

Standing Committee on Finance (SCOF): Report-Back Hearings

11 September 2013

DRAFT Taxation Laws Amendments Bill, 2013 and Tax Administration Laws Amendment Bill, 2013

DRAFT Response Document from National Treasury and SARS

Version as presented to Standing Committee on Finance on 11/09/2013¹

BACKGROUND

1.1. PROCESS

The Draft Taxation Laws Amendment Bill, 2013 and Tax Administration Amendment Bill, 2013 were publicly released on 4 July 2013. National Treasury and SARS briefed the Standing Committee on Finance on 24 July 2013 and the Committee heard responses from the public at hearings that were held on the 20 and 21 August 2013. The final report back to the Committee is on 11 September 2013.

1.2. PUBLIC COMMENTS

The deadline for public comments was 5 August 2013. National Treasury and SARS received responses from 87 organisations and individuals and held workshops with stakeholders to discuss and review their comments. General workshops were held on: 5 August for retirement savings; 7 August for personal income tax; 23 August for value added tax, 27 August for international taxation; 28 August for business tax and 4 September for tax administration issues. More focused workshops were also held to discuss more specific issues (such as the valuation of defined benefit fund contributions, excessive debt limitations, oil and gas exploration and research and development incentives).

1.3. POLICY ISSUES AND RESPONSES

Provided below are the responses to the policy issues raised by the public comments received. Both policy and technical issues have been fully reviewed and included within the revised Bills as appropriate. Comments that fall wholly outside the scope of the Bills have not been taken into account for purposes of this response document. The references to the Bill provided below only link to the main references (i.e. the references are not exhaustive).

DRAFT TAXATION LAWS AMENDMENT BILL

2. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

2.1. Bursaries or scholarships to employee relatives

(Main reference: section 10(1)(q))

Comment: The definition of remuneration is uncertain and will include variable factors such as overtime, commissions, bonuses and car allowances, some of which may not be at the

¹ This version is as presented in Parliament, but corrected for typographical errors and the insertion of a footnote on page 7.

discretion of the employer. Reference should rather be made to a guaranteed package that is more consistent through the years as the current structure would create a disincentive for employees to perform well.

Response: Not accepted. Adjusting the definition of remuneration to a 'guaranteed package' will not target the incentive effectively. Employees who receive a large portion of their income through variable methods such as commission or bonuses could then qualify for the incentive but may not require financial assistance.

Comment: The income threshold is too low and will exclude those who need it the most. The value should be increased to the tax return threshold of R250 000.

Response: Accepted. The income threshold will be increased to R250 000 to ease administration and to accommodate a greater number of potential beneficiaries. However, the threshold will not be directly linked to the tax return threshold going forward.

Comment: The tertiary bursary amount is too low since it would not cover textbooks, travel or accommodation which can be considered a part of tertiary education. The exempt amount should be increased to R15 000 for basic education and R50 000 for tertiary education.

Response: Not accepted. The bursary amount was increased from R10 000 to R30 000 for tertiary studies, a substantial increase. The incentive is intended to cover tuition fees and not to include other incidental expenses.

Comment: Budget Review says the increase is effective from 1 March 2013, but the Explanatory Memo states 1 March 2014. Some companies may have already acted upon this information so the implementation date should remain 1 March 2013.

Response: Accepted. The effective date will be amended to 1 March 2013.

Comment: Reimbursements for studies completed during employment and waivers of study loans (both of which are taxable benefits) should be afforded tax exempt status since the economic effect is the same as if they had been granted a company bursary.

Response: Noted. The comments raise a legitimate concern since employers may use other structures to pay for the tuition of their employees or relatives of their employees. An investigation will be conducted to determine whether the incentive should be broadened to take other design considerations into account outside of the bursary regime.

2.2. **Alignment of the tax treatment of individual – based insurance policies**

(Main references: Sections 10(1)(gG) and new paragraph 12C of the Seventh Schedule, sections 10(1)(gL) and 23(r))

Comment: Employees and employers would need to unwind and renegotiate all their disability policies since they will otherwise be over-insured. This would create a 'catastrophic administrative burden'. Recommend that the current policy is retained as it would remain in line with the tax treatment of similar policies in other countries such as Australia, New Zealand, Canada and Ireland.

Response: Partially accepted. Under this proposal the tax treatment of premiums for income protection policies will align with the tax treatment of premiums for other personal insurance products, such as life insurance and gap cover, as it is viewed as a personal

expense. However, it is agreed that the renegotiation of income protection policies will be administratively difficult and possibly could not be achieved in a short period of time. As a result, the implementation of the proposal will be delayed by a year to allow an additional period of time for employers and employees to renegotiate their income protection policies.

Comment: Individuals currently in claim and in receipt of the payments would see an increase in their policy pay-outs and research shows that a smaller proportion of these individuals would return to work (since these benefit payments could now be higher than their net income from working). This would decrease the number of people returning to employment, creating significant cost to the life industry.

Response: Not accepted. Changes to the tax treatment of benefits may lead to higher replacement rates which could contribute to an element of moral hazard. However, the necessity of ensuring that a claim is legitimate remains.

Comment: Take-home pay will be significantly reduced for those paying premiums, forcing companies to raise salaries or face reduced take-up of permanent health insurance policies and other income protection policies. Employers are likely to face reduced take up and participation by employees, forcing them to close down the entire scheme and resulting in many employees being under-insured. The comments recommend that the proposal be withdrawn.

Response: Not accepted. If the policy contracts are renegotiated for a lower benefit pay-out (because the benefits are not taxable) the corresponding premiums required by the insurers will also decrease. Even without this corresponding adjustment, the additional amount to pay in tax would not be significant. For example, an individual who pays tax at the marginal rate of 18% would pay an additional R36 a month if the monthly contributions were R200.

Comment: The pay-outs of income protection benefits will now be tax-free. For those on lower incomes who receive these benefits there will be no change in their position as they did not pay tax in any case. The policy will however only benefit those with greater incomes as they will see an increase in their benefits as they no longer need to pay tax.

Response: Not accepted. Although it is true that those on higher incomes who pay tax may receive a greater level of benefits, these individuals are also part of a vulnerable group as they have suffered a disability. The argument also does not look at the impact on the net pay of those on higher incomes who are not injured or disabled and would be paying premiums. These higher income individuals will be contributing more in tax on these premiums than those on lower incomes.

Comment: It was understood from previous discussions with National Treasury that they were looking to align the treatment of employer provided insurance and individual insurance and this proposal would negate that objective. Tax changes have only just been made in this area and are now being made again, instilling a sense of uncertainty. It is recommended that retirement funds be allowed to provide temporary disability benefits.

Response: Comment misplaced. The treatment of employer provided personal insurance and individual personal insurance is the same as both types of premiums are not tax deductible, while the pay-outs are not taxable. The retirement savings tax regime applies to insurance provided through a retirement fund (the contributions are tax deductible up to a limit and the pay-outs are taxable whether as a lump sum or an annuity). The

recommendation that retirement funds be allowed to provide temporary disability will be considered.

2.3. **Rollover treatment of excess deductible donations**

(Main reference: Sections 18A(1))

Comment: The percentage cap incentivises donors to donate less in certain years to make room for rolled over amounts and will not stimulate the regular and increased flow of donations. Regular donors will see no additional benefit. Recommend that the deduction limit be set at 15% instead of 10% or that gross income is used as a base instead of taxable income. Also suggest that the build-up of any rolled over amounts may be utilised at a particular point in the future, such as at retirement.

Response: Not accepted. The incentive has been amended to be increasingly generous by moving from a policy which did not allow any rollover to a policy which now does allow a rollover. Increasing the incentive is unlikely to lead to a lower level of donations. Allowing the rolled over amounts to be used in a particular year would effectively eliminate the percentage cap entirely.

Comment: Unclear how in kind property donations will be rolled over since there's no record of this type of transaction. Recommend that the value of the property donation be included.

Response: Not accepted. The certificate must contain the necessary information regarding the value of the property or no deduction will be available.

Comment: Activities falling under the heading "cultural" (libraries, museums etc.) are not afforded deductibility status and neither are professional services. Both of these types of donations should be included in the deductible percentage.

Response: Comment misplaced. The policy intent was to expand the generosity of the current allowable deductions for donations and not to expand the allowable list.

Comment: Wording should change to allow both full and partial donations eligible for deduction and more than one donation within the year.

Response: Accepted. The legislation will be clarified as applying to roll forward both a portion and/or an entire donation made by a person if it exceeds the allowable deduction in particular year of assessment.

2.4. **Revised contribution incentives for retirement savings**

(Main references: Sections 11(k) and 11(l), new paragraph 2(l) of the Seventh Schedule)

Comment: Remuneration is included in taxable income so there is no need for the maximum of one or the other as taxable income is always higher. This structure could also create alternative distortions between the decision to be a sole trader or to run a business through a company.

Response: Comment misplaced. Remuneration is often higher than taxable income (due to tax deductions). However, the maximum of taxable income or remuneration is used so that employers would not exceed the percentage cap as they can base it on the employee's remuneration only. A business owner could still pay himself in wages and contribute that amount to a retirement annuity fund to make full use of the allowable deduction.

Comment: Remuneration should include the full value of travel and car allowances. This is the current approach of retirement funding income for retirement annuity contributions. This change would lead to a closer alignment between the cost to the employer and the income base. Dividends should be included in taxable income otherwise sole traders will not be able to get a deduction for their contributions if they have an unsuccessful year where their income is low.

Response: Not accepted. The level of remuneration is clearly set out in legislation and specific alterations would unnecessarily complicate the system. The tax treatment of contributions is based on deductions and not credits, therefore if no tax is payable there cannot be a deduction. There is also generous rollover treatment to accommodate those with variable incomes.

Comment: The monetary cap is not supported. The cap is too low and is not in line with government's aim to motivate people to save. The cap will have a significant impact on household savings and will affect more people than originally estimated. Those needing to catch up on saving toward retirement will not be incentivised to do so. If it is to be included than it should be linked to inflation.

Response: Not accepted. A monetary cap is important to ensure that the tax incentives for retirement savings are equitable and that the majority of this expenditure is not spent on those with the highest incomes. Non-deductible amounts will still be free of tax on withdrawal. It is not the intention to decrease the real value of the cap over time by not adjusting it upwards.

Comment: The current wording of the legislation no longer allows medical aid contributions to be deductible for the employer and should be amended.

Response: Comment misplaced. Employer contributions to medical schemes are under normal circumstances deductible in terms of the general deduction provision.

2.5. **Valuation of fringe benefit for defined benefit purposes**

(Main references: New definitions of "defined benefit component of a fund", "defined benefit component of a fund" and retirement-funding income" in paragraph 1 of the Seventh Schedule and new paragraph 12D of the Seventh Schedule)

Comment: The formula appears to be excessively complicated. The formula should be simplified or the contribution should be based on actual employer contributions. It will be administratively difficult for payroll departments to implement if the formula or the values were to change often. Costs of a complicated system will ultimately be borne by the members of the fund. Consideration should be given to deferring these proposals until the true nature of the tax risk is known.

Response: Not accepted. Using the actual value of employer contributions will lead to unfair tax charges as the employer contributions may not relate to employee benefits. The formula is already in a simplified form in order to make it easier for companies and payroll departments to implement and it is not expected that the formula or values used in the formula (other than remuneration) will change often.

Comment: It does not appear as if there is a pre-retirement discount rate included in the calculation. A smoothed contribution rate should be applied to each member based on their particular entry age. The current formula should be replaced with the formula used by the

FSB to value minimum individual reserves and should align to the same assumptions. Allowance for expenses should be included in the calculation.

Response: Partially accepted. The pre-retirement discount rate is included in the factor “F” in the formula and the current formula does not differentiate by the age of the member. The pre-retirement discount rate that is supplied by the FSB will be used as the basis for the calculation of the factor. The formula used to value the minimum individual reserve would not be suitable in this instance as it refers to the minimum, not actual, benefits and the values would be adjusted monthly making it difficult for payroll administrators to implement. An allowance for expenses will be included in the factor.

Comment: The formula will generate tax charges for older members of defined benefit funds. The policy is thus unfair to older members.

Response: Comment misplaced. Internal calculations show that very few members will exceed the percentage cap for deduction on retirement contributions. The formula does not differentiate by age and so is not age discriminatory.

Comment: If an employer has a different benefit structure for different employees (e.g. different accrual rates) it would be excessively costly for payroll systems to allocate each employee to a different set of values that are assigned to them by the valuator. Propose that the values are applicable to all employees per employer so that there is no need to carry out a different calculation for each member.

Response: Not accepted. The concerns are legitimate from an administrative point of view. However, the consequences of averaging accrual rates across an employer are not acceptable, as they will overstate the contributions for those with less generous benefits. Stakeholders will be consulted to find a solution with minimal impact.

Comment: Amounts contributed from employer surplus account will not be included as a fringe benefit for the employee since the contribution is not coming from the employer. Clarity is needed in this regard.

Response: Noted. Allocations to an employee from an employer surplus account are not currently taxable as a fringe benefit. Due to arbitrage concerns this element of the tax system may need to be revisited.

Comment: Past service improvements that are paid for by the surplus in the fund are akin to greater than expected returns and should not be a taxable fringe benefit (since no additional contributions are made). Inclusion of retrospective benefit improvements would be unfair where these were included to redress imbalances of the past.

Response: Noted. There is merit in the notion that the disbursement of an enlarged surplus due to greater than expected returns should not be taxed. However, unfunded increases in benefits due to past service improvements are economically the same as a new increase in benefits. The taxation of such increases in pension benefits will be explored further.

Comment: Some funds have various complex combinations of both DC and DB approaches. It may be difficult to implement a simple differentiation in tax treatment. An ‘exception process’ should be implemented to deal with unusual funds, rather than creating complicated new taxation rules for a small number of unique circumstances.

Response: Noted. The current treatment will see the valuator of the fund split the contributions for the DC element and the DB element. Further investigation will be required to specifically deal with more complicated fund structures (e.g. funds with an under-pin).

2.6. **Provident fund post-retirement annuity alignment**

(Main references: The definitions of “pension fund”, “provident fund”, “retirement annuity fund”, “pension preservation fund”, and “provident preservation fund” in section 1, and paragraph 6(1)(a) of the Second Schedule)

Comment: At the moment the legislation only protects the rights of those over 55 years if they stay in the provident fund they were in at T-day. They will lose their vested rights if the employer closes down the provident fund, which is unfair.

Response: Accepted. The legislation will be amended to preserve the vested rights of fund members who were over the age 55 at T-day and were in a provident fund but then moved their fund assets into a different retirement fund.

Comment: The increase in the de-minimus amount is counter-intuitive to the government’s thrust towards annuitisation. The proposal is intended to soften the impact for provident fund members, however it could lead to a proliferation of funds as individuals try to spread their pension amounts across different providers. The de-minimus amount should only be increased in phases.

Response: Noted. The current dispensation of retirement funds does not allow an individual to split their retirement interest amongst different accounts, which should mitigate this impact to some extent. This issue will be investigated further.

Comment: The current legislation does not allow for non-deductible contributions from previous years to be deductible in the future.

Response: Comment misplaced. The proposed changes deem contributions made in prior years to be made in the current year to the extent that the contributions were not deductible as a result of exceeding the deduction limits.

Comment: Abolition of the old age grant means test should coincide with these changes or follow straight afterward. These proposals should be tabled only when preservation has been implemented as the administrative difficulty of separating accounts still further will be felt for many years to come.

Response: Noted. Appreciate that there could be additional administrative costs and complexity if T-day and P-day are on different dates, hence the postponement to implement on 1 March 2016².

2.7. **Employer provided accommodation – low-cost housing**

(Main references: Paragraph 5 of the Seventh Schedule and new definition of “remuneration factor” in section 1)

Comment: Remuneration is based partly on income that is variable, depending on bonuses and other once off amounts (relocation allowances) that cannot be smoothed over the

² After the hearing in parliament please note that this date may be reviewed to possibly take effect as originally proposed on 1 March 2015.

previous year. Reference should rather be made to a guaranteed package that is more consistent and should pro-rate lump sum payments.

Response: Not accepted. Adjusting the definition of remuneration to a 'guaranteed package' may not target the incentive effectively. Employees who receive a large portion of their income through variable methods such as commission or bonuses could then qualify for the incentive but may not require financial assistance.

Comment: The threshold is too low as inflation would push many of those who would benefit in the current year above this level. Propose that the income threshold is linked to the tax return threshold (currently R250 000) and it is linked to this value so that the threshold does not reduce in real terms over time.

Response: Partially accepted. The income threshold will be increased to R250 000 in order to increase the number of potential beneficiaries. It would be inappropriate to link this value to the tax return threshold as it is not related to the level of earnings in the economy. Furthermore, the 'remuneration factor' used relate to the remuneration earned in the previous year of assessment. The employee therefore enjoys the benefit of inflation in that the R250 000 is effectively based on 'last year's' remuneration.

Comment: There is no clarity on how the 'cost' of property should be calculated. It is uncertain as to whether the amount refers to the cost of the building alone or includes the cost of the land and infrastructure. The threshold also does not represent the true economic transfer if based on cost since houses built a while ago could qualify but may be worth far more than a house that an employer builds (or buys) in the current year.

Response: Accepted. The basis on which the property value limitation will be assessed will be amended from 'cost' to 'market value'. The amendment will more closely reflect the economic value of the transfer to the employee and align with the taxation of other fringe benefits.

Comment: The R350 000 limit for the property is too low. Some residential units cost far more than R350 000. The limit may be appropriate in some areas, but not in other areas where the cost is far higher as the houses may have been built in remote locations with little infrastructure.

Response: Accepted. The property limit will be increased to R450 000. Adjusting the limit upwards accounts for the amendment from cost to market value for property that was built in previous years.

Comment: If the threshold cannot be raised it is requested that there is an exemption for specific cases where cost exceeds R350 000. Alternatively, threshold could apply to houses below a certain size threshold or the relief could apply to the first R350 000 for any residential unit. The "cliff edge" effect results in that those just below threshold will lose out completely.

Response: Not accepted. Creating specific subjective exemptions would unnecessarily complicate the incentive. Allowing the exemption to apply to the first R350 000 of a property of any value would broaden the scope of the incentive beyond the original intention.

Comment: Relief should also be given in situations where the employer is willing to loan the employee money for the property or in the cases of subsidised interest payments.

Response: Noted. Additional incentives for employers do currently exist for the transfer of property to employees on a loan account, although the design of the incentive does not currently cater for all benefit structures.

Comment: There is concern that the incentive may be abused through the manipulation of an employee's remuneration, particularly in the case of connected persons.

Response: Noted. An anti-abuse mechanism will be put in place to prevent abuse in the case of where the employer and employee are connected persons.

2.8. **Share schemes income recognition and removal of dividend character overlap (replaced by employee share scheme dividends)**

(Main references: Para's (c), (d) and (k) of the definition of "gross income" in section 1, section 10(1)(k)(dd) and section 11(t); replaced by new section 10(1)(k)(ii))

Comment: In the main, the proposal was found to be too broad, impacting on bona fide employee share schemes, and leading to inequity.

Response: Accepted. It is agreed that the proposal was overly broad and that it exceeded the policy intent. The concerns raised in the submission were taken into account and the proposal was significantly narrowed.

3. **INCOME TAX: BUSINESS TAX (GENERAL)**

3.1. **Anti-hybrid debt instrument re-characterisation rules**

(Main reference: Sections 8F and 8FA)

Comment: The effective date of the proposal should be moved forward to allow taxpayers to restructure their transactions.

Response: Accepted. The effective date will be deferred to 01 April 2014 and the reclassification will apply in respect of amounts incurred on or after that date.

Comment: Although it may be relatively uncommon in the South African market, it is not uncommon for arm's length third party debt to be issued for periods in excess of 30 years. The issue of debt with longer maturity periods may often be appropriate in certain circumstances (for example, the financing of infrastructure projects). The 30 year threshold should not apply where the instrument is secured and the value of the security is at least 50 per cent of the value of the amount payable in terms of the instrument.

Response: Partially accepted. Although the 30 years redemption period is a reasonable indication for equity, debt that is unredeemable within this reasonable period is more of a concern where there is an economic connection between the issuer and the holder. The application of the 30 year redemption rule will therefore be limited to instances where the issuer and the holder of the debt are connected persons.

Comment: The proposed anti-hybrid instrument rules should not apply to headquarter companies.

Response: Not accepted. The head-quarter company regime is premised on a flow through system using back-to-back financing. Therefore, a headquarter company funded with hybrid debt that is on-lent by the head-quarter company through similar hybrid debt instruments would not attract negative tax implications. This is on the basis that the

hybrid debt yield will be reclassified on both the incurral by and accrual to the headquarter company – resulting in a neutral tax position.

Comment: The proposed rules are only applicable in respect of debt owed by resident companies. It is unclear why these rules are not applicable to branches of foreign resident companies.

Response: Accepted. The proposal will apply to any company and not only to resident companies.

Comment: The proposed rules should not apply to linked units debt issued by property companies and owned by pension funds, long and short term insurance companies and a REIT.

Response: Accepted. See comments under “Simplification of tax regime for collective investment schemes in non-property investments”.

Comment: Clarity should be provided on instruments that have debt features but is subsequently converted to shares as a result of a business rescue plan or arrangement.

Response: Comment misplaced. When the business rescue plan or arrangement is concluded the debt will be converted to shares and the tax benefits associated with debt should not be provided because the debt instrument is exchanged for an equity instrument (for which the general rules applicable to equity instruments should apply).

Comment: Start-up companies should be granted temporary relief from the application of the rules. The rules should only apply with retrospective effect if payment is not made after a certain period from the date of issue

Response: Not accepted. The proposed temporary relief puts an undue administrative burden on SARS's audit processes (i.e. additional or reduced assessments). Instruments issued by small business corporations are expressly excluded from the application of these rules.

Comment: It is not uncommon for companies to obtain third party funding that carries an “equity kicker”. This entitles the funder to share in the upside of the business or assets being funded. Such funding is beneficial to the issuer of the instrument by obtaining better terms on the funding. It is submitted that third party debt should not be subject to the anti-hybrid rules.

Response: Partially accepted. If the terms of an instrument allow the holder to share in a certain percentage of the upside, the rules will apply as the interest is potentially not determined with reference to a specified rate of interest. However, if the terms are such that the holder is entitled to an additional percentage of interest if the profits of the issuer exceed a certain level, only the portion of the adjusted interest rate will be affected. If the base rate is also adjusted for the downside performance, the tainted portion is determined with reference to the lowest rate during the year of assessment in question and the previous five years of assessment.

Comment: A distinction should be made between a conversion or exchange of the instrument for a fixed number of shares and a variable number of shares – in line with accounting reclassification rules and economic substance of the transaction. An instrument exchangeable for a fixed number of shares is clearly equity, because the holder is exposed to the underlying performance of the shares. However, an instrument convertible to a variable

number of shares depending on the value of the instrument still outstanding is comparable to secured debt and should not be covered by the rules.

Response: Partially accepted. A distinction will not be made between conversions or exchanges for fixed or variable number of shares. However, a carve-out will be provided where the value of shares converted or exchanged is equal to the amount outstanding in respect of the instrument.

3.2. **Cross-issue of shares**

(Main reference: Sections 24B and 40CA)

Comment: The deletion of section 24B will result in the any cross-issue of shares in a BEE transaction context being an uneconomical and impractical way to fund an acquisition.

Response: Accepted. The effective date will be changed to 1 April 2013. In addition, the deletion will apply in respect of shares acquired, issued or disposed of on or after that date.

Comment: There is a conflict between section 40CA and paragraph 38 of the Eighth Schedule where a company issues shares for an asset and the market value of the shares and the asset differ. Section 40CA states that the expenditure in respect of the asset is the market value of the shares issued whilst paragraph 38 deems the expenditure to be the market value of the asset.

Response: Accepted. Paragraph 38 will not apply to disposal of assets to which the rules under section 40CA apply.

3.3. **Removal of dividend exemption for dividends applied against deductible financial payments**

(Main reference: Section 10(1)(k)(i)(hh))

Comment: The exemption for dividends should not be dependent on the deductibility of the expenditure in question.

Response: Comment misplaced. The provision excludes the exemption of dividends for a company if the counter-payment by that company is determined with reference to those dividends.

Comment: The wide scope of the provision targets not only transactions which shift dividends to the detriment of the South African fiscus, but also covers a multitude of vanilla transactions which form part of standard business practice within the South African financial and equity markets. It is submitted that these transactions cannot be argued to constitute tax avoidance arrangements or to create a loss to the South African fiscus because the deductible payment in the hands of the recipient of the dividends should be taxable in the South African counterparty's hands.

Response: Not accepted. The provision is targeted at mismatch arrangements in the hands of the party receiving the dividends. That is, the exempt dividend is not matched by a deductible payment even though the two amounts are related. Without the dividends exemption, the company will be taxable on the dividends but a tax deduction is available for payments determined with reference to those dividends – leaving the company in a tax neutral position.

3.4. **Deductible donations of appreciated immovable property**

(Main reference: Section 18A)

Comment: There is uncertainty as to whether the formula is intended for the valuation of donations of immovable property to all public benefit organisations or only for donation of land relating to environmental conservation and maintenance.

Response: Comment misplaced. The provision covers all donations of immovable property irrespective of the purpose of the donation.

3.5. **Deductible interest limitation in respect of acquisition indebtedness**

(Main reference: Sections 23K, 23N and 23O)

Comment: The effective date for the deletion of section 23K should be clarified.

Response: Accepted. The effective date will be clarified in the final Bill. The date is to be changed to 1 April 2014.

Comment: The provision is silent on the carry forward for the amount disallowed as a deduction.

Response: Comment misplaced. There is no carry forward under this provision for the first 6 years. The core purpose of the rule is to prevent the use of excessive acquisition debt mainly to achieve tax savings. A carry forward of lost interest deduction simply goes against this purpose. However, in order to narrow the impact of this permanent loss, the limitation rules are limited to a shorter period.

Comment: Clarity needs to be provided on whether in calculating the adjusted taxable income either 175 per cent or 75 per cent of rental income is included.

Response: Comment misplaced. Rental income is fully included (i.e. 100 per cent) in calculating the taxable income. Only an additional 75 per cent of the rental income is included in the determination of the adjusted taxable income.

Comment: The interest limitation rules should not apply in respect of transactions which have not yet been implemented but approval for the deduction of interest in terms of section 23K has been obtained. It is not clear whether a transaction is entered into when the agreements are signed or where all the conditions in respect of the agreement are fulfilled.

Response: Accepted. All transactions that have been approved by way of directive in terms of the section 23K rules will be excluded from the application of the new rules. The issue of whether a transaction is entered into when the agreement is signed or when the conditions (i.e. resolute or suspensive) are met is a matter of interpretation.

Comment: The focus on the acquired company in respect of section 24O transactions in determining the adjusted taxable income is problematic, especially where the acquired company is an investment holding company (i.e. with its income constituting mainly of dividends and interest).

Response: Accepted. The rules will be amended to focus on the adjusted taxable income of the acquiring company.

Comment: Section 23O (Reorganisations in controlling relationship): The 18 month rule, whereby interest deductions will be disallowed if there was a controlling relationship (more

than 70 per cent) for 18 months in a 36 month period during which the debt was assumed, is considered to be too restrictive and excessive. The 70 per cent restriction is also questioned. It is noted that in BEE vehicles, the 70 per cent could have a meaningful and negative commercial impact and that it is too low and restrictive. It is proposed that this percentage be increased to 80 per cent or that the entire section 23O be scrapped.

Response: Accepted. The limitation rules of interest deductions in respect of reorganisation and acquisition transactions between persons in a controlling relationship and the deferral rules of deductions in respect of debt between a debtor and creditor in a controlling relationship have been withdrawn from the draft Bill.

3.6. Deferral of incurred expenditure between taxable payors and exempt payees
(Main reference: Section 23M)

Comment: A number of concerns were raised regarding the wide scope of the aforementioned provisions, their interplay with the other debt limitation rules and possible impact on legitimate transactions.

Response: Accepted: Given the potential impact of these rules on current commercial practice and the overall time constraints within the current legislative cycle, these proposals will be removed from the Bill for further consultation. Further consultation time is required to refine the proposals so that the right targets are impacted without having unintended adverse commercial effects.

3.7. Deductible interest limitation in respect of loans between exempt persons and domestic companies
(Main reference: Section 23P)

Comment: The definition of a “controlling relationship” is confusing. Clarity should be provided as to the persons intended to be covered by this rule.

Response: Accepted. This rule will simply apply to a relationship between a company and any connected person in relation to that company.

Comment: The definition of “creditor” should exclude Companies Foreign Companies (“CFC”) to the extent the net income at issue is taken into account in determining the income of a resident in terms of section 9D.

Response: Accepted. In order to avoid double counting, where the CFC is a creditor, any interest payable to that CFC will not be subject to this interest deduction limitation rule to the extent that an amount equal to the interest income is taken into account in the hands of a resident.

Comment: The definition of “creditor” is confusing and open ended. Clarity must be provided as to the meaning of the phrase “not subject to tax”.

Response: Accepted. The focus will be changed from the creditor not being subject to tax to the interest income (i.e. for the rules to apply the interest income must not be subject to tax).

Comment: The proposed rules should not apply to linked unit debt issued by property companies and held by pension funds and long and short term insurance companies.

Response: Accepted. See comments under “Simplification of tax regime for collective investment schemes in non-property investments”.

Comment: In the case of long term capital projects (i.e. farming or mining) income may only be generated after 10 years. The limitation of the carry forward period may be insufficient in respect to funding for long term capital projects.

Response: Accepted. The 10 year carry forward limitation rule will be removed (i.e. the excessive interest expense will be carried forward indefinitely).

4. INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)

4.1. New system for the taxation of financial instruments of banks and brokers

(Main reference: Section 24JB)

Comment: There is confusion on whether taxpayers falling under the new rules for the taxation of financial instruments (section 24JB) will also be subject to additional tax on the forced exit event under section 24J(9A) (deemed disposal and reacquisition of financial instruments at market value). The confusion mainly stems from seemingly conflicting effective dates for the new rules for the taxation of financial instruments and the exit event under section 24J(9A).

Response: Accepted. To provide clarity, the effective dates of the exit event (section 24J(9A)) for persons covered under the new rules for the taxation of financial instruments will be aligned. More specifically, section 24JB will come into effect on 1 April 2014 and apply in respect of years of assessment ending on or after that date; whilst section 24J(9) will apply to covered persons in the year of assessment immediately preceding the year of assessment ending on or after 1 April 2014. In respect of any other person, section 24J(9A) will apply in respect of the year of assessment immediately preceding the year of assessment commencing on or after 1 April 2014.

Comment: The new rules for the taxation system of financial instruments should be extended to non-banking companies (i.e. financial services companies that do not constitute banks that got approval in the past from the Commissioner under section 24J(9)).

Response: Noted. The scope of the new rules for the taxation system for financial instruments will be reviewed after evaluation of the effect of the new rules on covered persons and on tax collections.

Comment: The exclusion of designated financial assets of a “capital nature” from the new rules is not in line with the intended purpose of excluding assets designated solely for management purposes. Financial accounting treatment does not distinguish between capital and revenue financial assets for the purposes of distinguishing between the various designated assets.

Response: Accepted. The wording will be adjusted in order to limit the exclusion to items designated as a result of management decision to manage and evaluate assets on a fair value basis. Items that are designated in order to avoid accounting mismatches will, as originally intended, continue to fall within the new rules for the taxation system for financial instruments.

Comment: The spreading of the transitional charge for two years is too short as there are significant built-in gains for some banks that were previously on a realisation basis of tax.

The limit of the spreading to two years could cause significant cash flow problems during the transition period.

Response: Accepted. The transitional charge spreading period will be extended to three years.

4.2. **Simplification of tax regime for collective investment schemes in non-property investments**

(Main references: New Section 10(1)(dA), section 25BA, and paragraph 61 of the Eighth Schedule)

Comment: Interest incurred on linked debentures and other profit-linked loans will no longer be deductible under sections 8F and 8FA unless the entity is a REIT, controlled company or any other company that is wholly owned by a pension fund. This effectively hinders uncontrolled property entities that are partially owned by pensions fund or insurers. Also section 23P limits the deduction for interest paid to 70 per cent controlling entities to a 40 per cent taxable income amount; certain few property funds remain subject to the anti-avoidance rule.

Response: Accepted. As a transitional measure until legislation to regulate unlisted REITs is introduced, the application of sections 8F and 8FA has been delayed.

Comment: Unlisted property companies will fall foul of the debt-equity rules because they used linked units to capitalise. Many investors are old age pensioners on low incomes. At present the investors receive interest in respect of their debentures. The interest is linked to the underlying rental income return on property. Under the proposal, this interest is to be re-characterised as a dividend from the paying company. This will greatly reduce the return received by the investors on their investment, as the amount will be subject to 28 per cent company tax and generally, 15 per cent dividends tax. In addition, the investors will no longer be able to utilise the interest exemption.

Response: Not accepted. It is questionable even under current law whether the amount received by the investors under the circumstances is indeed interest. In any event, the process of extending the current REITs dispensation to unlisted REITs will only commence once the regulatory framework for REITS is finalised.

Comment: The deletion of “associated property company” creates anomalies as the amount received from an “associated property company” will qualify as ordinary non-rental revenue thereby affecting the 75% threshold of a REIT or controlled company. An associated property company will no longer be able to deduct the interest in respect of their linked debentures. More-over this deletion may result in JSE and tax calculations to be out of synch with each other.

Response: Accepted. The concept of “associated property company” will be re-instated; however the definition will refer to “property company”.

Comment: The current proposal allows a REIT to freely cancel the debenture part of a linked unit without any tax impact as long as the “face value” is capitalized in favour of the linked shares. However the “face value” requirement is not clear.

Response: Accepted. To give clarity the term “face value” will be changed to “issue price” of the linked unit.

Comment: The rollover relief rules in sections 41-47 need to be expanded to cater for the conversion of property unit trust to companies without adverse tax consequences.

Response: Partially Accepted. Section 44 of the rollover relief rules cater for all conversions and not only for companies in terms of the Companies Act. Thus section 44 does cater for situation when a collective investment scheme in property sells assets to a company (REIT) in exchange for shares. Minor adjustment will be made to sections 41 and 44 to provide clarity.

Comment: The current proposal on conversion of high-taxed salary to low taxed dividends arising from share schemes shouldn't apply to qualifying dividends distributions of REITs.

Response: Comment misplaced. There's no special treatment as dividends will be subject to tax under either the amended employee's taxable dividend proposal as well as under section 25BB but will only be taxed once.

Comment: There are two timing methods of treating a dividend in terms of IFRS for financial reporting purposes. These methods are based on when a dividend was received during a financial period. The current tax rules need to reflect these two accounting methods.

Response: Accepted. The "qualifying distribution" definition will refer to dividends determined with reference to the financial results for the year of assessment.

4.3. **Deemed ordinary treatment in the case of certain disposals of participatory units in collective investment schemes**

(Main reference: section 1; new section 9CA)

Comment: Retail and qualified investor hedge funds should be given the same tax treatment as collective investment schemes in securities. Whilst the disposal of participatory interest in collective investment schemes in securities would be taxable at capital gains tax rates if the units were held for more than three years qualified hedge funds would not enjoy the same dispensation. Tax should not distort investment decisions in relation to closely similar investment management systems.

Response: Accepted. The current tax treatment for collective investment schemes in securities will be retained and extended to regulated hedge funds.

More specifically: (i) Capital gains will be exempt in the hands of the funds and only be taxable when the investor disposes of the participatory interest. On disposal of the participatory interest, gains will automatically be taxable at capital gains tax rates if the asset was held for more than three years; (ii) Income will be granted flow-through treatment if distributed within twelve months and taxable as income based on the tax profile of each individual investor; (iii) Retained income will be taxable in the hedge fund vehicle.

The proposal will come into effect once the regulatory framework for hedge funds has been finalised by the National Treasury's Financial Sector Policy Unit and the FSB. It is envisaged that this regulatory process will be completed in the first half of year 2014. Tax should not influence the decision whether to invest in a regulated hedge fund or collective investment scheme in securities.

4.4. **Additional technical amendments**

(Main references: Sections 43, 46, 64EB and 29A(11))

Comment: Substitutive share-for-share transactions (section 43): A few comments were raised about the conversion of pre-valuation date shares into post-valuation date shares and that the provision should provide for the rollover of contributed tax capital.

Response: Noted. However, whilst the need for substitutive share for share rollover relief is understandable in the case where a linked unit is converted to equity shares, the same cannot be said of consolidations and share splits where the shareholder rights do not change. Share consolidation or splits may not constitute disposals for capital gains tax purposes and therefore do not require rollover relief. The revised section 43 will therefore be limited to the disposal of linked units in exchange for shares. As an ancillary matter, the revised provision will also provide for the preservation of the issue price of linked units as contributed share capital.

Comment: Unbundling transactions (section 46): Clause 101(a) refers to “shareholders” although (virtually) all other references in the Income Tax Act to “shareholder” have been replaced with a reference to “holder of a share” following the deletion of the definition of “shareholder”.

Response: Accepted. Reference to “shareholder” will be replaced with “holder of shares”.

Comment: Deemed dividends (section 64EB): Clarity should be provided on whether or not sections 64EB (2) and (3) require a person to be a beneficial owner of a dividend in order for the sections to apply.

Response: Accepted. Persons to which this provision applies will be described. As a result of this change, the reference to “beneficial owner” will be removed.

Comment: Long-Term Insurance (sections 29A(11)): The current four-fund indirect expense deduction formula only caters for the “unrealised gains” in the denominator however the intention was to also include the “unrealised taxable gain” portion in the numerator.

Response: Accepted. The numerator of the formula will be amended to include a portion of the total unrealised gains.

5. **INCOME TAX: BUSINESS (INCENTIVES)**

5.1. **Refinements to the research and development incentive**

(Main reference: Section 11D)

Comment: Retrospective amendment will result in harsh implications for taxpayers who have already engaged in R&D since that date and have relied on existing provisions in the law. The proposal will have an impact on provisional tax calculations, cash flow and planning and will require changes to financial statements where incentive was accounted for. Proposal results in uncertainty and is unfair.

Response: Accepted. Amendments will be effective from 1 April 2014.

Comments: Deletion of ‘discovering non-obvious scientific or technological knowledge’. This was meant to assist taxpayers to get into the R&D definition by keeping an element of ‘non-

predictability' (non-obvious) alive, given the very high standards demanded for patentability in respect of inventions, for example.

Response: Noted. The current provision will be retained.

Comments: Deletion of 'knowledge essential to the use of such invention, design or computer program'. Such knowledge (e.g. operating manuals) enables the developer to sell or licence invention / computer programme & is integral part of R&D process.

Response: Noted. The provision will be retained; however, the R&D tax regime is not intended to incentivise operating manuals and this will be stipulated. It is recognised that certain companies legitimately rely on this provision when developing certain types of know-how essential to the use of their in-licensed / own patentable technology.

Comment: Exclusion of aesthetic designs: activities relating to aesthetic designs should (as in past) be allowed as qualifying activities as long as they are of a scientific or technological nature.

Response: Not Accepted. Aesthetic designs by nature are not technological in nature and thus should not qualify.

Comment: The insertion of the term 'innovative' within the definition of R&D itself is irrelevant and, in absence of a clear definition, problematic for companies to interpret. The term should be removed as a qualifier, or alternatively, that language with clearer meaning and a meaning distinct from patentability is adopted.

Response: Accepted. A definition for 'innovative' will be developed.

Comment: The proposed wording that states '...mainly intended for the purpose of sale to, or for use by the general public' may be overly harsh in instances where genuine R&D is intended to assist product sales. R&D is often used and incorporated into products for sale or R&D (product, process, etc.) is intended for sale to a specific market (not general public). R&D items are often sold to a group member with the group member selling / offering the product to general public.

Response: Accepted. This proposal was intended as an anti-avoidance measure to curtail claims for R&D that was solely intended for improving internal business processes or R&D for use by / sale to connected persons. An internal business process will henceforth be accommodated provided it is sold to an unconnected party.

Comment: Requirement for R&D to be globally novel: Limiting applicability of the incentive to R&D that is in effect "world-beating" is directly contradictory to policy intention of parliament to encourage and stimulate home-grown investment. The definition is far too onerous (and subjective) and does not recognise that much R&D carried on in SA is to improve current state of art in SA and to ensure local developments match and leap ahead of global competition (many smaller local companies are competing with global giants). Most research in SA, like in most developing countries, relies on reverse engineering that leads to innovative improvements going forward – this will no longer qualify, with exception of pharmaceutical industry, which is concerning. No industry-specific treatment should be introduced and regulations / guidelines from DST are urgently needed (pharmaceuticals).

Response: Noted. This requirement (proviso (f)) will be removed.

Comment: Capital assets: disallowance of claiming selected capital expenses as revenue deductions is contrary to the nature and intention of the R&D regime and past practice.

Response: Noted. This was not the intention – the revised wording will be more explicit and further explanation given in the guidelines / regulations.

Comment: Capital assets prototypes and pilot plants: concerns about lack of clarity. Guidance was previously provided in a SARS Interpretation Note that specifically provides for capital costs to be claimed when constructing a pilot plant.

Response: Noted. Pilot plants and prototypes will be accommodated.

Comment: Disallowing deductions for ‘activities undertaken solely to satisfy regulatory or other legal requirements...’ - concern that this exclusion will be misapplied to detriment of taxpayers as R&D typically contains an element dedicated to regulatory & legal compliance (e.g. clean energy / CO2).

Response: Noted. The intention was not such a narrow interpretation; however the insertion will be removed.

Comment: The requirement in (6) [...a person carries on research and development if that person may determine or alter the methodology of the research] is not adequately captured by the proposed (2)(c). Current (6) adequately provides for determination of possible authority levels between entities – no need for changes. While provision for internationally funded R&D, removal of (6) raises issue of locally funded R&D.

Response: Noted. Wording in current (6) will be retained and an additional subsection (b) will be inserted to allow the Minister of Science to prescribe (by way of regulation) certain industries that are deemed to be exempt from the requirement in current (6).

Comment: Criteria for additional 50 per cent uplift: problematic as introduces further compulsory grounds for qualification. Words “substantially novel, innovative and unique” and “non-obvious” used will cause confusion / uncertainty as Patents Act & Designs Act include their own definition of terms “novel” and “inventive”. Proposed (9)(a) and (c) should be deleted.

Response: Noted. However s(9) will be retained to give the Minister of Science and Technology the authority to approve / reject applications. The definition in (1) will be enhanced to make sure that the definition encompassing new creations / developments and improvements is robust and that both elements are subject to the ‘innovative’ / ‘significant improvement’ test.

5.2. Tax incentives for special economic zones

(Main reference: Section 12Q)

Comment: Requirement that ‘not less than 90 per cent of the income of that company is derived from the carrying on of business or provision of services within that SEZs’ seems incorrect: Several port areas are proposed and many companies will have activities elsewhere – the legislation reads as though they may not qualify for the incentive and may prompt larger companies to relocate. This is also problematic for companies planning a number of investments in more than one SEZ.

Response: Partially accepted. It is possible that companies may invest in more than one approved (by Minister of Finance) SEZ and the proposed legislation will be amended accordingly. However, a company operating elsewhere in the Republic (not in an SEZ) that wants to operate in a SEZ and be eligible for favourable tax dispensation will have to set up a new company in the designated SEZs.

Comment: Companies would need to split their income – lower tax rate should apply to all income of a qualifying company, not just taxable income on activities within SEZ

Response: Not accepted. Companies could generate 80 per cent (for example) of their income from operations elsewhere (not in a SEZ) and subjecting all income to lower rate is not in line with policy objective (will lead to distortionary behaviour).

Comment: Restrictiveness of ‘qualifying company’ definition: the 15% concept could be dropped and qualifying activities within the zone should instead be subject to partial taxation (at a 50% inclusion rate). One can solely focus on activity as opposed to the entity, thereby allowing entity freely within or outside the zone.

Response: Not accepted. A new company will need to be set up for operations in SEZs. In addition, consideration will be given to prevent domestic transfer pricing between connected entities in and outside the designated SEZs.

Comment: Propose that s12I be amended to cater for SEZs in addition to IDZs to avoid preference for IDZs.

Response: Accepted. S12I will be amended to cater for SEZs in addition to IDZs.

Comment: 12S requires that building must be owned by taxpayer, thus if constructed on leased land (as could be the case in SEZs), taxpayer will not qualify. 12N should be amended to include allowances in respect of 12S.

Response: Accepted. S12N will be amended to include a reference to s12S.

Comment: Green economy is one of sectors to be supported by proposed SEZs, yet biofuels excluded due to issues relating to food security – this should be removed and companies judged on case-by-case basis.

Response: Comment misplaced. Legislation states that exclusion of biofuels only takes effect if issues relating to food security.

Comment: Incentive should rather apply for 10 years from start of operations, subject to 5 yearly reviews. Incentive can be withdrawn / amended at any stage – to provide certainty (recognising significant long-term investments) a fiscal stability provision should be provided for.

Response: Not accepted. Government has a responsibility to strike a balance between encouraging investment and protecting the fiscus.

5.3. Oil and gas incentive (Main reference: Tenth Schedule)

Comment: Exclusion of onshore oil and gas operations from the definition of an 'oil and gas right': Unconventional gas (UCG) is an emerging industry in SA and Onshore UCG has not been explored yet, so its potential is as yet unproven. Onshore UCG operations are as complex, difficult and costly to bring to production as offshore oil and gas and may have a much longer pay out period. Energy exploration and production entails significant capital costs before long-term revenues can be potentially realised. Energy companies will engage in exploration only if a reasonable hurdle rate can be realised with the political environment having a strong bearing on that hurdle rate (coincides with DMR's proposed amendments to the MPRDA, the scope of which appears to undermine potential investment opportunities).

Response: Accepted. Our initial understating was that there is much more risk (financial and otherwise) involved in offshore oil and gas activities. The submissions we have received to date in this regard indicate that the risk and reward profile for offshore and onshore oil and gas might be very similar and that unconventional gas exploration (i.e. shale gas) could also faces high risks. The Tenth Schedule will apply to both offshore and onshore oil and gas exploration and production. The need for a more flexible (sliding scale) tax regime for oil and gas (to take account of fluctuations in commodity prices) will be explored.

Comment: Fiscal Stability Agreements: Linking the definition of an FSA to section 13 and 14 of the MPRRA is problematic and clarity required on delegation to Minister of Minerals and Resources.

Response: Noted. The link to section 13 and 14 will be removed and the proposal to delegate this function to the Minister of Minerals and Resources will be removed.

Comment: While the draft TLAB proposes amendments to paragraphs 8(2)(a) and (b) to remove requirement that the oil and gas right must be disposed of to another oil and gas company, it does not deal with the question of whether the acquirer may benefit from the same FSA concluded by the seller, or whether the seller will have to enter into a new fiscal stability agreement should it decide to assign the existing FSA to the purchaser. (Request that paragraphs 8(2)(a) and (b) be amended to clarify that the party disposing of a part of an oil and gas right will be entitled to dispose of such right together with the benefit of the FSA, without losing the benefit of the FSA with respect to the part of the oil and gas right retained by the seller).

Response: Noted. This will be catered for in the 2014 legislative cycle.

Comment: Some mechanism is needed to prevent oil and gas companies being taxed 'through the back door' elsewhere in the Act (should a future administration fail to recall the favourable tax treatment). Propose an amendment to s26B.

Response: Not accepted. It is not feasible to make oil and gas companies exempt from any change in the Income Tax Act. Changes could be made that apply to all companies and there is no reason why oil and gas companies should receive special treatment.

Comment: Revised definition of 'exploration' and insertion of 'post-exploration' with definition: Proposed amendments effectively convert exploration expenditure (wells that are drilled as part of exploration activities) into post-exploration expenditure. This is extremely negative for

oil and gas rights holders, as a substantial part (if not the majority) of exploration expenditure relates to the drilling of wells.

Response: Comment misplaced: What the amendments seek to achieve is to move away from definitions based on activities, to one based on phases, i.e. exploration, appraisal, development and production. The basis for this decision is to acknowledge that various activities can occur in more than one phase. The drilling of wells, for instance, can occur in both the exploration and development phases. Under the proposed amendments, taxpayers will be able to claim 100 per cent of capital expenditure associated with wells drilled during the exploration phase and 50 per cent of capital expenditure associated with those drilled for the purposes of development or production. It appears that the insertion of the term '*the construction of a well*' into the '*post-exploration*' definition has created confusion. To provide more clarity, this term will be removed from the definition of '*post-exploration*'.

Comment: Withholding tax: there is no mention of the 0 per cent rate (afforded to withholding tax on interest) for withholding tax on services.

Response: Noted. This was the intention.

Comment: Exploration rights converted versus those granted. Amendment to the Royalties Act at s13(8) is required to include exploration rights converted pursuant to Schedule 2 section 4 MPRDA and not just those rights that are granted. This mirrors the change inserted to Schedule 10, Income Tax Act No. 58 of 1962 at paragraph 1 which defines an oil and gas right.

Response: Noted. This will be catered for in the 2014 legislative cycle.

6. INCOME TAX: INTERNATIONAL

6.1. Exit charge on interests in immovable property

(Main reference: Section 9H)

Comment: Taxpayers who cease to be resident and are subject to the exit charge on shares attributable to immovable property should not be subject to an additional layer of tax when the taxpayer ultimately disposes of the shares. That is, property shares should be treated the same way as any other share upon ceasing to be a resident.

Response: Not accepted. As a matter of international tax best practice, indirect interests in immovable property are treated the same as the underlying immovable property; with the source country retaining direct and indirect taxing rights. The exemption of non-residents on South African shares (other than property shares) is based on different policy considerations. The primary exit tax also serves as an anti-avoidance measure for South African residents exiting to certain countries in order to permanently evade both primary and secondary South African tax on indirect interests in immovable property.

Comment: The proposed amendment will result in unnecessary hardship for exiting residents who retain interests in immovable property upon ceasing to be residents. The proposal will result in such taxpayers being subjected to an exit charge in respect of unrealised gains on assets that remain within the South African tax net.

Response: Not accepted. Under the proposed dispensation, the exit charge is imposed on the unrealised gain upon ceasing to be a resident. The secondary tax on the ultimate

disposal of shares is levied on a higher base cost in order to avoid double taxation on the same economic gains.

6.2. **Currency rules for domestic treasury management companies**

(Main references: Sections 1, 24I, 25D of the Income Tax Act and paragraph 43 of the Eighth Schedule)

Comment: The exchange control circular appears to state that a domestic treasury management company must also hold shares in offshore operating subsidiaries. The shareholding requirement makes this dispensation complex and not practical.

Response: Noted: The issue has been taken up with the Financial Surveillance Department of the South African Reserve Bank for clarity. As a general matter, a domestic treasury management company does not have to be a holding company.

Comment: Many treasury companies utilise multiple currencies. Therefore, the proposed dispensation should allow for the use of multiple currencies without adverse currency tax implications. Alternatively, wholly owned subsidiaries of treasury management companies should be able to operate on the same basis as the approved treasury company.

Response: Noted: The issue has been taken up with the Financial Surveillance Department of the South African Reserve Bank for further clarity. For tax purposes, approved multiple subsidiaries of treasury management companies will qualify for the same currency tax dispensation.

6.3. **Refinement of participation exemption in respect of foreign dividends derived from non-equity shares**

(Main reference: Section 10B(2))

Comment: It is questionable whether an anti-preference share rule makes sense in the context of wholly owned subsidiaries as the shareholder in that instance is already exposed to the underlying performance of the entity – similar to equity share exposure. Foreign preference share dividends should be acceptable if the holder has full control over the foreign entity.

Response: Not accepted. The participation exemption was never intended to extend to foreign dividends derived from debt-like instruments. For example, the capital gains tax participation exemption is only available to the disposal of pure equity shares. Similarly, foreign interest is not exempt from tax even if received from a group company. Preference shares with prescribed coupon rates resemble debt and therefore should be treated the same as debt. Exempting foreign interest like yield poses a further tax base erosion risk through the use of circular schemes.

Comment: Taxpayers should be allowed to convert foreign preference shares under the substitutive share for share rollover relief provisions and the effective date of the provision should be deferred to 2015 to allow adequate transition period.

Response: Partially accepted. Rollover relief is generally provided in order to defer tax on built-in gains and rollover the tax cost. Because of the close resemblance to debt financing, preference shares with specified coupon rates would generally bear little or no built-in gains and can be redeemed at face value. The effective date of the changes will however be deferred until 1 April 2014 to allow sufficient time for restructuring.

6.4. **Controlled foreign company and the working capital exemption**

(Main reference: Section 9D)

Comment: Insert a definition on what constitutes a treasury operation and captive insurers for the purposes of the controlled foreign company rules.

Response: Not accepted. Determining treasury operations or captive insurance business is a factual exercise, based on the nature and extent of the business undertaken – hence it is left for determination on a factual basis.

Comment: The exemption of intra-group passive income within related controlled foreign companies should be extended to insurance premiums that have no relation to the South African payor.

Response: Accepted. This is a technical correction from the previous revision of the controlled foreign company rules.

6.5. **Exemption for international shipping transport entities**

(Main reference: Section 12Q)

Comment: It is not clear whether activities carried out by offshore support vessels supporting the offshore oil and gas industry would be included in the proposed regime.

Response: Not accepted. Offshore activities of this nature are more akin to a service than transportation. The current dispensation is limited to shipping engaged in international transportation of goods and services.

Comment: Extend the regime to non-South African flagged vessels. Shipping regimes, such as the UK and Singaporean permit foreign flagged vessels within their regimes.

Response: Not accepted. Article 8 of tax treaties with major trading partners would cover foreign resident ships by allocating taxing rights to the State of residence.

Comment: The current exemption of crew members on foreign ships should not be limited to crew members on South African registered ships. The effect of the amendment is that crew members on board foreign ships will now have to be outside the South Africa for a period of 183 days and more than 60 days of which have to be continuous, in order to qualify for exemption.

Response: Accepted. The amendment to section 10(1)(o) was intended to add a new blanket exemption for crew members on-board South African registered ships and not change the existing exemption framework. The exemption of crew members' on-board foreign ships will be reinstated.

Comment: Shipping companies should be entitled to use functional currency for purposes of section 24I.

Response: Accepted. This was always intended.

Comment: Expand the scope of tax incentives to companies engaged not only in the transportation of goods, but also in shipbuilding, ship brokering, trading in shipping derivatives, ship financing, ship insurance, ship servicing and ship repair (including services to offshore oil and gas operations).

Response: Noted. The issue is out of scope of the current legislative framework.

6.6. **Uniform cross-border withholding regime to prevent base erosion**

(Main references: Sections 37J through 37O and section 49A through 49G; new sections 49; 50 and 51)

Comment: The old withholding tax on royalties (at a rate of 12%) was substituted for a new withholding tax at a rate of 15% with effect from 1 July 2013. In the current bill, the new withholding tax was deferred to 1 January 2015 without providing for the reinstatement of the old tax in the interim (i.e. the period between 1 July 2013 to 1 January 2015). As a result, there is confusion – i.e. whether to continue to withhold tax at an old rate of 12% or impose a new rate of 15% or simply assume that there is no longer withholding tax on royalties until 1 January 2015 (or until the error is rectified).

Response: Accepted. The new withholding tax (current sections 49A to 49G) will be retained at a rate of 12%. The withholding tax rate will be increased to 15% with effect from 1 January 2015.

Comment: The Bill proposes to impose withholding tax on service fees. It is questionable what the tax is intended to achieve considering that a number of Double Taxation Agreements does not confer taxing rights to a source country unless the foreign service provider has a permanent establishment in that country. It is also unfair for South Africa to impose a tax simply for the purposes of gathering information on whether there is a permanent establishment or not. The domestic payors are unlikely to have this information at their disposal; hence most payors will resort to withholding tax in order to err on the side of caution even if that tax will ultimately be refunded by SARS. This could cause significant cash flow problems for foreign service providers.

Response: Noted. The withholding tax on services will be deferred to 1 January 2016 to provide sufficient time for further consultations and refinements.

Comment: A withholding tax on services at a rate of 15 per cent is too high considering that services are generally priced at cost plus a small margin. Because the tax is imposed on gross fees, it will effectively wipe out the entire profit margin. Furthermore, the tax is imposed on services sourced in South Africa. Domestic payors cannot be expected to establish whether or not the services are sourced in South Africa. The source rules in section 9 do not specify when services are regarded as sourced in SA, meaning that the payor need to resort to common law doctrine of originating cause.

Response: Noted. A review of the scope and rate will be undertaken as part of the general review of the withholding tax before the effective date of 1 January 2016.

Comment: The deletion of Part IA of the Income Tax Act (ITA) in section 93 of the TLAB is effective from 1 October 2014. Not only is this out of line with the intended effective date of 1 January 2015 of the replacement legislation referred to in section 103 of the TLAB but it also means that the legislation contained in the current sections 37I to 37O of the ITA remains effective until 30 September 2014 which could expose taxpayers to penalties if they do not comply with the existing law between 1 July 2013 and 30 September 2014.

Response: Accepted. Part IA will be deleted from inception pending the proposed 2015 dispensation.

Comment: The 2012 legislation indicates that tax will only be withheld from interest that accrues or that is paid or that becomes payable on or after 1 July 2013. This wording seems to suggest that if interest has accrued on a loan account before this date but is only paid on or after this date, tax will not be withheld.

Response: Noted. The trigger for the new withholding tax on interest must be interest that is “paid or becomes due and payable” on or after 1 January 2015. This is in line with intended purpose (as outlined in the explanatory memorandum) to prevent accelerated interest accruals before the effective date in order to avoid the tax.

Comment: Although section 49B refers to interest received or accrued from a source within the Republic in terms of section 9(2)(b), no specific definition of interest is provided in this section thus making it unclear if it is interest as defined in section 24J or if it is the common law definition of interest. A definition of interest should be inserted into section 49A.

Response: Not accepted. It was always intended that the withholding tax will only apply to common law interest. As a general rule of interpretation, in the absence of a specific definition or cross reference to section 24J, the common law definition will apply.

Comment: It appears that the exemption provided for in section 37K(1)(a)(ii) (the purchase of goods into the Republic) and section 37K(1)(c) (interest accrued to a foreign person in terms of section 25BA(a)) have been removed. Reasons for the removal of these exemptions should be provided in the EM or this section should be adjusted accordingly.

Response: Noted. The exemption of interest on international trade finance was purely intended for short term trade debt. In particular, the intention was to ensure that the withholding tax does not create an undue administrative burden on debt interest that is largely incidental to profits on the underlying imported goods. The idea was never to exempt any interest associated with imported goods being exempt.

Comment: The exemption from interest withholding tax in respect of collective investment schemes afforded by section 37K (1) (c) of the Act has been removed. We are of the view that this is an oversight arising as a result of the changes made to section 25BA of the Act.

Response: Noted. The current dispensation for taxation of collective investment schemes (section 25BA) will be retained. As a result, interest distributed by collective investment schemes will retain its nature if distributed within twelve months. In light of the exemption of listed debt and bank deposits, interest distributed by collective investment schemes will largely be exempt.

6.7. **Transfer pricing relief for equity loans**

(Main reference: Section 31)

Comment: The transfer pricing relief for equity loans is limited to situations where the creditor directly holds shares in the offshore operating subsidiaries. This requirement makes the relief impractical, as group finance companies are generally not holding companies.

Response: Accepted. The relief will be extended to group financing companies, in line with intended purpose.

Comment: The redemption feature of qualifying equity loans makes the relief too narrow. These requirements should be prescribed in the alternative; i.e. either the redemption of the

loan should require consent from all the creditors or should be conditional on the solvency of the debtor.

Response: Partially accepted. The consent from creditors' requirement will be deleted as it does not sufficiently indicate equity relationship and could potentially capture current or short term trade creditors.

Comment: The 30 year redemption requirement is too restrictive. While in certain industries this lending period may be warranted; in other industries, like mining, loan capital is committed for a significantly longer period.

Response: Not accepted. The 30 years benchmark is also used elsewhere for debt-equity reclassification.

7. INDIRECT TAX

7.1. Streamlining of VAT Registration

(Main reference: Value-Added Tax Act provision: Section 23(1)(b), section 23(3); new section 24(5A); new section 44(3)(e))

Comment: The proposed amendments will not assist in streamlining the VAT registration process nor will it reduce the risk to the fiscus in terms of fraudulent refunds. The proposals will pose an unbearable compliance burden to small business as restricting refunds presents a cash flow problem for small business. The R5 million expenditure threshold proposed for persons other than small business, is onerous and there is un-clarity as to whether this expenditure threshold includes pre-registration expenditure incurred. Furthermore, the requirement that the entity makes taxable supplies within the next 12 months must be deleted.

Response: Accepted: The proposed amendments will be withdrawn and replaced with a softer set of proposals.

Firstly, small businesses will be allowed to register for VAT under the current provisions i.e. being subject to the R50 000 taxable supplies threshold test before SARS would register these businesses. Alternatively, small businesses that cannot satisfy the R50 000 threshold will be allowed to register for VAT but only on the payments basis; these businesses will be allowed to remain on the payments basis if taxable supplies made by them do not exceed R2,5 million in any 12 month period – thereafter they migrate to the invoice basis for VAT. There is no withholding of refunds.

Secondly, the current section 23(3)(d) that applies to a limited number of persons seeking VAT registration will be clarified via regulation. Stated differently, the regulation will delineate types of activities that will qualify for registration under this provision; activities include: oil and gas exploration, mining, farming, etc. The expenditure threshold of R5 million falls away, as does, the requirement that the person makes taxable supplies of R50 000 in a period of 12 months.

7.2. Registration of e-commerce suppliers

(Main reference: Value-Added Tax Act provision: Section 15(2)(a)(viii); section 20(5B); and section 23(1A))

Comment: The definition of e-commerce services is too wide and is ambiguous. It is too wide because a number of services supplied by foreign service providers will be caught by this provision (business-to-business and business-to-customer transactions alike), which may not have been the intention of the legislature. Furthermore, ambiguity is associated with: what

does the placing of an order entail and when does delivery of a service take place? The definition of e-commerce services must be changed to electronically supplied services in order to align with international norms.

Response: Accepted: The word definition “e-commerce services” will be replaced with “electronically supplied services”. In order to attenuate uncertainty and provide more clarity, the types of electronically supplied services that would be subject to VAT is listed in a regulation that will be issued by the Minister of Finance. This list of services is in keeping with international norms/trends.

Comment: The proposed amendment should not apply to business-to-business supplies of e-commerce services as these transactions are catered for under the current reverse charge provisions for imported services. The proposed amendment should not be limited to e-commerce services supplied by non-residents as this could lead to VAT leakage if residents can provide e-commerce services from abroad.

Response: Partially accepted: The non-resident requirement is deleted. There is no distinction done between business-to-business and business-to-customer as it will increase compliance for the foreign supplier, coupled with the risk that private customers may mask as business customers to avoid the levying of the tax – this would nullify the spirit and purpose of the legislation.

Comment: Lastly, the proposed registration requirement lacks a monetary threshold which means that the foreign supplier is compelled to register for VAT if supplies over a 12 month period are made for less than R1 million (in aggregate), which places the foreign supplier at a disadvantage vis-à-vis local suppliers (who are compelled to register only if taxable supplies in excess of R1 million is made in a 12 month period).

Response: Partially accepted: A foreign supplier of electronically supplied services is compelled to register for VAT if the total value of taxable supplies made by that person exceeds a threshold of R50 000 in a period of 12 months, commencing from the start of any month. A lower threshold was mooted to ensure that every effort is made to level the playing field between local and foreign suppliers of electronically supplied services (as the current compliance level associated with the reverse charge provisions is unacceptably low or non-existent).

Comment: The effective date of 1 Jan 2014 should urgently be brought forward to 1 November 2013 (or 1 December 2013).

Response: Not accepted. The implementation of the proposal has to follow the legislative approval process which will not be finalized before the suggested date and the date of implementation has to take account of SARS’ administration system readiness. SARS has indicated that even 1 January 2014 might not be feasible and 1 April 2014 is now proposed as the implementation date.

Comments: the 1 January 2014 is short notice for foreigner suppliers to comply with. The effective date should be shifted 3-6 months later to provide the businesses with an opportunity to change their systems.

Response: Noted. The implementation date will be delayed until 1 April 2014 to allow for SARS system readiness. This will also accommodate concerns about the need of foreign suppliers to update their system.

8. MINERAL AND PETROLEUM ROYALTIES

The main purpose of the proposed amendments to the Mineral and Petroleum Resources Royalty Act is to remove any anomalies that have arisen, and to refine and strengthen the current legislation. There are three main refinements:

Current reporting requirements place an unnecessary compliance burden on taxpayers, requiring them to report to SARS and National Treasury. To reduce this burden and streamline the data collection process, the proposed amendment will require the Commissioner for SARS to provide the Minister of Finance with detailed data (*no comments received on this*).

The proposed amendments will alleviate the compliance burden on small business corporations (SBCs) (*no comments received on this*).

The schedules have been reviewed in light of misinterpretation of the legislation, which appears to be prevalent in the case of coal. The value of coal sales in 2011 was larger than any other mineral (27.5% share), while its contribution to royalties was minimal (5.3% share in 2011/12). The table expands on this point.

R mn	2010				2010/11		Estimated Royalty Rate
	Sales				Royalty Payments		
	local	export	total	%	total	%	
Platinum	7 893	65 894	73 787	28.7%	481	13.5%	0.7%
Coal	33 702	37 477	71 179	27.7%	258	7.3%	0.4%
Gold	2 056	51 037	53 093	20.7%	515	14.5%	1.0%
Iron ore	3 270	40 148	43 419	16.9%	1 675	47.1%	3.9%
Manganese	1 321	9 340	10 661	4.2%	104	2.9%	1.0%
Copper	3 160	1 209	4 369	1.7%	125	3.5%	2.9%
Zinc	280	43	323	0.1%	69	1.9%	
Other					328	9.2%	
Total	51 681	205 150	256 831	100%	3 555	100%	1.4%

R mn	2011				2011/12		Estimated Royalty Rate
	Sales				Royalty Payments		
	local	export	total	%	total	%	
Coal	37 286	50 549	87 834	27.5%	297	5.3%	0.3%
Platinum	10 619	73 234	83 853	26.3%	853	15.2%	1.0%
Gold	3 633	65 258	68 891	21.6%	817	14.6%	1.2%
Iron ore	4 208	58 444	62 652	19.6%	2 501	44.6%	4.0%
Manganese	1 325	8 570	9 895	3.1%	149	2.7%	1.5%
Copper	3 938	1 495	5 433	1.7%	79	1.4%	1.5%
Zinc	169	233	403	0.1%	143	2.5%	
Other					772	13.8%	
Total	61 178	257 783	318 961	100%	5 611	100%	1.8%

8.1. Taxation of beneficiation

Comments: One of key principles agreed to between National Treasury and industry is that the royalty should be charged at the first saleable point (as close to point of extraction as possible) to realise a fair level of compensation for the state, but also not to penalise beneficiation (beneficiation was not intended to be captured in royalty calculation). Proposed amendments result in a paradoxical incentive for an extractor not to beneficiate a mineral any further than the least refined condition (value added will be captured in the royalty tax net).

Response: Not accepted. The policy intent and design features of the mineral and petroleum royalty regime took the issue of beneficiation into account. Because it is impossible to value minerals at the mine mouth, the principle is to establish 'the value' at the 'first saleable point', which will naturally have an element of beneficiation. A compromise was struck in which unrefined minerals would be subject to a royalty rate that is slightly lower than what would have been used at the mine mouth, and refined minerals are subject to an even lower rate, thus recognising the beneficiation effort.

8.2. Coal – re-introduction of a range as specified condition

Comments: Do not support the proposed range for coal and question the specified condition of 19 as industry has indicated that a minimum range of 15 would be more suitable (given actual deliveries of coal at between 15 and 19 to Eskom).

Response: Not accepted. Eskom's coal power plants' weighted average calorific value of such sales is around 18.9 MJ/kg. New power plants require coal with calorific values of between 22 MJ/kg and 24 MJ/kg. Coal that is exported ranges from 23.5 MJ/kg and above. Hence the comment is flawed and the introduction of a range as a specified condition is justifiable. The lower contribution by the coal sector to the mineral royalties, compared to its share of total mineral sales and the very low estimated effective royalty rate for the coal sector is an indication that the current point reference of 19.0 MJ/kg is not appropriate and that a range of 19 MJ/kg to 27.5 MJ/kg is justifiable.

Comments: Proposed wording with respect to a scenario where a mineral resource is transferred within the range is contrary to a transfer whether within or beyond the range, whilst the extraction condition specified would be within the conditions specified within the stated range.

Response: Noted. The policy intent is to calculate the royalty due on the value at 'transfer', recognising that minerals cannot easily be valued at the point of extraction. Note that the specified conditions in the schedules reference to the point at transfer.

9. Draft Tax Administration Laws Amendment Bill

9.1. Income Tax Act, 1962 (ITA)

9.1.1. Clause 1: Section 3 ITA - Deletion of repealed provision

Comment:

The now repealed paragraph 12(5)(c)(i) of the Eighth Schedule to the Income Tax Act, 1962, afforded the Commissioner for SARS a discretion to extend the period to qualify for the exemption in respect of debt waivers in anticipation of liquidation or deregistration. This discretion is replicated in the proviso (bb)(A) of paragraph 12A(6) of the Eighth Schedule.

It is proposed that section 3(4) of the Income Tax Act, 1962, be amended by replacing paragraph 12(5)(c)(i) with proviso (bb)(A) of paragraph 12A(6).

Response:

Accepted. The reference to paragraph 12(5)(c)(i) of the Eighth Schedule in section 3(4)(h) of the Income Tax Act will be changed to paragraph (bb)(A) of the proviso to paragraph 12A(6)(e) of the Eighth Schedule.

9.1.2. Clause 3: Section 64K ITA - Submission of returns by recipients of exempt dividends

Comment:

This amendment is unnecessary and must be deleted. There is no need for the additional reporting requirement as the information will be disclosed by the exempt institution on an annual basis in the ITR14. The proposed amendment puts an unnecessary administrative burden on taxpayers without adding substantial additional risk management measures for SARS. Neither the employees' tax system nor the payment of interest to an individual requires the individual to also submit a return to SARS confirming the amounts received as these amounts are included in the recipient's prepopulated return that is based on the information provided by the employer or bank, as the case may be. Dividends should not be treated any differently.

Response:

Not accepted. In contrast to the examples mentioned, an exemption from an otherwise final withholding tax is at stake here. It is essential that SARS has full sight of the exempt dividend flow so as to ensure that where one entity declares a dividend as being exempt it is in fact received by an exempt beneficial owner of the dividend. This enables SARS to complete the audit trail and reconcile the dividend withholding tax flows. The design of the reporting system has involved over two years of consultation with industry bodies and the information required has been reduced to the minimum required for reconciliation purposes. Once put in place the reporting process for larger recipients is largely automated and SARS is in a position to accept bulk data transfers from such recipients. Smaller recipients may use SARS eFiling and SARS remains open to further suggestions on how to streamline the process, while retaining its ability to reconcile dividend flows.

9.1.3. Clause 5: Paragraph 11B of the Fourth Schedule to ITA - Written declaration by employees for verification of age

Comment:

It is proposed that age verification in paragraph 11B of the Fourth Schedule to the Income Tax Act, 1962, be deleted. This verification obligation is no longer required as SITE has been made obsolete by the increased tax threshold. For example: as the tax threshold for 2014 (with regard to persons under 65 years of age) is R67 111 and the SITE threshold is R60 000,

taxpayers will never be liable for SITE or PAYE below R60 000 and the section 6(2)(b) rebate will not be considered, which makes verification unnecessary.

Response:

Accepted.

9.1.4. Clause 7: Paragraph 13 of the Fourth Schedule to ITA - Delivery of tax certificates to employees

Comment:

The removal of the “registered post” requirement trivialises the importance of the employee having such certificate and limits the employer being able to prove it was sent. The certificate plays many important roles and provides the employee with a rebuttable presumption that the taxes declared thereon have been deducted.

Response:

Not accepted. The removal of reference to “registered post” does not trivialise the importance of the employee having such certificate, as the employer’s obligation to deliver the certificate to an employee remains under paragraph 13(4) of the Fourth Schedule. The non-delivery of an employees’ tax certificate by the employer to the employee also remains an offence, under paragraph 30(1) of the Fourth Schedule, which supports the significance of this certificate. The proposed amendment simply allows the employer the option to deliver the certificate to the employee in another manner, for example electronically. In most instances the employer will choose the option that is most convenient for both the employer and the employee and which satisfies the requirement to prove delivery.

9.2. Customs and Excise Act, 1964 (C & E Act)

9.2.1. Clause 9: Section 4 of the C & E Act - Search of premises

Comment:

It is proposed that more amendments should be effected to ensure that SARS’ information gathering powers remain within the boundaries of the Constitution.

Response:

Not accepted. The comment relates to the proposed section 4(4)(e)(i). Paragraph (e) sets out the requirements for obtaining a warrant and subparagraph (i) specifically requires that a magistrate or judge may issue a warrant if it appears from the “*information on oath that there are reasonable grounds for suspecting that an offence in terms of this Act has been committed*”. This clause merely states the requirements for obtaining a warrant and is not meant to specify the formal requirements to which the warrant itself must comply with for validity. The magistrates and judges who are responsible for issuing warrants are well versed in the requirements for their validity

9.2.2. Clause 9: Section 4 of the C&E Act - Investigation of statutory offences by SARS officials

Comment:

It is proposed that SARS officials should be limited to merely referring to matters for criminal investigation or assisting where requested to do so by the relevant authorities.

Response:

Not accepted. Section 179 of the Constitution establishes the National Prosecuting Authority and subsection (2) authorises it “*to institute proceedings on behalf of the state and carry out*

any necessary functions incidental to instituting criminal proceedings". The institution of criminal proceedings has authoritatively been held to have a narrow meaning that does not cover any step taken in a criminal prosecution, but means the charging of an accused by the presiding officer of a court of law.³ The Constitutional provisions, therefore, do not preclude any other organ of state from carrying out functions incidental to instituting criminal proceedings, such as conducting investigations and laying of charges with the South African Police Service (SAPS).

Unlike section 179(2) of the Constitution, which restricts who may institute a criminal prosecution, section 205 of the Constitution does not state that only the police service may conduct investigations for purposes of criminal prosecution. It is submitted that it is indeed practical for SARS officials to conduct such investigations due to their technical expertise in the tax and customs environment and the fact that they can be of great assistance to the SAPS in this regard. The practice of Departments to assist the SAPS in the investigation of statutory offences is a long-standing and common one throughout the public administration.

9.2.3. **Clause 14: Section 73 of the C&E Act - Currency conversion for imported goods**

Comment:

It is proposed that section 73(6)(a) be amended to read as follows:

"The applicable date for a currency conversion in respect of goods imported into or exported from the Republic is the date of first entry of the goods for any purpose in terms of this Act."

Response:

Accepted. The proposal will assist in fixing the date for currency conversion to the date of entry of the goods. Since a bill of entry can be subsequently substituted or amended, accepting the date of entry irrespective of any substitution or amendment will create certainty on the date to be used for currency conversion purposes.

9.3. **Tax Administration Act, 2011 (TAA)**

9.3.1. **Clause 21: TAA section 1 - New definitions of "tax debt" and "outstanding tax debt"**

Comment:

The term "tax debt" should not be defined as tax *due or payable* as referred to in section 169(1), but only as *tax due*, as a tax debt only becomes payable when it is not paid by the prescribed payment date. Only after the latter date does it become a "tax debt" that is due *and payable* and accordingly an "outstanding tax debt". The use of the term "tax debt" and "outstanding tax debt" in the TAA, as proposed in the TALAB, is inconsistent. Clarity is also sought on whether tax not yet assessed falls within the definition of "tax debt".

Response:

Not accepted. A tax debt may be payable but not due. For example if a tax debt is disputed, it remains payable pursuant to the pay-now-argue-later rule but will only be due if a Tax Court or higher court finally determines the dispute in favour of SARS.⁴ Conversely, a tax debt may also be due but not payable, for example additional tax.⁵ Accordingly, a "tax debt" means an amount of tax due *or payable* in terms of a tax Act as set out in section 169(1) of the TAA. The term "outstanding tax debt" is used in the sections assigning recovery powers to SARS

³ *Minister of Law and Order v Kader* 1991 1 SA 41 (A) and *Kader v Minister of Law & Order* 1989 4 SA 11 (C).

⁴ *Singh v Commissioner: SARS* 2003 (4) SA 520 (SCA) at par [11].

⁵ *Ibid.*

i.e. it is a prerequisite before recovery proceedings may be instituted by SARS. The proposed amendment therefore clarifies that the recovery powers can be used only if an amount of tax is not paid.

If this meaning is applied and pursuant to the enactment of the proposed amendments in the TAA, the terms are used consistently.

9.3.2. **Clause 21(b): TAA section 1 - Amendment of definition of “return”**

Comment:

The proposed amendment is too broad. A taxpayer may be prejudiced if its return is only “a basis” for assessment and SARS includes other bases of assessment. There can only be a single basis for an assessment and should the SARS determine a different basis of assessment, a revised or new assessment must be issued which will have its own basis of assessment.

Response:

Not accepted. The proposed amendment clarifies that a return by the taxpayer only constitutes *one* basis on which an assessment by SARS is based and is not the *only* basis. SARS may have multiple sources of information to determine the correct tax liability of the taxpayer. These include the taxpayer’s return, third party returns such as returns regarding interest received by the taxpayer, as well as information obtained by SARS’s under its powers to request information. These sources of information may be used to issue an original or revised assessment.

9.3.3. **Clause 23: TAA section 10 – Delegations by Commissioner**

Comment:

All SARS officials to whom the Commissioner delegates his powers, whether named specifically or the incumbent of a post, must sign acceptance of a delegation before it becomes effective.

Response:

Not accepted. The initial proposed amendment sought to limit the acceptance requirement to cases where the Commissioner delegates his powers to a specific individual and not to the incumbent of a post. After further consideration, it is recognised that under the common law a delegation is a unilateral act that does not require the written acceptance of the person so delegated to become effective – it becomes effective when signed by the delegating person. Section 10 will be amended to conform to this approach.

9.3.4. **Clause 24: TAA section 11 - Prior notice of legal proceedings and address for service**

Comment:

The proposal goes beyond the protection afforded under the Institution of Legal Proceedings Against Certain Organs of State Act, 2002, which is limited to proceedings that involve the execution of debt claims against the specified organs of state. Requiring service at the head office of the Commissioner as opposed to the relevant branch office will result in additional costs to the taxpayer, as they will now have to use correspondent attorneys to serve documents where such address is not in the same jurisdiction. Both proposals are unnecessary limitations of the right to procedural fairness.

Response:

Not accepted.

Prior notice of intended legal proceedings

This amendment essentially seeks to *avoid* unnecessary and costly litigation. Prior notice of an intended court application seeks to ensure that the matter is brought to the attention of an appropriately senior official, who can use the prior notice period productively to investigate the merits of the intended application and, if appropriate, resolve a dispute before formal court proceedings. It is submitted that most parties to a dispute would prefer resolution over litigation. The opportunity afforded by the prior notice requirement to seek resolution will also lessen the burden on the court system.

SARS is huge organisation and, particularly with respect to urgent applications, the size of the organisation may be deliberately exploited by litigators. A clear example of this is the case of *Contract Support Services (Pty) Ltd and Others v Commissioner: SARS and Others* 1999 (3) SA 1133 (W), at 1136I to 1137F and 1148D, where the applicant served its application on the State Attorney 45 minutes before the matter was heard, resulting in a judgment against SARS due to its failure to appear. It is difficult to see how 72 hours prior notice limits procedural fairness. Furthermore, the proposed amendment recognises extreme urgency and a court may waive compliance with prior notice.

It is submitted that the slight inconvenience of providing prior notice is both ameliorated by allowing a court to waive formal compliance in extremely urgent cases, and it is justified after taking into account the benefits to SARS, the public at large, and to the existing court structures.

Specified place of service of proceedings

No standard practice has evolved, and no clear law exists, which clarifies where court papers citing SARS are to be filed. In practice, applications have been served haphazardly on branch offices of SARS or on an Office of the State Attorney. Although the head of SARS is the Commissioner, at SARS Head Office, SARS has not normally taken issue with the place of service. However, this has often resulted in challenges being experienced in complying with the time limitations prescribed by the court rules. Under the TAA the Commissioner must be cited as respondent for purposes of any legal proceedings arising under a tax Act and not the relevant SARS branch office or SARS official.

It is submitted that in principle it is not an adverse obligation to require service of proceedings at a specific place. In the commercial context it is a norm for each party to select a *domicilium citandi* as the place where the party will accept delivery. It is also not correct to state that service at specified addresses as opposed to a branch office will necessarily result in additional costs to taxpayers. Many taxpayers do not live in the city where a High Court is located and must in any event appoint correspondent attorneys. The Uniform Rules of the High Court also do not require only physical delivery but allow service by less costly electronic means such as facsimile and e-mail.

Finally, it is not intended that the proposed public notice under the proposed section 11(4) will only prescribe one address, but will, where practically possible, list both a physical and electronic address, which includes email and a telefax number, in each jurisdiction of the High Court.

9.3.5. **Clause 25: TAA section 25 - Affording the Commissioner the power to require returns**

Comment:

The obligation to submit and the criteria for a return must be prescribed in a tax Act for purposes of which the Parliamentary procedure must be followed. Assigning an open-ended power to the Commissioner to require any return is over wide and may be abused to the prejudice of taxpayers. SARS has sufficient information gathering powers to obtain information in addition to prescribed return information.

Response:

Not accepted. The scheme of the TAA is to administer a return obligation imposed under another tax Act or the TAA. A tax Act generally only imposes the obligation to submit a return, while the form and manner is prescribed under the TAA. A return must contain the information prescribed by a tax Act or the Commissioner.

A return is simply one method of information gathering. Information requests are *ad hoc* whereas returns are much broader, apply to a category of taxpayers and are generally, but not always, required on a recurring basis. The proposal that returns must be specifically prescribed in a tax Act, is contrary to the internationally accepted principle that a revenue authority must have wide information gathering powers in order to achieve an equitable levying of taxes and to discharge its public duty to correctly assess tax.

In practice, it may happen that returns other than those currently specifically required under the tax Acts are necessary to administer a tax Act, including the TAA itself. While SARS could send out individual requests for information in some cases, this option is inappropriate when information is sought from a large number of people. Furthermore, if the identity of persons from whom information is required is unknown, then the standard information-gathering process is inappropriate. For example, if information is required by other countries in terms of an international tax agreement, the Commissioner should be enabled to request a specific return even if it is not specifically required under a South African tax Act.

9.3.6. **Clause 28: TAA section 46 - Obtaining information in the manner prescribed under the Criminal Procedure Act**

Comment:

SARS is not legislatively tasked with investigating criminal matters, merely in assisting the persons tasked with investigating criminal matters. SARS cannot procure information under the powers of these persons in terms of the Criminal Procedure Act, 1977 ("the CPA").

Section 236 of the CPA contemplates criminal proceedings taking place and it is the "court concerned" in those proceedings that must issue the order to a bank to produce. SARS does not have the power to issue that order.

Response:

Not accepted. It is evident from the CPA that the ability to require information to be provided in a prescribed manner is not limited to specific investigative authorities, such as the SAPS or NPA. Extensive criminal investigative powers are assigned to SARS in the TAA. SARS may, under the TAA, complete a criminal investigation and lay a charge with SAPS. The NPA must then determine whether to institute a prosecution.

The proposed amendment does not empower SARS to use authority under the CPA. SARS's power to request information is under section 46 of the TAA, which allows SARS to direct the *manner* in which it may obtain information for purposes of an audit or criminal investigation, including under oath or by way of solemn declaration. All that the reference to sections 212 and 236 of the CPA do is extend the general admissibility requirements of documentary

evidence to criminal proceedings. In practice, affidavits are obtained during a criminal investigation, from banks for example, and then presented as evidence *if* criminal proceedings are instituted. The proposed amendment will enable these documents to be used as *prima facie* evidence to obviate the unnecessary calling of third parties as witnesses.

9.3.7. Clause 30: TAA section 68 - Inclusion of examining or auditing procedure or method used by SARS as “SARS confidential information”

Comment:

This proposal is too wide as the audit method or examination used by SARS may be at the heart of a dispute as to whether SARS acted reasonably. It also directly impacts on taxpayer rights to administrative justice by limiting taxpayers from being able to ascertain how SARS ascertained a tax risk or liability. The classification should be subject to an onus rule against SARS for such position as well as SARS having to explain why the disclosure would result in jeopardising the effectiveness of the methodology.

The proposed amendment can even go so far as preventing SARS from providing reasons for an assessment raised or the method of calculation of the amount of tax.

Response:

Partially accepted. The proposed amendment is not clearly understood. SARS is seeking to protect its audit selection methods, also referred to as the risk matrix or risk profiling factors, that underlie audit selection. SARS’s audit selection methods are premised on the reality that it is impossible to audit all returns. The effective administration of the tax system presupposes that taxpayers should not know when they will be selected for an audit. At the conclusion of an audit, the taxpayer is entitled to SARS’ reasons and examination methods that result in an assessment.

However, to clarify any misconception about what SARS seeks to protect, the following change will be made:

“(k) information relating to the **[examining or auditing]** verification or audit selection procedure or method used by SARS, the disclosure of which could reasonably be expected to jeopardise the effectiveness thereof.”.

9.3.8. Clause 31: TAA section 73 – Disclosure of information to taxpayer

Comment:

Section 73(1)(b) relates to information on which the taxpayer’s assessment is based. This information forms part of the reasons that SARS should provide to justify the assessment and must be given to the taxpayer as a matter of course. The taxpayer should not have to pay for copies of this information

Response:

Accepted.

9.3.9. Clause 34: TAA section 99 – Extension of prescription

Extension of prescription period for reduced assessments

Comment:

Although the proposed amendment that relief be granted from prescription of assessments for the issue of reduced assessments where the taxpayer applied in time but the reduced assessment was not issued in time, is welcomed, this will not resolve cases where no request for a reduced assessment within the prescribed period was made and where it would be inequitable to recover the tax under such erroneous assessment.

Response:

Accepted. In practice, erroneous assessments are sometimes only discovered after all prescription periods and remedies have expired and it becomes apparent that it would be highly inequitable to recover the tax due under such assessments. Examples are assessments that result from fraud unbeknown to the taxpayer, a serious undisputed error by the taxpayer in a return or a serious processing error by SARS in making the assessment. It is proposed that this problem be addressed if an assessment was issued under the following circumstances:

- (a) it was based on—
 - (i) an undisputed factual error by the taxpayer in a return;
 - (ii) a processing error by SARS; or
 - (iii) a return fraudulently submitted by a person without the knowledge of the taxpayer;
- (b) it imposes an unintended tax debt in respect of an amount that the taxpayer should not have been taxed on;
- (c) the recovery of the tax debt under the assessment would produce an anomalous or inequitable result;
- (d) there is no other remedy available to the taxpayer; and
- (e) it is in the interest of the good management of the tax system.

Extension of prescription period for additional assessments

Comment:

This proposed amendment conflicts with the principle of finality – it is in the public interest that disputes should come to an end. Applying the provision would be impractical and result in protracted disputes regarding whether there was dilatory tactics by the taxpayer and whether the taxpayer had just cause not to provide requested information..

The provision is also open to abuse as SARS can commence an audit and require information close to prescription period and then argue that there was a delay in providing the information. SARS can also close to prescription period send out unnecessary information requests to avoid prescription and buy more time to finalise an audit.

Response:

Partially accepted. The proposed amendment intended to address delaying tactics employed by some taxpayers in particularly complex matters, such as transfer pricing and the General Anti-Avoidance Rule. Information is withheld from SARS to force a matter closer to the prescription period, which places SARS under pressure and may result in incorrect assessments.

However, after further consideration it is recognised that delaying tactics are only one of the difficulties in this area. Often the matters are simply too complex to finalise in the time available. Alternative legislative solutions are possible, for example by providing for extended prescription periods for particularly complex matters. These solutions will be pursued in the 2014 legislative programme.

9.3.10. Clause 35: TAA section 103 – Power to prescribe forms for rules

Comment:

The amendment should be deleted as it dilutes the powers specifically afforded to the Minister under section 103. The amendment proposes a rule which would supersede the power of the Minister, thus taking away the Ministers power to prescribe to SARS what it may or may not do in terms of “the rules”, including the powers regarding the form of documents.

Response:

Not accepted. The proposed amendment provides very limited authority to the Commissioner to prescribe the form of documents, such as the notices of objection and appeal, required under the dispute resolution rules. It is and always has been the practice that the form of the documents used in the dispute resolution process be prescribed by the Commissioner but only within the ambit of the empowering provision. The Minister is not involved in the design of documents used for purposes of tax administration, since this is the responsibility of the Commissioner.

9.3.11. Clause 37: TAA section 117 – Tax Court review powers

Comment:

Though the endeavours to reduce legal costs are welcomed, assigning the tax court jurisdiction to hear review matters in terms of the Promotion of Administrative Justice Act, 2000 (“PAJA”), does not seem legally tenable. Only PAJA can assign jurisdiction to hear review matter and currently such jurisdiction is limited to the Constitutional Court, a High Court or ‘court of similar status’ or a designated Magistrate’s Court. It is also unclear how this will work in practice and which procedural rules will apply.

Response:

Accepted. The proposed amendment to afford the tax court jurisdiction to hear constitutional review applications under PAJA, was in response to a constant demand for a more cost effective and accessible remedy to taxpayers in respect of administrative decisions by SARS. As there are divergent views on whether the amendment is legally tenable, this matter requires further consideration.

9.3.12. Clause 39: TAA section 129 – Test Cases

Comment:

It is generally accepted that tax court judgments apply *inter partes* and are only of persuasive value in respect of other tax cases. The effect of the proposed amendment would make the judgment in a test case binding on other tax courts. To provide that the decision of a tax court in a case involving a third party is determinative of another taxpayer’s objection or appeal undermines the constitutional principles of access to justice and the right to be heard. All taxpayers should have the right to have their cases heard before the courts and SARS should only be entitled to rely on the judgment of the outcome of any test case for the purposes of engaging in the stayed cases.

Response:

Not accepted. It is not intended that the judgment by the tax court in the test case will be binding on other tax courts – it will only be binding on the taxpayers whose objections or appeals were stayed or selected for the test case.

The remedies of taxpayers who are selected but do not wish to be part of the test case will be regulated in the new dispute resolution rules to be issued under section 103 of the TAA, which are intended to be published before commencement of the proposed amendment.

Taxpayers who agreed to a stay of their disputes (or have been ordered by a tax court order to stay their disputes) will be bound by a final judgment. Taxpayers whose disputes were stayed and exercised their right to participate as co-appellant in the case, will be able to further appeal the test case. In addition, if a taxpayer is of the view that the test case judgment does not apply to the facts and issues in their stayed dispute, the rules will permit the taxpayer to approach the tax court for an order to pursue their dispute independently. This

is specifically catered for in the proposed amendment by the insertion of the words “unless a tax court otherwise directs”.

It is therefore submitted that the proposed amendment, read with the draft rules, does not limit a person’s access to court but rather balances taxpayers’ and SARS interests equitably, while reducing demands on the judicial system.

9.3.13. **Clause 40: TAA section 130 TAA – Costs in test cases**

Comment:

The amendment only provides for costs relating to the test case but does not deal with the costs of the stayed cases. Provision should be made for costs for both the staying of the case, i.e. wasted costs, as well as for costs for stayed cases where SARS wholly or partly loses the test case and the judgment is then determinative of such objection or appeal.

Response:

Partially accepted. The proposed amendment enables the tax court to award costs and this is provided for in the draft dispute resolution rules. The issue of costs will be regulated by rule 12(11) which provides:

“(11) In the event that a tax court under section 130 of the Act, or a higher court dealing with an appeal against the judgment of the tax court in the test case, awards costs and—

- (a) SARS is substantially successful in a test case, the appellants in the test case will be responsible for the legal costs of the appellant whose appeal was selected as the test case on the proportionate basis as may be determined by the tax court; or
- (b) the appellants are substantially successful in a test case, SARS will be liable for the legal costs of the appellants and the taxpayers whose objections or appeals were stayed.”

9.3.14. **Clause 42: TAA section 160 – Right of recovery**

Comment:

The reference to section 179 in section 160(1) is incorrect. A third party appointed under section 179 does not pay a *tax* to SARS, which it could recover from the taxpayer, but only pays *money* to SARS which the third party holds or owes to the taxpayer. This money is then used by SARS to satisfy the tax debt of the taxpayer.

Regarding the proposed amendment to protect third parties appointed under section 179 against recovery actions by the taxpayer, the amendment does not go far enough. With reliance on the matter of *Nedbank Limited v Pestana* 2009 (2) SA 189 (SCA), it is proposed that the amendment should also cater for situations where a third party makes a payment to SARS of money owed or held for a taxpayer pursuant to an instruction by SARS under section 179, and a court subsequently “overrules such instruction as being unlawful”. The amendment should provide for SARS to repay the amount to the taxpayer immediately and not the third party.

Response:

Partially accepted. The reference in section 160(1) will be corrected. The comment regarding the amendment to section 160(2) is, however, not accepted. The comment is based on an incorrect interpretation of the case relied on. In that matter, the court did *not* hold that the appointment of the bank under the then section 99 of the Income Tax Act (now contained in section 179 of the TAA) was unlawful. It held that the *conduct of the bank*, subsequent to

receiving the SARS notice, was unlawful in that it reversed a credit to a client's account made on instructions of the tax debtor.

It is accepted that if a court finds a notice by SARS under section 179 of the Tax Administration Act invalid, it will have to refund the money. However, SARS cannot indemnify third parties against their own unlawful conduct pursuant to the receipt of a valid notice.

9.3.15. **Clause 44: TAA section 163 – Preservation orders**

Comment:

Preservation can currently and should only be available as a remedy for the recovery of tax debts due. The proposal has now extended this to “tax that is or may be due or payable”. SARS should not be entitled to relief for anticipated tax debts as they already have various remedies in ensuring that a tax debt is created such as estimated and jeopardy assessments.

Response:

Not accepted. A preservation order is not a recovery mechanism. SARS's recovery powers of quantified and outstanding tax debts are contained in Chapter 11. This amendment seeks to clarify the main purpose of preservation, namely to deal with both the situation where a taxpayer subject to an audit takes steps to transfer assets to avoid payment of the tax properly chargeable *and* where a taxpayer takes such steps once there is a quantifiable tax liability. This is in line with the common law *Mareva injunction* remedy.

The provision is also used as a conservancy measure under an international tax agreement, in respect of an amount which is alleged to be due by a person under the tax laws of the requesting country as referred to in section 185(1)(a) of the TAA. SARS has an obligation to honour such international agreements.

However, the fact that SARS may apply for a preservation order in respect of tax that may be due or payable, does not mean that SARS may make use of this measure to preserve assets under circumstances where it has yet to be determined that it is likely that a debt will arise. This will be clarified in the proposed amendment.

9.3.16. **Clause 45: TAA section 164 – Partial suspension of disputed tax**

Comment:

SARS must only be given the discretion to partially enforce the pay-now-argue later principle to the extent that a taxpayer admits liability for a portion of the liability.

Response:

Not accepted. Section 164 does not apply to the undisputed part of the assessment. The proposed amendment provides that the disputed amount under an assessment may be partially suspended, rather than an all or nothing approach.

9.3.17. **Clause 49: TAA section 172 – Judgment procedure**

Comment:

Though it is stated that the purpose of this amendment is to clarify that the collection should only follow “outstanding tax debts”, the reference to section 164(6) has no effect as SARS is not compelled to provide a response under section 164(6).

Response:

Not accepted. The comment is incorrect. Section 164(6) provides that during the period commencing on the day that SARS receives a request for suspension for disputed tax and ending 10 business days after the issue of SARS' decision or revocation, no recovery proceedings may be taken, unless SARS has a reasonable belief that there is a risk of

dissipation of assets. If SARS does not give the notice required under section 164(6), the 10 day period does not commence and SARS cannot take any recovery proceedings.

9.3.18. **Clause 51: TAA section 176 – Withdrawal of judgment**

Comment:

It is proposed that tax not contained in the statement filed should not be a consideration for the withdrawal of the statement where the tax in terms of that statement is no longer due and payable.

Response:

Not accepted. A debtor normally has to apply to court for rescission of a judgment and a creditor is generally under no obligation to withdraw a judgment once the debt is paid. As a departure from this general principle, the provision compels SARS to withdraw the judgment once all tax debts are paid to assist taxpayers in restoring their financial credibility. The significant additional obligation SARS will assume should accordingly be limited to deserving taxpayers who have *no* outstanding tax debts. It should be noted the proposed amendment does not apply to cases where a tax debt is or was never owed. If the debt should never have existed SARS already has the power to withdraw the judgment.

9.3.19. **Clause 62: TAA section 222 – Understatement penalty**

Proposed amendment to section 222(1) – Effective date

Comment:

The effective date for the amendment to provide relief from understatement penalties for *bona fide* errors should apply from the effective date of the TAA i.e. should only apply to “offences” arising on or after 1 October 2012 in order to limit its current retrospective application.

Response:

Partially accepted. The amendment will apply with effect from 1 October 2012, but will apply to understatements made in a return before 1 October 2012. See discussion on retrospectivity in paragraph 9.3.22. below.

Proposed amendment to section 222(1) – Bona fide inadvertent error

Comment:

The term “*bona fide* inadvertent error” is not defined and it is unclear what type of errors will be regarded as such. It is proposed that the criteria that SARS would look at should be included in the Act and not only referred to in the Memorandum of Objects.

Response:

Partially accepted. Due to the broad range of possible errors, the proposal to define the term “*bona fide* inadvertent error” has the potential to inadvertently exclude deserving cases and include undeserving cases. SARS will, however, develop guidance in this regard for the use of taxpayers and its staff.

Proposed amendment to section 222(1) – Application of penalty percentages

Comment:

The wording of section 222(2) should remain as is to prevent the imposition of an extremely onerous penalty.

Response:

Not accepted. The purpose of the amendment is precisely to avoid an unnecessarily onerous penalty. If more than one understatement is made in a return, the applicable behavioural category in respect of each understatement must be separately or individually determined as the behaviour may differ. For example, one understatement may result from reasonable care not taken while another may result from gross negligence. The amendment clarifies that the approach should not be to determine the net shortfall of the entire period and then apply the “highest applicable percentage”. To follow the example above, this would mean that the higher percentage for gross negligence would apply in respect of both understatements.

Proposed amendment to section 222(5) – Tax rate applicable to assessed losses

Comment:

In the context of assessed losses, the basis on which the shortfalls are taxed pursuant to section 222(3)(c) i.e. on the difference between an assessed loss properly carried forward and the amount that would have been carried forward if the understatement were accepted, remains inexplicably harsh. The TAA in effect imposes a penalty equal to the tax rate multiplied by the shortfall, whether or not the taxpayer has in fact benefited from a reduction in prior tax payable or not.

It is proposed in the context of assessed losses that a lower flat rate be applied to the shortfall. For example, the UK tax law has a similar concept, but a flat rate of 10% is imposed on the shortfall, and not the statutory tax rate.

Response:

Not accepted. As this provision deals with tax losses carried forward, rather than brought forward, there is no question of a reduction in prior tax. The current tax rate is applied to a current shortfall, albeit one that may only have a cash impact in the future. The best estimate of the unwarranted cash benefit to the taxpayer as a result of an understatement is arrived at using the current tax rate. This is also commercial practice when valuing assessed losses.

9.3.20. Clause 63: TAA section 223 TAA – Substantial understatement penalty

Comment:

There is no basis for this amendment as there should not be any differentiation between an in-house and an external tax practitioner. In-house tax practitioners are subject to the same regulation as other practitioners and therefore this limitation only serves to increase the cost of obtaining an opinion that will serve as a basis for remitting a substantial understatement penalty. If the in-house tax practitioner was biased in drafting and issuing a tax opinion that tax practitioner can then be reported to the relevant controlling body in terms of section 241 of TAA.

Response:

Not accepted. In-house tax practitioners are not independent of their employers and are not subject to the same statutory sanctions as other practitioners. They are not required to register as tax practitioners, since they qualify for an exclusion from registration, and could legally retain their employment even if removed from the rolls of a recognised controlling body.

9.3.21. **Clause 68: TAA section 240 – Accountability for non-registered tax practitioners doing tax work**

Comment:

As a general matter, partners and directors don't formally accept accountability for the actions of persons acting under their supervision. The proposal to regard the tax practitioner as accountable for the actions of the person (albeit for purposes of a complaint to a recognised controlling body only) is not the appropriate way to address the issue at hand.

Response:

Not accepted. The exclusion from registration for subordinates must be balanced against the need to ensure that a registered tax practitioner is accountable for the actions of a subordinate. The requirement for a formal acceptance of accountability ensures that there is no dispute as to who is finally accountable for a subordinate's actions. As an example, a subordinate may report to more than one registered tax practitioner, one of whom should accept accountability for the subordinate's actions and ensure that adequate supervision is in place.

9.3.22. **Clause 72: TAA section 270 – Transitional Provisions**

Proposed amendment to section 270(6)

Comment:

It seems that SARS will still have a discretion whether to impose understatement penalties on understatements that occurred before the commencement of the TAA, despite the provisions of sections 270(6) in terms of which additional tax must be imposed

In its current form, the only reasonable interpretation of section 270(6) is that it requires that any additional tax, penalty or interest that could have been levied under a tax Act but for the repeal of the relevant provisions must be levied notwithstanding such repeal. Furthermore, on such an interpretation, it is clear that any understatement penalties, administrative penalties or interest under the TAA in relation to defaults that took place prior to the effective date may not be levied.

The proposed amendment fundamentally changes this position by making the levying of the additional tax, penalties or interest under the repealed provisions of a tax Act subject to the non-levying of the equivalent under the TAA. SARS is well aware that taxpayers are challenging the levying of understatement penalties under the TAA in respect of tax positions adopted prior to the TAA coming into effect. One of the grounds of such a challenge is on the basis of section 270(6) as it currently stands. The proposed amendment is therefore a less than subtle attempt to eliminate such an argument with retrospective effect.

Any amendment to section 270(6) should be effective only from the date of promulgation of the TALAB. The effective date should cater for years of assessment and not merely a fixed date, to avoid that taxpayers with the same year ends are treated differently merely because they decided to submit their returns at different times, either before or after 1 October 2012.

Response:

Not accepted. As was made clear during the Parliamentary process when the TAA was enacted, the general transitional approach when drafting the Tax Administration Bill was that the new Act would apply to an act, omission or proceeding taken, occurring or instituted before the commencement date - see section 270(1). To have continued these actions or proceedings under the "old law" would have necessitated different processes and systems in SARS into the indefinite future which would have increased the cost of tax administration substantially.

Most of the commentators have now used the following analogy to argue that the retrospective application of the understatement penalty under the TAA is wrong:

"An analogy for the manner in which SARS has implemented the understatement penalties is for the speed limit on a road to be lowered with retroactive effect and for all cars that exceeded that reduced speed limit in the past to be fined."

While the analogy is flawed, in that it deals with a criminal matter, the answer to it is this; the TAA has not changed the "offence", i.e. an "understatement" is still an omission; default or incorrect statement as was the case under "additional tax". Furthermore the maximum "fine" has not been changed, it remains at 200%. Rather what has changed is the basis on which the "fine" or understatement penalty is arrived at. The amount of the penalty is now determined by the statutorily specified behaviour of a taxpayer when making the understatement.

The Memorandum of Objects on the Tax Administration Bill, 2011, states as follows regarding the new understatement penalty legislation:

"Provision is made that the current open-ended discretion to impose an understatement penalty (under current law referred to as 'additional tax') of up to 200% is now limited by a new structure whereby the percentage of the understatement penalty will be determined by the taxpayer's behaviour and objective criteria listed in a table. This is aimed at ensuring consistent treatment of taxpayers in comparable circumstances."

Under the additional tax legislation the amount of the penalty was subject to an open-ended discretion because a taxpayer could be levied with a penalty anywhere between 0 to 200%. Both before and after the commencement of the TAA a penalty was imposed and was and still is calculated as a percentage of the amount of the "shortfall". In both cases the relevant behaviour of the taxpayer influences the amount of the penalty. Whereas the pre-TAA penalty allowed the recognition of "extenuating circumstances" to reduce penalties from 200%, the TAA now incorporates similar factors and now broadly categorises behaviours as reasonable care not taken, unreasonable tax position, gross negligence and intentional tax evasion.

SARS accepts that there may be unanticipated consequences arising from the approach adopted. It is open to engagement around these issues, will continue to review the approach for unanticipated consequences and will propose amendments to address them if necessary. That said, it would be inequitable to allow a taxpayer to escape both the previous additional tax and the current understatement penalty in respect of its unacceptable behaviour, merely because it is well advised. One reading of the third paragraph of the comment above implies that this is may be what some seek to achieve. If so, this cannot be permitted.

Proposed amendment by insertion of new section 270(6A)

Comment:

The proposed insertion of section 270(6A) is to be welcomed in light of the proposed amendment to section 270(6). The proposed amendment, however, does not go far enough. Aside from the requirement to have the opinion by the due date of the return, section 223(3)(a) requires full disclosure of the arrangement, as defined in section 34, to have been made by the due date of the return. As this requirement would have been unknown prior to the effective date it would not have been open to taxpayers to ensure compliance therewith.

Response:

Not accepted. The duty to report a reportable arrangement was inserted in the Income Tax Act in 2006 and taxpayers have been required to report a reportable arrangement in terms of section 80O of the Income Tax Act since then.

Proposed amendment by insertion of new section 270(9)

Comment:

The provision provides no relief as deeming the application for a reduced assessment to be 1 October 2012 does not defer the prescription period calculated from the issuance of the original assessment.

Response:

Noted. The proposed amendment was intended to provide additional time to deal with pre-TAA requests to correct undisputed errors by taxpayers and processing errors by SARS. This transitional approach has been overtaken by the permanent approach described in paragraph 9.3.9. above and is no longer necessary.

DRAFT

10. LIST OF ORGANISATIONS AND INDIVIDUALS WHO PROVIDED WRITTEN COMMENTS ON THE 2013 TAX BILLS

	Company Name	Contact person
1	ABSA consultants & Actuaries	Anita Roodman
2	Actuarial Society of SA	Tommie Doubell
3	AEL Mining services	Gerda Berga
4	Allan Gray	Richard Carter & Carla Rossouw
5	Allan Gray	Claire Solomon & Carla Rossouw
6	American Chamber	Carol O'Brien
7	ASISA	Peter Stephen
8	Banking Association	Leon Coetzee
9	BDO	David Warneke
10	Bowman Gilfillan	Kelly Pretorius & Lizel Oberholzer
11	Bravo (Deloitte client)	Greg Boule & Halamandaris, Nike
12	Cassidian	Julie von-la-Chevalerie
13	Catalyst Solutions	Christo Engelbrecht
14	CFM (Coronation Fund Managemetn)	Lizelle Meyer
15	Chamber of mines S.A	Lara Carneiro
16	Clicks	Annalize Barnard
17	Crop life	Tom Mabesa
18	CulminIT	Casper Steenkamp
19	Deloitte	Halamandaris, Nike & Kader, Nazrien
20	Discovery	
21	DLA Cliffe Dekker Hormeyer	Emil Brincker
22	DST (Dept. of Science & Tech)	Godfrey Mashamba
23	Dube tradeport	Kate Ralfe
24	Durban Chamber of Commerce	Andrew Layman
25	Edward Nathan Sonnenbergs Inc (ENS)	Beric Croome
26	Eric Naude	Eric Naudé
27	Ernst & Young	Ruth Ovens
28	Ernst n Young	Melissa van As
29	Eskom	Natasha Singh
30	Falcon	Philip O'Quigley
31	FirstRand	Tarryn Atkinson
32	Furniture Bargaining Council (Deloitte client)	Halamandaris, Nike
33	GeneralMotors SA (GM)	Renee Schulze
34	Glencore	Dean Sherman
35	HSBC	Mark Herbert
36	IDC	Gert Gouws
37	IDS	Geneve Carse
38	Investec	Tasnim Hassen
39	IP Mangement	Brett Paton
40	IPASA	Shakira Ramlakhan
41	Johan vd Westhuizen	Johan Van Der

42	KPMG	Isherwood, Lesley, Wessels, Erika & Stephan Minne
43	MAERSK	Martie Cruywagen
44	Margo Intellectual Property	Darren Margo
45	Masquarie Securities SA	Rob Grave
46	MetIndustrial	Jada, Mohammed
47	MIH Group	Alexia Christie
48	Momentum	Stephen van Niekerk
49	MTN Group SA	Vim Zama
50	Multichoice (Deloitte client)	Adams, Adrian
51	Nautilus/JSE	Siobhan Cleary
52	Novare Investments	Carla De Waal
53	OASIS Group	Hugo Barnard CA(SA)
54	OPASA	David Clegg
55	PAGSA	Rob Cooper
56	Peregrine	Tania Waller
57	Philanthropy Service Providers (KPMG client)	Wessels, Erika
58	PKF	Paul Gering
59	Prof. Linda vd Schalkwyk	Van Schalkwyk, LINDA
60	PWC	Pieter Faber
61	RMB	Humphreys, Russell
62	SAB Miller	Lazelle Terblanche
63	SAICA	Piet Nel: Faith Meyer (PA)
64	SAIT	Sharon Smulders
65	SAMSA	Samuel Nkosi
66	Sanlam	Isabeau van Rooyen
67	SAPOA	Neil Gopal
68	SAREIT	Estienne de Klerk
69	SARS	Johannes Mallela
70	SASOL	Trollope, George
71	SAVCA	Erika van der Merwe
72	SBSA (Standard Bank)	Stephanie Patmore
73	SHELL	Ivan Collair
74	Simon Kelsey	Simon Kelsey
75	Sizwe Ntsaluba	Evelyn Vilane
76	Steyn Capital Management	Jamie Kent
77	Supreme Spring	Bunny Sivlal
78	Tax Consulting	Jerry Botha
79	The DTI	Kaya Ngqaka
80	Towers Watson	Erich Potgieter
81	Transnet	Helen Walsh
82	Turning Point Consultants	Reza Amra
83	Visio Capital	Craig French
84	Webber Wentzel	Anne Bennett, & Dries Hoek
85	Werksmans	Ernest Mazansky
86	Xstrata	Dean Sherman