

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

15 October 2014

**Draft Taxation Laws Amendments Bill, 2014 and Tax Administration
Laws Amendment Bill, 2014**

**Draft Response Document from National Treasury and SARS, as
presented to SCOF¹**



**NATIONAL
TREASURY**



¹ This version of the document includes additional information to the version that was presented to the SCOF. The extra paragraphs are in boxes and provide detail on some of the discussions that took place at the hearings.

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1. BACKGROUND

1.1. PROCESS

The Draft Taxation Laws Amendment Bill (TLAB), 2014 and Tax Administration Laws Amendment Bill (TALAB), 2014 were released for public comment on 17 July 2014. National Treasury and SARS briefed the Standing Committee on Finance on 30 July 2014 and the Committee heard responses from the public at hearings that were held on 26 and 27 August 2014. The final report back to the Committee occurred on 15 October 2014.

It should be emphasised that this draft response document is not necessarily the final response of the Minister of Finance. Rather it represents the final proposals put forward by the National Treasury and SARS to the SCOF for its consideration, following the hearings and submissions made on the initial Bills published on 17 July 2014. Following the hearings in Parliament today to consider the Draft Response Document, the Minister will take account of any further recommendations made by the SCOF, finalise the Bill over the next few days and then table a revised Bill in Parliament, expected to be next week.

1.2. PUBLIC COMMENTS

The deadline for public comments was 17 August 2014. National Treasury and SARS received responses from 90 organisations and individuals. There were 12 organisations who presented their responses orally during the public hearings hosted by the SCoF. Workshops with stakeholders to discuss and review their comments were held on 1 September 2014 for business and international taxes, on 2 September 2014 for personal incomes taxes and value added tax and on 12 September 2014 for tax administration. More focused meetings / workshops were also held to discuss specific issues (such as the introduction of tax free savings accounts, the valuation of defined benefit fund contributions, amendments to the small business corporation tax regime, the valuation of fringe benefits in the case of company cars, and the zero rating of certain agricultural intermediate inputs / products).

1.3. POLICY ISSUES AND RESPONSES

Provided below are the responses to the policy issues raised by the public comments received, both written and during the public hearings. These responses have been incorporated in the revised Bills. Comments that fall wholly outside the scope of the Bills have not been taken into account for purposes of this response document.

Draft Taxation Laws Amendment Bill

2. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

2.1. Retirement savings: Valuation of fringe benefit for defined benefit contribution

(Main reference: Paragraphs 1 and 12D of the Seventh Schedule and the issuing of specific regulations)

Comment: The methodology to calculate the value of the benefit should be aligned with the statutory valuations for benefit and contribution calculations, which would lead to a fringe benefit value that would more closely match the actual value of contributions.

Response: Not accepted. The rationale for estimating a fringe benefit value is that the actual value of contributions, as calculated through the statutory valuation, may not be an accurate reflection of the actual benefits that the individual would receive in retirement. For example, members of a fund that has had superior investment returns may not be required to contribute as much as another fund that has had poor investment returns, even if the retirement benefits granted for both funds are identical. Calculating a deemed notional contribution amount that is based on the rules of the fund will lead to an amount that more closely resembles the actual benefit that the individual would receive in retirement.

Comment: A one size fits all approach is not appropriate given the variance of funds and members. There could be different demographic profiles, marriage rates, number and age of children, guarantee periods, death benefits and spousal benefits. It is suggested that more discretion is provided to the actuaries to determine the value of the benefits.

Response: Not accepted. Comments received on the first batch of draft legislation that was released in June 2014 suggested that these calculations would be excessively onerous and would increase the costs of administering funds. To decrease the cost involved in administering the tax rules the level of prescription was increased in the next version of the draft legislation that was released in July 2014. This requires fewer tasks from the actuary, simplifies the method and avoids any additional pressure on the actuary to adjust assumptions that will impact the level of tax paid by active fund members. By removing a large portion of discretion in the calculation the approach ensures consistency across individuals. If there was a large amount of discretion available two individuals with the same retirement benefits, but at different funds with different actuaries, could end up being taxed on different fringe benefit values. Due to these reasons, there were also comments requesting that the calculations be simplified and the level of discretion afforded to the actuary is further limited.

The generalised approach will, however, result in a less accurate measurement of the benefit, but the difference should not be significant for the vast majority of cases.

Comment: Risk benefits that are fully insured in the market should not be included in the valuation methodology as the value of the premiums can be used instead.

Response: Accepted. The draft legislation has been changed to allow retirement funds that fully insure their risk benefits with an external insurance provider to use the actual

value of the premiums for the fringe benefit and will not be required to value the risk benefit.

Comment: The valuation of the risk benefits is not appropriate for funds that self-insure a portion of the risk benefits since the actuarial reserves can be used to fund a large portion of the risk benefits and it is not taken into account in the calculation. The definition of risk benefit should also be adjusted to include disability benefits and the valuation of risk benefits requires numerous assumptions on the proportion of members with spouses and children, which would be burdensome and difficult for actuaries to calculate.

Response: Misplaced. The factors that are provided in the regulations to estimate the value of the fringe benefit do not take into account pre-retirement mortality and so already includes the impact of the actuarial reserve for risk benefits. The assumption effectively assumes that no member will pass away before retirement, which leads to a lower factor (since the benefit including risk would be higher). The actual value of the risk benefit is then calculated separately.

Disability benefits are not explicitly valued, but the factor to calculate the death benefits has been increased to include the impact of disability benefits.

The data used to calculate the factors required for the contribution certificates should be the data that was available as at the most recent statutory actuarial valuation. The actuaries should have the data readily available from that valuation to be able to calculate the value of the risk benefits, including the impact of spouses and children.

Comment: The methodology does not take into account the pension increase policy of the fund, which would have a substantial impact on the value of the benefits received in retirement.

Response: Not accepted. The first draft of the regulations released in June 2014 included factors that varied with the level of pension increases in previous years. The comments received indicated that this could be unfair to current members who may receive smaller pension increases when they are in retirement. There may also be other unintended consequences, such as trustees lowering the level of pension increases for retired members to benefit the current active members who then have a lower fringe benefit value. Using the pension increase policy as stated in the fund rules would also not be useful since the actual level of pension increases does not always align with the pension increase policy of the fund (funds may have then decreased the stated pension increase policy while continuing with their previous levels of pension increases).

The level of pension increases was subsequently excluded from the table of factors in the next version of the draft legislation. The FSB provided National Treasury with data on the pension increase experience of funds and a prescribed pension increase value was chosen where over 90 per cent of funds would fall within 10 per cent of the level of pension increases assumed in the factors.

Comment: It is unclear how the average accrual rate should be determined. If the calculation averages across members who have different accrual rates based on years of service, the resultant average accrual rate would be inequitable since those with fewer years of service will subsidise those with more years of service. Request that the fund member category is split up by years of service.

Response: Noted. The average accrual rate should be calculated by taking the increase in annuity benefits over one year of service (not across all the potential future years of service) for each active member within the same fund member category and then take a simple (not salary weighted) average across those individuals using the data from the statutory actuarial valuation.

It is accepted that averaging the accrual rate will increase the fringe benefit for those with the lower accrual rate in the fund member category. The averaging mirrors the underlying subsidy that exists within the particular defined benefit pension fund and is allowed in order to reduce the burden on the payroll that would otherwise be required to have the years of service within the fund for every individual. However, the retirement fund should be able to amend their rules to allocate members into different fund member categories to avoid the impact of averaging the accrual rate (for example, by increasing the employer contribution for those who have a higher accrual rate with more years of service).

Comment: The requirement to show the actual contributions per component in the contribution certificate is onerous and not possible to do accurately. It is requested that this requirement be omitted from the contribution certificate.

Response: Accepted. The requirement to show the actual contributions has been amended to only indicate the total employee and employer contributions to the fund as a percentage of pensionable salary for the fund member category. This information should be readily available and should not be administratively difficult to include.

Comment: It is unclear whether the legislation will require defined contribution funds to complete a contribution certificate, even if they have approved risk benefits (risk benefits that flow through the fund but may be insured through an external insurance provider). In addition, it is requested that retirement funds are not required to provide a contribution certificate for members who only have defined contribution retirement benefits in the fund.

Response: Accepted. The draft legislation has been changed to exclude defined contribution funds from the valuation process (where no contribution certificate would need to be completed) if they have insured the full value of any risk benefits through an insurance policy with an external insurance provider. The fund would still be required to complete a contribution certificate if they self-insure any part of the risk benefit. Contribution certificates will also not be required for a group of members in a fund who only have a defined contribution component.

Comment: The draft legislation does not explicitly cater for additional voluntary contributions or payments to purchase past service. How should these amounts be treated in the contribution certificate and would these amounts be eligible for a deduction?

Response: Accepted. Additional voluntary contributions are now explicitly excluded from the calculation of the notional employer contribution fringe benefit. Additional voluntary contributions and payments to the fund to purchase past service will instead be treated as a regular contribution and will be subject to the usual deductibility limits under section 11(k). There will be no need to value the benefit for purchases of past service (or include any details in the contribution certificate) since this approach assumes the amount paid to purchase the past service is an accurate measure of the increase in benefits.

NB After further consultations, and in order to allow for additional time to more effectively communicate the importance of the reforms that were enacted in 2013 and further refined this

year, it was decided to postpone the implementation date of all the tax related retirement reforms from 1 March 2015 to 1 March 2017. It should be noted that the original proposed date for implementation was 1 March 2016 but was brought forward at the request of the previous Standing Committee of Finance.

Following the presentation of the Response Document to the SCOF by the National Treasury and SARS on 15 October 2014, the SCOF suggested that Government explore an earlier implementation date on the assumption that the consultation process might be concluded earlier. The effective date of the reforms has thus been amended to 1 March 2016. In the event the consultation process is not completed on this matter, Government will consider a further delay of a year to 2017, to be discussed with the SCOF when considering the 2015 TLAB draft legislation. Given the need for certainty for all those involved in the reforms, this decision will be made by 31 July 2015.

2.2. Exemption of amounts received or accrued in respect of tax free investments

(Main references: New section 12T, sections 10(1)(i), 29A and 64F(1))

Comment: The annual and lifetime contribution limits are too low and will not do enough to encourage savings at their current level. Recommend that the limits be increased substantially.

Response: Not accepted. The R30 000 annual limit and the R500 000 lifetime limit are reasonable in our opinion. The focus should be to provide a reasonable incentive to encourage middle income earners to save. We could consider a higher annual limit for those 65 years and older in subsequent years once the administration and compliance framework of the new legislation has settled down.

Comment: The annual and lifetime limits should be increased on a regular basis to take into account the impact of inflation. The legislation should include a provision to allow the Minister of Finance to adjust the limits in a public notice rather than through the legislation.

Response: Misplaced. As stated in the 2014 Budget Review, the annual contribution limit will be 'increased regularly in line with inflation'. There is no intention to regularly increase the lifetime limit since if it was increased in line with inflation then it would never be binding. The annual limit can be adjusted in subsequent years alongside the other adjustments to personal income tax brackets and excise duties through the annual Rates and Monetary Amounts Bill.

Comment: The tax free investment definition in the legislation is too broad and will include financial instruments that are not intended to be a part of the tax free savings accounts. The wording is also not clear in defining the distinction between qualifying products and service providers.

Response: Accepted. The qualifying institutions that may offer tax free savings accounts will be identified and published in a Notice by the Minister of Finance and the qualifying products that can be included within the tax free savings accounts will be published in Regulations. Draft regulations will be published for comment by the end of October 2014.

Comment: The 40 per cent penalty on contributions that exceed the annual limit is too severe since this is on top of after tax income. This provision would affect less sophisticated investors

the hardest. Suggest that either the penalty rate is lowered or it is removed and a different penalty mechanism is considered.

Response: Not accepted. The penalty was chosen to avoid the considerable administrative costs that may have arisen if a different approach was taken (such as setting up a real time system where service providers could check the remaining limits, or the additional system requirements for processing contribution and investment yield reversals). Comments received from potential service providers on the penalty option that was presented in the discussion paper that was published in March 2014 requested a simple penalty approach. All future returns on contributions above the limit would be tax free (so that providers are not required to implement any reversals or transfers). The penalty needs to be sufficiently high to deter individuals from intentionally over contributing to benefit from future tax free returns.

Comment: No provision has been made for the transfer of a tax free investment to an heir since only cash contributions can be made into the heir's tax free savings account which would result in unnecessary fees to liquidate the investments of the estate. Recommend that provision is made to allow a broader transfer of assets into the accounts.

Response: Not accepted. The tax free savings accounts are not meant to act as an inter-generational asset transfer incentive. The tax free returns within the accounts are only intended to apply per individual. Allowing a transfer of investments from an estate into the accounts of heirs, that bypasses the annual limit, would result in a significant further tax benefit to the heir, which is not in line with the policy intent.

Comment: The draft Explanatory Memorandum (EM) states that the reinvestment of withdrawals must be within the annual limits, however section 12T(2) and (5) state that 'any amount that is reinvested must not be taken into account', which implies that withdrawals would not be allowed to be returned to the account. Suggest that the wording be changed to align with the intention stated in the EM.

Response: Accepted. Reinvestments from any source would be allowed, as long as it is within the annual limits. The draft legislation has been adjusted accordingly to clarify that receipts and accruals in respect of tax free investments will not be taken into account in determining the amount of contributions.

2.3. Valuation of fringe benefit for employer provided rental accommodation

(Main reference: Paragraph 9 of the Seventh Schedule)

Comment: The draft EM states that the market value should be used if the rental accommodation is obtained from an unconnected third party, however the legislation states that it is the lower of expenditure incurred or the amount from the proxy calculation. Request that the actual value is clarified.

Response: Accepted. The draft EM has been changed to be in line with the legislation where the lower of the amount of the expenditure incurred, as a representation of market value, or the amount from the proxy calculation may be used.

Comment: Suggest that a monthly market value as determined by a registered valuator is also included as an option to avoid circumstances where the landlord inflates the price or demand has spiked.

Response: Not accepted. The two current options available should be sufficient to determine a reasonable approximation of the value of the benefit.

Comment: The 2014 Budget Review stated that there would be proposals for cases where the accommodation is shared, but there were no proposals put forward in the draft legislation.

Response: Noted. Employers are currently able to obtain a directive from SARS for cases where accommodation is shared. The approach required to apply a general sharing formula requires more research, but will be investigated for possible inclusion in the legislative amendments in future.

2.4. Valuation of company car fringe benefits

(Main reference: Paragraph 7(1)(a) of the Seventh Schedule)

Comment: Why has the four year phase in that was announced in the 2014 Budget Review been disregarded?

Response: Misplaced. The proposed phase in period has been reconfigured, the intention is to continue applying the current rules to determine the fringe benefit value to motor vehicles where the right of use of the vehicle was granted to an employee before 1 March 2015 until the employee ceases using the specific motor vehicle. The proposed new rules only apply to motor vehicles that had been manufactured or acquired by an employer on or after 1 March 2015.

Comment: Fringe benefits are generally determined according to the cost to the employer and only where cost cannot be determined is the market value then used. Moving to retail market value goes against the spirit of the Seventh Schedule and it is suggested that the cost principle be retained.

Response: Not accepted. Fringe benefits are intended to reflect the additional benefit that an individual receives as if that individual had used their own financial resources to obtain that asset. The principle of fringe benefit taxation is to achieve neutrality in tax treatment of benefits to employees, regardless of the form that those benefits take. The use of a market value related measure is in line with this principle.

Comment: Retail market value is a subjective measure that would be administratively complex to use and may still result in two individuals with the same motor vehicle paying a different amount of tax (for example if the retail market value is different in towns across the country). Recommend that the original cost to the employer be retained when determining the valuation of company car fringe benefits.

Response: Partially accepted. The potential subjectivity of retail market value is acknowledged. The legislation will provide for regulations that will define retail market value. The intention is to use the list price for new motor vehicles as reference and to the prices obtained in the [M&M for insurance] for used motor vehicles.

Comment: Employees of rental agencies and vehicle manufacturers have a limited choice over the brand, colour and model of the motor vehicle that they may use. The benefits of using that vehicle are therefore not the same as with other employees who have choice and so the fringe benefit value should not be the same.

Response: Noted. The proposed regulations that will define the retail market value for vehicles (with the lists prices for new vehicles as the reference prices) might include certain rebates for employees in the motor vehicle sector (i.e. OEMs, motor dealers and rental agencies). Such rebates will only be considered if a strong case can be made that the real benefits that accrues to such employees are less than under normal circumstances - due to the nature of their work, e.g. they have no choice in the type of vehicle that they are allowed to drive because it is used as a marketing tool, etc. and a reasonable 'value' can be attached to such lower benefits.

Comment: Employers are likely to defer the replacement of vehicles under this proposal, which would lead to a substantially negative impact on new vehicle sales to the detriment of vehicle manufacturers and tax revenues.

Response: Noted. This statement appears to be more speculative. However, even if it is true it should be noted that the fairness of the income tax system should not be unduly compromised, as has been the case under the current practice, which has arguably been contrary to the letter and spirit of the law.

Comment: The inclusion of the words 'or business' in the amendment implies that employees would be required to travel to their place of employment first before visiting any clients in order for the trip to count as business travel. The amendment will have a severe impact on employees who travel to clients often and it is recommended that the wording be amended to maintain the current treatment.

Response: Accepted. The change was not meant to interfere with the meaning of business travel. The words 'or business' have therefore been deleted from the legislation to align with the previous definition.

2.5. Clarification of the loss requirement in respect of key person insurance policies

(Main reference: Section 11(w)(ii)(c))

Comment: Contingent liability policies will no longer be deductible from 1 March 2015, but 10(1)(gH) only exempts the pay-outs of these policies if they were not deductible from 1 March 2012. Request that the 10(1)(gH) exemption be extended to 1 March 2015 to allow these policies to be tax free on pay-outs.

Response: Not accepted. The amendment to 11(w)(ii)(c) is a clarification and not a change of policy. The original intent was not to allow a deduction for contingent liability policies. Creating more certainty to explicitly exclude these cases does not imply that a deduction was allowed in previous years for contingent liability policies. Given that a deduction would not have been allowed there is no reason to extend the 10(1)(gH) exemption.

2.6. The retirement fund accrual date

(Main reference: Section 1 and Paragraph 4 of the Second Schedule)

Comment: There are still many questions relating to how this reform would actually be implemented, such as will funds be required to change their rules to allow a member to remain in the fund even after they have stopped employment but before they have elected to

retire? Or would it be up to the discretion of the fund in terms of whether a member would be allowed to elect to retire at a later stage? Are there set guidelines as to how the assets should be invested over this period? Are there death and disablement benefits over this period? If an individual is no longer contributing and yet the fund is still required to manage their assets, would the fund be allowed to deduct the costs from their benefits? Given these questions and uncertainties it is recommended that the implementation of the reform be delayed for a year.

Response: Not accepted. The amendment to the retirement fund accrual date is intended to ease the administrative difficulties for pension funds when members make an election at a date later than the normal retirement age, in addition to aligning the actual lump sum amount with the amount used for tax purposes at the date of election. This is purely a tax amendment to enable consistency and provide individuals the option to receive their retirement benefits later, but only if it is allowed within the fund rules. The tax amendment has no bearing on the obligations of the fund to allow an individual to receive their retirement benefits at a date past their normal retirement age (or their ability to retire earlier). Decisions on the ability to allow members to retire later, the assets in which their funds will be invested during this period and their risk benefits and fund costs will be determined by the fund rules (as approved by the FSB). Since the tax amendment is an enabling mechanism rather than a compulsory requirement the effective date will remain as 1 March 2015.

Comment: Many pension and provident funds would prefer that the benefits of members who are no longer contributing but have not yet elected to retire are moved to preservation funds that have more experience in handling affairs on an individual basis. It may be excessively costly for employer sponsored funds to be able to manage each individual's retirement interests otherwise.

Response: Noted. There is a concern that if an individual's retirement interest is moved to a preservation fund then the individual can withdraw the entire amount in cash and avoid the annuitisation requirement. To avoid this there would need to be a restriction on the preservation amount that was transferred. This would require further amendments and may create additional complexity so is not included as part of the current legislative changes. However, the adjustment to preservation funds to accommodate a deferred retirement is a possibility that can be considered for future amendments.

2.7. Restraint of trade receipts

(Main reference: Paragraph (cA) of the definition of gross income and section 11(cA))

Comment: The effective date needs to be clarified as it is the date of promulgation in the legislation but it is 1 March 2015 in the draft EM.

Response: Accepted. The effective date is to be 1 March 2015.

Comment: The draft EM states that current legislation does not fit with the policy intent, implying that individuals have been paying tax where they should not have paid tax in previous years. The effective date for the amendment should therefore be 1 March 2014, if not earlier.

Response: Not accepted. There are many amendments to the tax legislation to reflect current policy intent. However, these amendments are not implemented retrospectively.

3. INCOME TAX: BUSINESS (GENERAL)

3.1. Third party backed shares: preference share refinements on guarantees

(Main reference: section 8EA)

Comment: There are other qualifying purposes aside from the acquisition of shares and refinancing of preference shares related to the acquisition of shares in the operating company that need to be correctly addressed in subsection (3)(b)(ii) e.g. refinancing of debt and payment of dividends.

Response: Accepted. Proposed wording to be changed to clearly address concerns that have been raised that certain exception rules might erroneously fail to achieve the relief originally envisaged.

Comment: The proposed subsection (3)(b)(vii) restricts the use of the funds as the issuer is limited to a direct acquisition of equity shares in an operating company. The proposed legislation does not cover the indirect acquisition of shares, refinancing of debt and payments of dividends in a guarantee scenario.

Response: Not accepted. The policy intended a targeted result, based on information available, that the guarantee as contemplated in subsection 3(b)(vii) would only ever be granted for the direct acquisition of shares.

3.2. Deductible interest limitation in respect of debts owed to persons not subject to tax

(Main reference: section 23M)

Comment: With respect to the formula, some comments received were positive. Others request that there should be a minimum percentage provided and no upper cap.

Response: Not accepted. The formula represents a balanced reflection of market conditions in that it is flexible, recognising that the costs of debt funding fluctuate. There is no evidence showing that levels of 60 per cent or higher relate to legitimate (commercially driven) debt financing.

There are indications that the 40 per cent might be too high as illustrated by the three graphs below. The 40 per cent will be reviewed and once a revised percentage (or percentages) has been determined it could be deemed to be the minimum (or there could be more than one minimum for some subsectors).

Figure 1 shows the average percentages for interest to EBIT and interest to EBITDA (based on gross interest) for five different company size categories for OECD countries. The global average in relation to EBITDA is below 20 per cent for all size categories.

Figure 1: Ratio of interest to EBIT and interest to EBITDA - by company size

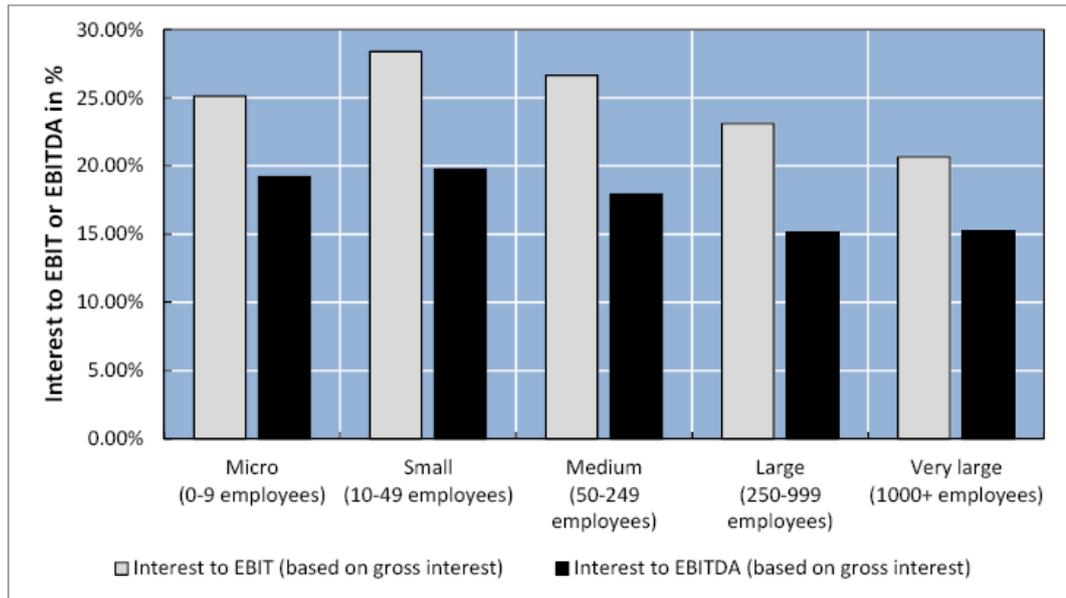
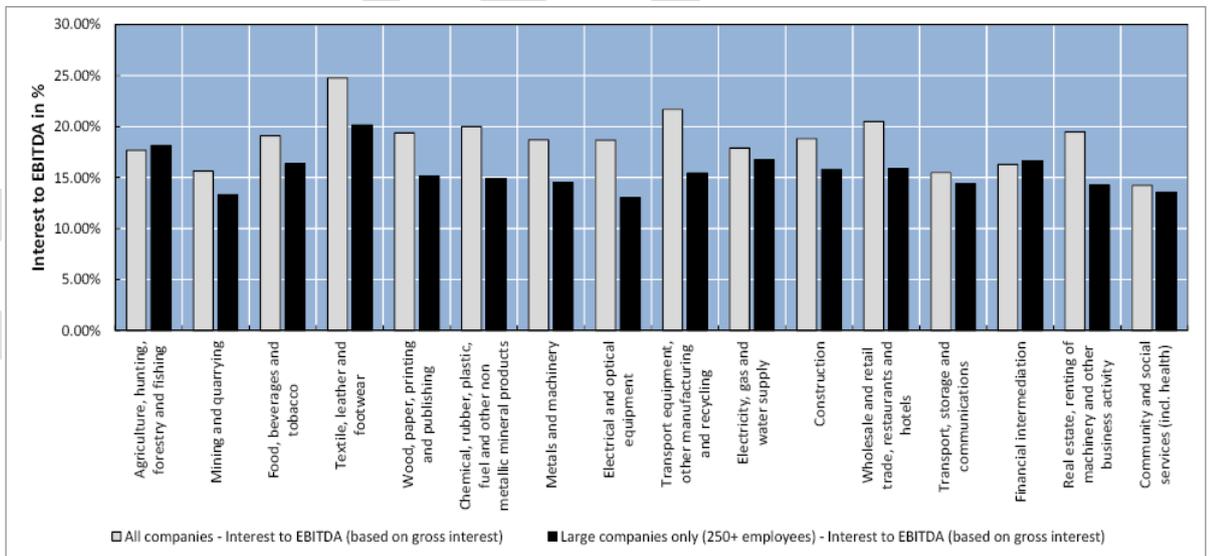


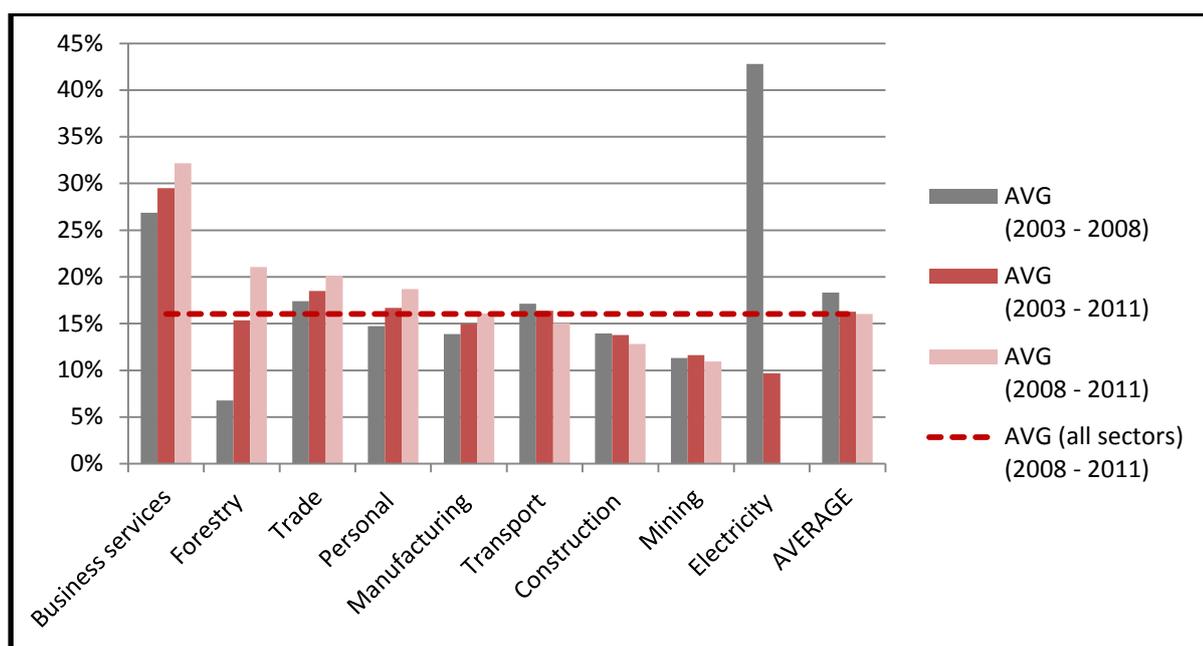
Figure 2 shows the interest expense / EBITDA ratios across sectors. Not much variation is evident and the average is below 20 per cent.

Figure 2: Interest to EBITDA ratio for all companies compared with large companies only - by sector



South African data from Statistics South Africa (Figure 3) shows a very similar picture, with the exception of the electricity and business services sectors. Financial intermediation, i.e. the banks and insurance companies, are excluded from this dataset.

Figure 3: Interest expense to EBITDA ratio for South African companies - by sector



One drawback in setting the level or ratio to try and suit all sectors is that the resulting cap may be set too high, rendering the rule ineffective in countering BEPS. Taxpayers stated that many smaller players would be unduly affected as gearing ratios tend towards 60 per cent; however no evidence has been provided of this at this stage.

Comment: The interaction between section 23M, section 23N and section 31 (transfer pricing) is not clear. The three sections could apply to the same debt.

Response: Noted. The purpose of section 31 is to ensure that if cross-border transactions, such as debt financing, are entered into by connected persons, they must be treated (for tax purposes) as if the amount lent and the interest rate charged between the parties are equivalent to that between two independent parties, i.e. the arm's length principle. In essence, section 31 seeks to correct mispricing due to the terms and conditions of the transaction.

The excessive interest limitation has a broader objective. By limiting the amount of interest deductible, it discourages companies from excessive leveraging, which is often done because the tax system inherently encourages debt over equity financing. Interest limitation rules based on profitability and the ability to fund the finance charges is closer aligned with commercial practice and is more effective at protecting the South Africa economy than a simple debt to equity ratio.

A cap on the amount of interest deductible thus assists in both how much debt (in relation to equity) a company takes on, as well as the price thereof. Transfer pricing always applies first by determining the correct pricing, the draft legislation will be changed to provide that section 23N applies first and then section 23M and that interest expenses disallowed under section 23N are not covered by 23M as well.

Comment: The rules relating to guarantees by controlling persons are creating a variety of anomalies. Section 23M(2)(b)(ii) should be deleted or at least delayed.

Response: Accepted. The relevant subparagraph will be removed.

Comment: The “connected person” test is far too low for the creditor and debtor to be viewed as a single economic unit (with a mere 20 per cent connection often triggering a connection when no majority shareholder exists). The threshold should be increased to at least 50 per cent.

Response: Accepted. The controlling relationship definition will be amended to a concept of control through a requirement of at least 50 per cent of equity shares or voting rights. This will allay the concerns raised by institutional investors (including retirement funds and long-term insurers) that often provide capital for infrastructure projects.

Comment: Section 23M should be deleted in its entirety, if not it must be amended to address unintended consequences.

Comment: South African tax exempt entities should be removed from the ambit of section 23M.

Response: Partially accepted. The limitation of excessive debt and the resulting high interest payments is necessary to protect the corporate income tax base. The amendments that might have unintended adverse effects will be resolved through proposed changes above.

Comment: There is no safe harbour rule in section 23M; however this is provided for in section 23N.

Response: Not accepted. Debt financing in the context of section 23M is typically more long-term, while section 23N debt is shorter-term. The safe harbour rule was provided for section 23N, which covers transaction-based loans that have the potential to reduce a taxpayer’s level of ‘tax EBITDA’ in the year of assessment in which the transaction is entered into. Longer-term financing in the context of section 23M is not likely to affect the taxpayer’s ‘tax EBIDTA ratio’ in the same manner.

Comment: Deductibility of interest can only be determined at year-end once a company’s audit has been completed and adjusted taxable income has been determined; thus provisional tax could unintentionally be understated at year-end when the second payment is due, potentially resulting in penalties.

Response: Not accepted. The 80 per cent second provisional tax payment rule should be sufficient.

3.3. Limitation of interest deductions in respect of reorganisation and acquisition transactions

(Main reference: section 23N)

Comment: With respect to the formula, some comments received were positive. Others request that there should be a minimum percentage provided and no upper cap.

Response: Not accepted. See response and accompanying graphs under 3.2.

Comment: The impact of section 23N should match the impact of section 23M – meaning that the excess interest above the formula should be carried forward instead of being wholly disallowed.

Response: Not accepted. The 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 goes against this purpose.

Comment: Unlisted REITs are currently exposed in respect of the debenture portion of the linked unit in the context of sections 8F, 8FA and 23M. Propose that interest limitations either provide a specific exclusion for unlisted property companies, or that implementation be postponed until the tax regime for unlisted property companies has been amended.

Response: Not accepted. Tax concerns relating to unlisted REITs will be addressed next year.

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

4.1. Tax treatment of the risk business of long term insurers

(Main reference: Section 29A)

Comment: The treatment of risk policies that were issued prior to 01 January 2016 is not clear.

Response: Misplaced. Per definition it is not a risk policy if issued before 1 Jan 2016.

Comment: One should consider the definition of risk policy, the exclusion relates to annuity contracts in respect of which annuities are being paid. In respect of some contracts (especially with reference to retirement annuity funds) annuities are not yet paid.

Response: Noted. A new definition of 'risk policy' has been drafted.

Comment: The definition of 'risk policy' is very wide, potentially any type of policy can be a risk policy. Tax could be avoided by structuring policies to include a tiny portion of risk in an investment product.

Comment: Definition of risk policy is too broad and seemingly includes a "smooth bonus" and early withdrawal of investment policy.

Response: Accepted. A revised definition of 'risk policy' has been drafted.

Comment: Recommends that the UK definition of risk policy be used as basis.

Response: Accepted.

Comment: It is suggested that risk policies be dealt with in a separate fund as opposed to being moved to the corporate fund.

Response: Accepted. A fifth fund will be introduced in which asset equal to the value of liabilities (determined with reference to adjusted IFRS liabilities) in respect of risk policies allocated to the risk policy fund shall be placed. The fund will be taxed at a rate of 28%.

Comment: Life insurers should be treated the same way as short-term insurers when it comes to dividends and capital gains tax.

Response: Accepted. Since a fifth fund is to be introduced, the tax treatment of dividends and capital gains in the initial draft Bill will be withdrawn.

Comment: The untaxed policyholder fund (UPF) should be allowed to issue risk policies. Risk business of UPF cannot be separated from the rest of a policy. Since UPF is not subject to tax, risk business cannot be subsidised by investment business. The words "other than a risk policy" should be deleted in subsection (4)(a)(i).

Response: Not accepted. All new risk policies irrespective of the nature of the policyholder should from 2016 be allocated to the new risk policy fund.

Comment: The implications of which actuarial basis one uses for calculating policyholder liabilities should be carefully considered. The expected changes to the International Financial Reporting Standards (IFRS) and the Solvency Assessment and Management (SAM) regime should be considered in subsection (13). Adjusted IFRS should be used for subsection (13) and no policy should be treated as an asset, negative reserves should be eliminated on a per policy basis.

Response: Accepted. An adjusted IFRS valuation will be proposed for risk business. Negative reserves are to be eliminated on a per policy basis.

Comment: The four month period that insurer shall re-determine the value of liabilities and transfer excess to corporate fund has been deleted in subsection (7).

Response: Partially accepted. A three month period will be introduced in subsection (7).

Comment: Effective date must be moved to 1 January 2017

Response: Not accepted.

4.2. Long term insurers: Unwarranted relief from taxation in respect of foreign reinsurance.

(Main reference: Section 29A(11)(g))

Comment: Reinsurance claims should not be included in gross income. The insurer should decide whether it should be taxed as a capital gain or gross income.

Response: Not accepted. Growth in investment reinsurance policies issued by non-residents should be taxed as gross income in order not to create an incentive for reinsurance to be placed with non-resident reinsurers rather than with domestic reinsurers.

Comment: Only 'linked policies' should be affected. For example, risk policies reinsured offshore should be disregarded.

Response: Accepted. The risk of untaxed build-up in a reinsurance policy is limited to investment policies taxed on the trustee basis..

Comment: Why does the effective date for amendments to s 29A(11)(g) state that it comes into effect on 17 July 2014 and applies in respect of years of assessment commencing on or after that date? Insurers must include all claims in respect of reinsurance policies in that year of assessment and previous years of assessment (going back to say 1995). The legislation is retrospective.

Response: Accepted. The effective date has been changed. The amendment is deemed to come into operation on 22 October 2014 and applies in respect of reinsurance claims received on or after that date.

4.3. Refinement of REIT provisions

(Main reference: Section 25BB)

Comment: Request legislation to extend the REITs tax regime to unlisted property companies.

Response: Noted. Legislation will be developed next year (2015) in terms of which some unlisted REITS will be considered.

4.4. Taxation of financial assets and liabilities of covered persons

(Main reference: Section 24JB, clause 40)

Comment: It is not clear on what basis the interest in a partnership can be excluded from financial assets in section 24JB(2). Case law makes it clear that one is in fact disposing of an interest in underlying assets and not an interest in a partnership.

Response: Not accepted. For IFRS purposes an interest in a partnership is treated as a financial asset.

Comment: The amendment that excludes 'an interest in a partnership' from subsection (2) will only come into operation on the date of promulgation of the TLAA. However, the draft EM states that all amendments are deemed to come into operation on the same date.

Response: Accepted. The wording of the Bill has been changed to provide that all the amendments to section 24JB are deemed to have come into operation on 1 January 2014 and apply in respect of years of assessment ending on or after that date.

Comment: The long-term insurer definition should be extended to refer to a controlling company as defined in the Long-term Insurance Act Amendment Bill.

Response: Not accepted. Tax legislation cannot be amended to refer to a definition in a Bill.

5. INCOME TAX: BUSINESS (INCENTIVES)

5.1. Refinement of allowances in respect of lines or cables used for the transmission of electronic communications

(Main reference: section 12D)

Comment: The revision of the write-off period (from 20 to 15 years) and eligibility of used assets for the purposes of section 12D is welcomed.

Response: Noted.

Comment: The scrapping allowance in section 11(o) only applies to assets with a useful life of up to 10 years and does not apply to section 12D assets that have a longer useful life (e.g. lines or cables used for the transmission of electronic communications or electricity, and pipelines used for the transportation of natural oil). If a section 12D asset is disposed of for an amount less than the tax value of the asset, no deduction is allowed for this loss. Scrapping of telephonic lines / cables by network provider companies is not unusual, based on fact that they have become obsolete due to technological advancements. Given the issues (improvements in technology, move from copper to fibre, damage due to maintenance) affecting the useful lives of such cables, the scrapping allowance should be allowed on disposal of telecommunication cables (same concerns for electricity cables).

Response: Not accepted. A loss in these circumstances is treated as a capital loss to be set off against capital gains. From a tax policy point of view the Income Tax Act treats losses on the disposal of assets with a longer write-off period as capital in nature and not as an expense to be deducted from income.

Comment: Section 11(f) provides for deductions of lease premiums in respect of submarine cables where the indefeasible right of use (IRU) is for a period of at least 20 years and was meant to align with owned cables in section 12D. To maintain alignment, the required contractual period should be reduced to 15 years.

Response: Not accepted. When introduced in 2009, the write-off period of 20 years was based on IRUs typically having a 20 year term, not to align the write-off period with telephonic lines / cables. As such, a write-off is only available in instances where the term of the IRU is at least 20 years.

Comment: The effective date of 1 April 2015 creates uncertainty for application in respect of existing assets.

Response: Accepted. Amendments will only apply to new or second hand cables acquired on or after 1 April 2015.

5.2. Revision of the research and development incentive

(Main reference: Section 11D)

Comment: Effective date in the draft regulations for clinical trials and generic medicines should be aligned to the effective date in the TLAB.

Response: Noted.

Comments: Introduction of the term 'innovative' which is not defined in the Act as a requirement for functional design is inherently subjective. The term 'innovative' should be

defined, or alternatively removed from the R&D definition in subsection 11D(1) due to its subjective nature of interpretation (i.e. innovative to the company, innovative to South Africa, or innovative to the world). In addition, caution should be exercised when using very technical intellectual property terminology that may result in ambiguity, confusion or the incorrect application of the provisions of section 11D.

Response: Noted. A definition for 'innovative' will be developed for incorporation in the Department of Science and Technology Guidelines.

Comments: Whilst seven of the nine clinical trial R&D tax exclusions listed in the draft Regulation seem quite reasonable (e.g. cost-effectiveness research, a product familiarisation program, etc.), there are two exclusions that seem inappropriate, and these are 'research in respect of the clinical interaction between a pharmaceutical product and other medicine' and 'epidemiological research'. Furthermore clarity is required on the interpretation of para 3(d) of the Regulation '...solely for the purpose of compliance with regulatory requirements...' exclusion.

Response: Partially accepted. Agree that research in respect of the clinical interaction between a pharmaceutical product and other medicine should also benefit from the incentive. Clarity will be provided through the guidelines and SARS interpretation note regarding activities solely for the purpose of compliance with regulatory requirements. Epidemiological research will be included within the ambit of the incentive; however, 'pure' data collecting activities in respect of conducting epidemiological research will not qualify. The guidelines will expand on what does / does not qualify in respect of epidemiological research.

Comment: Given that there is currently only one provision, rather than two, for the R&D deduction, the exception to preventing double deductions for R&D contained within section 23B(4) has become redundant. Subsection 23B(4) should be deleted. In addition, the reference to section 11D in section 23H should be removed.

Response: Accepted. The provisions will be amended in line with the current section 11D.

Comment: Previously, the Minister of Science and Technology or a person appointed by the Minister of Science and Technology had to approve any research and development with regard to a number of factors, including "such other criteria as the Minister of Science and Technology in consultation with the Minister of Finance may prescribe by regulation". The provision has been changed such that the Minister of Finance may prescribe 'other criteria' in consultation with Minister of Science and Technology. As submissions are made to the Minister of Science and Technology to determine the eligibility of a project, it would appear to be more practical for the Minister of Science and Technology to initiate these discussions with the Minister of Finance should they be required, as was previously the case.

Response: Not accepted. The responsibility to determine the eligibility criteria still lies with the Department of Science and Technology. The Department of Science and Technology will initiate discussions with the Minister of Finance should 'other criteria' be required in order to determine whether a project would be an eligible R&D project for the purposes of section 11D of the Act. Changes to the Income Tax Act are done by way of a money bill that (according to the Constitution) can only be introduced by the Minister of Finance. Only the Minister of Finance may issue regulations in terms of the enabling tax legislation.

Comment: The Draft Taxation Laws Amendment Bill (DTLAB) proposes that, with effect from 1 January 2014, the tax incentive for R&D expenditure in section 11D be restricted to companies only. Thus individuals and trusts would be excluded from benefitting from the incentive.

Response: Noted. The risks of tax leakage and the potential for tax avoidance from extending the incentive to individuals and trusts outweighs the benefits of allowing individuals / trusts to apply. It is recognised that individuals and trusts legitimately engage in R&D activities. However, the intention is not to create a perverse incentive not to incorporate or to 'unincorporate'. The option to incorporate should be considered.

Comment: Positive response to amending to Section 11D(4)(c)(ii) to cater for 150 per cent as opposed to 50 per cent. In addition, concern was raised regarding the position of R&D "funded" from non-residents. In the original versions of the legislation, the ITA set out the position in which a South African company conducted R&D in the Republic, and for which funding or recharged payments were received by a non-resident. This is a common scenario in South Africa – notably (but not exclusively) in the clinical research trial industry. Concern that neither the legislation nor the guideline deal adequately with this issue. There is confusion as to whether this scenario will be regarded as "funded R&D" and, accordingly, not qualify for the incentive. This was never the intention of the Legislature or of National Treasury when preparing the legislation.

Response: Noted. Over the past few years, it has become evident that base erosion and profit shifting (BEPS) is often closely intertwined with the creation of IP and R&D tax incentives. The use of the most generous R&D incentive in a particular country combined with the housing of the IP generated in a country using a Patent Box regime; royalty outflows / licensing fees leaving the country where the R&D activities are conducted; and cost-sharing arrangements have all become common features of multinational companies engaged in R&D activities. The more highly mobile the R&D activity, the easier it is to relocate it to a country with the most generous R&D regime at the time.

Government is tasked with ensuring that the best outcome is achieved for society as a whole. To do so requires balancing multiple objectives without impinging too much on equity and efficiency / neutrality in investment decisions. The tax incentive was introduced in recognition that there is a need to grow R&D activities in South Africa as a percentage of GDP, as well as encourage knowledge transfer and skills development. As such, the focus is attracting R&D activities to South Africa and not requiring the IP developed to be held locally. Having said that, BEPS is a real issue facing all governments and it is important to maintain a suitable balance between attracting investment and protecting the tax base. If corporate tax revenues decrease, there could be equity implications if more revenue needs to be generated from individuals / consumers. Because the ramifications of amending this provision could be large, more work will be done and if any amendment is decided upon it will be for consideration in the 2015 TLAB.

Comment: Exclusion of internal business processes or R&D for use by / sale to connected persons prevents companies conducting software development activities from claiming deductions under section 11D where they have received contracts to conduct research and development from connected persons outside of South Africa whom are not subject to tax in South Africa.

Response: Noted. Please refer to the response above.

Comment: Extend the allowance for capital assets to assets that were not solely created for the purpose of the process of research and development as there may be assets that would facilitate R&D, but have previously been used for a commercial purpose. The current legislation provides no incentive to taxpayers to remove assets from their otherwise commercial usage and utilise them for R&D.

Response: Not accepted. Section 11D incentivises the construction of prototypes and the construction and operation of a pilot plant, as long as the principal purpose is to obtain experience and to compile data to be used in the R&D process. As soon as this experimental phase is over, these assets switch to operating as normal commercial production units. Capital assets referred to in the comment can be written off over three years (50:30:20) under section 12C.

Comment: Current provision allows the Minister of S&T to designate certain categories of research and development to be deemed as carrying on of R&D for the purposes of section 11D, even where there is no control over the methodology of research. However, the proposed amendment seeks to limit this provision by only referring to clinical trials. It is suggested that the current provision be retained to allow the Minister of S&T to deem research and development undertaken in industries other than pharmaceuticals as R&D when there is no control of methodology, e.g. agriculture, and a new provision be inserted for clinical trials.

Response: Noted. The original policy intent will be maintained. The specific activities will be referred to by way of a Notice in the Gazette.

5.3. Tax treatment of allowances in respect of public private partnerships

(Main reference: Sections 12NA, 10(zl) and 12N)

Comment: Not clear why PPPs with municipalities are excluded. PPPs conducted with all spheres of government should be included in the ambit of 12NA.

Response: Accepted. PPPs conducted with all spheres of government will be included in the ambit of section 12NA.

Comment: Section 12NA should be made retrospective to the extent that the PPP had already factored such deductions into the financial model. If not, this will either render some existing PPPs unaffordable, or put certain concessionaires at financial risk (depending on wording in contracts).

Response: Partially accepted. Making this section retrospective will be impractical as it will require reopening assessments. As such, section 12NA will be deemed to have taken effect from 1 January 2013.

Comment: The need for a new section in respect of leased improvements to a lessor obligation is unclear. Main distinction between this and section 11(1)(g) appears to be the existence of a national or provincial government lessor.

Response: Misplaced. Section 11(1)(g) would not be applicable to serviced accommodation projects as it uses the same wording as section 12N (requires right of use / occupation, and land and buildings must be used / occupied for the production of income / income is derived therefrom). Hence, a new section needed to distinguish between right of use / occupation and access.

Comment: There is an anomaly with section 12C that needs to be remedied; otherwise it will continue to remain a debatable area resulting in disputes. Unlike machinery, plant constructed on a lessor's property is no longer owned by the lessee if constructed on a lessor's land.

Response: Accepted. Not all plant constructed on a lessor's property becomes the property of the lessor. However, the problem arises when the plant is immovable and is not seen as an integral part of a building. If, using case law, SARS determines that the plant is integrally linked to the building, the capital expenditure incurred to construct the plant will be treated as a building for the purposes of a capital allowance. However, if the plant is seen not classified as a building, but is attached to the land and becomes the property of the landlord, there is no write-off available under section 12N. Plant that is immovable will henceforth be included in the ambit of section 12N from 1 January 2013 (see comment on effective date of section 12NA).

5.4. Refinement of allowances in respect of industrial policy project incentive

(Main reference: Section 12I)

Comment: Proposed enhancements relating to industrial policy projects are welcomed.

Response: Noted.

Comment: The need for deeming ownership for purposes of sections 13 and 13quat in section 12I is not entirely clear given the existence of section 12N (unless to cover leased property owned by lessors outside the list of lessors in 12N). If so, it is not sufficient as the additional allowance will only be available in respect of section 12I, but not in respect of basic (depreciation) allowances in sections 13 and 13quat.

Response: Partially accepted. The policy rationale underlying section 12N and 12I should be seen as distinct from one another. Section 12N deems a private party to be owner of improvements on government's land, recognising that government requires assistance from the private sector for certain developments / infrastructure projects. Section 12I is an additional investment allowance (in addition to normal depreciation of the manufacturing assets if owned by the investor) seeking to encourage investment in manufacturing assets / capacity. As such, the eligibility for this allowance will be available to a lessee for immovable improvements on a lessor's land, even if the lessor is a private party. It was the intention not to provide a depreciation allowance for such improvements by a lessee. Doing so would run contrary to existing principles in the Income Tax Act. The deeming provision in respect of sections 13 and 13quat has been withdrawn. Instead, the policy intent in the Explanatory Memorandum is captured to allow immovable improvements to the land to be deemed to be owned by the investor solely for the purposes of section 12I (i.e. no depreciation allowance in respect of such improvement will be available).

Comment: Whereas the draft EM refers to immovable manufacturing assets, draft law refers to 'buildings'. If the intention is building, lessee created plant under 12C is a major omission. Cost of plant is substantial and the real value addition for industrial projects.

Response: Accepted. The intention was to refer to immovable improvements.

Comment: An IDZ is included in the definition of a SEZ; however 12I has not been amended to include SEZs and most companies may opt to locate in current IDZs as a result.

Response: Accepted. Section 12I will be amended accordingly.

5.5. Revision of allowance for environmental conservation in respect of nature reserves or national parks

(Main reference: Sections 37C and 37D, Clause 49(1))

Comment: It is no longer a requirement that the declaration of the property as a national park or nature reserve be endorsed for a period of 99 years.

Response: Accepted. The omission of the “at least 99 years contract” will be added to section 37D(1)(a) so it is clear that nature reserves or national parks have a duration of at least 99 years.

Comment: Timing of value determination – for the purposes of the proposed section 37D(3)(b) it is not clear at which date the relative market values should be determined. In our view the determination of market value of the declared land and the market value of the declared land had it not been subject to the right of use, should be made in the year in which the land becomes “declared land”.

Response: Noted. The effective date referred to in section 37D(2) is only highlighting what would happen if someone donated part of their land but the principles that apply to total land donations including the effective date should also be applied in this instance.

Comment: Amend the description of the ‘declared land’ in section 37D to be more accurate, and more prescriptive. The proposed wording has been changed somewhat from 37C(5)(b) in order to be more accurate in referring to the various mechanisms provided by the Protected Areas Act and the contract.

Response: Accepted.

5.6. Refinement of the employment tax incentive

(Main reference: Sections 7(5), 9(4) and 10(3) of the Employment Tax Incentive Act)

Comment: The 160 hour provision will create significant additional administrative burden for employers. Permanent workers who work less than 160 hours will need to be grossed up and employers will now be required to capture the hours worked for temporary staff. Propose that the 160 hour provision is removed and temporary employees are defined and the value of the incentive for them be based on a flat percentage of actual remuneration.

Response: Not accepted. It is inequitable to allow employers who have permanent employees who work fewer hours compared to another employer to be able to claim the same value of the incentive. The 160 hour provision creates more certainty for the calculation of the value of the incentive, certainty that employers were requesting. Employers should be able to ascertain the hours worked by their temporary staff since they would need this information to check that they are abiding by the relevant sectoral determination or bargaining council agreement.

Comment: It is unfair to lose the value of the incentive due to non-compliance if the reason for the non-compliance is outside of the taxpayer's control. Recommend that the Commissioner be given the power to reinstate the value of the incentive in these circumstances.

Response: Not accepted.

5.7. Public Benefit Organisations

(Main reference: Section 18A)

Comment: The proposal to lower the distribution requirement for PBO funding entities from 75 to 50 per cent was welcomed, but it was noted that the condition requiring 100 per cent of investment returns on undistributed funds to be distributed within 5 years is too restrictive. It was also suggested that the 5 year distribution rule be clarified and simplified.

Response: Accepted. The aim of the legislation is to make it easier for funding entities to build up an endowment and make themselves more financially viable. It is however important to have measures in place which will ensure that the money is utilised for what it is intended for. The 5 year distribution rule will be relaxed to ensure easier compliance.

Comment: The proposed prescribed investment regime for the undistributed funds is too restrictive and will limit PBOs in terms of for instance taking advantage of BEE opportunities. It was also noted that such a regime was in force in the past but was abolished in 2008 due to the reasons noted

Response: Accepted. Funding PBOs will not be subjected to a prescribed investment regime for undistributed funds.

5.8. Refinement of the special economic zone tax incentive

(Main references: Sections 12R and 12S)

Comment: Proposed enhancements relating to incentives for SEZs are welcomed. It is envisaged that these tax dispensations will promote domestic investment activity with a consequential impact on job creation and growth in the broader economy.

Response: Noted.

Comment: The following wording implies that the company will be limited to one specific SEZ in respect of qualifying for the tax incentive: '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 special economic zone'. Even if a company has all its operations in SEZs, it will not be eligible for the incentive because it does not derive its income from one SEZ only.

Response: Accepted. If a company operates in one or more SEZs approved by the Minister of Finance, the 90 per cent requirement will apply to more than one approved SEZ

Comment: Clarity lacking as to which version of SIC codes to use. Section 12R(4) refers to version 5, whereas most recent SIC codes are version 7.

Response: Accepted. The SIC codes will refer to version 7 and the legislation will be amended accordingly.

Comment: Agree with a time limit as implied by the sunset clause. However, it will not allow section 12R to fulfil its purpose of providing an incentive as many taxpayers that would seek to use this incentive will not receive the appropriate benefit. Companies' operations that are

newly located / moved to SEZs will not be in a tax paying position for some time, given the tax allowances claimed. Propose a provision that provides for the benefits of sections 12R and 12S to cease after a 10 year period following the entity achieving its first taxpaying position.

Response: Noted. The benefits of sections 12R and 12S will be allowed for a period of 10 years after the commencement of the carrying on of business in a special economic zone.

5.9. Small Business Corporations (SBC)

(Main reference: section 12E)

Comment: The proposal to replace the graduated tax rate structure for SBC's with a Refundable Compliance Rebate (RCR) of R15 000 generated a mixed response. Some do not support it at all while others argue that the proposed credit is too low and that it should increase with taxable income. It was noted that many small businesses would be in a worse tax position under the proposed RCR, and that this will negatively affect their cash flow and ability to grow their businesses. It was also noted that the proposed RCR amount was insufficient to cover the actual compliance costs of small businesses.

Response: Accepted. This proposal will be withdrawn for further consultation with stakeholders, including the new Small Business Ministry and the Davis Tax Committee.

5.10. Small Business Funding Entities

(Main references: Sections 1, 10(1)(cQ), 23O, 30C and 64F)

Comment: The proposal to create a new section 30C in the ITA to provide tax relief to entities funding small businesses was welcomed but respondents suggested that the funding entities should also be given relief for passive income and capital gains tax (CGT).

Response: Accepted.

Comment: It was noted that the wording "accessible to all" is confusing and too broad.

Response: Accepted. The word "all" will be deleted.

Comment: The 25 per cent rule states that amounts received or accrued in respect of assets held during any year of assessment must be disbursed annually. There is a concern that this could be interpreted as to mean that 25 per cent of current and prior accumulated receipts and accruals must be disbursed annually and that it will deplete the entity's monetary capital.

Response: Partially accepted. The wording will be clarified to state that only 25 per cent of accruals and receipts from that particular year need to be distributed.

Comment: Trustees should be permitted to hold shares of either listed or unlisted companies.

Response: Accepted. The limitation of unlisted shares has been withdrawn as section 30C(1)(d)(iii) already provides protection against potential abuse.

5.11. Venture Capital Companies

(Main reference: Section 12J(6A))

Comment: The proposed amendments to remove the recoupment provision for VCC investors, provided the investment is held for a minimum of 5 years and to increase the asset limits for qualifying companies were welcomed.

Response: Noted.

Comment: Respondents expressed disappointment that not all the alternatives raised in Budget 2014 were included in the TLAB. The requirement for incorporation and capital gains tax liabilities were retained, while the VCC tax benefit remains non-transferable.

Response: Not accepted. Due to administrative, avoidance and tax deferral concerns the transferability of the VCC tax benefit, CGT relief and allowing other business forms (such as partnerships) will not be introduced.

Comment: It was requested that the effective date (1 March 2015) in the draft Bill be moved to the date of promulgation of the TLAB.

Response: Accepted. The date will be changed to 1 January 2015.

Comment: It was pointed out that the 80 per cent rule amendment (where the base was changed from expenditure incurred to subscription monies received) may make it more difficult for VCCs to comply.

Response: Accepted. The proposed change to the 80 per cent rule will be withdrawn and expenditure incurred will remain the base for applying the rule. This will allow VCCs some flexibility, i.e. be able to use subscription money for administrative costs involved.

Comment: It was noted that including capital gains in the calculations for both the 20 per cent and 80 per cent rules could lead to unintended consequences, and would make it difficult for VCCs to comply.

Response: Accepted. Capital gains will not be included in the calculations.

6. INCOME TAX: INTERNATIONAL

6.1. Simplified Foreign Business Establishment Exemption For Controlled Foreign Companies

(Main reference: Section 9D(2A))

Comment: Provide a *de minimis* rule for small amounts of passive income such as interest in a bank account.

Response: Not accepted. The working capital exemption is already available for small amounts of passive income. An additional *de minimis* rule is not necessary.

6.2. Transfer Pricing Secondary Adjustment

(Main reference: section 31(3))

Comment: The proposed amendment does not expressly state when the deemed dividend *in specie* will be deemed to have been declared.

Response: Accepted. In the case of the company the deemed dividend *in specie* will be deemed to be declared and paid by the resident at the end of the period of six months after the end of the year of assessment in which that adjustment is made.

Comment: It is not clear how the amendment deals with transitional provisions and the interplay with the old deemed loans.

Response: Accepted. Deemed loans that are still in existence on the date of coming into operation on or after 1 January 2015,

- (i) in the case of the company that pre-existing loan will be deemed to be a dividend *in specie* declared and paid; and
- (ii) in the case of any other person (e.g. a natural person or trust), the pre-existing deemed loan will be deemed to be a donation.

Comment: the treatment of the amount as a dividend *in specie* declared by the resident does not seem to consider that the resident may be a natural person or trust

Response: Accepted. In the case of a natural person or trust, the secondary adjustment will be deemed to be a donation made by the resident.

Comment: The effective date of the amendments should be determined with reference to a year of assessment rather than 1 January 2015, as taxable income, on which the adjustment is based, is determined in relation to a year of assessment.

Response: Accepted. In the case of the company the deemed dividend *in specie* will be deemed to be declared and paid by the resident at the end of the period of six months after the end of the year of assessment in which that adjustment is made. In the case of any other person the deemed donation will be deemed to be made by the resident at the end of the period of six months after the end of the year of assessment in which that adjustment is made.

6.3. Foreign Dividend Exemption

(Main reference: section 10B(2)(c))

Comment: The proposed deletion of section 10B(2)(c) may result in an anomaly, where the carve out rules apply in terms of section 10B(4), despite the fact that the resident had a controlled foreign company imputation in terms of section 9D.

Response: Accepted. The proposed deletion of section 10B(2)(c) will be withdrawn.

6.4. Section 24I(10A)

(Main reference: section 24I(10A))

Comment: The provision appears to have a wider application than was intended. The use of “or” instead of “and” at the end of paragraph (a)(ii)(aa) has the result that the deferral could apply where the full amount of the exchange item is reflected as current.

Response: Accepted. The preposition “or” at the end of paragraph will be replaced with “and”.

Comment: The current wording seems only to apply to the portion of the loan payable within a period longer than 12 months. However, the intention of the amendment was for section 24I(10A)(ii) to apply to the entire loan, provided a portion of the loan is classified as a long term loan

Response: Accepted. The words “to the extent that” at the beginning of subparagraph (ii) of section 24I(10A)(a) will be deleted.

6.5. Currency of reacquisition of assets of person ceasing to be resident

(Main reference: section 9H(7))

Comment: Relief should be provided for underestimation penalties should taxpayers have underestimated their taxable income (used incorrect rates when calculating the taxpayer's second provisional tax payment in respect of the 2014 year of assessment) because of the use of the rate other than used to acquire the asset.

Response: Noted. The amendment is to become effective on 1 January 2015.

6.6. Foreign dividends of CFCs owned by individuals

(Main reference: section 9D(2A)(f))

Comment: The effect of the amendment will be that the inclusion rate for a company will apply to the capital gain in the calculation of the net income of the CFC in terms of section 9D(2A) for inclusion in the hands of an individual or special trust.

Response: Accepted. The proposed deletion of section 9D(2A)(f) will be withdrawn.

6.7. Withholding tax on royalties

(Main reference: section 49F)

Comment: The proposed amendment requires that the person that withholds withholding tax on royalties must submit a return to the Commissioner. The effective date for the submission of the royalty return is 1 July 2013. This will create huge administrative burden as the taxpayer will be required to submit royalty returns retrospectively.

Response: Accepted. 1 January 2015 will be the new effective date for the submission of royalty returns.

7. VALUE-ADDED TAX

7.1. Zero rating of goods for Agricultural, Pastoral or other farming purposes

(Main references: section (11)(1)(g), Schedule 1 and Schedule 2, Part A)

Comment: The removal of zero-rating would not eliminate VAT fraud, but will have even more severe cash flow implications and will imply incurring financing at unaffordable interest rates, which would most likely have devastating consequences for the agricultural sector. Stronger enforcement against farmers abusing the concession should be implemented to fight non-compliance. Zero rating should not be repealed or, at least, delayed until such time as further consideration can be given to the broader implications of this proposed amendment.

Response: Partially accepted. The repeal of the provision for zero-rating of certain agricultural inputs will be postponed for at least a year. This will allow SARS and the National Treasury together with the Department of Agriculture to do further analysis on the impact of these amendments, to undertake additional consultations and will also provide farmers sufficient time to prepare for the repeal.

Following the presentation of the Draft Response Document to the SCOF, the SCOF suggested that it be made clear to taxpayers in the agricultural sector that the current zero rating will remain and that the earliest that a change could be made would be after a 12 month period. The SCOF requested that consultations with industry around the proposed change and its impact continue and that their representations are again discussed with the SCOF next year. If necessary, further legislative amendments will be considered at that stage.

7.2. Second hand goods – Precious Metal

(Main reference: Sections 1)

Comments: The SA Diamond & Precious Metals Regulator and many jewellery council members are in favour of the removal of notional input value added tax deductions with respect to all precious metals associated with second hand jewellery (i.e. Gold, Palladium, Platinum, Ruthenium, and Rhodium).

Response: Noted. However the current amendment denies the VAT input deduction only in the case of second-hand gold (jewellery). The other types of jewellery will be considered at a later stage, after further consultation.

Comment: The removal of the notional input tax credit will have a dramatic effect on minted bar sales as non-vendors will not purchase bars for investment when it includes VAT and they cannot recover the cost. For investment purposes, they will never recover their investment unless the gold price increases by 18% (being a margin and the VAT portion). It is counter-productive to penalise an entire industry to prevent illegal activities being carried on by only a potentially small portion of that industry. The correct approach would be to adequately police and prosecute individuals linked to these illegal activities, rather than having an entire industry suffer as a result of the State's inability to do so.

Response: Not accepted. The removal of the notional input tax credit will go a long way in addressing the illegal activities in the industry as there is currently no certain way of distinguishing between illegally-mined gold that has been alloyed and scrap jewellery that has been melted down and refined. In the past few years of deregulation minted bars

have been very problematic, making the controls on possession of unwrought gold very challenging for the SA Diamond & Precious Metals Regulator.

7.3. Bargaining Councils

(Main reference: section 12(l))

Comment: If the intention behind the amendment was to take the bargaining council off the VAT register, this amendment alone will not achieve this as bargaining councils may also receive income from corporates for services rendered.

Response: Noted. The policy intention is to extend the current exemption to include the supply of administration services to members.

Comment: The proposed amendment represents a departure from other exemptions; it will exempt entities (i.e. bargaining councils) rather than merely extending the current exemption to include the supply of administration services.

Response: Noted.

7.4. VAT Treatment of Legal Tender or Money

(Main references: section 1 and Schedule 1)

Comment: The net VAT paid by the South African Reserve Bank (SARB) and its subsidiaries would not be limited to the subsidiaries' gross profits but would be the input VAT subsidiaries pay on their production costs. SARB prefers and would submit that this should be listed as a zero rate under section 11.

Response: Noted. However, the proposed amendment will be withdrawn and the *status quo* remains. Further consultation with the South African Reserve Bank is envisaged.

7.5. Contract Price

(Main reference: section 67)

Comment: At the stage that a contract is signed by a non-VAT vendor and this contract results in a person being required to be registered for VAT, no VAT was allowed to be added to the contract price as the person could only apply for registration after the contract had been signed. Practically it is therefore difficult to comply with this section. Section 67(1) already includes a statement that the right of recovery of the VAT is not available if it is agreed to the contrary by both parties in any agreement in writing. The proposed prohibition therefore seems to merely constitute an additional penalty measure for non-compliance by a vendor. Where penalties for non-compliance and protection for the recipient already exists, the relief mechanism should not be amended to further penalize vendors who failed to register and levy VAT. An interpretation note is required on how VAT should be treated when there is a liability to register and charge VAT but SARS does not allow a VAT registration before a legal contract has been concluded.

Response: Not accepted.

7.6. Documentation

(Main reference: section 16(2))

Comment: This amendment builds on the previous amendment (effective 1 April 2014) of section 16(3)(a)(iii). With the requirement to defer the claim to the tax period in which payment was made to SARS Customs, the input tax claim is now delayed by a further one to two months causing negative cash flow implications for the importer. The accounting treatment of these payments also creates a problem as generally when the clearing agent's invoice is received it is processed in that particular month, however, the VAT can now at the earliest only be claimed in the following month. This also has implications when trying to complete the IT14SD income tax declaration. The administrative burden of all of these requirements has definitely increased. Consideration should be given to revert back to the position prior to the April 2014 amendment by allowing an input tax deduction in the tax period in which the goods are imported, provided the VAT return is submitted after the Customs VAT was paid to SARS

Response: Accepted. An input tax deduction is to be allowed in the tax period during which the goods are released by Customs, provided that the VAT is paid to SARS before the VAT return (claim of the input tax) is filed.

7.7. Tax Invoice

(Main reference: section 54(1))

Comment: Welcome the change, however, recommend that the effective date of this change be the date of promulgation of the Bill

Response: Not accepted. Agents will be allowed the opportunity to change their system of invoicing where necessary. Therefore, the effective date of 1 April 2015 will provide sufficient time to effect changes.

Draft Tax Administration Laws Amendment Bill

8. Income Tax Act, 1962 (ITA)

8.1. Clause 1: Section 3 ITA – Deletion of repealed provision

Comment: Deleting the reference to paragraph 20(2) of the Fourth Schedule in section 3 of the ITA implies that SARS may only review a penalty in light of the "exceptional circumstances" in Chapter 15 of the Tax Administration Act, 2011 (TAA). This is unreasonable given the multiplicity of legitimate circumstances that may in practice give rise to an underestimation. It is proposed that the decision to remit an underestimation penalty in terms of paragraph 20(2) of the Fourth Schedule should continue to be subject to objection and appeal in terms of section 3.

Response: Misplaced. Decisions made under certain provisions of the ITA are subject to objection and appeal if included under section 3(4) of that Act. The proposed amendment to section 3(4) of the ITA deletes references to repealed provisions, which are now regulated under the TAA, and adds new sections containing decisions subject to objection and appeal.

The specific amendment commented on is part of making the generic provisions of the TAA, specifically Chapter 15, applicable to administrative non-compliance penalties imposed under any of the tax Acts. Section 220 of the TAA provides that a decision by SARS not to remit a penalty in whole or in part is subject to objection and appeal under Chapter 9 of the TAA. Thus, a decision not to remit a penalty under paragraph 20(2) of the Fourth Schedule is subject to objection and appeal under section 220 of the TAA.

8.2. Clause 3: Section 64K ITA – Return by recipient of exempt dividends

Comment: Section 64K(1)(d) contains a duplication as both items (i) and (ii) contain a requirement for the person paying the dividend to submit a return, although the requirements differ to some extent. It is proposed that the provision should simply impose a reporting obligation on a person paying a dividend or a person that receives a dividend that is exempt in terms of section 64F or section 64FA.

Response: Accepted. The proposed wording has been redrafted to impose a reporting obligation on a person paying a dividend or a person that receives a dividend that is exempt in terms of section 64F or section 64FA.

8.3. Clause 4: Section 64LA ITA – Refund of tax on dividends *in specie*

Comment: A company that distributes assets *in specie* and does not receive a declaration and a written undertaking from beneficial owners of the dividends in the allotted time must withhold and pay dividends tax on the amount of the distribution. If the declaration and undertaking are received after the tax payment, the company can claim a refund from SARS. The wording should reflect that in cases where only a portion of a dividend is not subject to tax, only a portion of the tax paid is refundable.

Response: Accepted. The proposed wording has been redrafted to provide for cases where only a portion of a dividend is not subject to tax, only a portion of the tax paid is refundable.

Comment: The new provision deals with refunds to companies and should follow on section 64L, i.e. it should be numbered 64LA instead of 64MA.

Response: Accepted.

8.4. Clause 7: Amendment of paragraph 18 of Fourth Schedule to ITA – Merging of exemption for persons over the age of 65 into the main exemption

Comment: The removal of the exemption from provisional tax for persons over the age of 65 will cause hardship for these taxpayers who as a result of illness and restricted mobility find it hard to cope with the requirements of the provisional tax system.

Response: Not accepted. The current provision provides that the taxable income of the taxpayer who is 65 and above should not exceed R120 000. The proposed amendment provides that it should not exceed the applicable tax threshold. The tax threshold with effect from 1 March 2014 is R110 200 for a person who is 65 and above and R123 350 for a person who is 75 and above. The threshold for taxable income derived from interest, foreign dividends and fixed property rentals is also raised from R20 000 (previously only applicable to under 65s) to R30 000 for all natural persons. The effective date for this amendment is 1 March 2015.

8.5. Clause 8: Paragraph 19 of Fourth Schedule to ITA – Determination of basic amount for provisional tax

Comment: The proviso to subparagraph (1)(e)(ii) provides for instances where SARS has issued a return for provisional tax. This allows the taxpayer to elect to use the taxable income for the latest preceding year of assessment (basic amount) indicated on the return to calculate the basic amount for provisional tax. This option should be retained as the basic amount is used as a threshold for estimates and penalties and it provides certainty.

Response: Not accepted. The proviso to paragraph 19(1)(e)(ii) is in conflict with the 14 day rule for the use of the most recent assessment for determining a basic amount. Taxpayers accessing the provisional tax function on e-Filing long before the final date of payment of provisional tax should not be permitted to use the basic amount generated by the system at that stage and then argue that the 14 day rule cannot be applied. In the context of e-Filing a single 14 day rule is appropriate.

8.6. Clause 9: Paragraph 20 of Fourth Schedule to ITA – Exclusion of rebates from amounts used to determine penalty amounts

Comment: The wording of the proposed amendment should refer to rebates deductible from normal tax payable to distinguish the rebates from deductions that are used in determining taxable income. At present underestimation penalties are based on the full amount of tax on taxable income (without taking rebates into account). To set the situation right, the effective date of the amendment should be moved back to 1 October 2012 (the effective date of the TAA) and not be 1 March 2015.

Response: Partially accepted. A rebate is not a tax deduction against taxable income but a deduction in determining normal tax payable. The proposed effective date has been changed to years of assessment commencing on or after 1 March 2014, since this is not a TAA issue and to ensure that no reopening of assessments will be required.

8.7. Clause 10: Paragraph 20A of Fourth Schedule to ITA – Aligning penalty provision with TAA

Comment: SARS should be able to remit a paragraph 20 penalty (levied for the failure to submit a provisional return) on the basis that there was no intent to evade or postpone the payment of provisional tax. This should be included in paragraph 20(2) and will be subject to objection and appeal under Chapter 15 of the TAA.

Response: Accepted. The wording of paragraph 20A(2) will be added to paragraph 20 as subparagraph (2C).

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

9.1. Clause 15: Section 47 C&E Act – Amended provision for tariff determinations for alcoholic beverages

Comment: The proposed amendment would instantly void present excise tariff determinations and halt current production of alcoholic beverages until re-determinations have been obtained. There is an unacceptable risk that such tariff re-determinations may promptly render some existing alcoholic beverages unprofitable, leading to the discontinuation of these products after substantial investment.

Response: Misplaced. In line with the announcement in the 2014 Budget Review, present tariff determinations for existing beverages will be upheld until their ultimate re-determination during the gradual phase-in of the amendment. In cases where such a re-determination gives rise to a tariff re-classification with a different excise duty tax implication, the new determination will only be applied going forward. This is provided the present determination was fully complied with and the beverage concerned did not alter in any substantive way after the determination was originally granted.

10. Value-Added Tax Act, 1991 (VAT Act)

10.1. Clause 26: Section 27 VAT Act – Removal of Category F tax periods

Comment: The effective date for the amendment is the date of promulgation of the proposed Act but taxpayers who have to move to a different category may need more time to prepare. This should be postponed to a later date in 2015.

Response: Accepted. The proposed amendment will come into effect on 1 July 2015 and apply in respect of tax periods commencing on or after that date.

10.2. Clause 30: Section 45 VAT Act – Relaxation of interest suspension

Comment: After the proposed amendment SARS would not have to pay interest to a vendor until the vendor has submitted bank account particulars to SARS in writing. Section 45(2) should be repealed in its entirety.

Response: Not accepted. This is existing law, which is not affected by the amendment. SARS should not be liable for interest on a refund that it cannot make because a vendor fails to provide banking details.

10.3. Clause 32: Section 30 SARS Act – Unauthorised use of SARS name

Comment: The prohibition goes too far. Persons should not be prohibited from referring to SARS. The prohibition should be limited to the use of the logo or the designs of SARS.

Response: Partially accepted. The proposed wording has been redrafted to restrict the prohibition to the cases of concern.

11. Tax Administration Act, 2011

11.1. Clause 34: Section 1 TAA – Definitions of “international tax agreement”, “relevant material” and “return”

Comment: The proposed amendment to the definition of an international tax agreement seeks to provide SARS with the power to enter into international tax agreements with other revenue authorities, and thereby bypass the provisions of section 108 of the ITA and section 231 of the Constitution of the Republic of South Africa, 1996, which clearly provides that the legislative authority rests with Parliament and not with the administrator. The amendment should be withdrawn.

Response: Partially accepted. An agreement between competent authorities flows from the main agreement, for example under section 108 of the ITA. To clarify this and to remove a circular reference the following revised wording is proposed:

“ ‘international tax agreement’ means an agreement entered into with the government of another country—

- (a) in accordance with a tax Act; or
- (b) any other agreement entered into between the competent authority of the Republic and the competent authority of another country relating to the automatic exchange of information under an agreement referred to in paragraph (a);”.

Comment: The proposed amendment to the definition of relevant material gives SARS the power to unilaterally determine what is ‘relevant’. This overrides the taxpayer’s ability to question the relevance of information requested by SARS and may lead to an abuse of SARS’s powers. Relevance should be determined with reference to the objective facts and circumstances of the matter and must be both rational and reasonable. The taxpayers should always have the right to challenge a request for material by SARS on the grounds of relevance, provided that such challenges are reasonable.

It is proposed that SARS should provide reasons as to why the relevant material requested is considered relevant and in relation to which SARS responsibility listed in section 3 of the TAA.

Response: Not accepted. SARS’ information gathering powers were extended in the TAA to prevent protracted disputes around entitlement to information and the consequent waste of resources. Concepts such as “relevant material” and “reasonable specificity” were introduced at the time to give guidance on requests for information.

According to the literature, the test of what is foreseeably relevant for domestic tax application has a fairly low threshold, and its application follows the following broad grounds:

- whether at the time of the request there is a reasonable possibility that the material is relevant to the purpose sought;
- whether the required material, once provided, actually proves to be relevant is immaterial;
- an information request may not be declined in cases where a definite determination of relevance of the material to an ongoing audit or investigation can only be made following receipt of the material;
- there need not be a clear and certain connection between the material and the purpose, but a rational possibility that the material will be relevant to the purpose; and
- there will be a tendency to order production of material first and allow a definite determination to occur later.

Taxpayers have the protection that taxpayer information held by SARS is secret and may only be disclosed under narrowly defined circumstances.

One of the comments to this amendment is that SARS should provide reasons as to why the relevant material requested is considered relevant. Besides the sheer impracticality of auditing in this manner, such an approach has also been rejected in international case law, e.g. in the *Australia and New Zealand Banking Group Limited v Konza* ([2012] FCA 196) case where it was held:

"It is... for the recipient to decide for himself, difficult though the task may be, which of the documents answer the description. If his decision is wrong he exposes himself to prosecution and penalty. The existence of this hazard is not a sufficient basis for the conclusion that the section requires the Commissioner to give a notice in such terms as would enable the recipient on reading it and on examining the documents in his custody or control to determine whether they fall within the ambit of the Commissioner's powers. To so hold would be to impose an impossible burden on the Commissioner. In many, if not most, cases he will be unaware of the contents of the documents of which he seeks production."

The fact that SARS determines what relevant material is required for purposes of the administration of a tax Act does not mean that the taxpayer has no remedies during, for example, the audit process. It is submitted that a taxpayer would have the following remedies:

- Request to withdraw or amend decision to request material – section 9 of TAA,
- Pursue the internal administrative complaints resolution process of SARS,
- Approach the Tax Ombud,
- Approach the Public Protector.

Remaining with Australia as an example of the international approach in this regard, the ATO Taxpayer's Charter – Explanatory Booklet – Part 11 Fair use of our access and information gathering powers, the following is stated:

"If you are dissatisfied with the way in which access and information gathering action is being conducted, you should raise your concerns with the tax officer with whom you are dealing. If the issue cannot be resolved, it may be appropriate to contact that officer's manager or the Problem Resolution Service...You also have the right to complain to the Commonwealth Ombudsman..."

Comment: The proposed amendment to the definition of return is too broad in its application. The words “or incorporates relevant material requested by SARS” would then arguably include all letters whereby a taxpayer or a third party provides SARS with information under section 46 and the remaining references to returns throughout the TAA do not align with this extended definition. The effect of this is that any request for “relevant material” by the Commissioner would have to be specified by the Commissioner through a public notice prescribing a return. It is proposed that the amendment be worded more accurately to reflect that a request for information for the purposes of compliance with an international tax agreement will be regarded as a return.

Response: Partially accepted. The proposed amendment will be clarified to link the definition of a return more closely provisions in the TAA and other tax Acts dealing with returns.

11.2. Clause 35: Section 3 TAA – Administration of tax Acts

Comment: Existing section uses the term “international agreement”. However this is not a defined term. The defined term is an “international tax agreement”.

Response: Accepted. The term “international tax agreement” will be used.

Comment: The use of the word “spontaneously” implies that no forethought or consideration has been made prior to the decision to share the information with another revenue authority in terms of an international tax agreement.

Response: Not accepted. The term is commonly understood in South African tax treaties and international law in the context of exchange of information. References to the authorities will be inserted in the memorandum of objects to assist those new to the topic.

11.3. Clause 37: Section 34 TAA – Definition of “tax benefit”

Comment: There is little rationale for extension of the definition of a tax benefit to tax evasion. Any tax evader (who would be the participant and would have the reporting obligation) is not going to report that they are evading tax. As such, the extension of a tax benefit to tax evasion will have little or no effect.

Response: Not accepted. The person reporting may not be the person evading tax.

11.4. Clause 38: Section 35 TAA – Description of reportable arrangements

Comment: Where the Commissioner lists an arrangement as a reportable arrangement in terms of section 35(2), the Commissioner should be required to identify the participant in the notice. This is because it is the participant that has the reporting obligation.

Response: Not accepted. One of the purposes of the reportable arrangement legislation is to discover who the participants in the arrangements are.

Comment: The proposed amendment creates a conflict between subsections 35(1) and (2) arrangements. The wording of both subsections (1) and (2) would commence: “An ‘arrangement’ is a ‘reportable arrangement’ if...”. The subsections should be combined into one subsection specifying when an arrangement is considered reportable.

Response: Not accepted. The distinction between subsections (1) and (2) is evident from the definition of reportable arrangement.

11.5. Clause 39: Section 36 TAA – Description of excluded arrangements

Comment: It is proposed that the Commissioner may list an arrangement as an excluded arrangement if it is not likely to lead to a tax benefit. The effect of this when read with the amended section 35 is that any arrangement that meets the definition of a reportable arrangement in terms of that section can never be listed as an excluded arrangement as a tax benefit is generally a prerequisite for it being a reportable arrangement in the first place. An excluded arrangement under section 36(4) should continue to refer to an undue tax benefit a material or significant tax benefit.

Response: Partially accepted. The reference to a tax benefit will be deleted in full, so that the anomaly identified will not arise.

11.6. Clause 40: Section 37 TAA – Disclosure obligations for reportable arrangements

Comment: Section 37 should be amended to put the primary reporting obligation on the primary promoter (i.e. the designer and seller of the scheme) to avoid confusion on who has to report when there are various promoters or various participants. Only if there is no promoter, the reporting requirement must fall on the participant(s), as previously was the case.

Response: Not accepted. The change is intended to make all participants in the arrangement responsible for reporting, since the promoter's roles may be split. It is also designed to ensure that if a person enters an existing arrangement, a reporting obligation exists. Once reporting has happened, section 37(3) will have the effect that other promoters or participants do not have to report.

Comment: The effective date of 16 July 2014 is problematic since only draft legislation has been issued to date, creating uncertainty with regard to which arrangements are reportable and by whom. It is further unlikely, depending on the date of promulgation of the Bill, that taxpayers will be able to comply with the 45 business day reporting requirement if counted from 16 July 2014. It is proposed that the effective date of the proposed amendments should be the date of promulgation of the Bill.

Response: Accepted.

Comment: It is not clear if it is intended that arrangements that become reportable arrangements subsequent to the arrangement having been entered into should be reported e.g. where a new reportable arrangement is listed by the Commissioner in terms of section 35(2).

Response: Misplaced. This comment relates to the public notice under section 35(2) of the TAA. The intention is that if the Commissioner lists an arrangement, this should only apply prospectively from the happening of a transaction or event as specified in the notice.

11.7. Clause 43: Section 46 TAA – Request for relevant material

Comment: The insertion of the words “in the format” in section 46 is problematic and potentially administratively unfair. As it refers not only to the physical format of the documents (i.e. electronic versus hard copy) it could also be interpreted to mean that SARS can give direction to the taxpayer regarding how the information must be provided and/or converted (e.g. in an excel spreadsheet) despite the manner or format in which the information is actually kept by the taxpayer. It is proposed that the wording be restricted by providing certainty to the taxpayer that SARS can only request data in a particular format if that is the format in which the taxpayer already keeps the data.

Response: Partially accepted. It is proposed that SARS may only request relevant material in a format reasonably accessible to the taxpayer.

11.8. Clause 44: Section 50 TAA – Authorisation for inquiry

Comment: The proposed amendment does not indicate whether the person appearing needs to be a SARS official or not. The institution of an inquiry is a serious matter and the delegation of this power to any SARS official or even another party entirely is concerning. It is proposed that the current wording of the section remains. Alternatively, that the section be amended to the effect that the authorisation/delegation be in writing whereby the authorised senior SARS official confirms that the inquiry is necessary and justified and such authorisation/delegation must be presented to the judicial officer making the order.

Response: Not accepted. The proposed amendment clarifies that the senior SARS official need not personally bring the intended application but must only authorise the bringing of the application by SARS. This scheme of the TAA is reflected in section 6(4) of the TAA which provides that the execution of a task ancillary to a power or duty assigned to a senior SARS official may be done by a SARS official under the control of the senior SARS official.

11.9. Clause 46: Section 164 TAA – Suspension of payment of tax

Comment: The amount of tax involved is not a relevant consideration. If the tax involved is relatively small from the taxpayer’s perspective, SARS could consider this to be a factor weighing against suspension of payment. However, if the tax involved is significant from SARS’s perspective, this may also be a factor weighing against the taxpayer.

Response: Accepted.

Comment: It is proposed that the decision under section 164 should be subject to objection and appeal thereby giving the taxpayer a remedy other than a High Court review if the taxpayer is of the view that the rejection or revocation of the suspension is invalid.

Response: Not accepted. The purpose of the pay now argue later rule is to separate the adjudication of the merits of the matter, which happens before the tax court, and the payment and recovery of the tax debt. If a taxpayer does not wish to approach the High Court the following remedies are available:

- Request SARS to amend or withdraw the non-suspension decision under section 9 of the TAA,
- Pursue the internal administrative complaints resolution process of SARS,

- Approach the Tax Ombud,
- Approach the Public Protector.

At the same time, the taxpayer can pursue an objection and appeal against the disputed assessment to the tax court under Chapter 9 of the TAA.

11.10. Clause 47: Section 184 TAA – Recovery of tax debts from responsible third parties

Comment: The effective date of this amendment is 1 October 2012. The amendment imposes additional burdens and/or impinges on vested rights of the affected persons. As such, it is arguable contrary to the rule of law and unconstitutional. It is proposed that this amendment only takes effect from date of promulgation of the Bill.

Response: Accepted. Although the proposed amendment does no more than regulate the recovery of a liability that already exists under current law, bringing it into effect on the date of promulgation of the Bill is a pragmatic approach.

11.11. Clause 51: Section 195 TAA – Temporary write off of tax debt

Comment: It is unclear what the purpose of the proposed amendment is because a debt that is compromised in terms of the business rescue proceedings by the acceptance of the compromise by the majority of creditors per section 155(7) of the Companies Act, 2008, will result in the debt becoming permanently irrecoverable by SARS as concurrent creditor and SARS cannot thereafter reinstitute the claim after the business rescue proceedings have been concluded. This is also quite evident in section 198(1)(c) of TAA which already lists compromised debt in terms of business rescue proceedings as being irrecoverable in law.

Response: Misplaced. Where a taxpayer is engaged in business rescue proceedings SARS' recovery efforts are suspended under the Companies Act, 2008, until the business rescue proceedings are over or when the business rescue plan has failed, and the tax debt becomes recoverable again. All that the amendment does is to allow SARS to temporarily write off the tax debt during business rescue to recognise this suspension.

11.12. Clause 53: Section 240 TAA – Registration of tax practitioners

Comment: A serious tax offence should be defined by reference to the specific offences in Chapter 17.

Response: Not accepted. The current definition of "tax offence" and "serious tax offence" is sufficiently clear that it would include statutory offences under the tax Acts as well as related common law offences. As many of the tax Acts other than the TAA still include tax type specific offences, it cannot only be limited to Chapter 17.

Comment: The suspension of registration of a tax practitioner where criminal proceedings have been instituted but not finalised is too onerous and may be unconstitutional. It amounts to the suspension of a tax practitioner's source of income and can have severe financial implications in situations where the tax practitioner may ultimately be acquitted. The proposal should accordingly be withdrawn. Furthermore, it is also submitted to be in contravention of the principle that a person is innocent until proven guilty. Merely relying on the professional judgment of the National Prosecuting Authority as to what constitutes a *prima facie* case is a too low a standard to impose such a detriment.

Response: Partially accepted. The proposed amendment will also require that the tax practitioner continued committing a serious tax offence after criminal proceedings had been instituted.

11.13. Clause 54: Section 240A TAA – Recognition of controlling bodies

Comment: It is proposed that SARS should provide the detail of members of the body who are registered as tax practitioners to the particular body. The body can then confirm that the individuals are members of the body.

Response: Misplaced. SARS may disclose the relevant information to the recognised controlling bodies under section 70(2)(e) of the TAA.

Comment: The proposed amendment extends the scope of who is liable to register as tax practitioner in section 240 of TAA, the latter which imposes a registration obligation on any person who completes or assists in completing a return.

Response: Misplaced. If a person does not perform the functions listed in section 240(1) or is excluded under section 240(2), neither of which is being amended, the person is not obliged to register.

11.14. Clause 55: Section 248 TAA – Public officer in event of business rescue

Comment: It is noted that the effective date of this amendment is 1 October 2012. The amendment imposes additional obligations on business rescue practitioners. As such, it is arguably contrary to the rule of law and unconstitutional.

Response: Accepted. The proposed amendment will come into operation on the date of promulgation of this Bill.

11.15. Clause 57: Section 256 TAA – Tax compliance status

Comment: The proposed amendment provides that a tax clearance certificate (TCC) can be declined if “relevant material” is still outstanding. A TCC plays an important role in our economy and are, almost without exception, a requirement when a person submits a tender or bid for doing business with government. There are numerous scenarios that can present themselves and reflect a request for relevant material as being outstanding thereby jeopardising the taxpayer’s financial position and business continuity. The legislation is also not clear as to whether the request for relevant information must relate to the taxpayer itself or whether it can be in the taxpayer’s capacity as a third party.

Response: Accepted. The TCC process will be replaced by the new tax compliance status (TCS) process. The requirement of no outstanding requests for information is removed as a requirement for TCS, but further review on the inclusion of such non-compliance will be conducted during the 2015 legislative cycle.

Comment: Tax clearance certificates are being withheld for immaterial amounts of outstanding tax. SARS should not be concerned with small outstanding amounts of tax that could arise for any number of reasons. Many of these amounts go back years and SARS is unable to substantiate what they relate to. The current limit of R100 is far too low. Section 256(3)(a) should incorporate a materiality limit of R5000.

Response: Not accepted. The *de minimis* amount in section 256(3)(a) is in line with the scheme of the TAA in the context of recovery of tax, i.e. that SARS will not seek to recover an amount less than R100 but carries the amount over to the next tax period. Larger amounts are considered collectible and should be paid.

Comment: It is not clear whether the date of confirmation as set out in section 256(4)(c) is the date of application by the taxpayer or the date the organ of state or other party requests such confirmation in terms of section 256(5). If it is the latter and the status changes between the two dates, the section does not require SARS to inform the taxpayer of the change in status. This appears to override the current process whereby a tax clearance certificate is valid for a year and may cause uncertainty for taxpayers and its clients. It is proposed that the tax compliance status confirmation be made valid for a period of time to provide certainty to all parties in tender and other processes. Also, no provision is made to allow for the remedy of the non-compliance by the taxpayer.

Response: Not accepted. The change in approach is in line with the purpose of the new system, i.e. taxpayers must remain compliant for the duration of the contract and they are responsible for checking and ensuring that they remain compliant. The system will, however, cater for sending alerts to taxpayers when their status changes from compliant to non-compliant to enable the taxpayers to immediately remedy their non-compliant status.

Comment: Section 256(4)(c) seems to indicate that the name of the organ of state or person to whom the tax compliance status is to be presented, will be printed on the tax compliance status confirmation. In large organisations these tax compliance status confirmations are requested on an ongoing basis to a large number of parties. The insertion of the names of such parties will place an additional administrative burden on both the company and SARS.

Response: Not accepted. As the new process will be automated, it is not foreseen that it will be too burdensome. The modernisation of the largely manual TCC process is intended to reduce the burden of the process.

Comment: The 21 day turnaround time set out in section 256(2) might not prove to be practical as shorter turnarounds would be required. It is suggested that the name be omitted and the turnaround time be reconsidered.

Response: Not accepted. The 21 day turnaround time is existing law. If the request is in respect of tender or good standing, the turnaround time in the TCS system will be virtually immediate in most cases. Some cases may, however, require additional review.

Comment: It is not clear whether the new compliance certificate replaces both the certificate of good standing and the tender clearance certificate.

Response: Noted. SARS is not doing away with the current request types by replacing the old TCC process with a new TCS process – taxpayers will still be able to request their overall tax compliance status in respect of tender, good standing, foreign investment account (FIA) or emigration. When the request is successful, SARS will issue the taxpayer with a PIN for the specific request. When the PIN is used by another person that person will see the real-time compliance of the taxpayer on the date that the PIN is used.

The TCS process will also enable the ability for taxpayers to print a TCC (in old format) from the new system for the phasing in period of the new real-time TCS system with PIN etc.

11.16. Clause 63: Section 270 TAA – Application of TAA to prior or continuing action

Comment: Amendment to section 270(6D) to shift the remittance of understatement penalties from employees' tax to the same considerations as apply for VAT, is welcomed. However, it does not go far enough as additional tax on a number of other taxes also only applied in the circumstances of evasion, e.g. securities transfer tax, UIC, SDL, while additional taxes did not apply at all in the case of dividends tax and mining royalties. Further amendments are required to section 270(6D) to appropriately address understatement penalties on all taxes.

Response: Not accepted. Under the Securities Transfer Tax Administration Act, 2007, the Unemployment Insurance Contributions Act, 2002, and the Skills Development Levies Act, 1999, 'penalties on default' could be remitted by the Commissioner simply by 'having regard to the circumstances of the case'. This is not comparable with the VAT and PAYE penalty scheme where taxpayers had a specific criterion, i.e. no intent to evade tax, which they knew had to be met to avoid the penalty.

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