B of the ITA (which provides that taxable capital gains – which are to be included in a taxpayer’s taxable income – are to be determined in terms of the Eighth Schedule to the ITA), the court considered the taxability of the capital gains in question, having specific regard to the provisions of the Eighth Schedule.

Paragraph 80 of the Eighth Schedule deals with the attribution of a trust’s capital gains to its beneficiaries. A distinction is drawn in paragraphs 80(1) and 80(2) between capital gains determined in respect of the vesting by a trust of an asset in a beneficiary, and capital gains determined in respect of the disposal of an asset by a trust, where the beneficiary has a vested interest in the capital gain but not in the asset in respect of which the capital gain was derived. Notwithstanding this distinction, in either of the aforementioned circumstances the capital gain must be disregarded for the purposes of calculating the trust’s taxable income, and must be taken into account when calculating the taxable income of the trust beneficiary in whom the capital gain vests

The court considered whether the capital gains derived by the Appellant (by virtue of it being a beneficiary of the vesting trusts), and the subsequent distribution of those capital gains to the Appellant’s beneficiaries, fell within the purview of either paragraph 80(1) or 80(2), as a result of which the capital gains could rightly be taxed in the hands of the Appellant’s beneficiaries rather than in the hands of the Appellant.

On the facts of the case, the court surmised that the vesting trusts disposed of capital assets, as a consequence of which capital gains were derived. The Appellant received the realised proceeds of these capital gains from the vesting trusts, which were accurately described as “amounts” in the agreed facts. The Appellant then awarded these amounts to its beneficiaries, which were proceeds of, and represented, capital gains.

On this basis, the court found that the capital gains that passed from the vesting trusts to the Appellant, and subsequently from the Appellant to its beneficiaries, were capital gains that were “determined in respect of the disposal of an asset” and which constituted a “capital gain but not an asset” within the meaning of paragraph 80(2) of the Eighth Schedule.

Ultimately, the court held that the capital gains in question fell within the ambit of sections 25B(1) and 25B(2) of the ITA, and paragraph 80(2) of the Eighth Schedule (as these provisions read for the years under consideration) and therefore stood to be taxed in the hands of the Appellant’s beneficiaries. On this basis, the Appellant’s appeal was upheld and the additional assessments issued by SARS for the Relevant YOAs were set aside.

Comment

It is a well-established rule of statutory interpretation that newly enacted legislation does not apply retrospectively except in very limited circumstances where the legislature has unambiguously provided for it. In this case, the court adopted an approach consistent with the rules of statutory interpretation as it applied the relevant provisions of the ITA as they read during the Relevant YOAs and not as they read presently.

To this end, it is noteworthy that on 20 January 2021, an amendment to section 25B(1) was promulgated to the effect that the previously wide concept of "any amount" as contemplated in this subsection has now been qualified to exclude "amount[s] of a capital nature which [are] not included in gross income or an amount contemplated in paragraph 3B of the Second Schedule".

The court stated that the impact of this amendment would be to trap certain capital gains and lump sums in the trust in order to ensure that they are taxed in the trust rather than in the hands of the beneficiaries of the trust. However, it should be appreciated that the attribution of the capital gains of a trust to its beneficiaries is specifically dealt with in paragraph 80 of the Eighth Schedule. As the court was not asked to interpret section 25B(1) after its amendment, its statement regarding the effect of the amendment could potentially be seen as obiter dictum. Where a similar issue arises to the one discussed in the judgment at hand after the amendment of section 25B(1), one would have to carefully consider the relevant sections and their interaction with one another.

***Purveyors South Africa Mine Services (Pty) Ltd vs Commissionerfor the South African Revenue Services* (135/2021) [2021] ZASCA 170 (7 December 2021)[4]**

The primary issue to be decided by the SCA was whether SARS had been correct in rejecting the appellant's VDP Application on the basis that the application had not been made voluntarily, as a result of which the VDP Application did not comply with the requirementsset out in section 227 of the TAA

It was held that the purpose of a voluntary disclosure application is to ensure that non-compliant taxpayershave a pathway to regularise their tax affairs out of their own volition and without any prompting, therebymaking amends in respect of their defaults by informing SARS thereof.

To this end, the SCA was of the view that the voluntary disclosure provisions would serve no purposeif they enabled taxpayers to obtain informal advice from SARS, following which the taxpayers would be able to apply for voluntary disclosure relief if the said advice was not in their favour.

In coming to its decision, the SCA had specific regard to the email sent by the appellant to SARS on 29 March 2017 and inferred from that email that:

- the VDP Application was promptedby compliance action on the part of SARS, which was aware of the appellant's default following the interactions between SARS and

  the appellant;
- the appellant recognised that it was liable for penalties which had to be paid before it would be tax-compliant; and
- the VDP Application was not motivated by the appellant's desireto come clean to SARS, but rather to avoid the payment of penalties by it.

These findings by the SCA were bolstered by the fact that there was no evidence to suggest that the appellant had previously been contemplating a voluntary disclosureapplication, and further that the appellant failed to take

[4] CDH Tax and Exchange Control Alert 3 February 2021

any action foran extended period. On this basis, the SCA concluded that the VDP Application had not been submittedon a voluntary basis.

The SCA then reiterated that voluntary disclosure relief cannot be granted in circumstances whereSARS had prior knowledge of the default (regardless of the source of such prior knowledge) and had, in addition, warned the appellant of the consequences of its default. It was held that to grant relief in thesecircumstances would be contrary to the purpose of the Voluntary Disclosure Programme, which is to "*enhance voluntary compliance with the tax system by enabling errant taxpayers to disclose defaults of whichSARS is unaware, and to ensure the best use of SARS' resources*."

The SCA therefore agreed with SARS' contention that, on a proper interpretation of section 227 of theTAA, the appellant's submission thatthe section must be construed as excluding prior knowledge on the partof SARS cannot be accepted. As such, the submission by the appellant that the VDP Application should be treatedas if no previous exchanges had been made with SARS was without merit on the basis that it would allowtaxpayers who have not complied with their tax obligations to seek an opinion from SARS and, upon receipt of that opinion, apply for voluntary disclosure relief. In the SCA's view, thisis exactly the type of mischief that thelegislature sought to avoid

VAT BGR 57

On 20 October 2021, SARS issued BGR 57 in which it clarifies whether the term "consideration" includes an amount of transfer duty paid or payable on the acquisition of second-hand fixed property for the purposes of calculating a notional input tax deduction available to vendors who acquire fixed property from non- vendors for taxable purposes.

Notwithstanding the findings of the Tax Court in VAT1857, and in line with its past practice, SARS has ruled that the term "consideration" does not include any transfer duty imposed under the
Transfer Duty Act. As a result, the amount of transfer duty paid by a vendor to acquire second-hand fixed property for taxable purposes cannot be included in the calculation of any notional input tax deduction which may be available to that vendor under the VAT Act.

SARS' ruling is issued on the basis that the transfer duty paid is not an amount in respect of any "consideration" in money paid for the supply of the property. SARS refers to its Interpretation Note 70 which states that "consideration" refers to the purchase price that must be paid to the supplier of goods or services by the recipient.

SARS stated that under the provisions of the VAT Act, the payment in money is recognised to the extent that it has the effect of reducing or discharging any obligation relating to the purchase price for the supply during the tax period concerned. It states that transfer duty is a tax levied under the Transfer Duty Act on the "value" of the fixed property and is payable by the purchaser to SARS. It is not an amount paid to the seller. Transfer duty therefore does not form part of the purchase price of the property and the payment thereof cannot be regarded as an amount paid which reduces or discharges any obligation of the recipient relating to the purchase price of the property.

TREASURY RETIREMENT REFORM PROPOSALS

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

14 December 2021

Encouraging South African households to save more for retirement
Excerpts only included below:

What is the policy proposal?

Government is sympathetic towards the difficulty many South Africans are currently facing and has continuously been engaging with the regulators and other key stakeholders to work out reliefmeasures for consumers. As a result, measures on contribution suspension and holiday, as wellas expansion of access to living annuities were enabled to ease the plight of some members.

Even though retirement savings should be used for their intended reason, namely retirement provision, Government recognises that there might be a need to allow some access to accumulated retirement savings before retirement. It is for this reason that the National Treasurynoted, in the Budget 2021 financial sector updates, the consideration to allow limited pre- retirement withdrawals from retirement funds under certain conditions, if this is accompanied by mandatory preservation at resignation.

Further, requests for early access to retirement savings have been made both before and after the advent of the current COVID-19 pandemic. As a result of the increased possibility of such ongoing requests, Government is considering restructuring its retirement policy provisions to allowlimited pre-retirement withdrawals in a manner that safeguards future benefits beyond the pressing financial needs that arise because of the COVID-19 pandemic or due to possible futureperiods of financial distress for retirement fund members.

One of the options currently being considered is a *two-pot* system, which will enable the restructuring of retirement contributions into *two-pots*.

The one account can be accessed at any time and the other account will not be accessible beforeretirement and must therefore be preserved until retirement.

It is proposed that one-third of any future contributions should go into the accessible retirement fund account and the other two-thirds goes into an account that must be preserved untilretirement.

- Treatment of the extent of vested rights on amounts accumulated by implementation date is still under consideration, comments and options would be welcome on how vested rights can be protected.

Allowing access to one-third of future contributions at any time and removing the ability to withdraw the full amount upon resignation, will eliminate the incentive to leave employment to gain access to retirement funds. Greater accessibility and flexibility could also encourage more savings into retirement funds. The accessible portion would be available at any time (but can onlybe withdrawn at most once a year, depending on a fund's ability to effect withdrawals and subjectto a minimum value, say R2,000), which would assist households if they needed funds for emergencies, without contemplating resigning to obtain those resources. The *two-pot* system spreads the availability of the lump sum that would usually become available upon retirement overthe lifespan of the member, so that it is accessible when it is most needed.

The withdrawing member would have to incur the cost of a withdrawal so that non-withdrawing members do not subsidise the cost of those withdrawing. A withdrawing member would have to update his member details with the fund and whatever details would be necessary to effect a withdrawal. A member may also be required to undergo retirement benefit counselling or financialawareness before a withdrawal is undertaken. A withdrawal from a retirement fund reduces the savings for retirement for a member, and they should be encouraged to increase their future retirement savings to replace what is being withdrawn (e.g. by increasing monthly contributions after a year).

By combining a greater level of access with the restriction that two-thirds of contributions go intoa pot that must be held until retirement, a much larger amount should be preserved in the retirement system compared to the current situation. This should increase the amount of assets available for the individual when they retire and increase replacement rates in retirement.

The vested rights provisions, though limited, will reduce the need for any employees to resign before the amendments become effective, as when they resign at any point in the future, they would still be able to withdraw an agreed amount of their retirement interest (together with growthon that amount) that was available at the implementation date. There would be no vested rights for individuals starting a new job after the implementation date[8].

Pension preservation funds and provident preservation funds do not receive contributions, but they will also be required to implement the *two-pot* system. Transfers into pension or provident preservation funds would mirror the structure of the transferor fund. This will enable members tocontinue to be allowed to withdraw from the one-third accessible pot from a preservation fund at any point after the implementation date. The once-off withdrawal for the two-thirds preserved potin pension preservation funds and provident preservation funds would be removed for contributions made after the implementation date. However, the once-off withdrawal would still

Below is a summary of how the proposed *two-pot* system may look:

	Vested pot occupational pension	**Vested pot occupationalprovident**	**Access pot**	**Retirement pot**
Contributions	All pension fund contributions before 1 March in the implementation year	All provident fund contributions before 1 March in the implementation year	1/3 net* contributions from 1March in the implementation year (*net=net of risk premiums & admin charges)	2/3 net* contributions from 1 March in the implementation year (*net=net of risk premiums & admin charges)
Investment growth (positive or negative)	Investment growth added	Investment growth added	Investment growth added	Investment growth added
Access rule	Can access in full in future if change jobs	Can access in full in future if change jobs	Can access at any time (but at most once a year)	Must preserve until retirement
Retirement rule	Must annuitise 2/3rds, but subject tode-minimis	May take in cash at retirement – subject to 1 March 2021provisions	May take (any) balance in cash at retirement	Must annuitize infull, but subject tode-minimis
Implementation year is anticipated to be 2023				

Withdrawals from the accessible account?

The retirement fund industry is founded on providing longer-term investments to create a lump sum that can be used for an annuity at retirement, therefore, it is not geared towards providing immediate access to funds or offering quasi-transactional accounts. Shorter-term savings vehicles, such as fixed deposits, ETFs or unit trusts, provide a better mechanism for individuals to obtain returns while retaining the option to access those funds if needed. Creating an accessiblepot from one-third of future contributions upends this distinction between retirement savings vehicles and short-term savings vehicles.

It is unlikely that individuals need another transactional account, and from a policy perspective, itis not the intention to allow a member to withdraw one-third of their contributions each month. Under the current tax system, this would also require a tax directive each month from SARS to check the cumulative withdrawal per taxpayer to calculate the tax to be paid according to the current tax dispensation. The previous discussion paper released at Budget 2013 proposed thatindividuals could withdraw the greater of 10 percent of their balance or the old age grant value each year. If no withdrawal is made, then the potential withdrawal amount is cumulative (e.g., after 5 years an individual could take out the higher of 5X10 percent of the fund value or the cumulative value of the old age grant).

A key component of the previous proposal was that it should not create a time limit for when someone can access those amounts, otherwise individuals will feel forced to access those fundsas soon as the opportunity arises. This should be avoided with the *two-pot* approach as the full value would be accessible in future.

The proposal is that individuals would be able to make a withdrawal from the one-third access potat any time, but they cannot make more than one withdrawal per year. Individuals should not feelforced to make a withdrawal, as the option to do so would still be available to them at any point going forward.

There may still be an incentive for individuals to withdraw the full allowable amount of their fundsin the one-third access pot if they make a withdrawal under this design since they would be required to wait a year until their next chance at a withdrawal. If they are worried that they may need additional funds before the year has passed, they may want to withdraw the full value ratherthan the portion that is required for their immediate needs. To mitigate this and improvepreservation in the one-third pot, it is proposed that a second withdrawal be allowed within the year for any remaining amount if the individual made a partial withdrawal. For example, if someone had R100 000 in their one-third pot and they withdrew R70 000 on 1 September, they would be allowed to make a second withdrawal of R30 000 at any point up to 1 September in thefollowing year. This would reduce the desire to take the full value on the first withdrawal but wouldincrease administrative complexity.

Application of the *two-pot* system

Retirement annuity (RA) funds

The *two-pot* system would remove the incentive to resign to gain limited access to retirement assets, as well as increase preservation, for employees who contribute to a pension fund or a provident fund. However, there is currently no incentive to resign for those who contribute to retirement annuity (RA) funds as there is no access to those funds before the age of 55. Self- employed business owners often contribute to RA funds, as their incomes may fluctuate, and theyare not eligible for membership of other fund types. As a result, a loss of business income can currently not be supplemented through access to RA assets.

By allowing a *two-pot* system for RAs, would reduce the amount that would be preserved by the time individuals reach the age of 55, undermining the first objective to ensure greater preservation, without fixing the same resignation issue that is present for pension and provident funds.

However, if RAs are not included in the *two-pot* system and no access is permitted before the ageof 55 then there will be no way to assist individuals in financial distress (who are most likely self-employed). There would then be no progress on the objective to allow for greater access and flexibility for RA fund members.

A further consideration is simplicity and the harmonisation of retirement funds, which would makeit easier for the public to understand and increase the potential for future consolidation and reduced administrative costs. If RAs were included in the *two-pot* system, it would be theoreticallypossible (because of tax harmonisation and the introduction of compulsory annuitisation for provident fund members) for each person to combine all their retirement fund holdings generatedbeyond the implementation date into a single retirement fund. (Although each fund would need tocater for several "pots" and vested rights.) Including RAs in the *two-pot* system would mean that pension funds, provident funds and RAs would all be identical in terms of tax treatment, pre- retirement preservation and post-retirement preservation[9].

Given that there would be greater discretion related to the use of RA funds if a portion of contributions were accessible before the age of 55, this may lead to greater demand for RAs. Butit is unlikely that preservation would be increased overall due to this higher demand as contributions to RAs would need to increase by more than 50 percent[10] (from around R40 billion to R60 billion each year).

To allow for a simpler and more harmonised retirement fund system going forward, it is proposedthat RAs be included in the *two-pot* system. This will satisfy the second criteria of allowing for early access but will partially undermine the first objective of greater preservation. Older generation RAs may require more time to operationalise the *two-pot* system.

Example of the proposed two-pot system

Person A is employed and has R200 000 in a provident fund at the time of implementation of these amendments on 1 March 202X. From 1 March 202X onwards, one-third of their contributions are deposited into an accessible pot and two-thirds of their contributions are deposited into the retirement pot.

- *After two years, there is R20 000 in the one-third access pot and R40 000 in the two-thirds retirement pot and R220 000 in the vested right pot. Person A faces some financial difficulties and can withdraw the R20 000 from their access pot without resigning to gain access to their retirement funds. No further withdrawals from the access pot can be made for one year (unless they made a partial withdrawal).*
- *After another two years, Person A has R25 000 in the one-third access pot, R100 000in the two-thirds retirement pot and R250 000 in the vested right pot. Person A resigns to join another company. On resignation, the one-third access pot and the two-thirds retirement pot would need to go to a preservation fund or the fund of their new employer. The one-third pot would still be accessible at any time. For the vested rightpot, Person A would have the option to either:*
  - *Withdraw the R250 000 vested right, although the amount would be subject totax according to the withdrawal tax table*
  - *Transfer the R250 000 to a provident preservation fund. The amount would remain eligible for a once-off withdrawal of up to the full value at any point before retirement.*
- *After another 10 years, Person A has reached retirement age. There is R75 000 in the one-third access pot and R600 000 in the two-thirds retirement pot. Person A retires and can withdraw the R75 000 from the one-third access pot as cash and is required to purchase an annuity with the R600 000 in the two-thirds retirement pot.*

The tax treatment for amounts withdrawn before retirement

The withdrawal tax table is considerably more onerous than the retirement tax table, as the first tax rate of 18 percent starts at R25 000 rather than R500 000. Even so, the top tax rate of 36 percent for cumulative withdrawals above R990 000 is lower than the top marginal tax rate of 45percent. This structure creates a potential tax arbitrage as the tax saved through the deduction on contributions is larger than the withdrawal lump sum tax on any withdrawals before retirement.

Tax arbitrage is not as likely to be easily harnessed under the current regime since pre-retirementwithdrawals are linked to resignation or retrenchment. The decision to resign is not likely to be influenced by the tax arbitrage potential (and is not a factor at all for retrenchment).

Options for adjustments to the tax treatment of contributions and withdrawals

Due to concerns around tax arbitrage, the potentially high tax rates on lower-income earners andthe fact that the one-third pot can be used as a short-term savings vehicle, the current tax treatment for contributions to, and withdrawals from, the one-third access account is unlikely to be appropriate. National Treasury will investigate potential alternatives (of which there are manyinternational designs[15] to use as a comparison) for the tax treatment of the one-third access pot that will try to retain incentives for individuals to save while improving equity and limiting the risksto the fiscus. These could include:

1. Adding withdrawals from the one-third access pot to taxable income in the year of withdrawal
   - This would limit the potential for tax arbitrage since if an individual received a deduction on the contribution and shortly thereafter made a withdrawal, it would be added back to taxable income in that year. Individuals may still withdraw in a later year to generate a tax advantage if their marginal tax rate is lower, but this islikely to be less of a concern than the current design. As the account is intended to help those who are in financial distress, the tax liability would automatically be lower in cases when there is a sharp drop in income. This design also discourages large lump-sum withdrawals since larger withdrawals will face a higher tax rate, although the amounts remain available if needed.
   - A concern with this approach is that the retirement fund would not be able to determine the amount of tax that should be withheld as it would be dependent onthe level of taxable income at the end of the year (unlike the current system wherea tax directive determines the exact amount of tax applicable on similar withdrawals). This could lead to either unexpected tax bills from SARS at

the endof the year or the presence of a refund, which would only be transferred if the individual filed a return.

2. Switching the application of tax from withdrawals to contributions for the one-third access pot. The tax structure would move from an EET regime to a TEE regime for contributions to this pot.
   - In effect, this would create a tax-free savings account within a retirement fund. There would be no tax arbitrage issues and no cases where lower income individuals face a higher ETR compared to higher income individuals. Retirement funds need not apply for a tax directive for withdrawals as there would be no withholding tax on withdrawals.
   - Since tax is paid upfront there would be a smaller initial deduction and a potential reduction in net income. Although over the lifetime of the investment there would be no difference as the benefit is tax-free (EET gives the same final investment value as TEE).
3. Moving to a flat deduction percentage for contributions
   - For example, individuals could receive a 30 percent deduction on their contributions. The deduction is unrelated to income and would be more beneficialfor those on lower income tax brackets, improving the progressivity of the tax regime. Lower-income individuals would see an increase in net income as their deduction increases, while the opposite occurs for higher-income taxpayers that face a marginal tax rate above the level of the flat deduction. Tax on withdrawals could either be at the same flat rate (which would not require the retirement fund to obtain a directive and would avoid refunds or unexpected tax liabilities) or couldbe added to taxable income for that year (with the same benefits and disadvantages as discussed previously).
4. Keep the current tax design
   - If the concerns with the current system are not sufficiently serious to warrant an adjustment.

One aspect that would require particular attention is the treatment of contributions in excess of deductibility limits. Currently, any contributions that are not deductible are added to the tax-free lump-sum on retirement or can be used to reduce the tax paid on the receipt of annuity income. The application of these limits needs to be carefully assessed under each option. For example, ifthe tax treatment of contributions to the one-third access pot mirrored that of the tax-free savingsaccount, individuals may be able to contribute an amount much higher than the current deductibility limits into this accessible pot to take advantage of the preferential tax treatment. Forthis option, a limit on transfers into the one-third access may be required, which would match thedesign of the tax-free savings accounts which has an annual contribution limit.

INTERPRETATION NOTES AND SARS UPDATES

Draft Notes

- Draft Interpretation Note – Understatement Penalty: Meaning of "Maximum Tax Rate applicable to the Taxpayer" under Section 222(5) of the Tax Administration Act

Due date for public comment: 27 May 2022

- Draft Interpretation Note – Determination of the taxable income of certain persons from international transactions: Intra-group loans

Due date for public comment: 29 April 2022

SARS UPDATES

21 February 2022 – An additional channel was added on eFiling to assist clients who want to inform SARS when they ceased to be a tax resident of South Africa.

The taxpayer must inform SARS by way of one of the following two channels:

- If a taxpayer ceased to be a tax resident of South Africa, the taxpayer can now inform SARS through the Registration, Amendments And Verification Form (RAV01) on eFiling by capturing the date on which the taxpayer ceased to be a tax resident. The form can be obtained on eFiling or SARS branch by making appointment. A case will be created whereby the taxpayer will receive a letter from SARS to submit supporting documents.
- Alternatively, the taxpayer can inform SARS by capturing the date on the ITR12 tax return.

How will supporting documents work:

- If the declaration is made on the income tax return (ITR12), you will receive a request for supporting documents to substantiate the declaration you have made. The relevant information that must be supplied to SARS will depend on the basis on which you have ceased to be a tax resident.
- If the declaration is made via the RAV01 form on eFiling, the Declaration form must be completed and be submitted with the relevant supporting documentation through eFiling or SOQS.

21 February 2022 – A once-off admin penalty will be imposed on the following two populations of taxpayers:

- Taxpayers that were selected for auto assessment and failed to accept, decline, or edit and then file their return after SARS issued an original based on estimated return (auto).
- All provisional and non-provisional taxpayers that were not auto assessed and submitted a return post filing season and pre-imposition of the recurring admin penalty.

Just like the PIT outstanding return recurring admin penalty, the PIT once-off admin penalty can be adjusted or cancelled.