20 January 2021

Final Response Document on the 2020 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2020 Draft Taxation Laws Amendment Bill and 2020 Draft Tax Administration Laws Amendment Bill

(Based on hearings by the Standing Committee on Finance in Parliament)

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1. BACKGROUND

1.1. PROCESS AND PUBLIC COMMENTS

Subsequent to the tax pronouncements made by the Minister of Finance (the Minister) as part of the 2020 Budget announcements on 26 February 2020, the 2020 annual draft tax bills were published to give effect to the tax proposals announced in the Budget. These 2020 annual Draft Tax Bills include the following, the 2020 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (Rates Bill), the 2020 Draft Taxation Laws Amendment Bill (TLAB) and the 2020 Draft Tax Administration Laws Amendment Bill (TALAB).

The 2020 Draft Rates Bill was first published on the same day as the Budget (26 February 2020) and gives effect to changes in rates and monetary thresholds to the personal income tax tables, adjustment of transfer duty rates to support the property market and increases of the excise duties on alcohol and tobacco. The 2020 Draft Rates Bill was published for the second time on 31 July 2020 in order to solicit public comments on it.

The 2020 Draft TLAB and the 2020 Draft TALAB contain the remainder of the tax announcements made in Chapter 4 and Annexure C of the 2020 Budget Review which are more complex, technical and administrative in nature. Due to the complex nature of these draft bills, greater consultation with the public is required on their contents. The 2020 Draft TLAB and the 2020 Draft TALAB were published for public comments on 31 July 2020. The closing date for all public comments on the 2020 Draft Rates Bill, the 2020 Draft TLAB and the 2020 Draft TALAB was 31 August 2020. Workshops with stakeholders to discuss their written comments on these tax bills were held on 9, 10 and 11 September 2020.

The 2020 Draft Tax Bills are split into two separate categories. These include the money bills in terms of section 77 of the Constitution dealing with national taxes, levies, duties and surcharges – the 2020 draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (the draft Rates Bill), the 2020 draft Taxation Laws Amendment Bill (the draft TLAB) and an ordinary bill in terms of section 75 of the Constitution, dealing with tax administration issues – the draft 2020 Tax Administration Laws Amendment Bill (the draft TALAB).

The National Treasury and SARS briefed the Standing Committee on Finance (SCoF) on the 2020 Draft Rates Bill, the 2020 Draft TLAB and 2020 Draft TALAB on 19 August 2020. Subsequently, oral presentations by taxpayers and tax advisors on these tax bills were made at hearings held by the SCoF on 7 October 2020. Today, on 13 October 2020, National Treasury and SARS present to the SCoF the 2020 Draft Response Document on the 2020 Draft Rates Bill, the 2020 Draft TLAB and the 2020 Draft TALAB containing a summary of draft responses to the public comments received and proposed steps to be taken in addressing the key issues raised during the consultation process.

1.2. PUBLIC COMMENTS

National Treasury and SARS received written comments from 112 contributors (see Annexure A) on the 2020 Draft Rates Bill, the 2020 Draft TLAB and the 2020 Draft TALAB. Public comments to the SCoF were presented at a hearing that was held on 7 October 2020. There were 34 contributors that submitted their comments to the SCoF for public hearings.

This Draft Response Document contains draft responses from National Treasury and SARS officials to the key issues raised by the public during the public hearings and workshops. After it has been considered by Parliament, it will be presented to the Minister for approval, including to approving consequential amendments to the 2020 Draft Tax Bills prior to the formal introduction/tabling in Parliament in 2020.

1.3. POLICY ISSUES AND RESPONSES

Provided below are the responses to the key issues raised by the public comments received in respect of the 2020 Draft Rates Bill, the 2020 Draft TLAB and the 2020 Draft TALAB from written submissions and during the public hearings. These comments will be taken into account in finalising the 2020 Draft Tax Bills to be formally introduced/tabled in Parliament. Comments that are outside the scope of the 2020 Draft Tax Bills are not considered for purposes of this response document.

However, a special exception is made with regard to one comment dealing with tax residency test in terms of section 10(1)(*o*)(ii) of the Income Tax Act exemption, in order to accommodate the impact of COVID-19 pandemic, which is outside the scope of the 2020 Draft Tax Bills. This is addressed in this response document in order to enable inclusion in this year's legislative cycle. This is in accordance with the Media Statement issued by the National Treasury on 31 July 2020 as well as the statement made by the National Treasury in their Response Document on the COVID-19 Tax Bills to SCoF on 28 July 2020 which reads as follows:

> "*National Treasury needs to carefully consider the additional tax proposals and there is no guarantee that these proposals will be accepted by the Minister. In considering these proposals there are many objectives we need to balance in terms of revenue and distributional impacts. There are a number of proposals which may have less of an impact on the fiscal framework, such as the tax-residency test. These can be considered but are less urgent as they relate to years of assessment and are finalised after the end of the tax year. These can potentially be included in the legislation later this year. Many of the additional tax proposals would lead to a reduction in tax revenue in 2020/21 and have an impact on the fiscal framework. The fiscal framework from the Supplementary Budget has already been approved and it would be difficult to put in new tax measures to amend".*

1.4. SUMMARY

The 2020 Response Document includes a summary of all the written comments received on the 2020 Draft Tax Bills published for public comment on 31 July 2020 as well as a summary of all the written and oral presentations made during public hearings on the 2020 Draft Tax Bills held by the SCoF on 7 October 2020.

Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill

2. CUSTOMS AND EXCISE ACT: INCREASE IN THE EXCISE DUTY ON TOBACCO

(Main references: Part 2A of Schedule No 1 to the Customs and Excise Act: Clause 8 & Schedule II, Part 1 of the Draft Rates Bill)

2.1. Increase in excise duty on tobacco

In the 2020 Draft Rates Bill, a proposal was made to increase the excise duty on tobacco from R16.66/20 cigarettes to R17.40/20 cigarettes, with effect from 26 February 2020. The policy guideline sets the targeted excise burden for tobacco at 40 per cent of the retail selling price of the most popular brand.

Comments: National Treasury has already gone beyond the 40% excise incidence (currently excise incidence sit at 41.4%). Government should not increase excise on cigarettes until the targeted incidence is maintained (or next year and inflation adjusted increases for the 2022/3 and 2023/4 financial years respectively)

Response: Noted. It is correct that the tax incidence is currently slightly above the 40% policy guidelines, however part of the policy is to increase the excise rates by at least inflation or an amount to move towards the targeted incidence, whichever is higher, on an annual basis. Sometimes industry absorbs a portion of the excise increases and therefore the incidence is surpassed. The year-on-year increases on cigarettes prices by manufacturers has been lower than excise rate increases.

Comments: It is recommended that tobacco and tobacco products should be exempted from any tax increase. We believe the freezing of any increase will help the local legal industry to recover from instability and uncertainty that has been caused by the rampant illicit trade and the effects of COVID-19 pandemic. Any increases will stimulate illicit trade and lead to a significant decline in state revenue.

Response: Not accepted. The reason there is an excise tax regime for tobacco products is that consumption of these products causes health harm, and the excise must be adjusted on an annual basis by at least inflation. The fear of loss of revenue is not a sufficient motivation for government to abandon its excise policy on tobacco products. The problem of illicit trade must be addressed through law enforcement mechanisms. Addressing the concerns regarding illicit trade in tobacco products should happen concurrently with the implementation of the excise tax policy on tobacco products.

Comment: It is requested that government should not increase excise duty on tobacco because it has failed over time to decrease smoking in the country. It is not successful as an anti-smoking strategy, as all it does is fuel illicit trade.

> *Response:* Not accepted. An excise tax policy regime is part of a broader strategy to reduce consumption of tobacco products, which includes non-tax measures in the purview of the National Department of Health through the Tobacco Products Control Act. Excise tax increases are a proven and effective tool, both in terms of cost and population-level effects, to make cigarettes and other tobacco products less affordable and reduce consumption. Research shows that since the implementation of these strategies from 1993 smoking prevalence has declined in SA.

Comment: It is suggested that National Treasury should, as an option, adopt a completely new excise tax model, not based on a targeted tax burden, but where the quantum of the excise tax increase is determined exogenously of the industry's pricing mechanism.

> *Response:* Noted. As indicated above, sometimes the manufacturers do not increase their prices which leads to the incidence being higher than the guideline set in our policy documents. National Treasury could explore the proposal.

2.2. Illicit trade on tobacco

Comments: The biggest threat to the local tobacco industry (and downstream industries) is the illicit market and the industry suffered massively under lockdown. There is a need to improve administration and enforcement.

> *Response:* Accepted. Government is also concerned with the issue of illicit trade in tobacco products, hence the efforts to rebuild capacity in SARS and collaboration with other law enforcement agencies to address the problem.

Comments: Government should also urgently ratify the WHO Illicit Trade Protocol in order to counter the growth of illicit cigarette trade.

> *Response:* Accepted. The National Department of Health is leading government on the matter of ratifying the World Health Organisation's Protocol to Eliminate Illicit Trade in Tobacco Products and are aware of the urgency of doing so. The protocol requires member countries to adopt and implement effective measures to control or regulate the supply chain of goods covered by the Protocol in order to prevent, deter, detect, investigate and prosecute illicit trade in such goods and shall cooperate with one another to this end, Government has already started with some aspects of the Protocol by amending the Custom and Excise Act in 2016 to provide for the marking, tracking and tracing of tobacco products.

Comment: The Minimum Retail Selling Price (MPL) concept which has been adopted by several countries globally provides some instructive insights on how SA can

increase the effectiveness and efficiency in combating illicit trade in cigarettes. MPL sets the price below which cigarettes cannot be sold to any consumer. It is instrumental in achieving related public health objectives and strongly recommend that National Treasury should adopt the MPL for cigarettes at R28 per pack of 20.

Response: Noted. National Treasury will consider exploring this proposal further as part of the normal tobacco regulations review process.

2.3. Excise duty on heated tobacco products (HTPs)

Comments: The cigarette excise is charged per stick and not based on the weight of the stick. Calculations based on weight creates a distortion vis-à-vis other categories especially cigarettes. Recommend that the excise on HTPs be adjusted to 75% of the excise per factory manufactured cigarettes which translates to ZAR 652.50 per 1000 heated tobacco sticks. Further recommend that a separate subcategory specific for tobacco heat sticks should be introduced under sub heading HS code 2403.91 to give effect to the foregoing.

Response: Noted. The newly created category of tobacco products is, at this stage, very broad, and includes different products in the form of the tobacco roll (different length and weight), tobacco capsule or tobacco plug. The reference of HTPs rate to that of cigarettes was intended for HTPs to be taxed like cigarettes albeit with a concessionary rate.

The mass for duty purposes is defined in General Note D to Schedule No. 1 of the Customs and Excise Act, 1964 (the Act), and D.3 states “The net mass of any goods shall be the actual mass thereof excluding packaging material”. Cigarette tobacco and pipe tobacco are taxed on R/kg net (thus excluding outer packaging material e.g. box, tin or bag) and cigarettes per pack of 20 or 10 sticks thus including the filter and paper.

The intention is to further refine the HTPs category in the following budget to ensure that there is equity in the treatment of similar tobacco products rather than a broad category we have currently. We will also be following the developments in this category to keep up with newer products that will be introduced in the market.

Comment: Net weight excise tax basis is currently adopted in all countries where a fully specific excise tax is applied based on weight and HTPs are on sale (28 countries including the UK)

Response: Noted. Several countries have implemented a weight-based form of taxation; however, the intention is to tax based on the number of sticks which will be considered for the next budget. In Hungary, the tax base is the stick of tobacco used heating device and it is taxed at HUF 10 per stick. Similarly, in The Kingdom of Jordan, an excise on heated tobacco products is based on consumable product (i.e. tobacco sticks) at a rate of 3 dinars per 200 units. The mass for duty purposes is defined as indicated above.

2.4. Excise duty on pipe tobacco

Comments: The excise incidence on pipe tobacco is 27% compared to an excise incidence of 41.4% on factory manufactured cigarettes. In line with the risk continuum argument on cigarettes, the excise on pipe tobacco should be increased to the same level of manufactured cigarettes, ZAR 1087.50 per kg.

Response: Not accepted. The tobacco excise policy uses the targeted incidence guideline approach. It should be noted that although tobacco products in South Africa are taxed per weight and/or volume, they are not taxed at a uniform weight or volume. The reasons for the divergence in excise duty rates per category include the application of the benchmark guideline of 40% of the retail selling price of the most popular brand within each product category (i.e. excise tax incidence) and the disproportionate pricing of tobacco products concerned. Also, cigarettes make up a larger proportion of the tobacco market.

3. CUSTOMS AND EXCISE ACT: INTRODUCTION OF EXPORT TAXES ON SCRAP METALS

(Main references: Section 48 of the Customs & Excise Act, Schedule 1 and Schedule 5 to the Customs and Excise Act: Clauses 57, 58 & 59 of the Draft TLAB)

On 10 May 2013, the then Minister of Economic Development issued a Trade Policy Directive ("the Directive"), in terms of section 5 of the International Trade Administration Act, No. 71 of 2002 ("the ITA Act"), for International Trade Administration Commission of South Africa ("ITAC") to regulate the exportation of scrap metal through the introduction of the Price Preference System (PPS). The objective was to improve the availability of better-quality scrap metal at affordable prices for foundries and mills in the domestic market to assist them in becoming more cost competitive as against imports, enhancing investment, jobs and industrialization. The PPS provided that ITAC would not authorise the exportation of scrap metal unless it had first been offered for sale to the domestic consuming industry of scrap metal for a period and at a price discount or other formula determined by ITAC. The PPS was introduced in September 2013 for an initial period of five years, which period ended on 30 September 2018. The PPS has been extended a number of times since then by notices in the Government Gazette. The PPS seems not to have provided sufficient support such that the sector can flourish in competition with global counterparts, many of which benefit from an export tax on scrap and lower domestic prices for scrap. The Minister of Trade and Industry therefore directed ITAC, in terms of section 18 of the ITA Act, to investigate and advise him whether it would be appropriate to replace the existing PPS regulating the exportation of ferrous and non-ferrous waste and scrap metal with an export duty on scrap metal. ITAC conducted its investigation and based on the findings, recommended that the current PPS be replaced with export duties since it has not effectively provided support to the foundries and mills with availability of affordable, quality scrap metal. The DTIC consider an export tax to be superior to the PPS in

terms of its easy administration and believe it should be more effective in reducing the domestic price as it will have the effect of reducing the export price achieved by local scrap dealers, unlike the PPS. Based on the above, it is proposed that changes be made in the Customs and Excise Act and schedules to the Customs and Excise Act to insert provisions dealing with the introduction of export duties on scrap metals. The specific export duties that are proposed on certain categories of scrap metal are as follows:

Scrap metal category	Equivalent specific tax *(Rand per tonne)*
Ferrous metals (including stainless steel)	R1 000.00 per tonne
Aluminium	R3 000.00 per tonne
Red metals	R8 426.00 per tonne
Other (waste and scrap metals)	R1 000.00 per tonne

That said, the export taxes will not apply to exports to countries benefitting from exemptions under international trade agreements to which South Africa is a party.

3.1. Export tax as a policy instrument

Comment: The Price Preference System (PPS) has so far proved to be ineffective in achieving its objectives. We strongly support this initiative of export tax on scrap metal replacing the PPS, as this will assist local manufacturers in their foundries to supply material locally which will stimulate and grow the economy and will also assist manufacturers to be competitive in the export market.

Response: Accepted. In 2013, Minister Ebrahim Patel issued a policy directive to ITAC to introduce the Price Preference System (PPS) regulating the exportation of scrap metal to enable the availability of good quality and affordable scrap for downstream users. Scrap metal is a key input for downstream manufacturing supporting local beneficiation. The system however, has been circumvented by both illegal means and using loopholes in the PPS, resulting in illegal and excessive exports of scrap with the consequence of a shortage of affordable scrap for local consumers. The export duty was recommended as an alternative for regulating the export of scrap from South Africa. Due to the shortcomings in the PPS, National Treasury, ITAC and the DTIC have been working on replacing the PPS with a proposed export tax.

It should be noted that South Africa is a signatory to a number of key trade agreements, which limit the use of export taxes – both in number and timing, but also through the implications of the most favoured nation concept and the web of overlapping trade agreements, and there remains a very real threat of retaliation from those outside of such agreements. For example, the EPA only allows up to 8 export taxes at one time and their use comes with time restrictions. Export taxes are a blunt tool to use to achieve the intended objectives and need to be carefully

considered as they directly harm one industry for the direct benefit of another, which hopefully creates wider benefits for the broader economy.

Comments: A growing number of countries have imposed export duties on raw materials in order to enable domestic industries to get it at a lower price than foreign manufacturers and capitalize on the competitive advantage on raw materials and other inputs, including labour.

Response: Noted. Scrap metal is an important feedstock in the production of downstream metals due to the relatively lower energy consumption and its lower carbon footprint versus other metal production processes. It is widely seen as a strategic resource and many countries have scrap metal policies and regulations in place to support the development of their domestic metal producing industries.

Export taxes on scrap metals are used in a few countries, and especially amongst a few of the large BRICS countries. According to the most recent update in the OECD's inventory of export restrictions on industrial raw materials, 32 countries have applied some form of export restriction on scrap metal (15 out of these countries make use of an export tax on scrap metal). In terms of ferrous scrap, 14 countries impose an export tax which is as high as 40%. As an example, China charges (40%), Russia (12.5%) and India (15%) whilst some countries impose an absolute tax per tonne.

Comment: The unaffordable rates charged by the local scrap merchants to the domestic metal industry creates a gap of inaccessible scrap material, which is available for export at a higher premium. Besides the high price, distortions may arise in the raw materials sector as producers opt to utilise the high-energy consuming primary raw material in the production process, instead of the already enhanced scrap material, which will further drive up local metal prices.

Response: Noted. The use and demand for metal scrap globally is on the rise driven by profitable and competitive scrap-based mini-mill electric arc furnace (EAF) technology which continues to support scrap exports placing the domestic industry and potential investments under strain. The increased global demand for raw materials has resulted in a significant price increases for all main inputs into the metals sector. The situation is aggravated by the effects of the COVID-19 pandemic and the subdued economic activity resulting in lower levels of scrap generation. The EAF method of steelmaking uses scrap steel, which is infinitely recyclable, resulting in a more positive environmental impact. Per tonne of secondary steel produced using scrap, this method can deliver a 74% saving in energy, accompanied by reductions in GHG emissions, primarily because this method bypasses the ironmaking process.

The fact that large scrap generating countries impose an export tax results in global prices increasing, requires South Africa to also impose an export tax to mitigate the impact of measures taken by larger countries to curtail the export of scrap to benefit local beneficiation. Affordable scrap metal is critical for the overall cost structure and competitiveness of steel foundries and mini mills.

In producing steel, one has an input option of either iron ore or scrap metal. Comparing the alternative of using scrap metal instead or iron ore drastically reduces energy consumption and CO2 emissions. Further using scrap metal as an input reduces barrier to entry into steel production, as mini-mills are a more affordable technology to produce steel, thus enabling competition in the sector.

*Comments: A*n export duty will make it considerably less profitable to sell stolen copper and aluminium "disguised" as scrap to international markets. This is because the proposed export duties will make it more expensive and difficult to source scrap metal from South Africa.

Response: Noted. The implementation of an export tax will result in less scrap being exported overall. It is therefore anticipated that the introduction of an export tax will also assist in curbing theft and damage to infrastructure.

Comment: In light of the shortage and insecurity of supply in our own country, government should ban the exportation of scrap in the interest of championing manufacturing and industrialisation. Otherwise, any avenue left to export ferrous scrap will be used even by false declarations, since inspecting every container by authorities seems impossible.

Response: Not Accepted. The application of a ban on export of scrap metals on a permanent basis is not currently considered prudent. Theoretically, a ban, a quota and an export tax all have similar effects on the domestic price – they increase the domestic supply and thus lower the domestic price. These three only differ in the severity of their impacts. An export ban and a quota sever the price link between the domestic and the international markets. For this reason, a quota and/or a ban can provide poor incentives to consumers and may encourage inefficient consumption of the commodities. In contrast, an export tax does not sever the link between the domestic and the global markets for commodities but creates a wedge between the domestic and "world" prices. This accords the domestic consumers of commodities some cost advantage, but the two prices will continue to move in tandem. This provides better efficiency incentives to the domestic consumers. Consequently, an export tax is generally preferable to either a quota or a ban.

The requirement of local foundries and mini mills must be balanced with opportunities for scrap merchants to export some levels of scrap. On 3 July 2020 the Minister of Trade, Industry and Competition issued a Trade Policy Directive to ITAC to investigate the PPS, during this time the administration of the PPS and the export of scrap metal was suspended, subject to exceptions, to address some of the immediate challenges relating to access to scrap due to the effects of COVID-19. The temporary suspension ended on 2 October 2020 after measures were put in place to deal with loopholes in the PPS system in order to once again make scrap available in the domestic market. The introduction of an export tax is proposed as a sustainable policy measure to mitigate the weaknesses and loopholes inherent in the PPS. Government has also established an inter-

governmental working group to increase efforts to combat illicit trade of scrap metal with the help of the South African Revenue Service (SARS).

An outright ban of the exportation of scrap metals will also be inconsistent with SA's obligations under the WTO agreement.

Comment: Any duty or restriction on the movement of metallic scrap for recycling in the long term is detrimental to not only the consuming industry but to the general economy. The only way that you will encourage both modernization and foreign investment is to fully open the industry

Response: Not Accepted. Scrap metal is a critical feedstock into manufacturing. The metals value chain is central to South Africa's industrialisation and has significant linkages to infrastructure, construction, mining and a range of manufacturing industries. The three largest consumers of metal products in South Africa are the construction industry, the mining industry and the transport equipment manufacturing industry which together account for approximately R750 billion or 15% of SA's GDP and employ nearly 2 million people (both formal and informal). Measures to support the availability of affordable scrap metal will therefore support the economy and add value to our raw material input base.

Comment: There is more than adequate supply available to meet local demand and such a tax would only dampen domestic prices, the benefits of which will not flow to the broader economy in general but rather accrue to the direct users of the resource (i.e. electric steel makers).

Response: Not Accepted. There is an inadequate supply of affordable scrap metal to support the existing, as well as growth and development needs of the downstream industry. There is evidence of shortages of scrap metal, in particular ferrous scrap. The current and future demand (due to expansions and investment) is growing. Local mini-mills and foundries have provided information of current and future scrap requirements. There are particular grades which the domestic industry does not consume or are not consuming at a particular point in time.

Comment: A decrease in local scrap price would dampen the incentive for collection and this would negatively impact the informal sector in particular and not be beneficial to the downstream scrap suppliers who should be the beneficiaries of such intervention

Response: Not Accepted. The proposed export tax rates are intended to balance the interests of both the scrap consuming and supply industry, and not to create a disincentive to any party.

3.2. Scope of the proposed export tax

Comment: Stainless steel scrap must have its own category of export taxation. Its inclusion in the Ferrous metals would render the taxation to be at a low value.

Response: Accepted. The tariff Schedule 6A in the draft 2020 TLAB already provides for stainless steel scrap under tariff subheading item 7204.21 and the applicable rate will be adjusted and is different from ferrous metals.

Comment: Tungsten scrap, although listed on ITAC's PPS since its inception, has been omitted from the proposal on the implementation of an export duty. The implementation of an export duty (tax) on all forms of tungsten metal, tungsten carbide and cemented tungsten carbide scrap and waste, be it in the powder or hardened form is supported

Response: Noted. The National Treasury and other role players will review the export tax regularly to establish if the export tax is meeting its intended objectives and review whether the types or grades of scrap metal should be included or excluded in the list of scrap metal subject to export tax. The 2020 draft TLAB also includes an amendment in section 48 of the Customs and Excise Act to make provision for the Minister of Finance, by notice to withdraw or reduce any export duty imposed in terms of this section, with or without retrospective effect, or increase such export duty, from a date and to such extent as the Minister may determine.

Comment: It is proposed to include Austenitic Stainless Steel (appearance stainless, non-magnetic) at R 5 950 per tonne, and Ferric Stainless Steel (appearance stainless, magnetic) at R3 450 per tonne and Pig Iron (including by-products from Titanium smelters) at R1 100 per tonne. Pig-Iron and by-products of smelters are currently exported without beneficiation to foundry castings or steel products across the world and therefore lost income for South Africa.

Response: Noted. The tariff Schedule 6A in the 2020 draft TLAB already provides for stainless steel scrap under tariff subheading item 7204.21 and the applicable rate will be adjusted and is different from ferrous metals.

Comment: Export of scrap metal imported in-bond (stored in bond) or in-transit and exported thereafter should be free from export tax since it is not admitted for home consumption. Reference to imported scrap metal be removed from the Notes in Section A of Part 6 to Schedule 1 of the Customs and Excise Act, No. 91 of 1964.

Response: Not Accepted. SARS would not be able to determine the origin of imported scrap metal that was cleared for home consumption and thereafter exported because once it goes into consumption, SARS loses control over the goods.

Comment: Lead is a critical raw material in the manufacturing of lead acid batteries, a major industry in SA and there is no domestic producer of primary lead (i.e. processing ore into lead) in the SACU market. As such, the demand must be satisfied by recycling spent lead acid batteries (secondary lead) and exports of spent lead acid batteries on a large scale have resulted in severe scrap lead shortages locally. We are supportive to the implementation of an export tax on scrap and used lead acid batteries and articles to dis-incentivise exports and ensure the local industry remains competitive.

Response: Noted. Although it may be a source of lead, batteries do not fall under metals and may require further scrutiny. The lead-acid waste and scrap batteries are classifiable under TH 8548.10.10 and the used batteries under 8507.10.11 We will have to be mindful of extending the scope and including more goods in view of the limitation of tariff lines pertaining to the EU.

ITAC assisted with a draft policy on the exportation of scrap, waste, used or second-hand lead acid batteries which are being dealt with as a separate issue. The draft policy is currently with the Minister of Trade, Industry and Competition for consideration. The Minister is currently seeking a legal opinion on certain aspects of policy.

Comment: The export of lead scrap comes with a unique set of regulatory requirements that practically impacts its export. Consequently, export volumes of this product are limited to a few hundred kilograms per annum, simply not warranting the imposition of an export tax.

Response: Accepted. There have only been two requests for the exportation of lead scrap in terms of the Price Preference System during the past three years. The exportation of scrap lead is also subject to regulatory requirements in terms of the Basel Convention and must therefore also be authorised by the Department of Environmental Affairs, Forestry and Fisheries.

Comment: There is absolutely no justification for an export duty on metals not processed or currently required in South Africa or SACU countries or exported in such small volumes that the imposition of an export duty will serve no purpose.

Response: Noted. The exclusion of specific grades of scrap metal within categories will add a layer of complexity to administration. However, as noted earlier, National Treasury and other role players will review the export tax regularly to establish if the export tax is meeting its intended objectives and review the types or grades of scrap metal should be included or excluded in the list of scrap metal that is subject to export tax. The 2020 draft TLAB also includes an amendment in section 48 of the Customs and Excise Act to make provision for the Minister of Finance, by notice to withdraw or reduce any export duty imposed in terms of this section, with or without retrospective effect, or increase such export duty, from a date and to such extent as the Minister may determine.

3.3. Rate of the proposed export tax

Comment: The Rand value per tonne that can be realised for scrap metals constantly varies and a fixed duty rate per tonne is simply not dynamic enough to be effective without being disruptive. We propose an ad valorem duty as it better serves both objectives of supporting domestic consumers of scrap metals and also protecting the collectors and recyclers.

Response: Accepted. The rates in the 2020 draft TLAB will be changed from a specific Rand rate per tonne to an ad-valorem equivalent rate to provide for the dynamic movements in the prices of metals, as shown in the table below. Government recognises there are concerns about the challenges of under-invoicing or under-declaration with ad-valorem duties. The DTIC experience with imports is that as the customs duties increase, the declared value decreases, which may undermine the applicable duty rates. The implementation of an ad-valorem duty will be monitored and where there is evidence of under-invoicing and/or under-declaration, government will review the manner the export tax is designed as provided for in the amendment to section 48 of the Customs and Excise Act.

Scrap metal category	Ad-valorem duty rate
Stainless steel	15%
Ferrous metals	20%
Aluminium	15%
Red metals	10%
Other (waste and scrap metals)	20%

Comments: A fixed duty will serve to further instil the distortion already evident in the application of existing Price Preferential System for scrap metals. Less flexibility will create more distortion and disruption for scrap generators, collectors and recyclers located further from Gauteng or the coastal regions (i.e. transport costs is a significant element). At the very least the PPS linked the discounted "Preference Prices" to market related prices.

Response: Noted. The rates in the 2020 draft TLAB will be changed from a specific Rand rate per tonne to an ad valorem equivalent rate to provide for the dynamic movements in the prices of metals. The system will be reviewed by government and its institutions periodically in order to determine its effectiveness and which could be revised to deal with challenges that manifest or to address unintended consequences such as under-invoicing and under-declaration. Government will review the manner the export tax is designed as provided for in the amendment to section 48 of the Customs and Excise Act.

Comment: The values given to each grade is firstly not consistent and secondly, the gross values are based on international metal prices and exchange rates, which are continually moving and will eventually distort this whole system. There should be a mechanism for increasing these duty as needed.

Response: Noted. The rates in the 2020 draft TLAB will be changed from a specific Rand rate per tonne to an ad valorem equivalent rate to provide for the dynamic movements in the prices of metals. Government will review the manner the export tax is designed as provided for in the amendment to section 48 of the Customs and Excise Act.

Comment: The good thing about the duty structure is that the proposed duty is tonnage based (i.e. R1000/MT) and not transaction value based as a lot of exporters send material through UAE and other tax haven countries from which the material is further exported to the Indian sub-continent. This would discourage manipulation on the invoice value and in turn give a boost to the foreign Exchange reserves of the country.

> *Response:* Noted. The rates in the 2020 draft TLAB will be changed from a specific Rand rate per tonne to an ad valorem equivalent rate to provide for the dynamic movements in the prices of metals. A specific excise rate may have unintended consequences.

Comment: These proposed duties have been listed without thorough investigation into the current state of the industry. When calculated with London Metal Exchange (LME) Index or rate and compared to the current PPS rate, there is still a significant difference favouring exports above selling locally.

> *Response:* Noted. The rates in the 2020 draft TLAB will be changed from a specific Rand rate per tonne to an ad valorem equivalent rate to provide for the dynamic movements in the prices of metals.

Comments: Taxpayers had previously highlighted VAT fraud, violent theft and the false declaration of the class of scrap goods to be exported by scrap dealers, hence an export duty on all forms of tungsten and other non-ferrous metal scrap of between 25 per cent to 50 per cent will adequately address and thus limit the continued proliferation of each of these pertinent and illegal issues.

> Response: Not accepted. Government has established an inter-governmental working group to increase efforts to combat illicit trade of scrap metal with the SARS.

Comment: Duty for aluminium should be a minimum of R4 000 /mt (or R4/kg) to ensure sufficient scrap (i.e. used beverage cans) is available for local beneficiation. The current rate is low must be raised to the threshold of R5 000 per tonne to stimulate local beneficiation.

> *Response:* Not accepted. ITAC have utilised the same standard method to calculate the rate for all metals which is based on the differential between the domestic and export prices. The rates proposed are intended to balance the interests of both the consuming and supply industries.

Comments: An export duty for aluminium in excess of R5/kg would likely result in unintended negative consequence. A reduction in export tax for aluminium would help Aluminium industry which is a net positive for South Africa and the subsidiaries that rely on the aluminium.

> *Response:* Not accepted. The rates proposed are based on a standard method used and are intended to balance the interests of both the consuming and supply industries.

Comments: The export tax value for red metal scrap is too low given the current price of copper. It should be set at the minimum of 20% of LME. The export tax should be set at the maximum value as opposed to the minimum value.

> *Response:* Not accepted. The rates proposed are based on a standard method used and are intended to balance the interests of both the consuming and supply industries. The implementation of an ad valorem excise will be monitored and where there is evidence of under-invoicing and under-declaration, government will review the manner the export tax is designed as provided for in the amendment to section 48 of the Customs and Excise Act.

Comments: A substantial local smelting and foundry sector for the red metals category, also covering brass, has been established in SA. This sector will likely benefit from a proposed export duty on red metals and this can be supported. A reasonable ad valorem duty would likely be in the region of 5%.

> *Response:* Partially accepted. Red metals including brass have been included in the proposed export tax/duty under tariff heading 7404.00 at the specified rate.

3.4. Exemptions from export tax and international trade agreements

Comment: The primary concern with the proposed exemptions is that it would give rise to the opportunity for circumvention of the export duty system if exports are re-routed to take advantage of the EFTA or SADC Treaty. Given that the relevant avoidance actions would take place outside of SA, there is very limited practical possibility of direct control or audit.

> *Response:* Noted. However, the risk that circumvention may undermine the effectiveness of an export duty is small, in particular because scrap metal exports to the EU and SADC countries have been insignificant when compared to total exports of scrap metal from South Africa. Any abuse of the system will be monitored, and firm action will be taken in the event of illegal activities.

Comment: The zero rate for EFTA and SADC – these are the larger destinations for SA scrap metals exports, in particular the suspected current practice of using an SADC operator as the route to bypass the permitting system

> *Response:* Noted. However, the risk that circumvention may undermine the effectiveness of an export duty is small, in particular because scrap metal exports to the EU and SADC countries have been insignificant when compared to total exports of scrap metal from South Africa. Any abuse of the system will be monitored, and firm action will be taken in the event of illegal activities.

Comment: South Africa could consider a refund mechanism (where exporter is required to make payment upfront) rather than an exemption, with refund requiring

proof of final destination. The refund mechanism will not breach the SADC Treaty (Art 5 & 9) since is to promote custom enforcement and prevent deceptive practices.

Response: Not accepted. As the export tax is a new system, careful consideration is required before implementation of any further mechanisms such as refund mechanism.

Comment: A quota system especially for the SADC countries should be imposed limiting scrap metals through EFTA or SADC, with the quota based on normal export levels before the announcement of the export levy. This will go a long way to prevent aggressive tax avoidance and circumvention schemes that undermine the tax base and economic development.

Response: Not accepted. As the export tax is a new system, careful consideration is required before implementation of any quota system.

Comment: Just as rules of origin are important, to protect the imported claiming of tax treaty relief on imported goods, it is submitted that the rules of destination are necessary to protect the improper claiming of tax treaty in relation to exported goods. The Custom and Excise Act (sec46) should be amended relating to rules of destination (example provided in submission) and to provide for registration requirements and criminalisation of various harmful practices.

Response: Noted. If re-routing is found to be a big risk, a solution will be considered in the future.

Comment: Government should take the necessary measures to ensure that processes are followed at customs and that the relevant duties are paid. Furthermore, government should apply export tax to all export destinations.

Response: Noted. The International Trade Administration Commission of South Africa (ITAC), SARS and other law enforcement agencies will be attending to these matters.

Comment: Request that the current PPS remain in place for export to countries where free duty is applicable.

Response: Not accepted. PPS system has proven to be complex to implement and oversee. Export control through the ITAC's permit system should be sufficient in supplanting all other enforcement mechanisms to ensure compliance.

3.5. Administration of export tax

Comment: Cash for scrap allows merchants to manipulate VAT returns, placing local manufacturers at a 15% disadvantage. Some scrap exporters have overvalued the value of the scrap in order to illegally claim the input VAT, which is a drain on the national fiscus.

Response: Noted. The VAT Act provides for a vendor who acquires second-hand goods on which no VAT is actually charged (the supply being not taxable) that are to be used wholly or partly in the course of making taxable supplies is entitled to an input tax deduction equal to the tax fraction of the cash price paid for those goods. National Treasury will explore alleged fraud in more detail first, especially in the context of the enforcement challenges being faced (and which cannot be resolved in the short to medium term) and then decide on how best to address the problem.

Comment: The notes should be amended to include a penalty duty or some mechanism if it is found that the ferrous scrap is being exported to a free duty country only to be further exported to another country on which duty applies.

Response: Not accepted. The Customs and Excise Act makes provision for SARS to deal with any person that contravenes or fails to comply with the provisions of the Act. Also, the exportation of all scrap metals will still be subject to the issuing of ITAC export permits after implementation of an export tax/duty. ITAC export permits will be issued on condition that scrap only be exported to its final destination country only. Contravention of permit conditions is a serious contravention and is normally investigated for purposes of criminal prosecution.

Comment: Container inspections must increase as the copper scrap is also illegally exported under false tariff codes. Suggest the introduction of physical audits at the scrap merchants place of business

Response: Noted. Government has through the inter-agency working group increased efforts to combat illicit and illegal exports in terms of increased inspections and detention of containers where there is evidence of false declarations. However, these measures require lots of resources.

Comment: Illicit or illegal export transactions are continuing to reduce the availability of raw materials and cause damage to the built environment and to infrastructure, there must be consequences for illicit trade. Policing will be needed to ensure that the systems and processes are adhered to and non-compliance is disciplined.

Response: Noted. SARS enforcement working together with the International Trade Administration Commission of South Africa (ITAC) and other law enforcement agencies will be attending to these matters as part of normal tax administration.

Comments: Export duty should still be coupled with the same permit system as the current PPS and exporters must be required to pay the export tax against tonnage applied for as a prerequisite to be issued with a valid export permit.

Response: Not accepted. The exportation of all scrap metals will still be subject to the issuing of ITAC export permits after implementation of an export tax. It will not be possible to exceed quantities as stipulated on export permits as electronic

clearance systems will reject entries where permit quantities are exceeded. However, export tax will be levied against actual export declarations to SARS Customs on physical exportation of the scrap metal.

Comments: The effectiveness of this duty would depend on how strongly SARS implements this. We are of the opinion that widespread smuggling of scrap can take place once the duty comes into operation. There are various powers with SARS to circumvent such practices. A whistle-blower portal can be created under SARS to inform the authorities of any such incidents.

Response: Noted. SARS already created a platform where any person may contact SARS to report a particular taxpayer if it is suspected that the said taxpayer may be non-compliant or there is a suspicious activity. This is a confidential platform to report an importer (including the clearing agent) that is found to have not declared, mis-declared or under-declared goods upon importation and of what is due to SARS in taxes or duties. This similarly applies for export duty purposes. The relevant information is available on the SARS website at https://www.sars.gov.za/TargTaxCrime/ReportCrime/Pages/Report-a-suspicious-activity.aspx

3.6. Earmarking of export tax revenue

Comment: The income generated from this tax should be ring-fenced and re-invested into the steel industry to upgrade our steel industry capacity in order to create the most needed jobs in this sector.

Response: Not accepted. All tax revenues accrue to the National Revenue Fund for general government expenditure, as per determined budget priorities. The legislative earmarking of revenue is not good public finance policy as it introduces rigidities in the budgeting process.

4. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

4.1. Addressing an anomaly in the tax exemption of employer provided bursaries

(Main references: Sections 10(1)(*q*), 10(1)(*qA*) and 23(*s*) of the Income Tax Act: clauses 10 and 25 of the Draft TLAB)

The Income Tax Act contains provisions that provide an exemption in respect of *bona fide* bursaries or scholarships granted by employers to employees or relatives of qualifying employees, subject to certain monetary limits and requirements stipulated in the Act. When these provisions were initially introduced in 1992, the applicability of the exemption was dependent on the fact that the employee's remuneration package was not subject to an element of salary sacrifice. However, in 2006 changes were made in the tax legislation to remove the exclusion of salary sacrifice for exemption. Following the 2006 amendments, the tax exemption was available irrespective of whether a bursary or scholarship scheme contained an element of salary sacrifice. Government has however noticed that a number of schemes have emerged in respect of employer bursaries granted to the relatives of employees. These bursary schemes are provided by an institution other than the employer and marketed to the employer as a means of providing tax-exempt bursaries to their employees at no additional cost to the employer. These schemes seek to reclassify ordinary taxable remuneration received by the employee as a tax-exempt bursary granted to the relatives of employees. As a result, an employee can cater for their relative's studies by way of a salary sacrifice. The portion of the salary sacrificed by the employee is paid directly by the employer to the respective school and is treated as a tax-exempt bursary in the employee's hands. In order to address these concerns, the following changes are proposed in the draft tax legislation:

- The exemption in respect of a *bona fide* bursary or scholarship granted by the employer to the relatives of the employee as contemplated in paragraph(ii) of the provisos to section 10(1)(*q*) and section 10(1)(*q*A), should only apply if that *bona fide* bursary or scholarship granted by the employer is not restricted only to the relatives of the employee, but is an open bursary or scholarship available and provided to members of the general public;
- The requirement that the applicability of the exemption is dependent on the fact that the employee's remuneration package is not subject to an element of salary sacrifice, be reinstated; and
- As a means of further encouraging employers to grant bursaries to relatives of employees without subjecting such bursary to an element of salary sacrifice, that the employer deduction in relation to said bursaries is only afforded if the bursary to the employee's relative is not subject to an element of salary sacrifice.

Comment: The requirement that bursaries to relatives of employees also be bursaries available to the general public is restrictive. It would also be extremely costly for employers (especially considering the impacts of the current COVID-19 pandemic). The loss to the fiscus is minimal considering the benefit arising from the current legislation.

Response: Accepted. Changes will be made in the 2020 draft TLAB to remove the requirement that bursaries to relatives of employees shall only be exempt if said bursary is an open bursary available to members of the general public. As a result, the tax-exempt status will not be dependent on whether or not the bursary is open to members of the general public.

Comment: Reinstating the salary sacrifice requirement undermines Government's objective for skills development.

Response: Not accepted. While Government remains committed to the skills development objectives, Government also needs to acknowledge when policy decisions previously taken are making tax abuse easier for taxpayers. Further to the above, and in the strictest interpretation of the law, a bursary that is subject to an element of salary sacrifice is not a *bona fide* bursary as defined. In fact, a bursary that is subject to an element of salary sacrifice enables employees to pay for their children or relative's school fees with "pre-tax income", whereas employees who do not receive the benefit of an employer provided bursary pay for their children or relative's school fees with "after tax income". Allowing a tax exemption in cases where a bursary is subject to an element of salary sacrifice results in the employee effectively paying for educational costs and receiving a tax deduction for those educational costs.

Comment: It seems unfair to disallow the employer deduction in respect of a bursary subject to a salary sacrifice if the benefit is going to be taxed in the employee's hands.

Response: Accepted. Changes will be made in the 2020 Draft TLAB, and the requirement that the employer deduction in relation to bursaries is only available if the bursary is not subject to an element of salary sacrifice will be removed. The employer deduction will be allowed even if the bursary is subject to an element of salary sacrifice.

Comment: The 2020 Budget announcement only catered for an amendment as relates to bursaries granted to relatives of an employee. The proposed legislative amendment, as relates to salary sacrifice, however caters for both bursaries to employees and relatives of employees.

Response: Accepted. Changes will be made in the 2020 Draft TLAB to limit the proposal to bursaries granted to relatives of employees. As such, subject to meeting the monetary thresholds, a bursary granted to a relative of an employee shall be tax exempt if the provision of such bursary is not subject to an element of salary sacrifice.

Comment: Due to current COVID-19 crisis, effecting the proposed change will impede a company's ability to assist middle- and lower-income earners to provide education for their relatives. If the proposal is not amended, can a postponement for 2 or 3 tax years be considered so as to afford the economy a chance to recover from the impacts of COVID-19.

Response: Not accepted. When initially announced on Budget Day, the amendment was meant to be a retrospective amendment with effect from 1 March 2020. However, due to comments received following the announcement, a decision was taken to postpone the effective date to 1 March 2021. It is also important to note that the proposed amendment falls outside the scope of any COVID-19 related tax measures. Moreover, the amendment seeks to limit the abuse of this provision.

4.2. Withdrawing from retirement funds upon emigration

(Main reference: Section 1 of the Income Tax Act: clause 2 of the Draft TLAB)

The definitions of "pension preservation fund", "provident preservation fund" and "retirement annuity fund" in section 1 of the Act currently make provision for a payment of lump sum benefits when a member of a pension preservation, provident preservation or retirement annuity fund withdraws from the retirement fund due to that member emigrating from South Africa, and such emigration is recognised by the South African Reserve Bank (SARB) for exchange control purposes. As outlined in Annexure E of the 2020 Budget Review, Government will be modernising the foreign exchange system. As a result, a new capital flow management system will be put in place. This new system will move from a "negative list" system to one where all foreign-currency transactions, other than those contained on the risk-based list of capital flow measures, are allowed. In relation to individuals, one of the changes to be implemented during modernisation of the foreign exchange system is the phasing out of the concept of "emigration" for exchange control purposes. The phasing out of this concept will have a direct impact on the application of the tax rules as the tax legislation makes provision for a payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes. In order to ensure efficient application of the tax legislation, it is proposed that the definitions of "pension preservation fund", "provident preservation fund" and "retirement annuity fund" in section 1 of the Act be amended to remove the reference to payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes. As such, a new test should be inserted which will make provision for the payment of lump sum benefits when a member ceases to be a South African tax resident (as defined in the Act), and such member has remained non-tax resident for three consecutive years or longer.

Comment: The 3-year waiting period places a financial burden on the individual as the amounts received from the retirement funds are often used to cover settling in costs in the new country. It also adds additional requirements (which includes administrative requirements) for fund members, SARS and fund administrators to meet. SARS will also be subject to a cash-flow delay while waiting for the 3-year period to lapse. Many commentators suggest that the withdrawal should be allowed immediately.

Response: Not accepted. The 3-year rule is a mechanism to ensure that there is a sufficient lapse of time for all emigration processes to have been completed with certainty, without affecting such workers whose residence status changes for

reasons other than emigration. The current system of financial emigration imposes a lot of strictures, not least its requirement that individuals close bank accounts and credit cards and repatriate funds that are taken out above the limits if return to the country before 5 years has elapsed. The envisaged system as a whole will have much lower compliance burdens overall for those looking to move abroad, and therefore it is not useful to focus on the 3-year requirement in isolation of the overall policy change.

One of the main objectives of the reform is to modernise the capital flow oversight system in a manner that balances the benefits and risks of more mobile people, financial flows and cross-border transactions. Now there is recognition that people's working lives may well include a unique combination of periods spent in South Africa and abroad. One possibility is emigration, with a multitude of possibilities on the continuum between emigration and a short business trip abroad. Policy design has to take all of these options into account, while the most vocal comments have focussed on only emigration.

When individuals contribute to pensions (tax-free), the understanding is that tax is deferred until benefits are received upon retirement. Government did not intend to provide a tax incentive for funds to be used for emigration. Our attempt is to reconcile the choice to emigrate and electing to withdraw a retirement lump sum with the design principle of deferred taxation upon retirement. This also illustrates a horizontal equity point: tax residents who decide not to emigrate have to wait until retirement for withdrawals from retirement annuity funds.

Comment: There is uncertainty as to whether the requirement to be a non-resident for 3 years refers to the physical presence test or ordinarily resident test. The 3-year test conflicts with other existing residency tests (e.g. section 9H). There is also uncertainty whether the 3 years refers to tax or calendar years. Clarity is also sought with regard to the interaction between Double Tax Agreements (DTA) and the new proposal. Many commentators recommended ceasing residence in terms of the ordinary residence test as a more appropriate measure.

Response: Not accepted. The 3-year rule applies if an individual has ceased to be tax resident in South Africa, irrespective of the particular test under which that tax residency is determined. Therefore, the 3-year rule does not focus on the ordinarily resident test alone.

Comment: Clarity is required with regards to how cases where the emigration process commenced before 1 March 2021, but have not yet been finalised when the effective date kicks in, will be dealt with.

Response: Accepted. All complete applications received by the SARB before 1 March 2021 will be finalised through the existing process, provided that they are approved by the SARB (even if the approval should occur after 1 March 2021). The amended provision will apply to all cases that meet the requirements on or after 1 March 2021 including individuals that did not receive formal approval to emigrate from SARB. In most cases, a change in tax residence, triggers capital gains tax on

the deemed disposal of assets. National Treasury and SARS encourage taxpayers to weigh their options carefully and not be swayed by superficial advice, often at exorbitant fees.

Comment: Uncertainty with regard to cases where funds are in a preservation fund before 1 March 2021 and emigration process commences after 1 March 2021.

Response: Noted. In applying these provisions, the rules of each preservation fund will be honoured.

Comment: The 3-year period may cause administration issues as there have been cases where SARS has deregistered individuals as soon as they ceased residency.

Response: Noted. Although this is not routinely the case as SARS deregisters taxpayers upon request by those particular taxpayers, however, SARS will monitor this.

Comment: Using tax residency as a criterion creates timing uncertainty as the ordinarily residence test is a subjective test – difficult to determine with certainty the point at which intention changes.

Response: Not accepted. The residency rules apply as they have in all other cases, guided through Interpretation Note 3.

4.3. Amending the 183-day rule to the foreign remuneration exemption, in light of 2020 travel restrictions

(Main Reference: Section 10(1)(*o*)(ii) of the Income Tax Act: clause 35 of the draft TLAB)

The impacts of COVID-19 on the economy are widely known and widely felt. Lock downs and travel restrictions have resulted in a year that will be remembered for its upheaval of plans and expectations. In most countries in the world, travel restrictions of some nature have applied for extended periods this year. This has suppressed the volume of international trips dramatically. These regulations are unavoidable and mandatory – but were unforeseeable and imposed on persons with immediate effect. From a tax perspective this holds impacts for the notion of tax residence.

South Africa taxes residents on their worldwide income, since its move to the residence base of taxation in 2001. As a result, the concept of residency is key to defining our tax base and taxpayers' obligations. This is true of other jurisdictions that have also had to consider the application of residency rules in light of travel bans and restrictions. Travel bans would have affected this group of taxpayers more directly than most others – as they potentially face a steep and unforeseen tax liability as a result of their inability to travel.

Comment: Consider reducing the number of days that employees have to be outside South Africa to qualify for the exemption of foreign remuneration.

Response: Accepted. As stated in the Response Document to the COVID-19 Tax Bills, National Treasury would consider additional tax proposals which may have less of an impact on the fiscal framework, such as the tax-residency test. In terms of the current provisions of section 10(1)(o)(ii) of the Income Tax Act, individuals who spent more than 183 days working outside South Africa would have qualified for exemption in respect of their remuneration. However, due to travel bans during the COVID-19 pandemic, these individuals could not travel in order to work outside South Africa, and therefore could not qualify for the above-mentioned section 10(1)(o)(ii) exemption. In order to take into account, the lockdown period during the COVID-19 pandemic, it is proposed that changes be made in the 2020 draft TLAB so that the 66 days that commenced on 27 March 2020 and ended on 31 May 2020, when the country operated under COVID-19 alert level 5 and 4, should be subtracted from the 183-day threshold rule used to determine the eligibility for exemption of foreign remuneration. In order to qualify for exemption, the number of days that a person spent working outside South Africa will be reduced to more than 117 days in any 12-month period, for years of assessment ending from 29 February 2020 to 28 February 2021. The current requirement in section 10(1)(o)(ii) that 60 of the days abroad should be a continuous period remains as is. In view of the fact that these individuals would have qualified for section 10(1)(o)(ii) exemption if there was no lockdown due to the COVID-19 pandemic, the proposed relief to reduce the number of days from 183 to 117 in order to take into account the lockdown period during the COVID-19 pandemic is likely to be revenue neutral and will have minimal impact on the fiscal framework.

4.4. Clarifying deductions in respect of contributions to retirement funds

(Main references: Paragraphs 5(1)(*a*) and 6(1)(*b*) of the Second Schedule to the Income Tax Act: clauses 40 and 41 of the draft TLAB)

Paragraphs 5(1)(*a*) and (6)(1)(*b*) of the second schedule to the Act make provision for deductions in respect of contributions to retirement funds when calculating the amount of lump sum benefits to be included in the person's gross income. In particular, these paragraphs make provision for deductions in respect of retirement fund contributions that did not qualify for a deduction in terms of section 11F of the Act (section 11F was introduced with effect from 1 March 2016 and makes provision for deductions in relation to contributions to retirement funds to be allowed when calculating the annual taxable income of a person). These paragraphs however only refer to "the person's own contributions", which inadvertently prevents employer retirement fund contributions on behalf of employees (made on or after 1 March 2016) from qualifying for a deduction when calculating the taxable portion of retirement lump sum benefits. To ensure that both employer and employee contributions to retirement funds qualify for a deduction in terms of paragraphs 5(1)(*a*) and 6(1)(*b*) of the second schedule to the Act, it is proposed that retrospective changes (with effect from 1 March 2016) be made to the above-

mentioned paragraphs and the reference to “a person’s own contributions” is replaced with a reference to “any contributions”.

Comment: Consequential amendments would also be required to section 10C to cater for employer retirement fund contributions made after 1 March 2016.

Response: Accepted. Consequential amendments will be made in the 2020 Draft TLAB

Comment: Contributions that were not deducted in terms of section 11(*k*) are currently not catered for.

Response: Not Accepted. Section 11F(3) makes specific reference to section 11(*k*) deductions. It is therefore our view that any reference to section 11F thereby caters for section 11(*k*).

4.5. Living annuities and the termination of trusts

(Main references: Section 1, new paragraph 3B of the Second Schedule to the Income Tax Act: clauses 2 and 39 of the Draft TLAB)

The proposed amendment in the 2020 Draft TLAB inserts a new paragraph (*f*) to the definition of “living annuity” to make provision for the termination of a trust as the word “death” in the definition of “living annuity” is problematic as trusts cannot die, but can only be terminated. Therefore, if the word “die” is only limited to the death of a natural person, there is an anomaly because when a trust that was initially nominated as the owner of a living annuity upon the death of the original annuitant is subsequently terminated, such trust is unable to make payments to its nominees. Subsequent to this change, the numbering sequence changes and the previous paragraph (*f*) now becomes paragraph (*g*).

Comment: There is uncertainty with regards to how to interpret the amendment as a terminated trust is unable to receive any assets, and is thus unable to distribute said assets to beneficiaries. Further, the section states that the amount “may” be paid to the trust, which creates the perception that it could also be paid to someone else.

Response: Accepted. Changes will be made in the 2020 Draft TLAB to clarify the initial policy intention that payment may only be made to the trust and that such payment is envisaged to be made as part of the process of terminating the trust.

4.6. Vested rights following annuitisation

(Main reference: Section 1 of the Income Tax Act: clause 74 of the Draft TLAB)

In 2013, retirement fund reform amendments were effected to the Act regarding the annuitisation requirements for provident funds. The main objective of these amendments was to enhance preservation of retirement fund interests during retirement, and to have uniform tax treatment across the various retirement funds,

thus resulting in provident funds being treated similarly to pension and retirement annuity funds with regard to the requirement to annuitise retirement benefits. As a result of negotiations with the National Economic Development and Labour Council (NEDLAC), Parliament postponed the effective date for the annuitisation requirements (which were meant to come into effect from 1 March 2016), to 1 March 2021.

Comment: The proposed amendment indicates that deductions (in terms of section 37D of the Pension Funds Act) from a member's benefit must, in all cases, first reduce vested rights. This is contradictory to what was stated in 2015 Response Document. Clarity is therefore sought as to whether the policy intent as communicated in the 2015 Response Document has since changed. Further to the above, the current legislative wording only caters for deductions from provident and provident preservation funds, and excludes any other retirement funds that said assets could be transferred to.

Response: Accepted. The policy intent as communicated in the 2015 Response Document still remains. That said, changes will be made in the 2020 Draft TLAB to indicate that deductions in terms of section 37D of the Pension Funds Act should proportionately reduce vested and non-vested rights. Amendments shall also be made to cater for instances where the assets are transferred from a provident or provident preservation fund into another retirement fund.

Comment: Based on the policy intent, in the event that a member of a provident fund transfers their assets to another fund before 1 March 2021, their vested rights shall remain protected even after said transfer. This is however not the case if said assets are transferred to a paragraph (*d*) pension fund.

Response: Noted. The exclusion of paragraph (*d*) pension funds is the policy intent and is based on the structures of the current GEPF rules.

Comment: The current legislative wording seems to suggest that the calculation of vested rights is to be based on gross contributions (inclusive of all costs) as opposed to the net contribution (excluding all costs).

Response: Accepted. The policy intent that the calculation of vested rights is be based on net contributions still remains. That said, the current wording in the 2020 Draft TLAB will be reviewed and if necessary, changes will be effected.

Comment: The current legislative wording seems to suggest that in the event that a provident fund member is over the age of 55 on 1 March 2021, any growth in said fund realised after 1 March 2021 will have to annuitised. This treatment differs greatly to the treatment of contributions made to the fund after 1 March 2021, as these contributions need not be annuitised. Both post 1 March 2021 contributions and growth should be treated in the same manner (namely subject to vested right protection).

Response: Accepted. The policy intent as relates to individuals over the age of 55 is to have both contributions and growth subjected to vested right protection irrespective of whether or not the contributions were made or the growth realised

on or after 1 March 2021. That said, the current wording in the 2020 Draft TLAB will be reviewed and if necessary, changes will be effected.

4.7. Reimbursing employees for business travel

(Main reference: Section 8(1)(*a*)(ii) of the Income Tax Act: clause 4 of the Draft TLAB)

The Income Tax Act makes provision for the exclusion from taxable income of advances or reimbursements paid by an employer to the employee in respect of meals and incidental costs if the employee is obliged to spend a night away from home for business purposes and the amount does not exceed the amount published by the Commissioner of the SARS by Notice in the Government Gazette, and such expenses were incurred in the furtherance of the employer's trade. An anomaly arises where an employee is obliged to be away from the office on a day trip, and such employee purchases meals and incurs incidental costs in the furtherance of the employer's trade, but the employee has not been explicitly instructed by the employer to purchase meals and incur incidental costs. Due to the fact that the employee is not explicitly instructed by the employer to incur such expenses, the reimbursement will be subject to tax in the employee's hands. In order to address the anomaly, it is proposed that, if the employee is obliged to be away from the office on a day trip, the reimbursement of expenses incurred by the employee in respect of meals and incidental costs in the furtherance of the employer's trade should be excluded from taxable income in the hands of the employee. This will apply provided that the employer's policy makes provision for and allows such reimbursement. In addition, as with advances and reimbursements when the employee is obliged to spend a night away from home, the exclusion from taxable income will also apply provided that the amount does not exceed the amount published by the Commissioner of SARS by Notice in the Government Gazette.

Comment: The monetary threshold published by Notice in the Government Gazette should be a reasonable amount that is sufficient to cover necessary expenses

Response: <u>Noted.</u> The applicable thresholds are to be circulated for public comment prior to being finalised for publication in the Government Gazette.

Comment: The legislative wording as relates to the proposed amendment is contradictory to the intention as stated in the Explanatory Memorandum, as section 8(*a*)(ii) refers to amounts paid in terms of the provisions of section 8(*a*)(i) which, *inter alia,* deals with instances where the employee is away from home for at least one night for business related purposes.

Response: <u>Accepted.</u> Changes will be made to the 2020 Draft TLAB to ensure that the policy intention as stated in the Explanatory Memorandum is clearly reflected in the legislation.

4.8. Addressing an anomaly in the roll-over of amounts claimable under the employment tax incentive

((Main reference: Section 9(4) of the Employment Tax Incentive Act; clause 69 of the of the Draft TLAB)

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The ETI programme makes provision for employers to reduce the amount of employees' tax (PAYE) they pay to SARS for the first two years, in respect of qualifying employees with a monthly remuneration of less than R6 500, subject to certain limitations. The ETI programme contains certain limitations aimed at encouraging tax compliance, and prevents non-tax compliant employers from claiming the ETI reduction of PAYE. An anomaly arises where tax compliant employers are placed in a worse off position than non-tax complaint employers. This is due to the fact that any amounts not claimed while the employer is non-tax compliant will be an excess ETI subject to roll over into the next month. This roll over will continue until such time that said employer becomes tax compliant and the excess ETI will be allowed as a reduction against their PAYE liability in the first month the employer is tax compliant (excess ETI amounts will not be forfeited in the last month of PAYE reconciliation period). In order to address this anomaly and encourage tax compliance, it is proposed that changes be made in the ETI legislation that non-tax compliant employers are subject to the forfeiture clause applicable to tax compliant employers if any excess ETI claims are not utilised by the end of the PAYE reconciliation period. As a result, the excess ETI claims of non-tax compliant employers will not be rolled over at the end of the PAYE reconciliation period.

Comment: Certain non-compliance statuses are not entirely due to fault on the employer's behalf, the outstanding returns that result in the employer being flagged as non-compliant may be for a period which falls outside the 5-year period for which information is to be retained for. Thus, fixing the error may take longer than 6 months. The roll-over period should therefore be extended to 12 months as opposed to 6 months.

Response: Not accepted. The intention behind the proposed amendment in the 2020 Draft TLAB is to encourage compliance. Extending the roll-over period would be contradictory to this policy intention.

Comment: Non-compliant employers are not given sufficient time to remedy their non-compliance. Industry also has concerns that the SARS systems creates anomalies in employer compliance statuses.

Response: Noted. SARS has corrected most of previously identified system issues. That said, employers are encouraged to advise SARS of any system anomalies that negatively impact the employer's compliance status.

4.9. Addressing the circumvention of anti-avoidance rules for trusts

(Main references: Section 7C of the Income Tax Act: clause 3 of the draft TLAB)

In 2016, anti-avoidance measures aimed at curbing the tax-free transfer of wealth to trusts through the use of low interest or interest-free loans, advances or credit were introduced in the Income Tax Act. Soon after the introduction of these measures, taxpayers devised further schemes to undermine the 2016 measures, by advancing interest free or low interest loans to companies held by trusts. In order to curb this, further changes were made in 2017. Taxpayers are now implementing other variations of the structures in order to avoid the deemed annual donation triggered by these anti-avoidance measures. These structures involve natural persons that subscribe for preference shares with no or a low rate of return in a company owned by a trust that is a connected person to those individuals. In order to curb this abuse, the following legislative amendments were included in the 2020 Draft TLAB:

- A deeming provision was inserted under which the subscription price of preference shares issued will be deemed to be a loan advanced.
- In addition, any dividends in respect of those preference shares shall, for purposes of the anti-avoidance measure, be deemed to be interest in respect of such a deemed loan.

Comment: The proposed changes relate to the use of preference shares to avoid the current anti-avoidance rules that focus on loans. However, a definition of "preference share" for purposes of section 7C has not been provided for and it is proposed that one should be included.

Response: Accepted. The Income Tax Act contains a definition of "preference share" in section 8EA that is used when applying the anti-avoidance rules relating to hybrid equity shares (in section 8E) and third-party backed shares (in section 8EA). As such, in section 8EA "preference share" is defined to mean any share other than an equity share or in the case of an equity share, where the dividends relating to such equity shares are based on or determined with reference to a specified rate of interest or the time value of money. It is proposed that for purposes of section 7C, the same definition of "preference share" available in section 8EA should be used. As such, changes will be made to the 2020 Draft TLAB to provide that for purposes of section 7C, "preference share" means a preference share as defined in section 8EA.

Comment: For the sake of completion and alignment with the current rules, these rules should be extended to foreign dividends accruing and reference should rather be had to dividends 'accrued' rather than 'declared' to align with the principle of interest 'incurred'.

Response: Accepted. Changes will be made to the 2020 Draft TLAB to extend the application of these rules to include foreign dividends and ensure that the rules apply to dividends and foreign dividends accruing under the envisaged schemes during a year of assessment.

Comment: With respect to the proposed changes to section 7C, the 2020 Draft TLAB provides that the changes are to apply in respect of years of assessments commencing on or after 1 January 2021. Further clarification is required to clarify whether the changes are intended to apply to subscriptions on or after that date or dividends accruing on or after that date.

> *Response:* Accepted. The effective date of the proposed amendments to section 7C will be clarified to provide that these amendments will come into operation on 1 January 2021 and apply in respect of any dividend or foreign dividend accruing during any year of assessment commencing on or after that date.

Comment: The appropriate benchmark should not be the official rate of interest as is currently applicable to loans in respect of the rate of interest charged thereon but rather 'the official rate of interest multiplied by one minus the applicable income tax rate for companies' to reflect the commercial reality that preference share funding is typically lower than interest rate funding to take cognisance of the non-deductibility and exempt nature of, respectively, the payment and receipt of the related dividends, e.g. where the official interest rate is 10 per cent an equivalent preference dividend yield should be considered to be 7.2 per cent.

> *Response:* Not accepted. The anti-avoidance rules contained in section 7C were introduced to curb the avoidance of Donations Tax, which is levied at 20 per cent of the value of the property or amount donated, that applies in respect of a Donor that either donates an asset to a Trust or capacitates a Trust to acquire an asset for the benefit of beneficiaries of that Trust. In this regard, the official rate of interest, which is currently 4.5 per cent on the value of the debt used to facilitate such arrangements, was preferred as the rate at which a deemed donation would be triggered as an annual donation in the limited circumstances that such arrangements are entered into. A lower benchmark than the official rate would give a concession for preference shares used in the same manner as debt and for purposes of avoiding the current anti-avoidance rules that apply to debt. From a policy perspective, this would be counterintuitive to the spirit and policy rationale of section 7C and thus cannot be accepted.

5. INCOME TAX: BUSINESS (GENERAL)

5.1. Clarifying rollover relief for unbundling transactions

(Main Reference: Section 46 of the Income Tax Act: clause 35 of the draft TLAB)

The corporate reorganisation rules contain provisions in section 46 that provide for roll over relief where shares in a resident company (unbundled company), that are held by another resident company (unbundling company), are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. These unbundling transactions are also subject to an anti-avoidance measure aimed at limiting or discouraging tax avoidance by taxpayers from distributing shares on a tax neutral basis. This anti-avoidance measure makes provision for roll-over relief not to be granted if, immediately after the distribution of shares in terms of an unbundling transaction, 20 per cent or more of the shares in the unbundled company are held by a disqualified person (such as a non-resident or a tax-exempt entity), either alone or together with any connected persons (who is also a disqualified person) in relation to that disqualified person. In order to close this loophole, changes were made in the draft TLAB to remove the reference to "connected persons". The intent was to disallow deferral in terms of an unbundling transaction if, immediately after any distribution of shares in terms of an unbundling transaction, an aggregate of 20 per cent or more of the shares in the unbundled company are held by disqualified persons. It is intended that these changes should apply in respect of unbundling transactions entered into on or after the date on which the draft TLAB was published for public comment (i.e. 31 July 2020).

Public comments received during public comment period

The following comments on the changes proposed for section 46 in the draft TLAB were received as part of the written submissions submitted during the comments period ending on 31 August 2020 and discussed during the public workshop held on 10 September 2020.

Comment: It is submitted by taxpayers that, as part of any proposed change to the anti-avoidance measure, reconsideration be given to the classes of person currently falling within the definition of "disqualified person". For example, it is particularly anomalous that this definition includes government or a pension fund as a shareholder.

Response: Not accepted. The corporate reorganisation rules were first introduced in the South African tax legislation in 2001 after Government considered the impact that the introduction of capital gains tax may have on asset transfers between entities forming part of the same economic unit. The corporate reorganisation rules were advised by the international trend of group taxation rules in some jurisdictions that have a form of capital gains tax. However, given the various concerns in those jurisdictions regarding the abuse of such group taxation provisions, a narrower set of tax relief provisions, in the form of the current corporate reorganisation rules, was favoured. These rules were introduced with the aim of facilitating transactions between group companies or between shareholders and their companies on a tax

neutral basis at the time of an asset transfer or distribution. However, the corporate reorganisation rules were introduced, not as a permanent concession, but one that would allow for the deferral of the normal tax consequences arising from the transfer of an asset or distributions. The rationale for this temporary concession was to allow for the entities with an economic unit to restructure their operations without an immediate tax consequence in anticipation of optimised South African business operations, reduced costs and ultimately higher profitability that would give rise to higher tax collection. In addition, it was always anticipated that, in the event that a previously tax-free transferred asset were to leave the economic unit or be transferred to an entity or shareholders that are not within the South African tax net (i.e. be it by virtue of residence or exempt status), that subsequent transfer would fall outside of the deferral benefits of the reorganisation rules. It is this principle of disallowing a permanent reduction in the tax base through granting a deferral benefit to persons from which tax cannot be collected in the future, that advised the current list of "disqualified persons" under the deferral provisions dealing with unbundling transactions. To exclude pension funds or any other category of persons from the definition of "disqualified persons" would not be desirable as there is no policy change in ensuring that the corporate reorganisation rules continue to operate as tax deferral provisions and not exemptions (as would be the case if tax deferral is allowed for transfers to persons outside of the South African tax net).

Comment: The proposal in the draft TLAB that removes the reference to "connected persons" and results in the anti-avoidance rule denying altogether deferral in terms of an unbundling transaction if, immediately after any distribution of shares in terms of an unbundling transaction, an aggregate of 20 per cent or more of the shares in the unbundled company are held by disqualified persons can be unduly punitive. This is particularly the case in the instance that a single non-resident shareholder holds 21 per cent of the shares in an unbundling company, with the other 79 per cent held by a South African tax resident. In its proposed form, the anti-avoidance measure means that tax deferred unbundling transactions would be denied in respect of the entire transaction and not only the 21 per cent.

Response: <u>Accepted.</u> The current anti-avoidance measure that takes into consideration connected persons as well as the proposed anti-avoidance rule that was contained in the draft TLAB that was published for public comment are structured as "all-or-nothing" rule in that they disallow tax deferral in its entirety when they apply. These types of anti-avoidance measures tend to be too punitive. As such, a rule, in the form of a pro-rata rule, that only disallows tax deferral to the extent of the disqualified persons (and not the qualifying persons) will be pursued.

<u>Public comments received following public workshops</u>

Following the public workshop during which the proposed anti-avoidance measure applicable to unbundling transactions was discussed, various stakeholders provided further written comments. In this regard, comments were provided on the consideration of a pro-rata rule. In order to engage further on this matter, on 23 September 2020, a further consultative meeting was held by National Treasury with

all the stakeholders that submitted comments on this matter during the public comments period and following the workshops.

Having considered these subsequent public comments, a pro-rata rule was proposed by National Treasury as the equitable mechanism to ensure that the principle of deferral is upheld and that tax deferral is disallowed to the extent that a distribution of the unbundled shares is made to "disqualified persons" – without wholly and unfairly denying tax deferral for distributions in respect of the qualifying persons. Under this pro-rata rule, tax deferral under the unbundling transaction provisions contained in section 46 will not apply in respect of any equity share that is distributed by an unbundling company to any shareholder that –

- is a disqualified person; and
- holds at least 5 per cent of the equity shares in the unbundling company immediately before that unbundling transaction.

Comment: The current and proposed anti-avoidance measure is again flawed as it tests the shareholding in the unbundled company immediately after the unbundling transaction by reference to all the shares in that company, i.e. including those that may not have been held by the unbundling company and in respect of which no relief is sought. As an example, it cannot be that where an unbundling company unbundles its entire shareholding (of say 60 per cent) in a listed company that other existing shareholders (holding the remaining 40 per cent) in the unbundled company that have nothing to do with the unbundling transaction can prejudice the relief to the unbundling company.

Response: Accepted. The test for which part of the distribution is denied tax deferral under the unbundling transaction provisions will be limited to the unbundled shares that are distributed to "disqualified persons". No regard will be had of any shareholder holding shares that are not held by the unbundling company and thus not distributed under an unbundling transaction.

Comment: A pro-rata rule is not a solution. Keeping in mind that some 37 per cent of the market capitalisation of South African companies listed on the JSE was held by foreign shareholders in 2016 and a further 24.4 per cent of the market capitalisation of the JSE in 2016 was held by retirement funds, only about 40 per cent of the unbundling transaction will qualify for rollover relief, while 61 per cent will not under a pro-rata rule. Further, even if the unbundling was still viable, the tax burden associated with the unbundling would create an inequitable situation for shareholders that are in the tax net. This is because the tax burden, in the form of CGT and dividends tax, associated with the unbundling to disqualified persons would indirectly be borne by all shareholders pro-rata to their shareholding in the unbundling company (on the basis that these taxes are levied on the company and not on the shareholders in question).

Response: Not accepted. Company distributions, by their nature, allow companies to put value directly in the hands of their shareholders. However, with consideration for the normal tax consequences applicable to company distributions outside of the corporate reorganisation rules, such as dividends tax (applicable to dividends) and

capital gains tax (applicable to returns of capital), the value placed in the hands of shareholders is always net of tax. That being said, a tax deferred unbundling transaction would result in a better position for shareholders given that no immediate tax would be payable under a tax deferred unbundling transaction. However, from a policy point of view, the opposite to the concern raised would be true if the high instance of “disqualified persons” holding shares in the listed space is not acknowledged. Under such a circumstance, the Government would, using the same example provided by taxpayers, permanently forego its right to taxing 61 per cent of a distribution made to persons outside of the South African tax net and that benefit will be shared by all the shareholders of the unbundled company. This result is not aligned with the policy intention of tax deferred unbundling transactions which defer tax consequences in instances were future collection is likely. Instead, a more equitable and policy compliant result is where rollover is provided in respect of 39 per cent of the shares (held by persons who are not disqualified persons) under a pro-rata rule so that the benefit of the rollover is passed on to all the shareholders as is expected from a company distribution.

Comment: While under normal circumstances the *in-specie* distribution of the shares, in the absence of tax deferred unbundling transactions attracts capital gains tax and/or dividends tax, this assumes that the transaction would have happened in the absence of the unbundling relief applying and is therefore hypothetical rather than real. However, when one considers the tax base from the perspective of the individual companies and shareholders, there is no erosion of the tax base at all. From the perspective of the non-resident shareholder in a listed company with an investment worth R1 billion before the unbundling transaction – if, after the unbundling, it holds a shareholding in the listed company that is worth R800 million and a shareholding in the unbundled subsidiary of the listed company that is worth R200 million, in aggregate, its combined investment is still worth R1 billion. It has simply swapped its indirect investment in the subsidiary for a direct investment. From the perspective of the listed company and its subsidiary there is also no erosion of the tax base. Their assets remain wholly within the tax net to the extent of the combined net asset value of R1 billion.

Response: Not accepted. As indicated above, the policy rationale for the introduction of the corporate reorganisation rules was to defer tax consequences on the transfer or distribution of assets between entities within the same economic unit, or their shareholders, in anticipation of more profitability from the effective use of such assets and finally collection of any embedded gains in the event that those assets were transferred out of those economic units. In this regard, tax deferred is subject to prescribed circumstances within these rules, including the exclusion of parties to whom these assets are transferred, no future taxes may be collected. As such, to expect that all corporate distribution in the listed space should benefit from deferral is misplaced.

It is also necessary to note that tax deferral is granted for the unbundling company (i.e. the listed company in the example made by the taxpayers) in respect of its shares in the unbundled company (its subsidiary in the example made by the taxpayers) and that it is only the after-tax benefit that is transferred to all the

shareholders in this regard. Those shares in the unbundled company are themselves assets in respect of which their transfer by way of a distribution attracts either dividends tax or capital gains tax. Given that a tax-deferred distribution in respect of shares distributed to a shareholder that is a person outside of the tax net, in essence, means that no future collection can be anticipated from any future transfer of those shares by such a taxpayer, therein lies the erosion of the tax base. Given the extent to which "disqualified persons" may hold shares in South African listed entities, by the taxpayers' own assertions (i.e. 61 per cent capitalisation of JSE listed companies), it is necessary to curb this erosion of the tax base to limit tax deferred unbundling transaction to distribution to shareholders that are not "disqualified persons".

Public comments received after the consultative meeting

In the consultative meeting during which the comments above were discussed and the pro-rata allowance of tax-deferred unbundling transactions was proposed. Taxpayers requested that, in considering a pro-rata rule, a *de-minimis* shareholding by "disqualified persons" in respect of which a pro-rata anti-avoidance rule will not be triggered should also be considered. In this regard, various commentators had submitted that a 5 per cent *de-minimis* rule, which prevailed prior to the 2007 legislative changes that brought into effect the current 20 per cent rule should be considered. However, following the consultative meeting the following comment was received with regards to the proposal of a 5 per cent *de-minimis* rule.

Comment: The less than 5 per cent *de-minimis* level in respect of which it was proposed should not trigger any anti-avoidance rule in this regard finds precedence in section 9D of the Income Tax Act where shareholders of less than 5 per cent in foreign companies that are listed companies do not need to calculate and impute in terms of section 9D. This level is arguably the more appropriate level for the reasons behind its inclusion in section 9D (i.e. the inability of companies and SARS to determine who their smaller shareholders are or what the nature and even residency status of such shareholders are). That being so, consideration should be given to the potential of pension funds holding 5 per cent or more of the shares in listed companies.

Response: Not accepted. The *de-minimis* level of less than 5 per cent will adequately and similarly exclude small shareholdings (that may be hard to track and ascertain their nature) from triggering the proposed pro-rata anti-avoidance rule for tax deferred transactions. As indicated during the public workshops and the consultative meeting, a limitation or further concession of any exempt entities is not in line with the policy of tax deferral under the corporate reorganisation rules and will lead to a scenario where legislation is made to accommodate or give preferential treatment to entities when it is not aligned with the currently prevailing policy.

Public comments during Parliamentary hearings

On 7 October 2020, the SCoF held public hearings in light of the stakeholder submissions on the 2020 draft TLAB, 2020 draft TALAB and the 2020 draft Rates Bill.

Stakeholders presented on issues already raised and set out above through their written submissions to National Treasury and SARS on the draft TLAB during the comments phase, after the public workshop and consultative meeting. In addition to those, the comment below was made during the public hearings of the SCoF.

Comment: The 2020 draft TLAB proposed that the amendments pertaining to the anti-avoidance rules on unbundling transactions involving "disqualified persons" comes into effect on the date of the publication of the draft TLAB for public comment, i.e. 31 July 2020. There are unbundling transactions that are currently underway and it is proposed that the effective date of any amendment to the anti-avoidance rule should be delayed. Furthermore, an effective date of no earlier than 1 January 2021 is proposed.

Response: Partially accepted. The proposed pro-rata anti-avoidance rule gives effect to a more equitable outcome in respect of unbundling transactions as only shares distributed to persons that are not disqualified persons will benefit from roll-over relief. This new mechanism of the anti-avoidance rule is in line with the policy rationale of the reorganisation rules that are intended to be tax deferral rules. As the proposed change has been softened and will no longer be an "all-or-nothing" rule, it is not necessary to delay this anti-avoidance rule beyond the date of the tabling of the 2020 draft TLAB given that this alternative mechanism has been communicated during the public workshops and the subsequent consultative meeting. Furthermore, it should be noted that in the case of anti-avoidance rules, the intention is to curb the use of structures that have the potential of negatively affecting the fiscus and it is not a new practice that anti-avoidance rules should have earlier effective dates. As such, the 2020 draft TLAB will be changed to provide that the pro-rata anti-avoidance rule will come into effect on the date on which the 2020 draft TLAB is introduced by the Minister of Finance in Parliament.

5.2. Refining the interaction between the anti-avoidance provisions for intra-group transactions

(Main References: Section 45 of the Income Tax Act: clause 34 of the draft TLAB)

The Income Tax Act contains corporate reorganisation rules (sections 41- 47 of the Income Tax Act) that allow for the tax neutral transfer of assets between companies that are part of the same group of companies. These corporate reorganisation rules also contain provisions dealing specifically with intra-group transactions (section 45). The intra-group transaction rules contain anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers of the tax neutral transfer of assets, namely, (i) the de-grouping charge rule applicable to the group of companies that entered into an intra-group sale, benefits from tax deferral and then one of the companies ceases to form part of a group of companies shortly after the said transaction, and (ii) the zero-base cost rule applicable to intra-group transactions where assets are transferred in exchange for debt or non-equity shares issued by another company that forms part of the same group of companies as the transferor of those assets. The interaction between the above-mentioned anti avoidance rules gives rise to anomalous results. As a result, amendments were proposed in the 2020 Draft TLAB to ensure that in instances that the de-grouping charge rule has

been triggered in respect of an intra-group transaction under which the zero-base cost rule was previously applied, the taxpayer be put in the same position as if the rollover provisions did not apply and be given base cost for their debt and non-equity shares in terms of the current applicable rules.

Comment: The proposal in the 2020 Draft TLAB provides that in re-instating the base cost of debt or shares used to facilitate an intra-group transaction, the starting point will be "market value" of such debt or shares on the date of de-grouping. It is proposed that the current reference to 'market value' should be replaced with 'face value' and for shares is should be 'capital subscribed' as base cost would have been with reference to the amount of the debt incurred or in the case of shares, the subscription price.

Response: Accepted. As the amount of debt incurred and the subscription price would have been the starting point when determining the base cost of the debt or a share under transactions entered into outside of the re-organisation rules, the face value of debt or the subscription price of a share should be the starting point in determining the re-instated base cost.

Comment: The 2020 Draft TLAB proposes that the base cost of a debt or a share used to facilitate the transfer of assets under an intra-group transaction will be re-instated in the instance that the de-grouping charge is triggered and the deferral benefits under section 45 are reversed. In this regard, the proposed changes make reference to the transferor and the transferee ceasing (in terms of section 45(4) or 45(4B) of the Income Tax Act) to form part of the same group of companies. This implies a narrower, certain or definite group of companies. Sections 45(4) of the Act, however, makes reference to the transferee ceasing to form part of any group of companies in relation to the transferor company or a controlling group company in relation to the transferor company. The proposed changes should be aligned with the current provisions that refer to a de-grouping in relation to any group of companies.

Response: Accepted. Changes will be made in the 2020 Draft TLAB to make reference to the transferee ceasing to form part of any group of companies in relation to the transferor company or a controlling group company in relation to the transferor company.

Comment: Intra-group transactions that have reached the 6-year anniversary would not benefit from the proposed amendment and therefore are prejudiced despite them not triggering the de-grouping provisions. It is recommended that the proposed provision be expanded to include intra-group transactions that have reached the 6-year anniversary, which would not have not triggered the de-grouping provisions.

Response: Noted. The 2020 Budget Review contained technical and anti-avoidance matters that should be included in the 2020 tax bills. With regard to the changes to be made in respect of intra-group transactions, the 2020 Budget Review provides for legislative amendments to be made to address the interaction between the de-grouping charge and the zero base cost rule that potentially give rise to double taxation. The proposal in respect of the re-instatement of the base

cost for a debt or a share used to facilitate the transfer of an asset once an intra-group transaction has reached its 6-year anniversary falls outside of the envisage legislative amendment proposed for the 2020 legislative cycle. As such, it is proposed that this proposal should form part of the proposals to be considered for the 2021 legislative cycle.

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

6.1. Clarification the meaning of "market value" for the taxation of long-term insurers

(Main reference: Section 29A of the Income Tax Act: clause 30 of the Draft TLAB)

Section 29A of the Income Tax Act makes provision for the tax treatment of long-term insurance companies based on a five-funds approach, namely, the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the risk policy fund and the corporate fund. The application of this five-fund approach requires long-term insurers to allocate their assets to the above-mentioned five different funds. The excess of assets in each policyholder fund or risk policy fund, which represents the long-term insurer's shareholders interest, that should be transferred to the corporate fund is calculated by deducting the adjusted IFRS value of liabilities relating to the fund from the market value of assets allocated to that fund. Currently, the Act makes provision for the allocation to be determined with reference to the market value of assets in the policyholder funds and risk policy fund, it is not clear what should happen with assets that do not have a "market value" as defined. The assets envisaged are assets such as prepayments or intangible assets that may not have a market value, as defined, although they are treated as assets for financial reporting purposes. In order to clarify the current rules, it is proposed that the definition of "market value" in section 29A be amended to make provision for the value of assets that can only be disposed of as part of a going concern to be the amount as disclosed in the financial statements at the end of the year of assessment.

Comment: The proposed amendment is welcomed however the requirement that the value of the asset must be capable of being determined only on sale of the business as a going concern is not likely to achieve the desired result.

Response: Accepted. Clarification will be made in the 2020 Draft TLAB so that the proposed amendment will only refer to instances where the market value of an asset cannot be determined and the value of the asset is an amount equal to the value at which that asset is recognised in the audited annual financial statements of the insurer.

6.2. Reviewing the interaction between rules for the taxation of benefits received by short-term insurance policyholders and the tax treatment of related expenses

(Main reference: Sections 23(*c*) and 23L of the Income Tax Act: clause 25 of the Draft TLAB)

Section 23L of the Income Tax Act makes provision for limitation of deduction by disallowing the deduction of any premiums incurred by a taxpayer on short-term insurance policies, unless that taxpayer is recognising the insurance premiums as an expense for the purposes of financial reporting pursuant to International Financial Reporting Standards (IFRS) in either the current or future year of assessment. Therefore, according to section 23L of the Act, policyholders may not deduct premium payments in respect of short-term policy contracts that are not viewed as an expense. Policy benefits reduced by non-deducted premiums are taxed. In contrast to the above, under section 23(*c*) expenditure and losses that would otherwise be allowed as deductions, for example under section 11(*a*), is not allowed to the extent that it is recoverable under any contract of insurance, guarantee, security or indemnity. The interaction between section 23(*c*) and section 23L of the Income Tax Act is not clear where on one hand, insurance benefits are being taxed in full and on the other hand, any expenditure recovered being disallowed as a deduction. In order to clarify the interaction between the taxation of policy benefits under section 23L and the deductions against short-term insurance policy benefits in section 23(*c*), it is proposed that the Act be amended to clarify that section 23(*c*) of the Act does not apply in situations when section 23L(3) of the Act applies.

Comment: The proposed amendment to section 23(*c*) is welcomed however it is requested that the application of section 23L should also be limited to only apply to the intended "investment policies" by amending the provisions of section 23L.

Response: <u>Accepted.</u> Given the fact that section 23L has wider application and its applicable to a broader range of bona fide short-term insurance transaction, the provisions of section 23L(3) will be limited.

Comment: The references to "investment contracts" in the EM should be removed and replaced with a reference to short-term insurance policies.

Response: <u>Accepted.</u> The Explanatory Memorandum will be updated to clarify the policy intention as stated in the legislation.

6.3. Clarifying the tax treatment of secured non IFRS 9 doubtful debt

(Main reference: Section 11(*j*) of the Income Tax Act: clause 13 of the Draft TLAB)

In 2018, amendments were made to section 11(*j*) of the Act to provide specific criteria for determining the doubtful debt allowance. These amendments provide specific doubtful debts allowance provision for taxpayers applying IFRS 9 for financial reporting purposes and for taxpayers not applying IFRS 9 for financial reporting purposes. However, for taxpayers not applying IFRS 9, the Act makes

provision for an age analysis of debt be used to determine the doubtful debt allowance. The following allowances are allowed as a deduction: (i) 40 per cent of the face value of doubtful debts that are at least 120 days past due date, and (ii) 25 per cent of the face value of doubtful debts that are at least 60 days past due date, but excluding doubtful debts that are at least 120 days past due date. That said, this age-based allowance used by taxpayers not applying IFRS 9 does not take cognisance of security given in respect of the debt. At issue is the fact that the tax legislation does not result in parity between taxpayers that apply IFRS 9 and those that do not apply IFRS 9 when determining the doubtful debt allowance under section 11(*j*) of the Act because the current 25 per cent and 40 per cent allowances for taxpayers not applying IFRS 9 do not take cognisance of security given in respect of the debt. In order to address this anomaly, it is proposed that changes be made in in section 11(*j*) of the Act to make provision for the amount of debt to be reduced by security that is available in respect of that debt before the 25 per cent and 40 per cent are applied by taxpayers that do not apply IFRS 9 for financial reporting purposes.

Comment: The amendment requires the allowance to be determined "after taking into account any security in respect of that debt" is welcomed as the proposal revises this approach in line with IFRS however, it is not clear what the term "security" means.

Response: Noted. It should be noted that the "third category" for 85 per cent allowance requires a Commissioner to take into account amongst other things any "security available in respect of the debt" therefore the proposed amendment was intended to align the current 25 per cent and 40 per cent allowances with the "third category" for 85 per cent allowance and IFRS. This comment is more of an interpretation issue of the word "security" than a policy issue.

6.4. Clarifying the tax treatment of doubtful debts for taxpayers conducted leasing business and applying IFRS 9 for financial reporting

(Main reference: Sections 11(*j*) and 11(*jA*) of the Income Tax Act: clause 13 of the Draft TLAB)

The Act sets out different rules for the tax treatment of doubtful debt in respect of taxpayers subject to prudential banking regulation for debt that is fair valued for financial reporting (section 11(*j*A) of the Act) as well as in respect of other taxpayers and other debt (section 11(*j*) of the Act). Currently all taxpayers conducting leasing operations and applying IFRS 9 for financial reporting purposes cannot claim a doubtful debt allowance because lease receivables are specifically excluded. One of the reasons for excluding lease receivables from doubtful debt allowance is that IFRS 9 lease receivables also include all lease receivables that have not yet been received by or accrued to the lessor. At issue is that arrear lease payments are not different from any other amounts that qualify for a doubtful debt allowance in terms of the provisions of section 11(*j*) or section 11(*j*A) of the Act. In addition, taxpayers not applying IFRS 9 for financial reporting purposes are able to claim a doubtful debt allowance in respect of these arrear lease payments, depending on the period that it has remained unpaid. In order to address this, it is proposed that

changes be made in the tax legislation to both sections 11(*j*) and 11(*j*A) so that taxpayers applying IFRS 9 for financial reporting purposes are allowed doubtful debt allowances in respect of lease receivables that have accrued to them but not in respect of future lease amounts.

Comment: The amendment is welcomed however the effective date should apply in respect of years of assessment ending on or after 1 January 2020.

Response: Partially accepted. Changes will be made in the 2020 Draft TLAB so that the effective date of the proposed amendment should apply in respect of years of assessment commencing on or after the date of tabling of the 2020 TLAB.

6.5. Curbing potential tax avoidance caused by dividend deductions

(Main reference: Section 24JB of the Income Tax Act: clause 27 of the Draft TLAB)

In general, section 24JB of the Act requires every "covered person" (that is, banks and brokers) for tax purposes to include in, or deduct from, their income all amounts in respect of financial assets and financial liabilities that are recognised for accounting purposes in profit or loss in the statement of comprehensive income. Therefore, in accordance to the principles of section 24JB of the Act a bank must, subject to exclusions, include in or deduct from their income all amounts from qualifying financial assets and financial liabilities that are recognised in profit or loss in the statement of comprehensive income. However, one of the exclusions of section 24JB is a dividend or foreign dividend received by or accrued to a "covered person". Since inception of section 24JB, it did not specifically cater for a structure where a special purpose vehicle company that is part of a banking group could be interposed between a bank and an investor such that it issues financial instruments to the investors that yield dividends while it receives interest or other income on its financial assets. The structure mentioned above of interposing special purpose vehicle companies between an investor and a bank gives rise to an undesirable mismatch in that the investor's underlying interest income is distributed as a tax-free dividend while the special purpose vehicle may arguably be in a tax neutral position. In order to close this loophole, it is proposed that of section 24JB(2) be amended to also exclude dividends declared and paid by a covered person.

Comment: Section 46 of the Companies Act No. 71 of 2008 (Companies Act) stipulates the requirements that need to be met in order for a company to make a distribution which must be authorised by the Board and no provision is made under the Companies Act for a formal declaration of dividends by the Board, therefore the reference to "dividend declared" in the proposed amendment is not in line with the provisions of the Companies Act.

Response: Accepted. The proposed wording of the Draft TLAB will be changed to "a dividend distributed."

6.6. Clarifying the meaning of a share in the definition of REIT

(Main reference: Section 1 of the Income Tax Act: clause 2 of the Draft TLAB)

A special tax dispensation of Real Estate Investment Trusts (REITs) was introduced in the Income Tax Act in 2012 with effect from 1 April 2013. When this REITs special tax dispensation was introduced, the policy rationale was for it to apply to both the company and trust REITs that comply with the Johannesburg Stock Exchange Limited (JSE) Listings Requirements, and are listed and publicly traded on the JSE. These requirements were based on the premise that the shares in a company or a trust which is deemed to be a company for tax purposes must be listed as shares in a REIT as defined in paragraph 13.1(x) of the JSE Listings Requirements and the company or trust will then qualify as a REIT for income tax (including capital gains tax) purposes. With the introduction of other recognised exchanges as defined in Financial Markets Act, 2012 in South Africa, the requirement that shares in a REIT should be listed on such recognised exchange and the listing requirements of such recognised exchange should be approved as stipulated in the Income Tax Act still remains. However, it has come to Government's attention that some REITs are considering to issue and list preference shares on an exchange. It was never envisaged that holders of preference shares should benefit from the REIT tax dispensation because preference shares are mainly used for financing, and not to provide full equity exposure to investors. It is therefore proposed that preference shares be excluded from the shares that must be listed on an exchange for purposes of the REITs special tax dispensation.

Comment: The proposed amendment still does not appear to prevent a REIT from issuing preference shares.

Response: Accepted. In order to clarify the policy intent, further amendments will be made to the definition of "qualifying distribution" in the 2020 Draft TLAB so that the reference to dividend in this definition is in respect of an equity share.

6.7. Amending the taxation of foreign dividends and foreign gains received by REITs

(Main reference: Section 25BB(2A) of the Income Tax Act: clause 29 of the 2020 draft TLAB)

The main feature of the REITs special tax dispensation is that it effectively follows a flow-through principle and that distributed income and capital gains are taxed solely in the hands of the investor and not in the hands of REIT or a controlled company. In turn, a REIT or a controlled company may claim distributions to its investors as a deduction against its income. This deduction may only be claimed if a distribution is a "qualifying distribution" (i.e. at least 75 per cent of the gross income of the REIT consists of rental income or other amounts received or accrued from property companies, as defined). In turn, the South African tax legislation contains a participation exemption in section 10B(2) of the Income Tax Act which exempts from income tax any foreign dividends distributed by non-resident companies to a South

African tax resident holding at least 10 per cent of the equity shares in such companies and in paragraph 64B of the Eighth Schedule to the Act which exempts from capital gains tax any disposal of equity shares held by a South African tax resident holding a least 10 per cent of the equity shares in a non-resident company. This implies that a REIT or a controlled company holding at least 10 per cent of the equity shares in a non-resident company qualifies for a participation exemption in respect of foreign dividends received from that non-resident company and also qualifies for participation exemption in respect of capital gains on any disposal of equity shares in a non-resident company. Therefore, in addition to the foreign dividends and capital gains tax participation exemption, a REIT or controlled company also gets a full deduction when it on-distributes profits from those foreign dividends and/or capital gains thereby possibly shielding non-property taxable income from tax. In order to address this mismatch, it is proposed that the REITs or controlled company should not qualify for participation exemption in respect of foreign dividends in terms of section 10B(2) and foreign gains in terms of paragraph 64B of the Eighth Schedule to the Act.

Comment: The proposed amendment should be reconsidered because it highlights anomalies such as discrimination where the current rules provide relief from capital gains to South African tax residents and this proposal proposes to impose tax on a REIT when it disposes of its interest in foreign company which is not a foreign property company. In addition, the sale of capital gains of immovable property and of property companies are exempt in order to encourage reinvestment of capital. More-over the proposed amendment also appears to be overly broad by excluding all section 10B(2), including relief for taxed CFC income that is subsequently distributed by the CFC.

Response: Accepted. The proposed amendment in the 2020 Draft TLAB in respect capital gains on any disposal of equity shares in a non-resident company will be withdrawn. In addition, in order to avoid economic double taxation that may result when a REIT pay tax on both the attributed profits and the dividend, the proposed amendment regarding exempt foreign dividends will be limited to the provisions of section 10B(2)(*a*).

6.8. Addressing tax avoidance involving lending and collateral arrangement provisions

(Main reference: Section 64EB(2) of the Income Tax Act: clause 37 of the Draft TLAB)

The Income Tax Act and the Securities Transfer Tax Act contains rules that provide relief in respect of an outright transfer of beneficial ownership in specific financial instruments for both collateral arrangements and lending arrangements, hereafter collectively referred to as "securities arrangements". As a result, if a listed share is transferred as a part of a security arrangement, there are no income tax (including capital gains tax) and securities transfer tax implications, provided that identical shares are returned to the borrower by the lender within a limited period of time from the date on which the security arrangement was entered into. The anti-avoidance provisions in section 64EB of the Income Tax Act were expanded in 2018 to also

apply to dividend conversion schemes using collateral arrangements. Despite these anti-avoidance measures, Government has identified certain dividend conversion transactions that are circumventing these anti-avoidance measures. In order to address this, changes were made in section 64EB(2) in the 2020 Draft TLAB to adjust the anti-avoidance trigger that currently requires the person paying a manufactured dividend to a person that is subject to dividends tax to hold a share in the company declaring the dividend. The holding of a share requirement is to be deleted.

Comment: The proposed amendment would significantly increase the administrative burden on affected South African resident companies which would be required to submit Dividends Tax Returns, even though no dividends tax is payable.

Response: Not accepted. Security arrangement transaction mostly remains the tool of larger financial institutions and large corporates. When government expanded the relief measures in respect of an outright transfer in beneficial ownership of specific financial instruments for both collateral arrangements and lending arrangements in 2015 it was made clear in consultation by the major financial institutions that they do have the administrative capacity to track and account for security arrangement transactions in order to fulfil their administrative obligations towards SARS.

7. INCOME TAX: BUSINESS (INCENTIVES)

7.1. Addressing the tax treatment of allowable mining capital expenditure

(Main references: Sections 15 and 36 of the Income Tax Act: clauses 22 and 32 of the draft TLAB)

The Income Tax Act contains rules in section 15 and section 36 that entitles taxpayers that are engaged in mining operations to a full upfront deduction of any capital expenditure actually incurred during any year of assessment against income derived from mining operations. Mining operations are defined in section 1 of the Income Tax Act to include every method or process by which any mineral is won from the soil or from any substance or constituent thereof. Thus, in order for the taxpayer to qualify for accelerated capital expenditure deductions in terms of sections 15 and 36 of the Income Tax Act, such taxpayer must be engaged in mining operations. A change in business models has led to the increase of what is called “Contract Mining”. In general, “Contract Mining” comprises the service of independent contractors with the required plant and machinery (contract miners) to excavate and extract minerals from the soil on behalf of the mineral rights holder for a fee. The current provisions of the tax legislation do not adequately address the tax treatment of capital expenditure incurred by taxpayers carrying on activities of “Contract Mining”. To address this, changes were made in the 2020 Draft TLAB to clarify that only the taxpayer who is a mineral rights holder and carrying on mining operations qualifies for accelerated capital expenditure deductions in terms of sections 15 and 36 of the Income Tax Act.

Comment: The industry requests that the proposed amendments be withdrawn based on the following reasons:

- In principle, it is accepted that contract mining should be distinguished from wholescale mining, in that contract mining should not qualify for the same tax treatment of allowable mining capital expenditure, specifically the timing of the claim for capital expenditure contemplated in section 36 of the Income Tax Act (i.e. immediate expensing or 100% deduction in the year of purchase). The proposed amendment in the 2020 draft TLAB should be postponed and National Treasury should liaise with the Mining Resource Council and the Department of Mineral Resources to find a way to distinguish and define contract mining.
- The proposed amendment should not be implemented in its current form as it presents adverse unintended consequences for mining companies that conduct legitimate mining operations for their own benefit but whom, in terms of the MPRDA, are not required to hold mining rights to conduct those mining operations. The proposed amendment requires more consultation with all relevant stakeholders to ensure that mining taxpayers who rightfully claim accelerated capital expenditure allowances are not inadvertently excluded.
- The proposed amendment, if enacted, will have dire consequences for the mining industry as it will not only impact contract miners, but also joint ventures. If the purpose of the proposed amendment is to curb abuse by non-qualifying taxpayers, then it is proposed that National Treasury obtains assistance from industry with the proposed drafting. It may be more appropriate to consider an amendment to the definition of “mining” and “mining operations” rather than limiting capital deductions to only the holder of mining right as is currently proposed.
- Given the far-reaching impact of the proposed amendment, this matter should be reconsidered as part of a future comprehensive overhaul of the entire mining tax regime. National Treasury should first consider the recommendations of the Davis Tax Committee (DTC) and also find policy alignment with the Department of Mineral Resources and Energy. It is worth noting that many of the problems (formerly associated with the taxation of contract mining) would fall away should the recommendations made by the DTC be accepted. This is because the incentive to classify expenditure as mining, rather than manufacturing, would in any event disappear with the move towards equalising the write-offs regimes for mining and manufacturing. Proper consultation with the mining industry on the impact and solutions is also advised to limit further impact on an already strained industry.

Response: Partially accepted. As discussed by National Treasury during public workshops on the 2020 Draft TLAB and as indicated by some stakeholders in their comments, the intent behind the full expensing of capital expenditure in the year of investment was to recognise the long lead times and risk taken on by mining companies when deciding to invest. This is the case across all the phases – exploration, development and production. Since companies engaged in mining activities for a fee (i.e. “contract mining”) are not exposed to equivalent risks, the accelerated capital allowance for mining expenditure (specifically the timing of the claim for capital expenditure contemplated in section 36 of the Income Tax Act) should not be made available to them. Their revenue base is certain and so they should not be given the same benefit afforded to companies with an uncertain revenue base. To avoid both unintended and negative consequences resulting from the proposed amendments in the 2020 Draft TLAB, the following is proposed:

- Government with the support of industry be given more time to investigate and find solutions that may have less negative impact on the mining industry before amendments are made to miningtax legislation;
- Legislative amendments only be considered after investigations and reviews have been conducted in this regard.

7.2. Changing the Minister of Finance discretion in lifting ring-fencing of capital expenditure per mine

(Main reference: Section 36(7F) of the Income Tax Act: clause 32 of the draft TLAB)

Section 36(7F) of the Income Tax Act (introduced in 1985) does not allow tax-deductible capital expenditure incurred in relation to a mine to reduce taxable income of another mine, unless the Minister of Finance, in consultation with the Minister of Mineral Resources and Energy Resources and having regard to the relevant fiscal, financial and technical implications, otherwise directs. This limitation of tax-deductible capital expenditure is colloquially referred to as the “capex per-mine ring-fence”. The above-mentioned section was introduced in the Act to prevent the reduction of taxable income from matured and profitable mines, given that those mines enjoyed an accelerated capital expenditure regime during their earlier years. In light of the low number of applications made over the past decade and in order to enhance administrative efficiency, it was proposed that the Minister’s discretion available in section 36(7F) be removed and the Commissioner for SARS be responsible for deciding on the non-application of ring-fencing capital expenditure per mine by applying specific criteria.

Comment: The industry requests that the proposed amendments be withdrawn based on the following reasons:

- Applications to the Minister of Finance in consultation with the Minister of Resources, is the preferable route, as policy should be set by National Treasury and Department of Mineral Resources, whilst the mandate of SARS lies with administration of the Tax Acts. There may be cases where investors will be approaching the Finance and DMRE Departments to invest in SA, which may involve contiguous mines, which will require the lifting of the per mine ring-fence. Without the Ministerial discretion, such investments may be lost.
- The current Ministerial discretion available in section 36(7F) of the Income Tax Act is not only based on a concept of tax base protection, but in an equal manner the interests of the country’s broader economic and investment needs and goals.
- SARS as an administrative organ designed for the collection and administration of taxes does not have the necessary fiscal, financial and technical insight to perform the necessary balance of the country’s broader economic interest. Moreover, SARS does not have the necessary mining technical insight or expertise to give the appropriate consideration to the specific needs and circumstances of miners.
- The proposed listed criteria in the 2020 Draft TLAB excludes the criteria that were relevant for purposes of the Minister’s discretion, i.e. relevant fiscal, financial and technical implications. The deletion of the criteria that the Minister may presently

consider in exercising the discretion limits the circumstances in which the discretion may be exercised.

- To the extent that the request to withdraw this proposed amendment is not accepted, we propose that the criteria be more objective so that they can be measured against, in keeping with SARS commitment to fairness, openness and transparency.

Response: Partially accepted. In the 2020 Budget Review, it was proposed that the Minister's discretion be reviewed with the aim of its removal or restructuring. The proposed amendments in the 2020 Draft TLAB removed the Minister's discretion and replaced it with the SARS Commissioner's discretion and set out specified criteria to be applied by the SARS Commissioner in this regard. In order to avoid negative impact and unintended consequences as a result of the proposed amendments in the 2020 Draft TLAB, the following is proposed

- When Government is conducting the above-mentioned investigations and reviews on tax treatment of allowable capital expenditure, Government should also conduct reviews on the provisions of section 36(7F) dealing with the Minister of Finance's discretion in ring-fencing capital expenditure per mine;
- Legislative amendments only be considered after investigations and reviews have been conducted in this regard.

7.3. Reviewing the special economic zone tax incentive regime

(Main reference: Sections 12R and 12S of the Income Tax Act: clauses 18 and 19 of the draft TLAB)

In 2013, the Special Economic Zone (SEZ) tax regime was introduced in sections 12R and 12S of the Act. Currently there is a misalignment in the sunset dates available in the two provisions dealing with the SEZ tax regime. The sunset date contained in section 12R of the Act dealing with the criteria for the determination of what constitutes a qualifying company that qualifies to be taxed at 15 per cent currently states that the provision applicable to qualifying companies under the SEZ regime will cease to apply in respect of any year of assessment commencing on or after 1 January 2024 or, if later, 10 years after the commencement of the carrying on of a trade in a special economic zone. The sunset date contained in section 12S of the Act dealing with the claiming of accelerated allowance in respect of buildings provides that section 12S will cease to apply in respect of any year of assessment commencing on or after 1 January 2024. To provide clarity and certainty, changes were included in the draft TLAB that the sunset dates of the two provisions encompassing the SEZ tax regime should be aligned and the two provisions of the SEZ tax regime should cease to apply in respect of any year of assessment commencing on or after 1 January 2028. The rationale for deciding on 1 January 2028 is that it allows for the incentive to apply for a ten-year period from 2018, which is the date of approval by the Minister of Finance of designated SEZs that are subject to corporate tax at a rate of 15 per cent. The amended sunset dates further provide clarity that investments made after promulgation of the draft TLAB will not

be guaranteed a full ten-year incentive benefit period as is the case in the current legislation.

Comment: The sunset date of 1 January 2028 should be reconsidered as it is creating uncertainty for investors and diminishes the attractiveness of South Africa's SEZ offering relative to alternative investment destinations. Failing that, consideration should be given to allowing investors accelerated building allowances under section 12S in respect of qualifying buildings that were expended on prior to the proposed policy change being publicly announced, be allowed to be written off in full for their investment in the buildings.

Response: Partially accepted. The sunset date in the 2020 Draft TLAB will be amended to provide that the two SEZ provisions (sections 12R and 12S) ceases to apply in respect of any year of assessment commencing on or after 1 January 2031. This new sunset date of 1 January 2031 provides for a 10-year period from when legislation is changed in terms of the 2020 draft TLAB. New investors and other stakeholders now have been alerted upfront that qualifying companies will, subject to a review of the SEZ tax regime, only be guaranteed the current tax benefits in their present form (i.e. taxation at 15 per cent and accelerated capital allowance) until 1 January 2031.

7.4. Introducing sunset dates for section 12DA and section 12F

(Main reference: Sections 12DA and 12F of the Income Tax Act: clauses 15 and 16 of the draft TLAB)

The 2020 Draft TLAB introduced sunset dates in respect of capital allowance provisions for rolling stock (contained in section 12DA) and airport and port assets (contained in section 12F). In this regard, it was provided that these allowances would only be available to taxpayers in respect of any year of assessment ending on or before 28 February 2022.

Comment: The sunset dates introduced in respect of rolling stock and airports and airport assets in sections 12DA and 12F should at the very least allow taxpayers the existing allowance in respect of currently held assets for the remainder of the benefit periods.

Response: Accepted. The sunset dates in respect of capital allowance provisions for rolling stock (contained in section 12DA) and airport and port assets (contained in section 12F) in the 2020 Draft TLAB will be amended to provide that the capital allowances will be available in respect of assets brought into use in the taxpayer's trade in any year of assessment ending on or before 28 February 2022. As a result, with respect to section 12DA, if the asset is in use by 28 February 2022, the taxpayer would be able to claim the allowance over a 5-year period. On the other hand, in respect of section 12F, if the asset is in use by 28 February 2022, the taxpayer would be able to claim the allowance over a 20-year period. However, in the proposed review of these incentives in 2021, Treasury will assess whether an

additional window to claim the incentive is required for projects that are in development, otherwise the incentive will lapse as of 28 February 2022.

7.5. Clarifying administrative provisions of Venture Capital Companies Tax Incentive Regime

(Main reference: Sections 12J of the Income Tax Act: clause 17 of the draft TLAB)

In 2008, government introduced the Venture Capital Company (VCC) tax regime as one of several measures to encourage the establishment and growth of Small, Medium and Micro-Enterprises (SMME) and as a tool to address job creation and inequality. Taxpayers investing in a VCC are allowed an upfront deduction for their investment in that VCC (whereas most equity investments are non-deductible) with a recoupment upon withdrawal if the investment is not held for a minimum period of five years. Unfortunately, over the past couple of years questionable VCC structures, advertised as tax investment solutions, started appearing. In response to this, government introduced anti-avoidance measures. It has come to government's attention that the anti-avoidance measures introduced in 2018 regarding the 20 per cent shareholding limitation on VCC shares has unintended consequences. As a result, changes were made in the 2020 Draft TLAB to allow for an exclusion of the application of the 20% ownership provisions, if that VCC, in writing, notifies the Commissioner for the SARS of that intent to terminate a class of shares within that VCC.

Comment: The proposed amendment is welcomed. However, certain additional perceived technical limitations relating to several other possible unwinding scenarios were raised by a taxpayer.

Response: Not accepted. Currently, the VCC tax incentive in section 12J has a sunset clause of June 2021 to allow government to review both the impact of the tax incentive and its possible structural shortcomings. As such the comments generally fall outside of the scope of the proposed specifics of the amendment described above and taxpayers are encouraged to submit these comments to government as part of the Budget Review 2021 public comment process towards the end of the year whilst keeping in mind that everything, including all technical aspects, of the incentive are currently under review.

8. INCOME TAX: INTERNATIONAL

8.1. Introducing an anti-avoidance provision regarding change of residence

(Main reference: Section 9H of the Income Tax Act: clause 7 of the Draft TLAB)

When a South African tax resident company changes its tax residency to another tax jurisdiction, such company ceases to be tax resident for South African income tax purposes (regardless of whether the assets of such company are still located in South Africa or whether the company still continues to do business in South Africa

or not) and the cessation of South African tax residence is deemed to be a disposal for tax purposes and triggers normal tax.

The interaction between the current rules applying to a company that is ceasing to be a South African tax resident and the current rules aimed at providing participation exemption from capital gains tax any disposal of equity shares held by a South African tax resident holding a least 10 per cent of the equity shares in a non-resident company represents creates a loophole. In order to close this loophole, it is proposed that changes be made in the tax legislation to deem a disposal and reacquisition of shares held by residents in the company that becomes a non-resident.

As such, it is proposed that changes be made in section 9H of the Income Tax Act to deem a South African tax resident shareholder who hold shares in a South African tax resident company that changes its tax residency to another tax jurisdiction to be deemed to have disposed of and reacquired the shares at market value on the day before exit.

Comment: The proposed amendment will lead to double taxation for the shareholders as they are subject to tax on both the deemed dividend and on the deemed disposal of the shares.

Response: Accepted. In order to alleviate double taxation, changes will be made in the 2020 Draft TLAB so that the proposed amendment will be limited to apply to those companies that may qualify for participation exemption in respect of capital gains in terms of paragraph 64B of the Eighth Schedule.

8.2. Introducing an anti-avoidance provision regarding taxation of foreign dividends received by residents

(Main reference: Section 10B(6A) of the Income Tax Act: clause 11 of the Draft TLAB)

Section 10(1)(k)(i) of the Act makes provision for dividends received or accrued from resident companies to be exempt from normal tax, subject to certain exceptions. The exceptions included under section 10(1)(k)(i) of the Act are aimed at limiting tax avoidance. These exceptions include a rule in paragraph (hh) of the proviso to section 10(1)(k)(i) referring to a scenario where a company incurs an obligation to pay deductible expenditure that is determined directly or indirectly with reference to dividends in respect of an identical share to the share from which the company received or accrued a dividend. The amount of the dividend is taxable to the extent of the deductible expenditure. However, section 10B of the Act (participation exemption) does not have an anti-avoidance rule similar to paragraph (hh) of the proviso to section 10(1)(k)(i), that denies the exemptions for foreign dividends on foreign shares if the amount of a deductible expense is determined with reference to the foreign dividends. In order to address this anomaly, it is proposed that foreign

dividends received by or accrued to a person on a share in a non-resident listed or unlisted company be denied participation exemption in terms of section 10B and be subject to tax if that person incurs deductible expenditure that is determined directly or indirectly with reference to a foreign dividend in respect of an identical share in relation to the share in that foreign company.

Comment: The scope of the proposed amendment is broader than the equivalent provision in section 10(1)(*k*) in that it applies to "any person" while proviso to section 10(1)(*k*) only applies to a company.

Response: Accepted. The proposed amendment in the 2020 Draft TLAB will be changed to refer to a company.

8.3. Refining the scope of the transfer pricing rules applying to CFCs

(Main reference: Section 31 of the Income Tax Act: clause 31 of the Draft TLAB)

The Income Tax Act contains transfer pricing rules aimed at preventing the reduction in South African taxable income as a result of mispricing or incorrect characterisation of transactions. In particular, the definition of "affected transaction" in section 31 of the Act make provision for a controlled foreign company in relation to a resident to adjust its taxable income to reflect an arms-length price in respect of a cross border transaction with a non–resident connected person that is not at arms-length and derives a tax benefit from that transaction. The current wording of the transfer pricing rules presents a limitation in its application. For example, in the case of a transaction between a controlled foreign company (CFC) in relation to a resident and a non-resident connected person, a tax benefit may not be derived by the foreign company, but may be derived by a South African resident shareholder as a result of a lower inclusion of controlled foreign company net income for the resident. In order to address this anomaly, it is proposed that changes be made in section 31(2) of the Act to refer to a tax benefit that may be derived by a person, in relation to a controlled foreign company, that is a resident.

Comment: It is not clear whether the effect of the amendment would increase the "net income" of the CFC or whether it would leave the "net income" unaltered but increase the taxable income of the resident through a transfer pricing adjustment made in terms of section 31 outside of section 9D.

Response: Accepted. The proposed wording in the 2020 Draft TLAB will be reviewed such that it is clear that it refers to a CFC contemplated in paragraph (iv) in the definition of "affected transaction".

8.4. Limiting the application of dividend and capital gain exemptions in loop structures

(Main reference: Section 9D and paragraph 64B of the Eighth Schedule to the Income Tax Act: clauses 6 and 50 of the draft TLAB)

Under the current Exchange Control Regulations of 1961, regulation 10(1)(c) provides that residents may not enter into a transaction or a series of transactions with the purpose or effect of directly or indirectly exporting capital from South Africa. In general, it is a contravention of the Exchange Control Regulations for a resident to set up an offshore structure that re-invests into the Common Monetary Area (CMA) by acquiring shares or other interest in a CMA company or CMA asset. However, as an exception to the above, private individuals and South African companies are permitted to acquire up to 40 per cent equity or voting rights in a foreign target company which may in turn hold investments (including loans) into any CMA country. Loop structures where the 40 per cent shareholding is exceeded require approval from the Financial Surveillance Department of SARB with due consideration to transparency, tax, equivalent audit standards and governance. As indicated in Annexure E of the 2020 Budget Review, Government proposes to review the current exchange control rules to a new capital flow management framework that is aimed at promoting investment, reducing unnecessary burdensome approvals by SARB and providing a modern, transparent and risk-based approvals framework for cross-border flows. One of the changes to the current exchange control rules envisaged above is the relaxation of the approval that is required for loop structures where the 40 per cent shareholding is exceeded after tax amendments are implemented to address the risk of reducing South Africa's tax base by loop structures. The Income Tax Act contains some rules that may reduce the risk of loop structures. However, increased tax planning opportunities may arise as a result of the relaxation of the approval by the Financial Surveillance Department of SARB that is required for loop structures where the 40 per cent shareholding is exceeded. These tax planning opportunities may arise from the current exemption available for dividends and capital gains derived from the disposal of shares in foreign companies to non-residents. Therefore, it is proposed that changes be made in the CFC legislation so that a non-resident company in a loop structure that is a CFC include a portion of a dividend that is received or accrued from a resident company in net income. In addition, based on the fact that gains on the disposal of shares in a non-resident company to a non-resident are not taxed because of the participation exemption in paragraph 64B of the Eighth Schedule. It is proposed that the participation exemption should not apply to the disposal of shares in a non-resident company in a loop structure that is a CFC to the extent the value of the assets of that CFC are derived from South African assets.

Comment: The proposed amendments would result in any resident holder of participation rights in a CFC being subject to income tax on the dividends received by a CFC. However, a CFC would also be subject to dividends tax on such dividends.

Response: Accepted: The current amendment in the 2020 Draft TLAB will be amended such that the aggregate of dividends received or accrued by or accrued to the controlled foreign company in a loop structure during the foreign tax year of that controlled foreign company may be reduced by 100% of dividends where

dividends tax has been paid at 20% or 50% of dividends where dividends tax has been paid at 10% or 40% of dividends where dividends tax has been paid at 8% or 37.5% of dividends where dividends tax has been paid at 7.5% or 25% of dividends where dividends tax has been paid at 5% .

Comment: The proposed amendments of the deletion of the "look-through" rule in paragraph *(f)* of the proviso to section 9D(2A) to create an equal treatment of residents holding South African assets directly or indirectly has an impact that an Individual Policyholder Fund (IPF) would be taxed at an inclusion rate of 80% instead of 40% where the capital gain is generated from a CFC which will impact unit pricing of policyholder investments that contain non-loop foreign investments.

Response: Accepted: Paragraph *(f)* of the proviso to section 9D(2A) will be retained only for long-term insurers to cater for the impact on the IPF. The higher tax rate on the gain may have affected savings by South African individual policyholders.

Comment: In terms of the proposed amendment, paragraph 64B will not apply to capital gains or losses determined in respect of the disposal of shares in a CFC to the extent that the value of the assets of the CFC is "derived from assets" in SA. This proposed method of apportionment is not appropriate and its application could lead to inequitable results for both the taxpayer and the fiscus therefore it is suggested that the method of apportionment should be based on the extent to which the capital gain or loss is attributable to assets in SA.

Response: Noted: The proposed changes were made as a result of the proposed changes to the current exchange control rules and not aimed at raising any revenues, therefore, it is understood that both the taxpayer and the *fiscus* may gain or lose at some point. In addition, from a practical point of view, it may be difficult to do valuations of and capital gains on individual assets and that method may be challenging when a CFC has a relatively large number of assets it owns.

Comment: The proposed changes to paragraph 64B should include a *de minimis* rule that this provision would apply where the South African assets constitute 10% or more of the market value of the CFC's assets.

Response: Not accepted: The current rules in paragraph 64B for the disposal of equity shares in foreign companies applies when a person holds 10% or more of the equity shares and voting rights in that foreign company.

8.5. Taxation of the transfer of listed securities to an offshore exchange

(Main reference: New section 9K of the Income Tax Act: clause 9 of the Draft TLAB)

Under the current exchange control rules, a resident individual or company that owns a listed domestic security is not permitted to export that listed security abroad to an exchange outside South Africa without prior approval from the South African Reserve Bank (SARB). The financial surveillance department of SARB has an

emigration form called MP336(b) that needs to filled by any person who wants to emigrate from South Africa upon receipt of that person of a SARS Tax Clearance Certificate for emigration. This emigration form also requires the person emigrating from South Africa to include any JSE listed security that person holds that will be migrated to any exchange outside South Africa. As indicated in Annexure E of the 2020 Budget Review, Government proposes to review the current exchange control rules to a new capital flow management framework that is aimed at promoting investment, reducing unnecessary burdensome approvals by SARB and providing a modern, transparent and risk-based approvals framework for cross-border flows. One of the changes to the current exchange control rules is the phasing out of the approval requirement by SARB when a resident individual or company that owns a listed domestic security is exporting that listed domestic security abroad. It is proposed that changes be made in the tax legislation by introducing a new rule that triggers a deemed disposal and reacquisition when a domestic listed security is removed from JSE register and is listed in an exchange that is outside South Africa. In addition, if the person holding the security remains a South African tax resident, such person will be liable for income tax on further gains when the security is subsequently sold.

Comment: The proposed amendments should be withdrawn because there is no rationale for this amendment.

Response: Not accepted: Based on the fact that the proposed amendment is part of the package to review the current exchange control rules and the potential risks that may emerge due to timing and tax compliance issues.

Comment: The proposed amendments is drafted very wide and has a potential of affecting a company that changes its listings from the JSE or where a dual listed company rebalances its registers between the South Africa and the foreign exchanges.

Response: Accepted: Changes will be made in the 2020 Draft TLAB so that the proposed amendments should only apply to the transfer of shares by individuals and trust, and should not apply to the transfer of shares by companies.

Comment: The proposed amendments requires an amendment that for purposes of section 9C the date of acquisition would be deemed to be the date of acquisition of the original holding on SA exchange.

Response: Accepted: Changes will be made in the 2020 Draft TLAB so that the reacquired shares are deemed to have been acquired at the date of the shares held before transfer for the offshore exchange, for purposes of section 9C.

Comment: When an actual disposal of a major shareholder occurs, the company would be aware of the transfer of listed securities to an offshore however a minority shareholder in the company will now be impacted by this proposal.

Response: Not accepted. The proposed amendments are aimed to apply on all transfer of shares by individuals and trust, irrespective of percentage shareholding.

9. VALUE-ADDED TAX

9.1. Changing the VAT treatment of transactions under corporate reorganisations rules

(Main references: Sections 8(25) and 11(1)(*e*) of the VAT Act: clause 61 of the Draft TLAB)

The VAT Act makes provision for VAT relief during corporate reorganisation transactions between companies that form part of the same group of companies. This is achieved by treating the supplier and the recipient of the goods or services as the same person, provided that the relevant rollover relief provisions of the Income Tax Act are met. The proviso to this relief is that supplies between group companies contemplated in sections 42 (asset for share transactions - company formations) or section 45 (intragroup transaction) of the Income Tax Act, may only be subject to this relief if the transfer relates to the transfer of an enterprise, or part of an enterprise capable of separate operation, as a going concern. It had come to government's attention that even though some of these assets do not qualify for the Income Tax relief, the assets being transferred may have qualified for the zero-rating provisions relating to "going concerns" had the parties not been part of the same group of companies. The proposed amendment in the 2020 Draft TLAB seeks to resolve this anomaly.

Comment: The proposed amendment does not clearly outline the fact that vendors in these circumstances (being part of the same group of companies) may elect to use the zero-rating provision of the VAT Act, dealing with going-concerns, where some of the assets do not qualify for the Income Tax relief in sections 42 and 45 of the Income Tax Act.

Response: Accepted: Changes will be made to the 2020 Draft TLAB to ensure that the policy intention as stated in the Explanatory Memorandum is clearly reflected in the legislation.

9.2. Reviewing the section 72 decision with regard to the VAT treatment of telecommunication services

((Main reference: Section 11(2)(*y*) of the VAT Act: clause 63 of the Draft TLAB)

In 2019 changes were made to section 72 of the VAT Act, which provides the Commissioner with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption from tax provided for in terms of the VAT Act, provided that the Commissioner is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise with regard to the application of the VAT Act. These changes have an impact on the arrangements or decisions made in terms of this section before 21 July 2019. In the 2020 Budget Review, government undertook to address these concerns by reviewing the

impact and the role of these arrangements and decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72.

One of the arrangements and decisions made in terms of section 72 of the VAT Act before 21 July 2019, which is impacted by these changes refers to the VAT treatment of telecommunication services. South Africa is a signatory to the International Telecommunications Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR) as well as the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai in 2012 (effective 2015) (Dubai ITR). In terms of these ITRs, the SA vendors may only levy VAT on these charges if the customer has a South African billing address. SA vendors supplying roaming and other services to non-resident telecommunications suppliers are thus obliged, in terms of the Dubai ITR, to zero-rate these charges levied to their non-resident counterparts. The proposed amendment is to introduce a new zero-rating provision in order to ensure that the provisions of the Dubai ITR are upheld, in line with the section 72 rulings that were previously given to taxpayers.

Comment: The proposed amendment does not specify whether all services between telecommunications suppliers are zero-rated or whether it is just telecommunications services that will be zero-rated. The proposed zero-rating seems to be on an entity level as opposed to being on a transaction level, as contemplated in the Explanatory Memorandum.

Response: Accepted. Changes will be made in section 11(2)(*y*) in the 2020 Draft TLAB to clarify that the zero-rating will be applicable on a transaction level.

Comment: Some commentators were in support of the proposed amendment. Others stated that the proposed amendment is too broad and does not clarify the types of services that will be zero-rated in order to comply with the Dubai ITR.

Response: Accepted. Changes will be made in section 11(2)(*y*) in the 2020 Draft TLAB to refer specifically to those services that the SARS Commissioner had previously issued rulings in terms of section 72 in relation to the supplies between Telecommunications suppliers in terms of the Dubai ITR and that are deemed to be appropriate to be included in the 2020 draft TLAB. Any further proposed amendments regarding the implementation of the Dubai ITR could be considered in the subsequent legislative cycle.

Comment: The proposed amendment does not make provision for any future International Telecommunication Regulations.

Response: Not accepted. The proposed changes in the 2020 Draft TLAB are only limited to the existing international agreements and refer specifically to those services that the SARS Commissioner had previously issued rulings on in terms of

section 72 in relation to the supplies between Telecommunications suppliers in terms of the Dubai ITR.

9.3. Reviewing the section 72 decision with regard to the VAT treatment of cross border leases of foreign owned ships, aircraft and other equipment for use in RSA

(Main reference: Definition of “enterprise” in section 1(1) of the VAT Act: clause 60 of the Draft TLAB)

Section 1(1) of the VAT Act defines an “enterprise” in the case of any vendor, to generally mean any enterprise or activity which is carried on continuously or regularly by any person in or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit. In turn, a “vendor” is defined in section 1(1) of the VAT Act to mean any person who is or is required to be registered for VAT in the Republic. In instances where foreign-owned ships, aircraft or other equipment are leased for use in the Republic, and the lessor of such goods has no physical or business presence in the Republic (other than the leased goods), and the lessee is obliged in terms of the lease agreement to import the goods into the Republic, uncertainty existed regarding whether the foreign lessor is conducting an enterprise in the Republic. The proposed amendment intends to clarify the instances when a lessee in such circumstances will not be required to register for VAT. It provides for a further exception to the “enterprise” test in the VAT Act.

Comment: Some commentators were in support of the proposed amendment and referred to the practical difficulties of opening a SA bank account that many foreign suppliers face when trying to register for VAT in SA. Other commentators were not in support of it, stating that the original SARS rulings that were issued in this regard were not necessary since the general provisions of the VAT Act should have been applied to these situations. These commentators stated that if Treasury is going to proceed with this amendment, then their further comment is that the scope of the proposed amendment is too wide and may have unintended consequence such as encouraging taxpayers to set up operations in other countries within the SADC region and then leasing goods into the Republic to avoid any VAT consequences. It was suggested that the types of goods covered by this proposed amendment be specified and be limited to foreign-owned ships, aircraft and rail (to be referred to as “rolling stock” as in the Income Tax Act).

Response: Partially accepted. Changes will be made in the 2020 Draft TLAB to limit these provisions to apply only to foreign-owned ships, foreign owned aircraft and foreign owned rolling stock.

Comment: The proposed requirement that the supplier must not be a vendor is problematic since some of these suppliers are already registered for VAT.

Response: Not accepted. Suppliers that are already registered for VAT are those that make other supplies in the Republic, in addition to the leasing of aircraft, ships

and rolling stock. This proposed amendment is not intended to cover such suppliers. Those suppliers will meet the requirements of an “enterprise” as defined in the VAT Act and would be required to be registered for VAT in South Africa. The proposed amendment is intended to exclude those suppliers that “solely” supply such goods in terms of lease agreements to recipients in South Africa.

Comment: The proposed requirement that the delivery of the asset must take place outside the Republic is problematic because parties agree on INCOTERMS which determine which party carries the risk of the product during the delivery process. Further, this proposed requirement will imply that where the lease agreements are ceded or extended, the transaction will fall out of the provisions of this exception to the “enterprise” test in the VAT Act since in such instances the goods will already be in the Republic at the time.

Response: Accepted. Changes will be made in the 2020 draft TLAB to remove this requirement from the proposed amendment.

10. CARBON TAX

10.1. Carbon Fuel Levy - Change the formula to divide by 1000 to change from $kgCO_2e$ to tonne CO_2e

(Main reference: Schedule to the Customs & Excise Act)

The Carbon Tax Act No. Act 15 of 2019 (“the Carbon Tax Act”) came into effect on 1 June 2019 and is administered by SARS in terms of the Customs and Excise Act. Non-stationary greenhouse gas emissions from petrol and diesel use are for purposes of the administration of the carbon tax incorporated in the current fuel levy as a carbon fuel levy in terms of the Customs and Excise Act. Given that the implementation of the carbon tax on fuel and its collection will be done through the fuel levy mechanism, several administration procedures have been implemented to indicate that the carbon tax will be administered as a separate line item. In terms of Note 6 to Part 5A of Schedule No. 1 of the Customs and Excise Act, the fuel levy consists of the GFL and the carbon fuel levy. The current cents per litre rates of the general fuel levy and carbon fuel levy are specified in Note 7 to the said Part. In order to create the necessary explicit link between the carbon fuel levy rate and the carbon tax rate, the Notes were amended to include the formulas to calculate the carbon fuel levy rates.

Comment: The stakeholders proposed that the emission factors per tonne petrol or diesel should be calculated as in the Carbon Tax Act where the emission factor calculation gives a result of $kgCO_2e$ per tonne petrol or diesel. The wording should state that the emission factor should be calculated in $kgCO_2e$ per tonne petrol or diesel respectively. The formula proposed in its current form should be divided by 1000 to change from kgCO2e to tonne CO2e.

Response: Not accepted. This has already been provided for in the 2019 Taxation Laws Amendment Act (Act 33 of 2019. Section 4(2)(a)(iii) of the Carbon Tax Act was amended by section 1(c)).

10.2. Carbon Fuel Levy - Change wording in the Act to allow for the periodic adjustment to emission factors (EFs), net calorific values (NCVs) and density factors (DFs)

(Main reference: Schedule to the Customs & Excise Act)

Comment: The stakeholders proposed that the wording of this section be adjusted so that these variables are properly accommodated in the wording of the Act – either by reference to a table or schedule or by reference to a determination after due consideration to be made by the Minister on calorific values, density and emission factors be taken on a periodic basis. It is envisaged that such an exercise of DEFF would need to be taken on a periodic basis and the National Treasury cannot be expected to be amending the law to take new values into account each time.

Response: Noted. The separation of schedules from the Act could be considered when there may need to be a move towards allowing the EFs, NCVs and DFs to be changed through a Notice. National Treasury will also engage on a process with the Department of Environment, Forestry and Fisheries to consider how the amendments made in terms of the reporting regulations can be accommodated through a Notice.

10.3. Carbon Tax Cost Pass Through: Pass through cost recovery should be backdated to 1 June 2019

(Main reference: Section 6 of the Carbon Tax Act: Clause 77 of the Draft TLAB)

Comment: It is noted that this section of the Act would only be applicable from 1 January 2021 when it should be made retroactive to afford the same treatment to electricity generators and due to the commitments made by National Treasury during hearings in Parliament. It was understood to be effective 1 June 2019. Further, as per National Treasury's National Budget Review 2020, it is stated that government will publish the applicable rates for specific regulated fuels with no indication that commencement will be effective 2021.

Response: Partially accepted. Changes will be made in the 2020 draft TLAB to make the effective date retrospective to 1 January 2020 but not to 1 June 2019 as the seven-month filing period has already closed. Taxpayers have already filed their tax returns for the 2019 period and this pass through will only be finalised by the end of 2020 and a retroactive application might be problematic.

10.4. Carbon Tax Cost Pass-Through: Allow for inflationary adjustment in the carbon tax cost pass-through

(Main reference: Section 6 of the Carbon Tax Act: Clause 77 of the Draft TLAB)

Comment: There is also no provision for the adjustment for inflation of the quantum on an annual basis unlike that for the headline rate of carbon tax. To accommodate such an adjustment, the final quantum should be expressed to two decimal places and provision should be made for inflationary adjustments.

Response: Accepted. The inflationary adjustment for the cost pass-through will be included in the draft legislation and the inflation rate will be adjusted as per the Carbon Tax Act (CPI plus 2 percentage points).

10.5. Carbon Tax Cost Pass-Through: Include other price regulated fuels which are part of refinery output so they are eligible for the pass-through.

(Main reference: Section 6 of the Carbon Tax Act: clause 77 of the Draft TLAB)

Comment: Stakeholders indicated that price regulated fuels also include Liquefied Petroleum Gas (LPG), Illuminating Paraffin (IP) and Diesel which are also part of refinery output. However, the carbon tax costs recovery, as provided, is only applicable to petrol production which is not consistent with the aforementioned statement nor with the accepted principal of pass-through on administered prices. The pass-through should also be applied to diesel.

Response: Not accepted. There are no taxes imposed on IP therefore it does not need to be included in the carbon tax net and it has one price throughout the country i.e. the Single Maximum National Retail Price (SMNRP) which is regulated and promulgated in the Government Gazette on a monthly basis. For LPG, the regulated Maximum Retail Price (MRP) are set for Retailers selling to the household consumer only and up the 9kg cylinders and retail prices may therefore be set below this maximum price. Diesel prices are quasi-regulated as the gazetted wholesale price is only a reference price but the wholesaler can sell at any price (have a lever to maneuver prices in the value chain) which could include cost recovery for the carbon tax costs. Only petrol prices are regulated to the retail level which is very tight and does not allow room for any cost pass-through. In consultation with the DMRE, it was agreed that the concession for refineries should only be applied to price controlled products. In addition, there is also need to consider that the average refinery output is approximately 50% petrol, 40% diesel, less than 10% IP and maximum 3% LPG hence has implications on refinery emissions. Thus, given that refinery output is mostly petrol and only petrol amongst the carbon tax liable fuels is regulated to the retail level, a carbon tax cost offset will only be considered for petrol.

10.6. Carbon Tax Cost Pass-Through: Quantum of cost recovery is insignificant creating an illusion of support

(Main references: Section 6 of the Carbon Tax Act: clause 77 of the Draft TLAB)

Comment: The 0.1 cents per litre is an approximate 1% of the carbon fuel levy currently imposed on petrol (7 c/l) which is very low. The proposal to allow a pass-

through is appreciated. The actual relief provided in the formula is however extremely and almost negligibly low. It is not clear whether it is intended to be so low or whether it is an unintended oversight in the formula inserted in section 6. The current structure of the Carbon Tax Act allows electricity generators to offset their carbon tax liability with the environmental levy until the end of 2022. This effectively allows these operators a pass-through of their carbon tax liability to consumers unlike the liquid fuels sector during this period.

Response: Partially accepted. The rationale for the pass-through (0.1 c / litre) should not be referenced to the carbon fuel levy as this relates to the emissions in the process of producing petrol and is not directly related to the 7c/litre as those are for the emissions from the burning of petrol. Also, the 7c/litre is in effect paid by the consumer as the regulated price has increased by that amount so it is not a cost for the producer (even though the payment is made by the producer, but that is not where the incidence lies). There was never a commitment to carbon price neutrality for fuels like was done for the electricity generation sector. However, Government proposes to increase the pass-through to around 50 per cent of the total expected pass-through cost (as described in the following methodology) and will increase the pass-through amount to 0.56 c/litre.

10.7. Carbon Tax Cost Pass-Through: Clarification of the methodology for the determination of the pass-through

(Main references: Section 6 of the Carbon Tax Act: clause 77 of the Draft TLAB)

Comment: The stakeholders commented that while the recovery proposal is clearly transparent, it is unclear as to how the quantum was derived which appears arbitrary. Considering that National Treasury's stated intention that the tax is not a revenue generation instrument but that to change behaviour, it cannot be considered equitable without taking into account the mitigation potential of the sector. It is widely acknowledged that the technical mitigation potential of refineries is limited without the adoption of Carbon Capture and Storage and this would make any carbon tax for refineries over and above this potential clearly punitive.

Response: Noted. The methodology for determining the quantum for the "pass-through" takes into account a proposal submitted by the South African Petroleum Industry Association (SAPIA). This approach was considered by the National Treasury and the DMRE and revised to cater for the tax-free allowances applicable to the different refinery activities and was limited to petrol fuel only due to the strict fuel price regulations.

The total pass-through is calculated based on the following and as outlined in the box below:

- The attributable emissions (derived from multiplying the percentage production by each refinery's emissions);

- The attributable emissions are then multiplied by the pass-through tax rate (determined by multiplying the headline rate (R127 / tonne CO_2e) by the percentage of tax-free allowances allowable for each refinery);
- This gives the total pass-through amount (R) which is then divided by the total production of petrol (m^3) to derive the R / m^3 which is then converted to a cents per litre amount and this gives a pass-through of 1,12 cents / litre.

Pass-through methodology

The calculation of the pass-through is based on the following steps:

a) The emissions used are based on companies' data submissions which are the latest emissions data reported to the DEFF for the 2019 reporting period and the publicly available 2015 GHG inventory data;

b) To estimate the emissions that will be subject to the tax i.e. attributable emissions for petrol production, the production percentage of petrol is multiplied with the refinery emissions. The production percentage for petrol from the different refineries averaged about 34% for oil refineries and 60% for Secunda and 59% for PetroSA;

c) Calculate the total tax-free allowances for the pass-through. The tax-free allowances used include the maximum allowances based on the Carbon Tax Act;
   - Oil Refinery allowances for pass-through = Basic + Trade Exposure + Carbon Budgets + Z Factor + Carbon Offsets = 90%
   - Synthetic Refinery Allowances for pass-through = Basic + Trade Exposure + Carbon Budgets + Z factor + Fugitive + carbon Offsets = 95%

d) The next step is to calculate the relevant tax rate, which is determined by the headline rate (R127 / tonne CO_2e) multiplied by the percentage of tax-free allowances for the facilities;

e) The attributable tax amount is calculated by multiplying the pass-through emissions and the relevant tax rate calculated above for each refinery which is then summed to get the total pass-through amount for all refineries;

f) Divide the total pass-through amount for all refineries by the total production of petrol by all refineries to get the pass-through amount in Rands per cubic metre;

g) Convert the pass-through amount to cents per litre to determine the pass-through and this method gives a pass through of 1,12 cents / litre.

Scenarios	Pass-through percentage allowed	Petrol only passthrough cents / litre	Costs to the fiscus R'million
Permit a 100% pass-through for all refineries	Allowing for a full cost pass-through where all emissions costs are passed on to the consumer.	1.12	116
Permit a 10% pass-through for all refineries	Allowing for only 10 per cent of the cost to be passed on to the consumer.	0.1	11.6
Permit a 50% pass-through for all refineries	Allowing for a 50 per cent of the cost to be passed on to the consumer.	0.56	58

Allowing each refinery to have use the same allowances for the pass-through similar to what is provided in the carbon tax design is the most equitable as refineries can applying all the tax-free allowances they are eligible for, which implies that for oil refineries, the allowable pass-through would be 10% and for synthetic processes, the allowable pass-through would be 5%. This option mirrors the policy objectives as allowances for the pass-through equal all the tax-free allowances provided for in the Carbon Tax Act each refinery is eligible to claim. This would result in a rate of 1.12 cents / litre of petrol, which would cost the fiscus R116 million assuming a full 100% pass-through allowance.

However, as stipulated in the policy paper, refineries will not be allowed to pass-through all of their costs hence in consideration of the price inelasticities associated with a regulated fuel market which refineries operate in, a 50% of the cost could be allowed as a pass-through resulting in a pass-through rate of 0.56 cents / litre at a cost of R57.9 million to the fiscus.

Draft Tax Administration Laws Amendment Bill

11. Income Tax: Administration

11.1. Replacement of term "mentally disordered or defective person" with the modern term "mentally disabled"

(Main reference: Section 1 of the Income Tax Act, 1962: clause 2 of the Draft Bill)

Comment: A definition of "mental disability" should be included.

Response: Partially accepted. On reconsideration the term is not required at all, since a person with a mental disability that requires the appointment of a curator or the like already falls under the existing concept of a "person under legal disability".

11.2. Removal of the requirement of "wilfulness" from statutory offences

(Main reference: Paragraph 30(1) of Fourth Schedule; clause 8 of the Draft Bill)

See the discussion in paragraph 14.4 below.

12. Customs and Excise: Administration

12.1. Adjustment of bills of entry by substitution where purpose code is altered

(Main references: Section 40(3) of the Customs and Excise Act, 1964; clause 13 of the draft Bill)

Comment: An error involving a purpose code, requiring correction by means of substitution, should not require a different standard from any other invalid declaration requiring a voucher of correction. Making a substitution of an erroneous customs declaration subject to section 40(3)*(a)*(ii), will require "good cause to be shown" to customs and confer a discretion on the Commissioner to refuse such corrections.

Additionally, deleting current section 40(3)*(a)*(i)(B), would have the unintended effect of reducing potential general refund claims from two years to 1 month, in respect of the erroneous substituted customs declaration, which must be cancelled. This would be severely prejudicial to the public interest, by depriving citizens of customs refunds that are legitimately due to them.

Erroneous customs declarations in terms of section 40(1) that can only be corrected by means of substitution due to an amendment of the customs procedure, should not be subjected to a different standard, or a different general refund claim period, than vouchers of correction amending erroneous customs declarations that similarly entail customs general refunds. It is proposed that the draft amendment of the substitution provision in the Amendment Bill should be withdrawn, enabling SARS to draft new provisions for public comment

Response: Not accepted. There is a distinction between amendment by voucher of correction (VOC) and the substitution of a bill of entry. A bill of entry that is invalid must be corrected by VOC, whilst substitution can only be used where the

bill of entry is valid. Furthermore, adjustment by VOC is a legal obligation whilst a substitution is a trade facilitative benefit that may be allowed to a declarant. An example of where substitution could arise is when a declarant realises that goods validly entered for home use could have qualified for a rebate under a different procedure code. There is a risk of abuse associated with substitution and therefore the Commissioner has a discretion to evaluate the reasons for substitution.

Substitution may in terms of section 40(3)*(a)* be allowed subject to the provisions of section 76. In terms of section 40(3)*(b)* the application for substitution must be received within a specific time as set out in that paragraph, but this does not shorten or limit the period within which application for a refund may be submitted in terms of section 76(4). The proposed deletion of section 41(3)*(a)*(i)(B) does not affect a declarant's ability to cancel a bill of entry in circumstances prescribed under section 40(3)*(a)*(i)(C).

13. Value-Added Tax: Administration

13.1. Removal of the requirement of "wilfulness" from statutory offences

(Main reference: Section 58 of the Value-Added Tax Act, 1991; clause 21 of the Draft Bill)

See the discussion in paragraph 14.4 below

14. Tax Administration

14.1. Raising of assessments based on an estimate

(Main reference: Sections 91, 93 and 95 of the Tax Administration Act, 2011; clauses 26, 27 and 29 of the Draft Bill)

Comment: A concern is raised that the proposed changes, insofar as they relate to denying a taxpayer the right to object to an estimated assessment raised by SARS in the instance where a taxpayer has not provided what SARS has unilaterally deemed to be 'relevant material', represents an unconscionable limitation of taxpayer rights.

It must be borne in mind that SARS' right to request information is not, nor should ever be, unlimited and the extent to which it has those powers represents a balancing act between the need for the *fiscus* to obtain information and, *inter alia*, a taxpayer's constitutional right to privacy.

It is submitted, the proposed amendment denying the taxpayer the right to object to an estimated assessment, particularly where the taxpayer may be pursuing a dispute with SARS as to the legitimacy of the underlying issue (extent of request for relevant material) denies the taxpayer both critical constitutional rights and the right to administrative justice.

Response: <u>Partially accepted.</u> Section 95(1) read with section 95(4) will be redrafted to provide that a taxpayer will only be barred from lodging an objection against the assessment based on an estimate if the taxpayer does not submit a

return or does not submit a response to a request for relevant material in respect of the taxpayer under section 46, after delivery of more than one request for such material. The response may thus set out valid grounds as to why the relevant material is not available or need not be supplied to SARS. It is implicit that the response must be something more than a frivolous response.

Comment: A concern is that taxpayers are not always aware of requests for information, since a valid method of communication is the uploading of a letter on the taxpayer's or tax practitioner's eFiling profile without notification that the correspondence has been uploaded. Requests for information must be sent via multiple communication platforms and where a tax practitioner is the preferred contact, the correspondence should be sent both to the taxpayer and tax practitioner using the contact details on the taxpayer's RAV01 form.

Response: Noted. A taxpayer making use of eFiling should ensure that the option on the eFiling platform, which if selected sends eFilers an SMS about communications that have been issued on the eFiling platform, is activated. Taxpayers should also ensure that their cell phone number and email addresses listed on the eFiling platform are current.

Comment: It should also be borne in mind that SARS can request relevant material from a taxpayer in respect of third parties. The failure to comply with such a request (again in the instance where a taxpayer challenges SARS legal competence as to the extent of such request) has no impact on the taxpayer's own tax affairs so it is difficult to understand why in such instances SARS should even be empowered to make an estimated assessment in respect of the taxpayer to whom the request is addressed, even less so that such assessment may not be objected to.

Response: Accepted. Although it is difficult to see on what basis an estimated assessment would be raised on a taxpayer in respect of a failure to provide a response in respect of third-party data requested, section 95(1) will be redrafted to make it clear that the request for relevant material is in respect of the affairs of the taxpayer to whom the request was directed.

14.2. Insertion of a period to determine if a payment in excess of an assessment was in erroneous or not

(Main reference: Section 187 of the Tax Administration Act, 2011; clause 30 of the Draft Bill)

Comment: While it is administratively efficient for SARS to be given a period of time to confirm whether an amount is a genuine overpayment or an amount which must be set off against existing tax debts before interest is calculated, the suggested period of 60 business days is excessive. In our view, a period of 21 business days would be more than sufficient and would align with other similar legislative provisions.

Response: Accepted. The period will be shortened to 30 calendar days.

14.3. Provision that a refund need not be authorised where a matter is under criminal investigation

(Main reference: Section 190 of the Tax Administration Act, 2011; clause 33 of the Draft Bill)

Comment: The proposed amendment may be in breach of taxpayer's constitutional rights and the presumption of 'innocent until proven guilty'. It is submitted that the proposed amendment be deleted.

Response: Partially accepted. The same rule already applies with regard to verifications, inspections or audits. It expresses no view on the final outcome of a verification, inspection, audit or investigation but provides SARS with the discretion not to make a refund while the risk that led to the verification, inspection, audit or investigation remains unresolved. Section 190(3) will, therefore, be extended to require SARS to make the refund if the taxpayer subject to investigation provides security in a form acceptable to a senior SARS official.

14.4. Removal of the requirement of "wilfulness" from statutory offences

(Main reference: Section 234 of the Tax Administration Act, 2011; Clause 34 of the draft Bill)

Comment: The standard required before a person can be found guilty of a criminal offence has been considered by the Constitutional Court, where it was found that the basic tenant of blameworthiness and criminal liability is intent (*dolus*).

Response: Noted. The commentator relies on the judgment by O'Regan J in *S v Coetzee and Others* (CCT50/95) [1997] ZACC 2 at paragraph 162. "The general principle of our common law is that criminal liability arises only where there has been unlawful conduct and blameworthiness or fault (the *actus reus* and m*ens rea*)… At common law, the fault requirement is generally met by proof of intent (*dolus*) in one of its recognised forms, and, in rare circumstances, by the objective requirement of negligence (culpa)." Two points may be made in this regard.

The first is that a good deal of the analysis in this part of the judgment revolves around comparative statutory law dealing with absolute or strict liability, where the prosecution need prove neither intent nor negligence, although certain defences may be available to the accused. This led to the statement in paragraph 176 of the judgment that "The striking degree of correspondence between different legal systems in relation to an element of fault in order to establish criminal liability reflects a fundamental principle of democratic societies: as a general rule people who are not at fault should not be deprived of their freedom by the state. This rule is the corollary of another rule which the same comparative exercise illustrates: when a person has committed an unlawful act intentionally or negligently, the state may punish them."

The second is that the paragraph 177 of the judgment specifically recognizes that the discretion afforded the legislature in respect of statutory offences. "In addition, it should be borne in mind that significant leeway ought to be afforded to the

legislature to determine the appropriate level of culpability that should attach to any particular unlawful conduct to render it criminal. It is only when the legislature has clearly abandoned any requirement of culpability, or when it has established a level of culpability manifestly inappropriate to the unlawful conduct or potential sentence in question, that a provision may be subject to successful constitutional challenge." (Emphasis added in all quotations above.)

Comment: The suggested amendment is a dramatic change from a legal approach that has been applied for numerous decades in tax law that it is only intentional criminal conduct that criminalises non-compliance.

To change the *mens rea* criteria to negligence, will open the floodgates of prosecutions against taxpayers, to prosecute taxpayers for their failure to have ensured that for instance, they have declared correctly (where in some instances tax positions are open to interpretation) and furthermore to hold them liable for their advisors (tax consultants, auditors, representative taxpayers, etc) actions i.e. that ensure that they took sufficient steps so as to avoid the *mens rea* requirements of negligence.

This will probably result in multiple prosecutions, or at least potential prosecutions, against tax advisors, tax representatives or consultants, who will all be drawn into possible prosecutions where the taxpayers will inevitable rely on a defence that they have been "advised" to adopt certain positions.

Response: Comment misplaced. Prior to the introduction of the Tax Administration Act, 2011, the provisions in respect of so-called lesser tax offences did not explicitly state whether intent or negligence was required for *mens rea* for such tax offences. Taking section 75 of the Income Tax Act, 1962, as it read then, as an example:

"**Penalty on default**.—(1) Any person who—

(a) fails or neglects to furnish, file or submit any return or document as and when required by or under this Act; or

…

(c) fails to show in any return made by him any portion of the gross income received by or accrued to or in favour of himself or fails to disclose to the Commissioner, when making such return, any material facts which should have been disclosed; or

…

shall be guilty of an offence and liable on conviction to a fine or to imprisonment for a period not exceeding 24 months.".

The provisions of sections paragraph 30 of the Fourth Schedule to the Income Tax Act, 1962, and 58 of the VAT Act, 1991, as they were before the Tax Administration Act, 2011, also did not expressly mention wilfulness. It is thus incorrect to say that the proposed deletion of "wilfully" is a dramatic change from a legal approach that has been applied for numerous decades in tax law.

Intent was (and still is) specifically required for the more serious offence of tax evasion. In other instances, where the courts were satisfied that the legislature intended that negligence was the level of *mens rea* required, prosecutions were conducted and offenders convicted on this basis.

None of the adverse consequences feared by commentators arose, since it remained for the prosecution to prove negligence beyond reasonable doubt.

Comment: The removal of an element of a crime in order to make it easier to prosecute is almost certainly unconstitutional. A standard of objective reasonableness could be introduced which would go some way to assisting policing of non-compliance, but without going as far as the strict liability proposed in the draft TALAB.

Response: Accepted. It is not the intention to introduce strict liability, so explicit references to negligence will be inserted to remove any doubt in this regard.

Comment: The Memorandum of Objects to the draft TALAB states that negligent conduct should be criminally punishable and that the requirement of intent should be removed so that taxpayers can be held to the objective standard of reasonableness contained in the test for negligence. Negligence (*culpa*) as *mens rea* for criminal liability in South Africa is reserved for matters where death occurs such as, for example, culpable homicide in cases of doctors, engineers or directors for corporate criminal liability (e.g. negligence for death by faulty products).

Response: Comment misplaced. As the Law of South Africa, Volume 11, paragraph 98 notes; "Although *culpa* plays a limited role as far as common-law crimes are concerned… it plays an important role in respect of statutory offences." The footnote at the end of this sentence notes that "It has eg been held that *culpa* is a sufficient form of *mens rea* for a contravention of the following provisions: Insolvency Act 24 of 1936 s 139(1) read with ss 64(1) 66(2)–(3): *S v Van Staden* 1976 3 All SA 130 (N); 1976 2 SA 685 (N); Petroleum Products Act 120 of 1977 (*Government Gazette* GN R386, 3 March 1978 reg 14(2)): *S v Du Toit* 1981 3 All SA 633 (C); 1981 2 SA 33 (C). Cf *Valashiya v S* 1998 2 All SA 116 (NC); 1998 1 SACR 713 (NC); National Road Traffic Act 93 of 1996 s 65(1): *S v Hartyani* 1980 4 All SA 272 (T); 1980 3 SA 613 (T); Prevention of Organised Crime Act 121 of 1998 s 2(1)(f): *Prinsloo v S* 2016 1 All SA 390 (SCA); 2016 2 SACR 25 (SCA) par 52." Other Acts where negligence explicitly attracts a criminal sanction include section 29A(9) of the Alienation of Land Act, 1981, with a maximum of one year's imprisonment and section 52(2), read with section 68 of the Financial Intelligence Centre Act, 2001, with a maximum of fifteen years' imprisonment.

Although some writers have disagreed with this approach, it remains the approach followed in South African law to date.

The then Appellate Division noted in *Ney-General, Cape v Bestall* 1988(3) SA 555 (A) at 569, in relation to the absence of the word "wilfully" in certain subsections of section 44(1) of the Prisons Act, 1959, that "negligence may constitute sufficient

proof of *mens rea* if there was a duty on the accused to be circumspect… There are a number of well-established criteria which are taken into account in determining what degree of *mens rea* was intended by the Legislature. The main ones are: (i) the language and context of the prohibition; (ii) the ease with which the provision can be evaded if only *dolus* constitutes the necessary *mens rea*; (iii) the reasonableness or otherwise of holding that culpa suffices and (iv) the degree of circumspection which the statute demands. Relevant in the latter regards are (a) the object and scope of the statute and (b) the nature of the penalty imposed." (Emphasis added.)

In the light of the importance of the duties of a taxpayer vis-à-vis the fiscus enunciated by the Constitutional Court per Kriegler J in *Metcash Trading Limited v Commissioner for the South African Revenue Service and Another* (CCT3/00) [2000] ZACC 21, it is submitted that taxpayers should be held to a standard of reasonable care in carrying out those duties. This is especially so when so much of our fiscal management relies on the *bona fides* of taxpayers and truthful self-assessment.

Comment: There are three types of intention recognised in South African law, *dolus directus, dolus indirectus* and *dolus eventualis. Dolus eventualis* does not require the accused to have purposefully committed an offence, or even to have understood the commission of an offence to be an inevitable consequence of their conduct. The accused must merely have foreseen a possibility (even if only a remote or slight possibility) that a prohibited consequence may occur as an indirect result of their conduct. This constitutes a very low threshold of intent, capturing a wide range of conduct, and is often compared to recklessness or gross negligence.

Although the taxpayer's intention is a subjective matter, relevant objective factors are already taken into account when determining the taxpayer's subjective intention (i.e. what the taxpayer "must have" been thinking when the offence was committed and therefore, whether the offence was committed intentionally).

In other words, in order to determine the accused's intention, the court must infer the accused's (subjective) state of mind from the (objective) circumstances and available evidence. Most (if not all) of the offences in the relevant sections under amendment involve conduct which the average taxpayer would know is unlawful, and therefore, the requirement of intent can be established without broadening the scope of the provisions to include negligent conduct.

Response: Not accepted. It is for the prosecution to prove the form of *mens rea.* Where negligence is the fault requirement, the prosecution must prove that the taxpayer did not perform their duty in the manner as would be expected of the reasonable taxpayer in the circumstances (objective standard evaluated in a court of law). When intention is the fault requirement, as for the offences relating to tax evasion, the State must prove *dolus* in whichever of its forms. The court may draw an inference as to the subjective state of mind of the accused at the time of the commission of the offence. That inference will be premised on all the evidence presented during the course of the trial.

Comment: Many other jurisdictions have noted that a "reasonable mistake" should be a defence and not result in criminal culpability. The Constitutional Court has also held that the length of punishment must be proportionate to the offence.

Response: Noted. Other jurisdictions that apply absolute liability or strict liability may permit defences such as the accused having performed due diligence or, in other words, having taken reasonable steps to avoid committing the offence. This ameliorates the fact that neither intent nor negligence have to be proved by the prosecution.

In a South African context, it is for the prosecution to prove intent or negligence. In the case of negligence, the prosecution must prove, beyond reasonable doubt that the person did not measure up to the objective standard, that the taxpayer did not conduct themself in the manner that would have been expected of a reasonable person in those circumstances. Where there is a positive duty on the taxpayer, the court will consider whether the taxpayer did what was expected of a reasonable person in the circumstances in performing that duty. The NPA would have to be satisfied that the investigating agency had provided sufficient evidence for there to be reasonable prospects of success before it would institute a prosecution.

With respect to proportionality, the existing legislation and the proposed legislation do not set a minimum punishment only a maximum. If the NPA is able to prove the case, it is thus open for the presiding officer to consider the degree of culpability involved in arriving at an appropriate sentence. This would range from a modest fine for minor degrees of culpability, to a more significant fine, to suspended imprisonment and to imprisonment for the highest degree of culpability.

Comment: It is acknowledged that, in the context of tax law, it would (in certain circumstances) be appropriate to treat negligent non-compliance as a criminal offence. For example, it may be appropriate that the negligent non-submission of a return or non-payment of tax be criminalised. However, it is unconscionable that less serious offences (such as failure to notify SARS of a change of address or to appoint a public officer) should be criminal offences purely on the basis of negligence.

Response: Not accepted. So-called less serious offences nevertheless have substantial consequences on further analysis. With respect to the first example cited, section 253(3) of the Tax Administration Act, 2011, provides that if SARS is satisfied that a notice, document or other communication (other than an assessment) has not been received by the addressee or has been received considerably later than it should have been, it must be withdrawn and issued anew. The potential for non-compliant taxpayers to frustrate the many aspects of tax administration other than assessment is self-evident.

With respect to the second example, a public officer is an individual who represents a company in its dealings with SARS and is subject to penalties for the company's defaults. The public officer must be a senior official of the company or,

if no senior official resides in South Africa, another suitable person. If, for example, a senior official resigns from a company and no replacement is appointed, there is no individual that may be held accountable for the company's actions under the Tax Administration Act, 2011. While SARS has the power to designate a director, secretary or other official of the company as a public officer, this is cold comfort with respect to the period between the vacancy arising and SARS learning of it and exercising this power. The duties and liabilities of representative taxpayers are detailed in Chapter 10 of the Tax Administration Act, 2011. For purposes of accountability and ultimately criminal prosecution of a corporate taxpayer (and whoever might be personally liable), it is imperative to know which individual was responsible at a particular time to ensure that the corporate taxpayer complied with whichever fiscal obligations are under scrutiny.

Significantly, the purpose of criminalizing the failure to appoint a representative, the non-submission of returns, the failure to update registered particulars and so forth, is to ensure that the collection of revenue can be monitored and enhanced. The system of tax collection is premised on the submission of returns, accurate information, etc. by taxpayers as and when required by law to do so. This compliance is essential to the success of South Africa and government's ability to meet *inter alia* the socio-economic needs of the public. It is submitted that to hold taxpayers to account to an objective standard of reasonableness in these areas, is not out of proportion with the purpose of the legislation.

Comment: There has been a consistent move away to criminalise conduct for minor administrative failures. This is the exact reason why penal provisions such as administrative non-compliance penalties and understatement penalties are contained in the tax laws so as to avoid expensive and resource demanding prosecutions where administrative penalties satisfy as a deterrent to offenders. It is submitted that the criminal offences listed in section 234 of the Act should be reviewed and that pure administrative non-compliance should merely be subject to civil sanction or only criminalised for repeat offenders.

Response: Noted. Although there is no doubt that administrative non-compliance penalties assist in addressing certain forms of non-compliance, experience has shown that they are not a panacea. Some taxpayers either ignore the penalties or simply consider them a cost of doing business. Despite outstanding tax personal and corporate income tax returns being subject to administrative non-compliance penalties, several million such returns remain outstanding.

Comment: A criminal conviction for a relatively minor offence may have a disproportionately negative effect or serious limitation on a taxpayer's right to freedom of movement (e.g. to emigrate) and right of association (e.g. to be eligible for certain positions / forms of employment). Hence, a deviation from this standard position would have to be justified and generally applied under section 36 of the Constitution.

Response: Not accepted. The limitations imposed by other countries, legislation and employers are matters for those countries, custodians of legislation and

employers. It may be that they feel that it is in the interest of good governance to ensure that people who occupy positions of responsibility have a good track record of compliance.

Comment: SARS refers to international precedent without considering our local law notwithstanding that even the Australian judges have criticised their Parliament's lowering of the culpability standard.

Response: Not accepted. It is striking that countries with well-established cultures of compliance, such as Australia, Canada and New Zealand impose absolute or strict liability to address so-called lesser tax non-compliance. As a perusal of SARS' Annual Report 2018/19 will demonstrate, South Africa has not yet reached anywhere near these levels of tax compliance. See above for comments with respect to local law.

With respect to the Australian case referred to, this is presumably the Court of Criminal Appeal (New South Wales) case of *Griffin & Elliot v. Marsh* 122 ALR 552. The court held that there is a public interest in the Commissioner obtaining access to the documents mentioned in section 8D(1) of the Tax Administration Act, 1953, in order to ascertain the taxable income and to assess (and later to exact) the proper amount of taxation due. After considering the two paragraphs of section 8D(1), the first of which could be an offence of absolute liability but the second of which was found to be one of strict liability, the court held that section 8D(1) as a whole required strict liability. The Australian Parliament then introduced section 8D(1A) to confirm that strict liability was intended in section 8D and section 8C(1A) to confirm that absolute liability was intended in 8C.

Comment: Whilst SARS may choose not to prosecute for administrative 'mistakes', amending the legislation as proposed would give SARS the power to do so, should it so wish. This in itself leads to another Constitutional concern of arbitrary prosecution. In effect, the Tax Administration Act, 2011, does not, like the Criminal Procedure Act for the NPA, set a standard of proof that compels prosecution, namely a *prima facie* case.

Response: Comment misplaced. SARS does not prosecute offences in terms of the Tax Administration Act, 2011, the NPA does. The NPA decides the institution of prosecution on the basis of whether there is a *prima facie* case and reasonable prospects of a successful prosecution and it is constitutionally compelled to do so without fear, favour or prejudice.

In view of the widespread non-compliance found in South Africa, SARS must prioritise the application of its scarce criminal investigation resources to maximize their impact on overall compliance. The SARS Annual Report 2018/19 reflects that 487 investigations were finalized in the financial year. A total of 459 cases were handed over to the NPA to consider prosecution and 28 cases were finalized administratively during the year. At the end of the financial year 528 cases were under investigation.

Comment: The effectiveness of this proposal as a deterrent to unlawful conduct must be evaluated particularly considering the perception of this proposal by taxpayers as an overly heavy-handed measure which is likely to further diminish the trust which law-abiding taxpayers have in SARS and the Government. In fact, the proposed amendment may have the opposite effect on voluntary compliance.

The latest data collected and published by the OECD indicates that the core focus of tax compliance management should be proactive measures (encouraging positive compliance attitudes through "fit for purpose" enforcement mechanisms), rather than relying on reactive measures (punitive sanctions). Proactive measures tend to result in increased collections, even from habitually non-compliant taxpayers.

Response: Noted. As set out in SARS' Strategic Plan 2020/21 – 2024/25, SARS's first three strategic objectives, which are considered equally important, are:

1. Provide Clarity and Certainty for taxpayers and traders of their obligations.
2. Make it easy for taxpayers and traders to comply with their obligations.
3. Detect taxpayers and traders who do not comply, and make non-compliance hard and costly.

The third strategic objective is expanded as follows; "Taxpayers and traders who negligently, deliberately, aggressively, or criminally stay out of the tax system, or do not comply, will be detected. They will experience a response appropriate to the nature and degree of their non-compliance, which progressively may include friendly reminders to more intrusive and investigative engagements that enforce compliance. Where necessary, hard enforcement may include court action, asset seizure and criminal prosecution. Non-compliant taxpayers and traders may under certain circumstances be named and shamed. The costs for non-compliance will be high and severe."

As can be seen from the above, a balanced approach will be followed with a mix of proactive and reactive measures. The proposed amendments do not seek to increase the severity of non-compliance offences for example by proposing a higher fine or imprisonment – they simply seek to make tax non-compliance offences more effective sanctions to deter non-compliance.

Comment: It is recommended that the proposed amendments should be withdrawn. Alternatively, a differentiated approach should be applied to the various offences depending on their severity.

Response: Accepted. A differentiated approach will be adopted in the redraft of paragraph 30 of the Fourth Schedule to the Income Tax Act, 1962, section 58 of the Value-Added Tax Act, 1991, and section 234 of the Tax Administration Act, 2011.

Rather than do away with intent entirely, offences will be categorised into those for which intent or negligence is required and those for which intent is required.

The first category will include aspects of non-compliance that strike at key duties that the tax system's broad application depends on, such as failing to register, submit returns, pay over tax that has been collected from a third party and so on.

The second category will include aspects of non-compliance where the nature of the non-compliance is such that the requirement of intent is implied, such as issuing a false document, obstructing or hindering a SARS official, assisting another person to dissipate their assets to impede tax collection and so on.

The maximum penalty of a fine or two years imprisonment will remain and it will be left to the presiding officer to decide what sentence is appropriate on conviction, considering all the aspects of a case.

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