DRAFT RESPONSE DOCUMENT

2017 DRAFT TAXATION LAWS AMENDMENT BILL (TLAB) AND DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL (TALAB)

Standing Committee on Finance

Presenters: National Treasury and SARS | 14 September 2017

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Consultation process

- The 2017 Draft Taxation Laws Amendment Bill (TLAB) and 2017 Draft Tax Administration Laws Amendment Bill (TALAB) were published for public comment on 19 July 2017.
- National Treasury and SARS received written comments from 1420 organisations and individuals by deadline of 18 August 2017.
- National Treasury and SARS briefed the Standing Committee on Finance (SCoF) on the draft bills on 15 August 2017.
- Oral presentations by taxpayers and tax advisors on the draft bills were made at hearings by the SCoF on 29 August 2017.
- Workshops with stakeholders to discuss their comments on the 2017 Draft TLAB & TALAB were held on 4 and 5 September 2017.
- Today, 14 September 2017, National Treasury and SARS present to the SCoF a draft response document containing a summary of draft responses to public comments received on the draft bills.

Key issues raised during consultation process

The proposed amendments included in the draft bills that received most comments are:

20017 Draft TLAB

1. Repeal of foreign employment income exemption
2. Tax relief for Bargaining Councils regarding tax non-compliance
3. Addressing the circumvention of anti- avoidance rules dealing with share buy backs and dividend stripping
4. Tax implications of debt relief
   - Addressing the tax treatment of debt relief for mining companies
   - Addressing the tax treatment of debt relief for dormant group companies
   - Addressing the tax treatment of conversions of debt into equity and artificial repayment of debt
5. Exclusion of impairment adjustments in the determination of taxable income in section 24JB
6. Extending the application of controlled foreign company rules to foreign companies held via foreign trusts and foundations

2017 Draft TALAB

1. PAYE: Taxation of reimbursive travel allowance
2. PAYE: Spread of PAYE cap on deductible retirement fund contribution over year
3. PAYE: Dividends on employee share incentive schemes
4. TAA: Amendment or withdrawal of decisions by SARS
5. TAA: Fraudulent refunds – hold on taxpayer's account by bank

2017 DRAFT TAXATION LAWS AMENDMENT BILL

KEY ISSUES

1. Repeal of foreign employment income exemption

- **Our gratitude to commentators for sharing their views and informing the discussion on policy design.** Summarised 1308 comments in total, after duplications, resends and forwarded comments
- 3 economic concerns dominate
  - Potential impacts on remittances to SA, including retirement savings, investment and living expenses
  - Poor employment prospects (both as a cause for working abroad and on return)
  - High cost of living abroad
- From various geographic areas – also concerned taxpayers in SA
  - Predominantly Middle East (UAE, KSA, Oman, Qatar)
  - Also from countries with similar tax regimes (UK, though not many comments from Australia & NZ)
- Predominantly working in service sectors
  - Professional services (e.g. finance)
  - Social services (Education, health, security)
  - Offshore services
- Of those that reported it, average time abroad is 7 years and 4 months

Main comments	*Total*
Taxpayers' motivations and circumstances	
Taxpayer financial impact	760
Non-income taxes in foreign jurisdictions	794
Cost of living in foreign jurisdictions	866
Negative impact on foreign employment decision (i.e. have to return)	743
Poor SA employment prospects	1060
Impact on skills development	123
Policy design	
Break SA tax residence	814
Emigration/break citizenship	626
CGT & exit charge	736
Impact analysis	858
SA remittances	1041
List other jursidictions	930
Alternatives & irregular expenditure	842
Allow deductions for expenditure	572
Forex differential makes income seem inordinately high.	7
DTAs with other jurisidictions run contrary	327
Tax principles	
Benefit principle broken	678
Administrative	
SARS capacity	763
Compliance burden for individuals	25
Double taxation treaties	34
Foreign tax credits	6
Total number of comments	1308

1. Repeal of foreign employment income exemption

Comment:

- The tax will have a severely negative impact on finances, and remittances to South Africa, especially for those on relatively lower incomes. This includes amounts remitted to family members to fund living costs in SA, investment of foreign income in some family run businesses and money spent in South Africa during visits.

Response:

- Accepted. The proposal will be changed to allow the first R1 million of foreign remuneration to be exempt from tax in South Africa if the individual is outside of the Republic for more than 183 days as well as for a continuous period of longer than 60 days during a 12 month period. The exemption threshold should reduce the impact of the amendment for lower to middle class South African tax residents who are earning remuneration abroad. The effect of the exemption will also be that South African tax residents in high income tax countries are unlikely to be required to pay any additional top up payments to SARS.

Comment:

- The cost of living in foreign countries is higher than in South Africa, and should be taken into account in the design of the tax. The higher cost would include consumption taxes, high foreign levies, fees and user charges which cannot be taken account as foreign tax credits.

Response:

- Noted. The tax system does not usually cater for differences in the cost of living and other countries do not include consumption taxes, and other indirect taxes and charges, in the granting of a foreign tax credit. The capped exemption will, however, mitigate these types of concerns and is a simpler and cleaner solution compared to a country-by-country cost of living adjustment.

1. Repeal of foreign employment income exemption

Comment:

- Individuals and households made the decision to work and live abroad based on the current tax treatment, which had been in place since the introduction of the residence based system of taxation in 2001. It seems unfair that there will be such a sudden and large change in tax liabilities in one year, especially if taxpayers made plans according to a three to five year contract.

Response:

- Partially accepted. To allow greater time for individuals to either adjust their contracts or their circumstances and to finalise or formalise their tax status, it is proposed that the effective date for this proposal is extended to 1 March 2020.

Comment:

- There are only two out of 196 other countries that have implemented such a proposal. The amendment is unduly harsh and puts SA apart from comparator countries.

Response:

- Not accepted. The policy mentioned in these two countries is where individuals are taxed based on citizenship. The proposal is not based on citizenship, but is instead based on tax residency and is a commonly found principle amongst other countries with a residence based system of taxation.

1. Repeal of foreign employment income exemption

Comment:

- The foreign tax credit can only be claimed on assessment. This means that PAYE taxpayers and provisional taxpayers have to pay taxes in two jurisdictions and only claim the credit afterwards – this would result in severe cash flow problems. Provisional tax liabilities would also be difficult to estimate.

Response:

- Not accepted. Employers are currently able to apply for a hardship directive from SARS that effectively would take foreign employment taxes into account in the determination of PAYE, which effectively removes the incidence of being taxed twice during the course of a year and only being able to claim foreign tax credits on assessment at a later stage. For provisional taxpayers the law and forms currently do allow taxpayers to include foreign taxes paid in their calculations and should not result in adverse cash flow consequences.

Comment:

- There are very long delays to process and allow foreign tax credits. This proposal would overwhelm the current system.

Response:

- Not accepted. The tax credit system as administered by SARS is already functioning and the increase in applications for credits should be limited due to the availability of the capped exemption.

1. Repeal of foreign employment income exemption

Comment:

- The foreign tax credit can only be claimed on assessment. This means that PAYE taxpayers and provisional taxpayers have to pay taxes in two jurisdictions and only claim the credit afterwards – this would result in severe cash flow problems. Provisional tax liabilities would also be difficult to estimate.

Response:

- Not accepted. Employers are currently able to apply for a directive from SARS indicating that they would like to take foreign taxes paid into account in the determination of PAYE, which effectively removes the incidence of being taxed twice during the course of a year and only being able to claim foreign tax credits on assessment at a later stage. For provisional taxpayers the law and forms currently do allow taxpayers to include foreign taxes paid in their calculations and should not result in adverse cash flow consequences.

Comment:

- There are very long delays to process and allow foreign tax credits. This proposal would overwhelm the current system.

Response:

- Not accepted. The tax credit system as administered by SARS is already functioning and the increase in applications for credits should be limited due to the availability of the capped exemption.

1. Repeal of foreign employment income exemption

Comment:

- Amendments are required to section 6quat, namely to take social security and pension contributions into account and include deductions under sections 11(k) and 11F.

Response:

- Not accepted. Social security contributions have a different nature compared to taxes on income as they imply a potential future benefit for those contributions (such as a state pension). State pensions paid by other countries to South African tax residents are free from tax and allowing a credit for these contributions could be seen as allowing a tax deduction for both contributions and payments. It is general international practice to only allow taxes on income as foreign tax credits and not social security contributions. Individuals who would like a deduction for pension contributions are welcome to contribute to a local retirement annuity fund.

Comment:

- It is unfair to impose taxes on people who are not present in SA to enjoy the benefits of public expenditure.

Response:

- Not accepted. The residence based system of taxation is premised on the fact that tax residents of a country are liable for tax on their worldwide income if they are tax resident in that country, which is usually determined by applying an "ordinarily resident" or a physical presence test. If the individual does not meet the physical presence test and is not "ordinarily resident", the individual would not be a South African tax resident and is unlikely to benefit from public expenditure. South Africa would then not tax the individual on worldwide income.

2. Tax relief for Bargaining Councils regarding tax non-compliance

The 2017 Draft TLAB proposes the introduction of a specific relief for Bargaining Councils that have been non-compliant with the tax legislation as follows:

- Non-compliant Bargaining Councils will be required to pay a levy of 10% of the total PAYE that should have been deducted from all payments made to their members between 1 March 2012 and 28 February 2017;
- Non-compliant Bargaining Councils will be required to pay a levy of 10% of the total untaxed investment income between 1 March 2012 and 28 February 2017;
- The relief will apply in respect of the 5 year period, starting from 1 March 2012 to 28 February 2017. The 5 year period is linked to the period for record keeping required in terms of the Tax Administration Act.
- Non-compliant Bargaining Councils must submit a return and pay the levy to SARS on or before 1 September 2018 to benefit from the relief.

2. Tax relief for Bargaining Councils regarding tax non-compliance

Comment

- The proposed relief for Bargaining Councils is extraordinarily generous and raises serious questions as to whether it is fair and equitable that such relief should be granted. The relief may arguably be unconstitutional on the basis that it places Bargaining Councils in a favoured position vis-a-vis other taxpayers. The favourable treatment may not be in terms of law of general application and may not be reasonable and justifiable. Accordingly, it is suggested that the proposed relief be reconsidered.

Response:

- Not Accepted. The proposed relief for Bargaining Councils, although nominally targeted, is not discriminatory in nature and passes the test of general application as it applies to about 40 Bargaining Councils, their members who are 1.8 million as well as their employers. It would be grossly prejudicial to treat the proposed relief for Bargaining Councils differently to previous amnesties, for example, the Exchange Control Amnesty in 2003 and the Small Business Tax Amnesty in 2006. The prerequisite for government is to do the right thing to encourage the regularisation of tax affairs for taxpayers in order to ensure a compliant tax environment. These means have been introduced in differing circumstances to assist either a certain class of taxpayers to comply with the tax law or in some instances to regularise specific class of income types, such as the current Special Voluntary Disclosure Programme (2016) designated for taxpayers with offshore assets and income.
- The proposed 10% levy for the Bargaining Councils relief is not overly generous as compared to previous amnesties. The aforementioned Small Business Amnesty imposed a levy of up to 5 %, whereas the Exchange Control Amnesty applied a levy of 2% on foreign assets. The proposed amnesty levy for Bargaining Councils appears to be the uppermost compared to the amnesties which took place in the past.

2. Tax relief for Bargaining Councils regarding tax non-compliance

Comment

- The proposed relief for Bargaining Councils raises questions as to why separate legislation for this relief is introduced instead of dealing with this matter via the normal Voluntary Disclosure Programme rules available in the Tax Administration Act. The provisions of TAA dealing with compromise of tax debt should be applied to non-compliant Bargaining Councils in appropriate circumstances instead of the extraordinary generous tax relief proposed in the 2017 Draft TLAB

Response

- Not accepted. There are different facts and circumstances for each type of fund at each of the Bargaining Councils. Hence, there are different views about the liability to withhold taxes at the Bargaining Council level and the employer level. This in itself would imply that there is a systemic problem that requires a focused intervention aimed at regularisation of tax affairs. In addition, the administrative burden to file voluntary disclosures should not fall on the approximately 1.8 million members of Bargaining Councils.

***Comment*:**

- There are a number of uncertainties regarding the correct tax treatment of the contributions to, benefits paid and investment income of Bargaining Councils and the current legislation applicable to Bargaining Councils funds does not provide a one size fits all solution. In addition, based on the contractual structure, and type of these funds, they may have totally different tax consequences, affecting the employer, the member and Bargaining Council. It is proposed that the tax treatment of the Bargaining Councils be confirmed before a decision is made to provide relief for non-compliance.

Response

- Partially accepted. During public consultations, it became apparent that there is significant variation in the treatment of funds by different Bargaining Councils, not to mention different types of funds in each Bargaining Council. Bargaining Councils are currently being engaged to find means to address these inconsistencies.

3. Addressing the circumvention of anti-avoidance rules dealing with share buy backs and dividend stripping

In order to curb the abuse of share buy backs schemes and circumvention of dividend stripping rules, the Draft TLAB extends the application of the current rules in section 22B and paragraph 43A to apply to the following circumstances:

- The person disposing of the shares in another company must be a resident company; and
- The company disposing of the shares (together with connected persons in relation to that company) must hold at least 50% of the equity shares or voting rights in that other company or at least 20% of the equity shares or voting rights in that other company if no other person holds the majority of the equity shares or voting rights; and
- An exempt dividend was received or accrued within 18 months prior to the disposal of the target company shares or an exempt dividend was received or accrued by reason of or in consequence of the disposal of the target company shares.
- In view of the fact that this is an anti-avoidance measure aimed at preventing the erosion of the tax base, it is proposed that this provision should come into operation on the date of publication of the 2017 Draft TLAB for public comment, i.e., 19 July 2017 and apply in respect of any disposal on or after that date.

3. Addressing the circumvention of anti-avoidance rules dealing with share buy backs and dividend stripping

Comment:

- The extended anti-avoidance measures will apply to share sale transactions where there is no avoidance taking place as the measures will taint all dividends received in the preceding 18 months irrespective of whether they are related to or linked to the share sale. The dividend policies consistently applied by companies are ignored. It is proposed that the rule focuses either on extraordinary dividends or that the 18 month period should be reduced to 12 months.

Response:

- Partially accepted. The period of 18 months will remain. However, in addition to the anti-avoidance measures applying in respect of dividends arising by reason of or in consequence of a share disposal, the 2017 Draft TLAB will be changed to limit the application of the rules to dividends that are considered excessive as compared to a normally acceptable dividend (known as extraordinary dividends) received by a company within 18 months preceding the disposal of a share in another company. In this regard, any dividends received within 18 months preceding a share disposal in respect of that share that exceed 15 per cent of the higher of the market value of the share disposed of (as determined at the beginning of the 18 month period and the market value of the shares on the date of disposal) will be treated as extraordinary dividends and will therefore be subject to the anti-avoidance measure.

3. Addressing the circumvention of anti-avoidance rules dealing with share buy backs and dividend stripping

Comment

- The anti-avoidance measure is too wide and negatively affects vanilla preference shares typically used by companies to raise funding. These preference shares carry a coupon linked directly to the prime interest rate and are redeemable at their original subscription price after as long as 10 years. In some instances the preference dividends for the past years are all accumulated but not declared and are only declared upon redemption. This means that all those preference dividends are tainted.

Response

- Accepted. The 2017 Draft TLAB will be changed to contain an exclusion in respect of preference shares to the extent that the dividends are determined with reference to a specified rate of interest to the extent that the rate of interest does not exceed 15 per cent. Preference dividends that are paid in excess of this rate of 15 per cent will be regarded as extraordinary dividends for purposes of anti-avoidance measures.

3. Addressing the circumvention of anti-avoidance rules dealing with share buy backs and dividend stripping

Comment

- The Draft 2017 TLAB indicates that the proposed changes to section 22B and paragraph 43A of the Eighth Schedule will apply in respect of disposals on or after the date on which the Draft 2017 TLAB was published for public comment (19 July 2017). This means that the new rules will apply retrospectively to dividends received prior to 19 July 2017. In particular, the changes will affect transactions that were already entered into but are subject to suspensive conditions.

Response:

- Partially accepted. The proposed effective date will be changed to ensure that arrangements whose terms were finally agreed to by the parties to them on or before 19 July 2017 will not be subject to the new provisions of section 22B and paragraph 43A of the Eighth Schedule to the Act. Only those arrangements that were not finalised on 19 July 2017 as well as any future arrangements will be subject to the new provisions.

3. Addressing the circumvention of anti-avoidance rules dealing with share buy backs and dividend stripping

Comment

- The proposed qualifying shareholding threshold of 50 per cent and 20 per cent where no other person holds the majority of the shares is unlikely to curb the abuse aimed at. In a listed environment, there is unlikely to be a 20 per cent shareholder. It is proposed that the threshold should be reduced to 5 per cent or other measures be put in place to combat schemes that involve firstly reducing the shareholding to below 20 per cent. In addition, it is proposed that the 20 per cent test that has been added to the qualifying interest definition should apply where no other person (whether alone or together with connected persons) holds a majority stake.

Response

- Accepted. It is acknowledged that in the listed environment a lower shareholding in a listed company can confer a significant influence upon a shareholder. It is therefore prudent that a separate shareholding benchmark be considered for shareholding in listed companies. A shareholding of 10 per cent will therefore be proposed with regard to listed companies. With regard to non-listed companies, the proposed 50% and 20% under the definition of a qualifying interest for purposes of the anti-avoidance measures will remain. On the other hand, with regard to the 20 per cent shareholding test, the anti-avoidance measures will be applicable to a 20 per cent shareholding unless any other person (whether alone or together with connected persons) holds a majority shareholding as opposed to the current rule that require one other person to hold the majority shareholding alone.

3. Addressing the circumvention of anti-avoidance rules dealing with share buy backs and dividend stripping

Comment

- In order for the anti-avoidance measures to apply to any investor in shares, the qualifying interest requirement must be met. The proposed qualifying shareholding threshold is 50 per cent irrespective of the shareholding of other shareholders and 20 per cent where no other person holds the majority of the shares in the company. It is noted that where no shareholder holds a majority shareholding in a company, the 20 per cent shareholding rule can potentially affect BEE partners where a consortium can hold a shareholding of 20 per cent or more.

Response

- Noted. It is clear that the qualifying interest test is being perceived differently by different classes or groups of taxpayers. In some instance the 50 per cent rule is adequate in other instances (as is the case in respect of shareholdings in listed companies) lower levels of shareholdings need to be considered for the application of the anti-avoidance rules. With regards to the shareholding level in respect of BEE partners, it is true that these anti-avoidance measures will be applicable. However, it is important to note that these rules will apply in the instance that the BEE partner undertakes a disinvestment and disposes of the shares it holds in a company. From a policy perspective, the purpose of the anti-avoidance measures is to ensure that share disposals reflect the ordinarily expected tax consequences of a disinvestment (i.e. CGT when the shares are held on capital account or an inclusion of proceeds in income if the shares are held on revenue account). As with all other share investors, the share disposals of BEE partners should be subject to these anti-avoidance measures in the instance that the value of their shares has been reduced by exempt dividends. It should be noted that smaller BEE holdings in non-listed companies or holdings held by individuals (rather than companies) would not be subject to these anti-avoidance measures.

4. Tax implications of debt relief: Mining Companies

In order to address the disparity in tax treatment of debt relief for mining companies versus companies in other sectors, the 2017 Draft TLAB proposes specific rules dealing with tax treatment of debt relief for mining companies in order to address the disparity in tax treatment of debt relief for mining companies versus companies in other sectors.

Comment

- The current proposed wording of the new section 36(7EA) only makes reference to the tax treatment of debt that is used to fund an amount of capital expenditure. Unlike the provisions of section 19 and paragraph 12A of the Eighth Schedule that makes specific reference to debt used to directly fund expenditure (i.e. debt arising because a debtor funded expenditure through credit extended by the creditor) or indirectly fund expenditure (i.e. debt arising from loan funding that is subsequently used to pay for expenditure), the proposed provision seems to suggest that only debt that directly funds an amount of capital expenditure is envisaged. This issue needs to be clarified in the wording of section 36(7EA).

Response

- Noted. Currently, the existing provisions that deal with the tax treatment of debt that is subsequently reduced, cancelled, waived, forgiven or discharged apply to both debt directly or indirectly used to fund certain expenses. The inclusion of debt forgiveness rules for mining companies in the 2017 Draft TLAB is intended to be an extension of the rules to mining companies on the same basis and with the same scope. As such, the 2017 Draft TLAB will be changed to clarify that the tax treatment of debt relief rules applicable to mining apply to both debt that was used to directly fund capital expenditure and debt that was used to indirectly fund capital expenditure.

4. Tax implications of debt relief: Mining Companies

Comment

- There are various exceptions to the current tax dispensation in respect of debt relief contained in the Act. However, it does not appear that the proposed section 36(7EA) has the same exceptions.

Response

- Accepted. The current exceptions applicable to debt that funds capital expenditure (i.e. exceptions contained in paragraph 12A of the Eighth Schedule to the Act) will be extended to apply to mining companies.

Comment

- The proposed section 36(7EA) is subject to a proviso that provides for the tax treatment of any excess amount of a debt that is subsequently reduced, cancelled, waived, forgiven or discharged after the capital expenditure of a mining company has been fully reduced. Under the proviso, such excess is includable in the gross income of the mining company in terms of paragraph (*j*) of the definition of gross income. However, the reference to the term "mining company" in the proviso is technically incorrect and is not aligned with the terms used in the current provisions of section 36 and paragraph (*j*) of the definition of gross income. Reference should rather be made to a taxpayer carrying on mining operations.

Response:

- Accepted. Changes will be made in the 2017 Draft TLAB to refer to a taxpayer carrying on mining operations.

4. Tax implications of debt relief: Mining Companies

Comment:

- The proposed tax relief rules for mining companies do not take into account how the reduction of capital expenditure is to be applied in respect of the ring-fenced mining operations. It should be clarified if a taxpayer must only reduce the capital expenditure of the mine that the debt that is subsequently reduced, cancelled, waived, forgiven or discharged previously funded or is the capital expenditure of other mines that the same taxpayer operates also affected?

Response:

- Accepted. It is intended that only the capital expenditure of the mine that was funded with debt that is subsequently reduced, cancelled, waived, forgiven or discharged should be reduced by the resulting reduction amount. As such, changes will be made in the 2017 Draft TLAB to clarify this intention.

Comment:

- The definition of capital expenditure includes notional amounts like in the case of certain gold mines and certain amounts relating to low-cost residential units for employees. These amounts would not have been funded by any debt. When a reduction amount arises, must these amounts also be reduced?

Response:

- Noted. From a practical perspective it is not desirable to complicate the application of the debt reduction rules by requiring taxpayers to track and isolate notional amounts for purposes of excluding them from the rule. As such, notional amounts of capital expenditure will not be subject to the proposed rules in section 36(7EA).

4. Tax implications of debt relief: Dormant group Companies

The 2017 Draft TLAB proposes that the current relief for group companies available in paragraph 12A(6)(d) of the Eighth Schedule be restricted to dormant companies and intra-group debt converted to equity and be extended to section 19.

Comment:

- The proposed amendment in 2017 Draft TLAB narrows the current group exception that is contained in paragraph 12A and limits it to apply in respect of debt owed by dormant companies to the extent that the debt arose between group companies as contemplated in section 41 of the Act. Under the exception, a company is only considered to be a dormant company if during the year that the debt is waived and the 3 immediately preceding years of assessment it did not carry on any trade; receive or accrue any amount; transfer any assets to or from the company; and incur or assume any liability.
- These requirements are too stringent. Firstly, the period is too long as it requires that a company should be dormant for 4 years of assessment before the exception applies. Secondly, the other restrictions do not take the practicalities of dormant companies into account. These companies may be trying to sell their residual assets and may also incur liabilities in respect of statutory requirements such as audit fees. Lastly, these companies may also receive passive income like interest on past investments. It is proposed that the proposed requirements on dormant companies be relaxed.

Response:

- Accepted. Changes will be made to the 2017 Draft TLAB to provide that a company will be considered to be a dormant company for purposes of applying the exception if the company did not carry on a trade in the year of assessment that a debt from a group company (as contemplated in section 41) is reduced, cancelled, waived, forgiven or discharged and in the immediately preceding year.

4. Tax implications of debt relief: Conversion of debt into equity

The 2017 Draft TLAB contains amendments that make provision for the conversion of debt into equity, provided that the debtor and the creditor are companies that form part of the same group of companies. However, in order to ensure that this provision is not abused, it is proposed that any interest that was previously allowed as a deduction by the borrower in respect of that debt be recouped in the hands of the borrower, to the extent that such interest was not subject to normal tax in the hands of the creditor. In addition, where the creditor company and the debtor company cease to form part of the same group of companies within 6 years of the debt conversion, a deemed reduction amount is triggered.

Comment:

- The proposed amendments imply that an amount may only be excluded from the provisions of section 19 and paragraph 12A of the Eighth Schedule if these provisions are firstly actually applicable. In the past share issues at excessive subscription prices were used merely as a mechanism to circumvent the debt reduction rules and simply add unnecessary complexity to what in substance, is a reduction of debt for inadequate consideration. The proposed exclusions in sections 19A and 19B in the 2017 Draft TLAB of debt that is converted to shares complicates this further because it is unclear whether such conversions result in a reduction amount.

Response:

- Accepted. The current definition of a reduction amount arguably has technical limitations in respect of covering all instances of debt concessions. Debt compromises such as, for example, subordination agreements that recognise, in effect that the value of the claim that the creditor holds is less than the face value of that claim are arguably not covered in all instances. The same applies in respect of conversions of debt into equity. The benefits arising from any concession or compromise or debt restructuring arrangement should, from a policy point of view, be subject to the same rules. As such, amendments will be proposed in respect of the definition of a “reduction amount” in the 2017 Draft TLAB to ensure that the debt reduction rules apply in respect of all forms of debt restructuring arrangements. The proposed exclusion from section 19 in respect of debt to share conversions will be limited to debt between companies in the same group of companies as defined in section 41 that arose when those companies formed part of that group of companies. The current proposal in paragraph 12A regarding intra-group debt will be aligned with this proposal.

4. Tax implications of debt relief: Conversion of debt into equity

Comment

- The current proposal to insert section 19A of the 2017 Draft TLAB provides for an exclusion of debt to equity conversions between companies in a group of companies if the interest on the debt was not subject to normal tax. In some instances withholding tax on interest is paid as opposed to normal tax. Where an amount of interest was previously subject to withholding tax, the recoupment rule in respect of interest should not apply.

Response:

- Partially accepted. The current proposal in section 19A dealing with recoupment of interest that was not previously subject to normal tax will be withdrawn. This is due to the proposal that the exclusion of debt to equity conversions will be limited to companies that form part of the same group of companies as contemplated in section 41 of the Act. If the proposed provisions only apply between companies that form part of the same group of companies as contemplated in section 41 of the Act, it follows that all amounts of interest that accrued previously would have been subject to normal tax.

Comment

- The proposed de-grouping rule in section 19B of the 2017 Draft TLAB is extremely penal. The de-grouping provision is a 6-year rule. Such a rule will severely impede the ability of groups to manage their affairs, particularly given that it effectively applies to both the debtor and creditor companies. For example, if the group wished to wind up or dispose of the creditor company this would result in the trigger of section 19B. Similarly, the capitalisation of a debt may be a precursor to the disposal or part-disposal of shares or introduction of a new investor into the debtor company. It is submitted that the proposed section 19B should be withdrawn. Alternatively, the de-grouping period should be substantially reduced from an effective 6 years of assessment to 2 years.

Response:

- Accepted. The current proposal in section 19B dealing with recoupment in respect of intra-group debt exchanges for or converted to shares will be withdrawn.

5. Exclusion of impairment adjustments in the determination of taxable income of section 24JB

- On 17 February 2012, SARS issued a directive for the tax treatment of doubtful debts by banks that applied with effect from the 2011 year of assessment. The SARS directive applied to banks and does not apply to all other financial service providers. This directive only applied to banks as long as IAS 39 is applied by banks for financial reporting purposes.
- In the 2017 Budget Review, it was proposed that as IAS 39 is being replaced by IFRS 9, the principles of the SARS directive be reviewed and incorporated in the Act.
- Furthermore, the 2017 Budget Review propose that section 24JB should exclude impairment adjustments provided for under IFRS 9 as these impairment adjustments aim to provide for future risks instead of focusing solely on the current losses in the determination of taxable income as contemplated in section 24JB.
- In view of the fact that banks that are registered in terms of the Banks Act are treated differently from other financial services providers in that they are highly regulated by the South African Reserve Bank (SARB) and subject to stringent capital requirements and in order to avoid a negative impact on the banking sector, the 2017 Draft TLAB proposes that amendments be made to the Act to allow banks the following:
  - 25% of IFRS 9 loss allowance relating to impairment based on annual financial statements;
  - 85% instead of 25% of an amount classified as being in default in terms of Regulation 67 issued under the Banks Act and administered by SARB.

5. Exclusion of impairment adjustments in the determination of taxable income of section 24JB

Comment

- The stage 3 category of impairment allowance should refer to the IFRS 9 definition of "credit impaired financial asset" only, which equates to the stage 3 impairments for IFRS 9 rather than referencing to Regulation 67 issued under the Banks Act and administered by SARB.

Response

- Not accepted. Firstly, banks apply sophisticated models to determine impairment of loans which are highly regulated by SARB and this reference is deemed to be necessary. Secondly, the concept "default" is critical to the implementation of IFRS 9 but IFRS 9 does not define the term "default". The suggested definition of "credit impaired financial asset" includes references to defaults but largely, IFRS 9 requires each entity to define the term and this would not result in alignment between banks.

.Comment

- For purposes of stage 3 category of impairment, the proposed 85 per cent allowance of an amount classified as being in default in terms of Regulation 67 only applies to credit exposure and not retail exposure such as for individuals in respect of revolving credit, credit cards and overdrafts.

Response:

- Accepted. Changes will be made to the 2017 Draft TLAB in order for the proposed 85 per cent allowance to include retail exposure.

Comment

The proposed impairment provisions under IFRS 9 include "lease receivable". Given that lease receivables are covered by other provisions of the Act, lease receivables should be excluded.

Response

- Accepted. Changes will be made to the 2017 Draft TLAB so that the proposed impairment provisions exclude lease receivables.

5. Exclusion of impairment adjustments in the determination of taxable income of section 24JB

Comment:

- The allowance for impairment losses is limited to banks only and effectively excludes other financial institutions. This proposed allowance should apply to all taxpayers that are moneylenders and impair financial assets in terms of IFRS 9.

Response:

- Noted. The proposed amendments in the 2017 Draft TLAB only apply to banks and not to other moneylenders or financial services providers due to the fact that banks that are registered in terms of the Banks Act are treated differently from other financial services providers in that they are highly regulated by the SARB and subject to stringent capital requirements. The impact of the extension of the proposal to other moneylenders or financial services providers will be investigated and may be considered in the future.

Comment

- The industry request that for stage 3 category of impairment, the proposed 85 per cent allowance is inadequate and should be increased to 100 per cent.

Response

- Not accepted. The proposed percentage of 85% instead of 100% was based on ensuring that it yields a relatively neutral tax revenue position for both the fiscus and the banking industry.

Comment

- In general, the proposed impairment allowances (stages 1 to 3 at 25 per cent, 25 per cent and 85 per cent) are less than the current directive applicable to banks on impairment losses (which is 25 per cent, 80 per cent and 100 per cent) and this reduction will negatively impact the banks in a single year and therefore request a phase-in period of at least three years.

Response

- Noted. In the past, phase in provisions were allowed in order to reduce the significant negative cash flow impact on industries as a result of tax amendments. These phase-in provisions were introduced after quantifying the general impact on the relevant industry.

6. Extending the application of CFC rules to foreign companies held via foreign trusts and foundations

In order to close a loophole created by the fact that the current CFC rules do not capture foreign companies held by interposed foreign trusts and foundations the 2017 draft TLAB proposes that CFC rules be extended so that foreign companies held through a foreign trust or foreign foundation and whose financial results form part of the consolidated financial statements, as defined in the IFRS 10, of resident companies be treated as a CFC. Further, it is proposed that new rules be introduced to deem any distributions made by a foreign trust or foreign foundation that holds shares in a foreign company that would have been regarded as a CFC if no foreign trust or foundation was interposed to be income in the hands of South African tax residents.

Comment

- The proposed amendments are too broad. The definition of a CFC in the context of foreign companies held by trusts does not contain any threshold for the level of interest in a trust required to be held by residents.

Response

- Partially Accepted. The proposed amendment will be revised with a view to make them more targeted to the mischief that sought to be addressed.

Comment

- Clarity needs to be provided on the interaction between section 25BC and sections 7(8), 9D, 25B(2A) and the Eighth Schedule attribution and distribution rules.

Response:

- Accepted. The proposed amendment will be revised to provide clarity on the interaction between the proposed amendments and the existing rules in order to remove any potential double taxation.

6. Extending the application of CFC rules to foreign companies held via foreign trusts and foundations

Comment

- Clarity should be provided regarding the application of foreign tax credit provisions of section 6 quat to section 25BC.

Response

- Noted. Taking into account the above-mentioned proposed changes and to the scope of the 2017 Draft TLAB proposed amendments, the need for an extension of foreign tax credit rules may not be necessary.

Comment

- The proposed amendments contain significant loopholes, for example, it is simple to avoid the definition by splitting the shareholding of the foreign company between 2 or more foreign trusts such that each holds no more than 50 per cent of the participation rights in the foreign company.

Response

- Accepted. The proposed rules will be refined in order to close potential loopholes.

2017 DRAFT TAX ADMINISTRATION LAWS AMENDMENT BILL

KEY ISSUES

1. Fourth Schedule to ITA: Taxation of reimbursive travel allowance

To facilitate and simplify calculation and administration of employees' tax the 2017 Draft TALAB proposes that the portion of travel expenses reimbursed by an employer that exceeds the rate fixed by the Minister for the so-called "simplified method" (currently R3.55 per kilometre) be regarded as remuneration for PAYE purposes.

Comment

- Clarity should be provided regarding the impact of the 12,000 kilometre limitation on remuneration for PAYE purposes and the income tax consequences.

Response

- Noted. The reference to "the rate per kilometre for the simplified method" in the proposed amendment for PAYE purposes is not affected by the existing 12,000 kilometre limitation. The limitation is only relevant to the taxpayer's eligibility for the simplified method on assessment. The Memorandum of Objects will be adjusted to further provide clarity in this regard.

2. Fourth Schedule to ITA: Spread of PAYE cap on deductible retirement fund contributions over year

To clarify application of annual cap on contributions to retirement funds the 2017 Draft TLAB proposes that the R350 000 be spread over tax year for PAYE purposes.

Comment

- The proposed spreading means that a person who exceeds the R29,167 monthly cap in a single month but not in others will not be able to benefit from unused amounts in the other months.

Response

- Not accepted. Permitting the R350,000 to be used "at will" during a year places a second or subsequent employer in an impossible position if employment changes during the year. A rolling, cumulative approach introduces significant complexities in payroll systems, as well as differences between employees depending on whether the higher contribution takes place earlier or later in the year. As the monthly cap only applies for PAYE purposes, any unused portion of the annual cap will be taken into account on assessment.

3. Fourth Schedule to ITA: Dividends on employee share incentive schemes

As ‘remuneration’ in Fourth Schedule now includes certain dividends the 2017 Draft TALAB proposes that the person paying such remuneration be considered an employer and deduct PAYE in respect of dividends.

Comment

- As Central Securities Depository Participants (CSDPs) will be unable to identify employee shareholders from the normal shareholders, the provision should be deleted as it is not possible to manage dividends taxable as remuneration under the current dividends tax and PAYE systems as they are vastly divergent.

Response

- Partially accepted. The proposed wording will be changed to delete the proposal that the person by whom the dividend is distributed (a CSDP in the above comment) must deduct or withhold PAYE and, instead, the employer or person from whom the shares were acquired should:
  - inform the CSDP that no dividends tax must be withheld from the relevant dividend; and
  - withhold or deduct PAYE.

4. Tax Administration Act: Amendment or withdrawal of decisions by SARS

To facilitate a low cost internal remedy the 2017 Draft TALAB proposes to expand an existing internal review process to decisions by SARS, given effect in an assessment or notice of assessment that is not subject to objection and appeal.

Comment

- Taxpayers are unaware of this internal remedy in section 9 of the TAA, and how to practically take advantage of it. Descriptions and processes in relation to this internal remedy on the SARS website are, for example, not to be found on the page “Dispute Resolution Process”.

Response

- Noted. The proposed amendment relates specifically to a technical difficulty arising from the amendments last year with respect to estimated royalty payments under the Mineral and Petroleum Resources Royalty (Administration) Act, 2008. More generally, section 9 of the TAA is the enabling provision that allows a SARS official, in the official’s discretion or at the request of a taxpayer, to amend or withdraw decisions that are not subject to objection and appeal. It is thus separate from the dispute resolution process and instead forms a legislative underpinning for SARS’ internal complaints resolution procedures. Details of this process are available on the SARS website, for example, under Contact Us > How do I…? > Lodge a complaint

5. Tax Administration Act: Fraudulent refunds - hold on a taxpayer's account by bank

To improve the effectiveness of combatting refund fraud and in response to representations by members of the financial sector, the 2017 Draft TLAB proposes that a bank not be required to notify SARS of suspected refund fraud and then place a hold on the account on SARS's instruction but instead enables the bank to notify SARS and automatically place a hold on the taxpayer's account if the bank reasonably suspects that the payment of a refund into the taxpayer's account is related to a tax offence.

Comment

- The proposed amendment goes further than enabling a bank to place a hold on a taxpayer's account - it requires the bank to do so. The obligation to place a hold should not be automatic but should be on SARS' instruction or at the discretion of the bank after taking into account all factors, including taxpayer representations.

Response

- Not accepted. The hold in question is for a short period (maximum of two business days) and narrow (only when a bank "reasonably suspects" a refund payment by SARS has been obtained illegally). Requiring prior consultation with the account holder would render the provision ineffective, given the speed with which amounts can be transferred to other accounts.

Thank you

QUESTIONS ?