REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

TAXATION LAWS AMENDMENT BILL, 2016 (DRAFT)

08 July 2016

[W.P. – '16]

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1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

1.1. RETIREMENT FUND CONTRIBUTION DEDUCTION AGAINST PASSIVE INCOME

[Applicable provision: Section 11(k) of the Income Tax Act No.58 of 1962 ('the Act')]

I. Background

From 1 March 2016 the tax treatment of contributions to retirement funds was amended to be harmonized across all retirement funds. Previously, deductions to retirement annuity funds were only allowed to be set off against "non-retirement funding income" (which included passive income such as interest or royalties, but excluded taxable capital gains), while deductions to pension funds could only be set off against "retirement funding income" (which represented income from employment and did not include passive income).

II. Reasons for change

The harmonisation of the tax treatment of contributions in section 11(k) allowed for a deduction against income from "carrying on a trade", which unintendedly excluded passive income. This resulted in members of retirement annuity funds who were using the deduction against passive income to no longer able to deduct their contributions against the passive income.

III. Proposal

In order to correct this anomaly and to allow retirement annuity members to continue to receive a deduction and fully align the treatment between all retirement fund members, it is proposed that deductions for contributions to all retirement funds should be allowed to be set off against passive income. For the purpose of the section 11(k) deductions, the passive income does not include taxable capital gains.

Example 1

Facts:

Mr Thrift receives remuneration of R75 000 for part-time work over the course of the 2016/17 year of assessment. He also receives R10 000 in interest from a money market account and sells unit trusts to receive a capital gain of R750 000. The value of the taxable capital gain is R300 000. Before the end of the year he contributes R100 000 to his retirement annuity fund.

The maximum allowable deduction for the contribution to the retirement annuity fund is limited to either 27.5 per cent of the greater of taxable income or remuneration, or R350 000. Mr Thrift's taxable income of R385 000 in this case is higher than his remuneration and his maximum allowable deduction is thus R105 875.

Result:

The R100 000 retirement annuity fund contribution is below the maximum allowable deduction and may be deducted against income from “carrying on a trade” and passive income (but excluding taxable capital gains). Mr Thrift can deduct R85 000 (remuneration and interest income). The R15 000 in contributions that was not deductible can be carried over to be deducted in a subsequent year of assessment or will be tax free on receipt of the retirement benefit when Mr Thrift retires.

IV. Effective date

The proposed amendments are deemed to have come into effect from 1 March 2016.

1.2. ROLLOVER OF EXCESS RETIREMENT FUND CONTRIBUTIONS BEFORE 1 MARCH 2016

[Applicable provision: Section 11(k) of the Act]

I. Background

Before 1 March 2016 retirement annuity contributions that were above the allowable deductible amounts were allowed to be rolled over to the following year to potentially be deducted in that year. Pension fund contributions that were above the limit were not allowed to be rolled over to the following year, but upon retirement these amounts could be taken tax free.

II. Reasons for change

The 2016 changes to the legislation relating to the harmonisation of the tax treatment of contributions to retirement funds applies to contributions made after 1 March 2016, and any contributions above the limit to any retirement fund can be rolled over to the following year. However, these legislative changes do not cater for any excess contributions made before 1 March 2016 and previous contributions above the limit to retirement annuity funds can no longer be rolled over. Contributions above the limits to both retirement annuity funds and pension funds made before 1 March 2016 would then not be afforded the rollover treatment and could only be received tax free at retirement.

III. Proposal

To continue with the current rollover treatment for retirement annuity funds and align the treatment for excess contributions to pension funds it is proposed that excess contributions to both of these funds before 1 March 2016 should be allowed to be rolled over and deducted in the following tax year. Excess provident fund contributions would not be allowed to be rolled over since there was no requirement for provident funds to purchase an annuity before 1 March 2016.

IV. Effective date

The proposed amendments are deemed to have come into effect from 1 March 2016.

1.3. CLARIFYING SOURCE RULES FOR RETIREMENT ANNUITY FUNDS

[Applicable provisions: Sections 9(2)(i) and 9(3) of the Act]

I. Background

Sections 9(2)(i) and 9(3) of the Act deems the portion of the lump sum and annuity payments from a pension fund and provident fund to be from a source outside South Africa, if the amounts received are in respect of services rendered outside South Africa.

II. Reasons for change

There is a view within the industry that the exclusion from South Africa source rule referred to in sections 9(2)(i) and 9(3) of the Act also includes payments made from retirement annuities. However, contributions to retirement annuities are not linked to employment and should not be associated with any type of services rendered, whether they are within South Africa or outside of South Africa.

III. Proposal

It is proposed that changes should be made in section 9(2)(i) of the Act to remove the ambiguity and clarify that the exclusion from South Africa source rule in section 9(2)(i) does not apply to lump sum, or annuities received from retirement annuity funds.

It is also proposed that section 9(3) of the Act be repealed as it creates ambiguity.

IV. Effective date

The proposed amendments will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2016.

1.4. USING THE CORRECT DEFINITION OF INCOME FOR THE FORMULA TO DETERMINE THE FRINGE BENEFIT FOR DEFINED BENEFIT CONTRIBUTIONS AND ELIMINATING A POTENTIAL LOOPHOLE

[Applicable provision: Paragraph 12D of the Seventh Schedule of the Act]

I. Background

The new paragraph 12D of the Seventh Schedule (dealing with the valuation of contributions made by employers to certain retirement funds) inserted a formula to calculate the taxable fringe benefit for contributions to a retirement fund that has a defined benefit component. The provisions of paragraph 12D of the Seventh Schedule stated the formula would cover contributions by the employer to the retirement fund.

II. Reasons for change

The formula in paragraph 12D of the Seventh Schedule to the Act assumes that the value “A” represents the income that the retirement fund uses to calculate the required level of contributions given the expected liabilities of the fund. However, the wording of the provision

currently refers to “remuneration” which is a different income figure. Remuneration may also differ for two individuals depending on the level of travel allowance, leading to a situation where two identical members of the same defined benefit fund would have a different fringe benefit value for the employer contribution.

This wording also refers only to employer contributions and is silent on contributions made on behalf of the employer by the fund. These types of contributions may be interpreted to be exempt from the formula, creating a potential loophole.

III. Proposal

It is proposed that changes be made in paragraph 12D of the Seventh Schedule to adjust the definition of income to determine the value “A” in the formula and to include contributions made by the fund on behalf of the employer.

IV. Effective date

The proposed amendment in respect of the adjustment of the definition of income to determine the value “A” in the formula will apply in respect of contributions made after 1 March 2017.

The proposed amendments in respect of inclusion of contributions made by the fund on behalf of the employer will be deemed to apply in respect of contributions made after 1 March 2016.

1.5. INCREASE ON THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES

[Applicable provision: Section 10(1)(q) of the Act]

I. Background

Currently, the Act makes provision for tax exemption for all “bona fide” bursaries or scholarships granted by employers to employees or relatives of qualifying employees, subject to certain monetary limits and other requirements.

If a bursary or scholarship is awarded to a relative of the employee, the exemption will apply only if the employee’s remuneration does not exceed R250 000 during the year of assessment. In addition, the amount of the bursary or scholarship will only be exempted up to a limit of R10 000 for studies from Grade R to 12 including qualifications in NQF levels 1 to 4 and R30 000 for qualifications in NQF levels 5 to 10.

II. Reasons for change

The monetary limits associated with bursaries and scholarships granted to relatives were last revised in 2013. In order to support skills development and to encourage the private sector (employers) in the provision of education and training, Government intends to increase the monetary limits for bursaries and scholarships granted to the relatives of qualifying employees.

III. Proposal

It is proposed that the monetary limits be increased for bursaries and scholarships granted by employers to employees or relatives of qualifying employees:

a. The monetary limit in respect of remuneration for qualifying employees will be increased from R250 000 to R400 000.
b. The monetary limits in respect of exempt bursary or scholarship will be increased from R10 000 to R15 000 and from R30 000 to R40 000 respectively.

IV. Effective date

The proposed amendments are deemed to have come into effect from 1 March 2016 and will be applicable in respect of years of assessment commencing on or after that date.

1.6. INTRODUCING MEASURES TO PREVENT ESTATE DUTY AND DONATIONS TAX AVOIDANCE THROUGH TRANSFER OF ASSETS TO A TRUST USING INTEREST FREE LOANS

[Applicable provisions: New sections 7C and 56 of the Act]

I. Background

When transferring assets to a trust, a person currently has the following options. Each of these options gives rise to different tax outcomes.

a. In the first instance, a person may donate the assets and trigger donations tax at 20 per cent of the fair market value of the assets in the hands of the person.
b. Secondly, a person may sell the assets to the trust on loan account at an arm's length interest charge. If interest on the loan is market related, the seller will be fully taxed on the interest portion of the loan repayments.
c. Lastly a person may sell the assets to the trust on loan account at an interest charge that is below arm's length or charge no interest on the loan.

II. Reasons for change

At issue is the avoidance of estate duty and donations tax when a person sells assets to a trust and the sale of those assets is financed by way of an interest free loan or a loan with interest below market rates. Donations tax will not be triggered on the asset when the asset is sold at market value to a trust in this manner because there is no gratuitous disposal as required for donations tax purposes.

Coupled with the above, in some instances the seller reduces the loan capital which is supposed to be paid back to him/her by donating amounts to the trust to be set off against the loan to the trust using the current provisions of section 56(2)*(b)* which provides for the R100 000 annual exemption from donations tax. This further avoids estate duty through the tax-free reduction of the asset base of the seller achieved by such annual donation to the trust.

Due to the fact that the loan is an interest free loan or a loan with interest below market rates, no interest is paid to the seller or interest paid is less than market rates, the seller will not be liable

for income tax on the interest that is forgone or will not be liable for income tax on the interest that is below market rates. This results in a further reduction of the tax base.

III. Proposal

In order to limit taxpayers' ability to transfer wealth without being subject to tax, it is proposed that rules focusing on interest free loans or loans with interest below market rates that are made directly or indirectly by a natural person, or by a company that is a connected person in relation to that person to a trust, be introduced.

According to these rules, it is proposed that an amount equal to the difference between interest that would arise as determined with reference the official rate of interest (as determined in terms of the Seventh Schedule to the Act) and the applicable actual rate of the loan below market rates made to a trust and will be regarded as an amount of income accrued or received by the seller. Such amount imputed as income in the hands of the seller will not qualify for the section 10(1)(*i*) exemption in respect of interest.

Further, with regard to interest free loans, as there is no actual payment of interest by the trust to the seller, no deduction may be claimed by the trust. On the other hand, with regard to loans with interest rates below market value, only the amount of interest below market rates that is actually paid by the trust to the seller can be claimed as a deduction if the requirements of the general deduction formula are met.

In addition, any reduction of the interest free loans or to loans with interest below market rates to which these rules apply will not qualify for the section 56(2)*(b)* R100,000 annual exemption of donations tax.

Furthermore, the amount of normal tax attributable to the income which is included in the income received or accrued to the seller may be recoverable by the seller from the trust as the trust benefits from the low or no interest charge. If the seller does not recover this amount of tax from the trust within a period of three years after the end of the year of assessment in which the income was included in the income of the seller, the tax attributable to that income will be treated as a donation by the seller to the trust on the date on which the three year period ends, and thus attracting donations tax.

IV. Effective date

The proposed amendments will come into effect on 1 March 2017 and applies in respect of years of assessment ending after that date.

1.7. ADDRESSING THE CIRCUMVENTION OF RULES DEALING WITH EMPLOYEE BASED SHARE INCENTIVE SCHEMES

[Applicable provisions: Section 8C, new section 8CA and section 10(1)(k) of the Act]

I. Background

Amounts in cash or in kind that are received or accrue in respect or by virtue of services or employment are treated, as a point of departure, as ordinary revenue. Section 8C (dealing with taxation of directors and employees on vesting of equity instruments) forms part of a set of anti-

avoidance measures aimed at preventing the characterisation of an amount that relates to services or employment as a capital gain or as an exempt amount subject only to dividends tax. For example, dividends that are received or that accrue in respect of services or by virtue of employment or the holding of an office are treated as ordinary revenue.

Section 8C governs schemes that are based on equity shares. A restricted equity instrument represents an interest in the equity shares underlying the scheme that is held either directly or through a derivative mechanism. The retention or acquisition, by a scheme beneficiary, of the benefits flowing from the scheme, e.g. dividends, is subject to suspensive or resolutive terms or conditions. These benefits are dependent, in essence, on continued employment or the rendering of services for a specified period. The distributions derived from a restricted equity instrument and the growth in value of the underlying shares until the date the restrictions fall away constitute, in effect, benefits that arise in respect of services and form part of the reward for services rendered. Dividends in respect of a restricted equity instrument will be exempt only if that instrument complies with specific requirements.

Taxation under section 8C is as a general rule triggered when the restrictions in respect of the interest in the underlying equity shares fall away, i.e. when the employee can, in broad terms, freely dispose of or deal with those shares on the same basis as any shareholder who is not an employee, or is entitled to an amount equal to their value. The amount subject to s 8C is determined with reference to the value of those shares at that time, thus treating the growth in value of that payment in kind as revenue.

II. Reasons for change

Section 8C is based on the implicit assumption that the full value of the equity shares underlying a restricted equity instrument will vest in the employee when the restrictions fall away. The value derived from the underlying shares may, however, be liquidated in full or in part by means of distributions that are effected before these restrictions fall away, e.g. distributions resulting from the disposal or redemption of the underlying shares or resulting from a return of capital in respect of the underlying shares. Distributions qualifying as a return of capital or a foreign return of capital in respect of the underlying equity shares are treated as revenue. The current inclusion does not extend, however, to a return of capital by way of a distribution of an equity instrument. Distributions in the form of dividends may also impact negatively on the value of the underlying shares.

The policy intent underlying the inclusion, in the income of a holder of a restricted equity instrument, of a return or foreign return of capital was expressed as follows in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010: “Capital distribution will generally trigger ordinary revenue in recognition of this partial cash-out. However, if the capital distribution consists of another restricted equity instrument, the capital distribution will be treated as a non-event.” The current exclusion of a return or foreign return of capital does not reflect this policy clearly. A return of capital in the form equity shares that are not restricted will erode the value of the equity shares from which the value of a restricted equity instrument is derived.

The exclusion should apply only in respect of an equity instrument that qualifies as a restricted equity instrument subject to section 8C, i.e. if the gain or loss in respect of that instrument will be treated as being of a revenue nature. Other receipts or accruals in respect of a restricted equity instrument that are not treated as dividends and that are not taken into account in determining the gain or loss in respect of the restricted equity instrument may also erode the value of the underlying shares and result in a leakage of the gains that should be treated as income in terms

of section 8C. The current requirements regarding dividends in respect of restricted equity instruments that are exempt from normal tax do not deal adequately with dividends consisting of or derived from—

a. the proceeds from the disposal or redemption of—

    1. the underlying equity shares; or
    2. shares from which those equity shares derive their value; or

b. the liquidation of a company from which those equity shares derive their value.

The treatment, as an exempt dividend, of an amount that reduces or liquidates the gain subject to section 8C converts, in effect, an amount that should be taxed at marginal rates to an amount that is taxed at a lower rate. This conflicts with the policy objective underlying section 8C (i.e. that there should be parity of treatment of amounts in cash and in kind).

III. Proposal

The dispensation regarding restricted equity instruments should be aligned more clearly with the policy intent regarding amounts that should be subject to revenue treatment in terms of section 8C. Based on the above, the following is proposed:

a) It is proposed that the current inclusion, in the income of a holder of a restricted equity instrument, in respect of a return or foreign return of capital be extended to any amount received or accrued if that amount is not—

    1. a return of capital or foreign return of capital by way of a distribution of a restricted equity instrument; or
    2. subject to the provisions of the Act with respect to a dividend in respect of that restricted equity instrument; or
    3. taken into account in terms of section 8C in determining the gain or loss in respect of that restricted equity instrument.

Example 1

Facts:

Mr Eager, an executive director of Last Hope Ltd, holds a restricted equity instrument in the Last Hope Employee Share Trust that will remain restricted for a period of 5 years after that instrument was awarded to Mr Eager. It entitles him to dividends derived from 10 000 of the equity shares in Real Hope (Pty) Ltd that are held by the trust while the restrictions governing that equity instrument apply and the transfer of those shares once those restrictions fall away. Real Hope (Pty) Ltd is a subsidiary of Last Hope Ltd.

Real Hope buys back 90 per cent of the shares held in it by the trust at R200 per share 4 years after the award of that restricted equity instrument. The trust distributes an amount of R1 800 000 to Mr Eager as a dividend in respect of his restricted equity instrument.

Result:

The dividend of R1 800 000 will not be exempt as it consists of the consideration paid by Real Hope in respect of the share buy-back. This result will apply irrespective of whether the consideration in respect of the share buy-back consists of cash or an asset in kind.

b) It is proposed that a dividend in respect of a restricted equity instrument scheme be treated as ordinary revenue. As a result, carve out measures which qualified certain dividends in relation to restricted equity instruments as exempt from normal taxation will fall away. This implies that paragraph *(dd)* of the proviso to section 10(1)*(k)*(i) will be deleted. Further changes will be made to paragraph *(ii)* of the proviso to section 10(1)*(k)*(i) to clarify that dividends will only be exempt after the restriction falls away and the equity instrument vests in the employee in terms of section 8C or when a marketable security is held by an employee in terms of section 8A.

Example 2

Facts:

Ms Sharp, an executive director of Tower Projects, holds a restricted equity instrument in the Tower Group Employee Share Trust that will remain restricted for a period of 5 years after that instrument was awarded to her. It entitles her to dividends derived from 10 000 of the equity shares in Mini Tower that are held by the trust while the restrictions governing that equity instrument apply and the transfer of those shares once those restrictions fall away. Mini Tower holds 100 per cent of the class B equity shares in Tower Software while Tower Projects holds all the class A equity shares in Tower Software.

Tower Software redeems 80 per cent of the class B equity shares at R200 per share 4 years after the award of that restricted equity instrument. Mini Tower distributes this amount as a dividend to the trust. The trust distributes an amount of R1 600 000 to Ms Sharp as a dividend in respect of her restricted equity instrument scheme.

Result:

The dividend of R1 600 000 will not be exempt as it is derived from the consideration in respect of the redemption of the class B equity shares.

c) Due to the fact that employee share schemes are aimed at encouraging employees to remain in employment and providing an incentive to employees to align their interests with that of the company, any value flowing to an employee (whether through dividends or shares that vest) can be seen as remuneration in the hands of the employee. This reflects that regardless of whether an employee receives payment for employment in cash or another form, the resulting tax treatment is the same. Based on the above, it is

proposed that more certainty be provided on how the employer should treat the contributions in respect of restricted equity instruments. The following is proposed:

1. The historic cost actually incurred and paid by the employer to provide its employees with restricted equity instruments scheme will be regarded as being in the production of income and will qualify for a deduction in terms of the new section 8CA.
2. This deduction will be spread over the period during which the restriction in respect of the equity instrument applies. The new section 8CA will cater for this.
3. In instances where an employee leaves the employee share scheme, the current recoupment provisions in section 8(4)(a) will apply.

IV. Effective date

The proposed amendments will come into effect on 1 March 2017 and applies in respect of any amount received or accrued on or after that date.

1.8. DISALLOWING THE EXEMPTION FOR A LUMP SUM, PENSION OR ANNUITY FROM A RETIREMENT FUND THAT IS LOCATED WITHIN THE REPUBLIC

[Applicable provision: Section 10(1)(gC)(ii) of the Act]

I. Background

When the residence based system was introduced in 2001, section 10(1)(gC) was included in the Act to exempt the receipt of foreign pensions arising from employment outside of the Republic. The provisions of section 10(1)(gC) allows a South African tax resident who is employed outside of the Republic to receive those retirement benefits (that they earned while outside the country) free from tax.

II. Reasons for change

There is uncertainty regarding the interpretation of the current provisions of section 10(1)(gC). The consequence is that South African tax residents who work outside of the Republic can receive a tax deduction on contributions made to the South Africa retirement fund (local retirement fund). The deduction can either be made in the same tax year if they have other forms of taxable income or worked partially within that year or the amounts can be rolled over to be deducted in a future year of assessment. However, upon receipt of the retirement benefits the amount that accrued while the South African tax resident was employed outside the Republic will be free from tax.

III. Proposal

To ensure a fair tax treatment of retirement benefits received by South African residents, it is proposed that the exemption provided in section 10(1)(gC)(ii) only applies to retirement benefits from foreign retirement funds, i.e. retirement funds other than a pension fund, pension

preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in section 1 of the Act (where members are eligible for deductible contributions).

IV. Effective date

The proposed amendments will come into effect on 1 March 2017 and applies in respect of years of assessment commencing on or after that date.

1.9. INCLUSION OF EMIGRATION FOR EXCHANGE CONTROL PURPOSES IN RESPECT OF WITHDRAWALS FROM RETIREMENT FUNDS

[Applicable provision: Definition of “retirement annuity fund” in section 1 of the Act]

I. Background

In 2015, changes were made in the Act to allow individuals to withdraw a lump sum from the retirement annuity fund when they cease to be tax resident or when they leave South Africa at the end of their work visa.

II. Reasons for change

The 2015 Draft Taxation Laws Amendment Bill (2015 Draft TLAB), which was released for public comments on 22 July 2016 made provision for the following criteria to be met in order for individuals to be able to withdraw a lump sum from their retirement annuity fund:

a. when the individual emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control, or
b. when the individual ceases to be a tax resident; or
c. when the individual leaves South Africa at the expiry of the work visa contemplated in the Immigration Act, 2002 and
d. is not regarded as a resident by the South African Reserve Bank for purposes of exchange control

Based on the public comments received on the 2015 Draft TLAB, changes were made in the 2015 TLAB to limit the criteria to be met in order for the individuals to be able to withdraw a lump sum from their retirement annuity fund to only the following:

a. when the individual ceases to be tax resident; or
b. when the individual leaves South Africa at the expiry of the work visa contemplated in the Immigration Act, 2002.

It has come to Government attention that exclusion of the requirement that an individual must emigrate from the Republic and that emigration must be recognised by the South African Reserve Bank for purposes of exchange control creates a loophole for South African nationals or tax residents to be able to make an early withdrawal from their retirement annuity funds, without formally emigrating. This was not the original policy intention.

III. Proposal

In order to align the current provisions of the Act allowing individuals to withdraw a lump sum from their retirement annuity fund to the underlying policy objectives, the following is proposed:

a. The definition of the "retirement annuity fund" in section 1(b)(x)(dd) should be amended to include the requirement that an individual must emigrate from the Republic and that emigration must be recognised by the South African Reserve Bank for purposes of exchange control as one of the criterion to be met in order for individuals to be able to withdraw a lump sum from their retirement annuity fund.

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IV. Effective date

The proposed amendments are deemed to have come into effect on 1 March 2016 and applies in respect of years of assessment commencing on or after that date.

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2. INCOME TAX: BUSINESS (GENERAL)

2.1. CROSS-BORDER HYBRID DEBT INSTRUMENTS

[Applicable provisions: Sections 8F and 8FA of the Act]

I. Background

In 2013, changes were made in the Income Tax Act to introduce specific anti-avoidance rules in section 8F and section 8FA dealing with hybrid debt instrument and hybrid interest. These anti-avoidance rules reclassify interest as dividends *in specie* under a two-fold regime. In the first instance, the anti-avoidance rules focus on the equity-like features that relate to the debt instrument itself. The second set of rules focuses on the nature of the yield (i.e. the interest labelled return).

The rules focusing on the debt instrument seek to identify the equity features of the debt instrument. By so doing the rules focus on the convertibility of the debt instrument into shares, the repayment of the debt or interest on the debt instrument conditioned upon the solvency of the issuer and the reasonableness of the period the debt will remain outstanding. The rules focusing on the nature of the yield require that the yield must be determined with reference to a rate of interest, and that the rate of interest must not be dependent on the profits of the issuer for that yield to qualify as interest instead of some other equity-like return (i.e. hybrid-interest).

These anti-avoidance rules are aimed at preventing the artificial generation of interest deductions by an issuer if the debt instrument qualifies as a hybrid debt instrument because of its equity features, or if the yield is determined not to constitute *bona fide* interest. In addition, the issuer is furthermore liable for dividends tax at a rate of 15 per cent.

II. Reasons for change

The 2013 Draft Taxation Laws Amendment Bill (2013 Draft TLAB) which was released for public comments on 4 July 2013 made provision for these specific anti-avoidance rules to only apply to debt that was issued by South African tax resident companies. Based on the public comments

received on the 2013 Draft TLAB, changes were made in the 2013 TLAB to extend the application of these rules to debt issued by both resident and non-resident companies.

It has come to Government's attention that the application of the current re-classification feature of the anti-hybrid debt instrument and anti-hybrid interest rules creates opportunities for tax arbitrage. Transactions involving non-resident issuers of debt instruments are intentionally made to include equity features in their debt instruments as a mechanism of taking advantage of the re-classification feature of these anti-avoidance rules.

Under these schemes, the parties (e.g. a non-resident issuer and a resident holder) intentionally make the debt instrument or the interest subject to the anti-hybrid debt instrument and anti-hybrid interest rules. The re-classification of interest as dividends in specie under these anti-avoidance rules will not, in these circumstances, deny the non-resident issuer an interest deduction. This is because the non-resident issuer would not be subject to the South African anti-hybrid debt rules. However, the re-classification will be beneficial for the resident holder as that holder will be deemed to have received a dividend in specie that is exempt from normal tax in respect of which the non-resident issuer is only subject to a dividends withholding tax of 15 per cent (subject to various exemptions and treaty benefits).

This creates a mismatch in the tax treatment applicable to the interest paid by the non-resident issuer as the non-resident issuer benefits from a full tax deduction of the interest it incurs in its country of residence, but only pays tax at a preferential tax rate of 15 per cent (or potentially no tax at all) as a result of the operation of the re-classification in the South African tax legislation and treaty benefits.

III. Proposal

In order to curb this mismatch and discourage non-resident issuers from structuring their loans to specifically contain the equity features that trigger the re-classification of their interest payments for South African tax purposes, it is proposed that both sets of anti-avoidance rules should be limited to instances under which the intended denial of the interest deduction will be applicable.

As a result, it is proposed that the anti-avoidance rules should only apply to the following:

a. in instances where the issuer is a resident company,
b. in instances where the issuer is a non-resident company, the rules should only apply in respect of a debt instrument that is solely attributable to a permanent establishment in South Africa or a controlled foreign company whose profits are attributed to a South African resident.

IV. Effective date

These amendments are deemed to have come into effect on 24 February 2016 and are applicable in respect of amounts incurred on or after that date.

2.2. HYBRID DEBT INSTRUMENTS SUBJECT TO SUBORDINATION AGREEMENTS

[Applicable provision: Section 8F of the Act]

I. Background

Section 8F of the Act makes provision for the specific anti-avoidance rules aimed at reclassifying any amount of interest in respect of a debt instrument or interest incurred as a dividend *in specie* declared and paid by the issuer if that debt instrument or the interest contain equity-like or dividend like features. This re-classification of the interest denies the issuer an interest deduction and the issuer also becomes liable for dividend withholding tax at a rate of 15 per cent in respect of such dividend *in specie*.

For purposes of section 8F, the anti-avoidance rules take into account not only the equity features of the instrument itself, but the side agreements or subordination agreements that were entered into in respect of the debt instrument. In particular, these anti-avoidance rules will be triggered by any arrangement where the obligation to repay any amount owing in respect of the debt instrument (i.e. the corpus or interest) will be disregarded if that obligation is conditional upon the solvency of the debtor (i.e. the market value of the issuer's assets being less than its liabilities).

In such an instance, these anti-avoidance rules do not only look to the imbedded features of the instrument itself, but any other side agreement or subordination agreement that gives rise to an arrangement that makes the issuer's obligation to make a payment in respect of the debt instrument conditional upon the solvency of that issuer.

II. Reasons for change

In the current economic climate, it is not uncommon for companies to find themselves going through periods of varying levels of financial distress. These periods of financial distress may be short-term or may be fairly sustained. As a result, many companies revert to entering into subordinate agreements aimed at subordinating their shareholder loans in favour of third party borrowings. Furthermore, it has come to Government's attention that oftentimes the trigger for these subordination agreements is that when a company is undergoing audit, auditors of the company will in certain circumstances require that shareholder loans should be subordinated to ensure that the annual financial statements do not need to be qualified as it may be questionable whether the company is a going concern given its financial position.

Typically a subordination agreement provides that the company will not make any payments in respect of a debt until such time as the assets of the company fairly valued exceed the liabilities of the company. This conditionality of the repayments and/or interest payments upon the solvency of the company is more aligned to the payment considerations directors of companies are faced with in paying out dividends and is a trigger for the re-classification under the anti-hybrid debt rules.

The re-classification of the interest as a result of the subordination agreement, gives rise to added pressures for the company. In the first instance the company will be treated as having paid a dividend *in specie* in respect of any interest payments it may make on the subordinated loan (which interest payments are not always suspended under the subordination agreement). Secondly, the denial of an interest deduction in respect of the paid or unpaid but incurred

interest charges may place the company in a tax paying position in its period of business difficulty.

III. Proposal

It is proposed that the re-classification feature of the anti-avoidance rules should not apply in the instances where an issuer that owes an amount to a company that forms part of the same group of companies as the issuer and payments in respect of that amount owing are suspended due to the financial difficulties of the issuer. For purposes of this concession, the liquidity and solvency tests envisaged under the Companies Act will be the benchmark for the levels of financial distress aimed at assisting. This is in line with audit practices, as auditors would require an issuer that is technically insolvent and/or illiquid to subordinate its shareholder loans in favour of third party creditors.

This concession for group debt that is subordinated in favour of third party creditors will result in the company continuing to claim its interest deduction of the debt. In addition, as there will be no re-classification of the interest as dividends *in specie*, the company will not suffer the added burden of a dividends withholding tax.

IV. Effective date

These amendments will come into effect on 1 January 2017 and are applicable in respect of amounts incurred on or after that date.

2.3. EXTENDING THE SMALL BUSINESS CORPORATION REGIME TO PERSONAL LIABILITY COMPANIES

[Applicable provision: Section 12E of the Act]

I. Background

In 2001, a special dispensation for qualifying business corporations was introduced. In order to qualify for the special dispensation, the entity had to meet the definition of a “small business corporation” as defined in the Act. The Act required that an entity qualifying as a small business corporation had to either be a close corporation or a company registered as a private company in terms of the then applicable Companies Act, 1973 (Act No. 61 of 1973). Furthermore, the scope of the definition of small business corporation was intentionally limited to curb the disguise of passive income and remuneration as business earnings. Such a disguise would otherwise have allowed persons rendering professional services to take advantage of the concessionary tax rates that apply to small business corporations instead of taxing the disguised passive income and remuneration at the normal company tax rate.

The limitation measure provides that an entity that has more than 20 per cent of its revenue receipts and accruals and capital gains being made up of passive income and income earned by the entity for rendering certain professional services which are performed by a person who holds an interest in the entity (i.e. personal services) could not qualify as a small business corporation. In 2005 the abovementioned measure in respect of personal services was relaxed. As a result entities that rendered personal services could qualify as small business corporations provided that they employ at least three full-time employees who do not have an interest in the entity and are not connected persons (i.e. relatives) in relation to those that have an interest in the entity.

II. Reasons for change

In 2009, the new Companies Act, 2008 (Act No. 71 of 2008) was promulgated and is administered by the Department of Trade and Industry. Many provisions of the Income Tax Act depended or referred to company law principles and definitions contained in the old Companies Act, 1973 (Act No. 61 of 1973). Over the past years subsequent technical corrections have been made in the Income Tax Act due to the commencement of the 2008 Companies Act in 2011.

It has come to Government's attention that amendments made to the provisions dealing with small business corporations as a result of the 2008 Companies Act did not adequately take into account some of the issues related to small business corporations, for example, under the 2008 Companies Act the definition of a private company expressly excludes a personal liability company. As the definition of a small business corporation in the Act includes a private company, the resultant anomaly is that personal liability companies which typically render personal services are currently automatically excluded from being small business corporations for tax purposes.

III. Proposal

In order to correct this anomaly created by the exclusion of personal liability companies from the definition of a private company in the 2008 Companies Act, it is proposed that personal liability companies should be expressly included in the definition of a "small business corporation" contained in the Income Tax Act. However, these personal liability companies would be subject to the requirement to employ at least three full-time employees who do not have an interest in the entity and are not connected persons in relation to those that have an interest in the entity.

IV. Effective date

These amendments will come into effect in respect of years of assessment ending on or after 1 January 2017.

2.4. ASSET-FOR-SHARE TRANSACTIONS FOR NATURAL PERSONS EMPLOYED BY A COMPANY

[Applicable provision: Section 42 of the Act]

I. Background

Roll-over treatment is granted where a person disposes of an asset to a company that issues shares to that person in exchange for the asset. This roll-over relief is granted in an asset-for-share transaction in the instance that either –

a. subsequent to the transaction the person holds a qualifying interest in the company acquiring the asset of that person; or
b. the person disposing of the asset to the company is a natural person who is engaged on a full-time basis in the business of that company of rendering a service.

When the roll-over provisions were introduced, the abovementioned qualifying conditions were put in place to ensure that only substantial and long-term transfers of assets in exchange for shares issued by the acquiring company could benefit from roll-over relief. Furthermore, the

latter condition in respect of natural person was aimed at professional service firms, which operate in an incorporated form, that wish to incorporate. It was intended that a Shareholder/Director of such professional service firm would not be required to hold a qualifying interest in the company after the asset-for-share transaction.

II. Reasons for change

Some taxpayers have indicated that the original intention of the qualifying condition in respect of natural persons that are involved in the business of the company that acquires the assets in an asset-for-share transaction is not clearly reflected. As it currently stands, the wording potentially allows for unintended roll-over relief without requiring the natural person to hold a qualifying interest in the acquiring company. This results in the qualifying condition going much further than the original policy intention to provide roll-over relief to a group of professionals setting up business under a professional services firm without regard for the qualifying interest requirement.

III. Proposal

To clarify the conditions under which an asset-for-share transaction between a natural person and a company will qualify for roll-over relief without having regard to the required qualifying interest at the close of that asset-for-share transaction, it is proposed that only asset-for-share transactions involving personal liability companies should qualify. This is because professional service providers to whom the benefit was initially intended for, such as lawyers, doctors or accountants after incorporation operate as personal liability companies.

IV. Effective date

The proposed amendments should be applicable in respect of transactions entered into on or after date of promulgation of the Taxation Laws Amendment Act, 2016.

2.5. REFINING THE TAX IMPLICATIONS ON OUTRIGHT TRANSFER OF COLLATERAL PROVISIONS

[Applicable provisions: Section 1, 22 and paragraph 11 of the Eighth schedule of the Act and section 1 of the Securities Transfers Act No. 25 of 2007]

I. Background

In 2015, changes were made in the tax legislation to provide relief in respect of an outright transfer in beneficial ownership of collateral. As a result, there are no capital gains tax and securities transfer tax implications if a listed share is transferred as collateral in a lending arrangement, provided that the identical shares are returned to the borrower by the lender within a limited period of 12th months from the date in which the collateral arrangement was entered into. The 2015 tax dispensation that was introduced in the tax legislation for the outright transfer of collateral is similar to the tax dispensation applicable to securities lending arrangements.

The above-mentioned new tax dispensation for collateral arrangements necessitated the introduction of a concept of “identical share” in the tax legislation as well as changes to the provisions dealing with amalgamation transactions in section 44 of the Act, to take into account the impact of amalgamation transaction on the ability of a party to a lending arrangement to

return a share of the same class in the same company as that share originally transferred in terms of that lending arrangement.

II. Reasons for change

The tax relief on collateral arrangements has been welcomed by industry and taxpayers but concerns have been raised about certain of the restrictions and potential shortcomings not addressed in the current legislation. These restrictions include the following:

A. *12th Month limitation*

The limitation of a collateral arrangement to a period of 12 months or less without the ability to re-post collateral due to the underlying obligation is unduly restrictive and would have the effect that it can only be applied in a context of a short term debt and would severely restrict the ability of banks to benefit from collateral arrangements in terms of meeting the regulatory requirements in so far as it relates to high quality liquid assets.

B. *Corporate Actions*

The 2015 changes to the definition of "identical share" in the Act only recognize the impact of specific corporate actions on the ability of parties to collateral arrangements to return an identical share only to the extent of amalgamation transactions as envisaged in section 44 of the Act. These changes do not cater for situations outside of the control of a party to a securities lending/collateral arrangement that could possibly result in an identical share being unable to be returned in terms of securities lending/collateral arrangements. In practice, corporate actions and its impact on the ability to deliver an identical share in relation to collateral arrangement can be separated into two categories where a corporate action can either:

a. impact the listed status of the share through the following actions (list not exhaustive nor definitive):
    1. suspension/termination or withdrawal of share listing on a recognized exchange;
    2. winding up/insolvency of issuer of shares; or
    3. unbundling transactions; or

b. result in additional or different shares being returned through the following actions (list not exhaustive nor definitive):
    1. rights offers;
    2. scrip dividends;
    3. capitalization issues; or
    4. unbundling transactions.

These categories or actions could potentially impact the securities lending/collateral arrangement definition post implementation of the securities lending/collateral arrangement, by no fault of the parties to the securities lending/collateral arrangement, which would result in the application of both capital gains tax and securities transfer tax to such securities lending/ collateral arrangement.

C. *Listed shares*

The special tax dispensation for the outright transfer of collateral only applies to the instruments listed in paragraph (a) of "security" as defined in the Securities Transfer Tax Act that is listed on an exchange. This limits the exemption on collateral arrangements to listed shares only to be transferred as collateral. As a result, if bonds and other instruments not listed in paragraph (a) of the definition of security are transferred as collateral, they will not qualify for this special tax dispensation.

III. Proposal

A. Extending the 12th Month limitation to a 24th month limitation

Government is still concerned that the 2015 changes made in the tax legislation to provide relief in respect of an outright transfer in beneficial ownership of collateral moves away from common law principles in regard to a change of beneficial ownership. As a result, the 12 month limitation in respect of collateral arrangement was introduced to assist in limiting tax avoidance scenarios where either the sale of shares are disguised as collateral transactions or transactions where the collateral is used against rolling debt positions that are designed to keep a collateral position open for extended periods of time or even indefinitely.

Due to the fact that collateral arrangements supports financial stability objectives because of the role they play in mitigating credit risk, it is proposed that the legislation be amended to extend the allowable period within which the identical shares are returned to the borrower by the lender from the date on which the collateral arrangement was entered into from 12 to 24 months.

B. Broadening the definition of "identical share" to cater for other specified corporate actions

It is proposed that the legislation, as it relates to an 'identical share' for purposes of a collateral arrangement, be broadened to cater for corporate actions in relation to situations outside of the control of a party to a securities lending/collateral arrangement that could possibly result in an identical share being unable to be returned in terms of that securities lending/collateral arrangement. The legislation should only recognize corporate actions announced and released, post finalisation of the securities lending/collateral agreement, by a Stock Exchange News Service (SENS) announcement if it specifically relates to the allowable security/collateral within that securities lending/collateral arrangement.

As an additional measure, no party to the securities lending/collateral arrangement in question that is subject to a corporate action should be able to directly or indirectly control or influence the outcome of such corporate action as published by the Johannesburg Stock Exchange.

C. Including listed government bonds as allowable instrument on collateral arrangements

Government is concerned that the extension of collateral arrangements to other instruments, for example bonds, has little merit due to the fact that bonds are not subject to securities transfer tax and will only be subject to capital gains tax if and when bonds are traded in the secondary market at a capital gain. The value of bonds generally only increases when the market has low inflation or disinflationary expectations, which would see increased demand for fixed instruments such as bonds. The vast majority of bonds in South Africa are held until maturity, meaning that there will be no gains or losses at maturity, regardless of market conditions.

That said, Government recognises that the use of government bonds as collateral is embedded in the financial markets industry and affects all its participants and transactions. Based on the above, it is proposed the provisions of collateral arrangements be extended to include listed government bonds. As a result, listed government bonds that are transferred as collateral, will qualify for the above-mentioned special tax dispensation.

IV. Effective Date

The following effective dates are proposed:

- Extending the 12th month limitation to a 24 month limitation on collateral arrangements
- Including listed Government Bonds as allowable instrument on collateral arrangements
  - The proposed amendments will apply in respect of any collateral arrangement entered into on or after 1 January 2017.

- Broadening the definition of "identical share" to cater for other corporate actions in relation to situations outside of the control of a party to a securities lending or collateral arrangement
  - The proposed amendments will apply in respect of any securities lending or collateral arrangement entered into on or after 1 January 2017.

2.6. REFINEMENT OF THIRD-PARTY BACKED SHARES: PRE-2012 LEGITIMATE TRANSACTIONS

[Applicable provision: Section 8EA of the Act]

I. Background

Third-party backed share anti-avoidance rules were introduced by Government during 2012 to deal with identifiable concerns regarding preference shares with dividend yields backed by third parties. These anti-avoidance rules deem dividend yields of third-party backed shares to be treated as ordinary revenue unless the funds derived from the issue of the third-party backed shares are used for a qualifying purpose.

The policy rationale for these rules (with its subsequent amendments) seeks to introduce anti-avoidance rules applicable to share instruments (typically preference shares) loaded with debt like features. The legislation targets share issues where the dividends in respect of those shares are guaranteed by unrelated third parties. These third party guarantees effectively meant that the holder of the share had no direct or indirect meaningful stake in the risks associated with the issuer.

For purposes of these specific anti-avoidance rules, section 8EA of the Act defines third-party backed shares as preference shares in respect of which an enforcement right or obligation exists for the benefit of the holder of the preference shares. In turn, an enforcement right or obligation, in relation to any share, means any obligation or right, of any person, other than the issuer of the share to acquire the share from the holder of the share or make any payment in respect of a guarantee, indemnity or similar arrangement.

II. Reasons for change

Over the past 2 years, changes have been made in the third-party backed share anti-avoidance rules to address adverse tax consequences affecting legitimate business transactions with no intention of anti-avoidance. Concerns have been raised that certain provisions in these rules still impede certain historic arrangements and transactions that were entered into before the introduction of these anti-avoidance rules in the Act in 2012.

These historic arrangements and transactions were often entered into with excessive guarantees and obligations being bolted on by lenders as standard practice effectively trapping parties to these transactions and arrangements within the ambit of the targeted anti-avoidance, post introduction of the legislation.

Taxpayers who entered into the historic arrangements and transactions could restructure them so as to remove the excessive guarantees and obligations but at issue is the fact that in absence of any commercial reasons for restructuring other than to avoid the provisions of section 8EA of the Act, such restructuring could attract the application of the general anti-avoidance rules.

III. Proposal

In order to provide relief in respect of those transactions entered into before 2012, it is proposed that the:

a. legislation be amended to allow any parties that entered into any arrangement or transaction finalised (all terms and conditions precedent of the arrangement or transaction being met) before 01 April 2012, (earliest effective date of the third-party backed share anti-avoidance rules) that fall foul of the provisions of section 8EA be allowed to cancel any enforcement obligation or right;

b. cancellation of any enforcement obligation or right be made within a proposed window period. The period will start from the date of introduction of the TLAB 2016 and will end on 31 December 2017.

c. relief be prospective and no refund of tax will be given by SARS to taxpayers already affected by the provisions of section 8EA of the Act.

IV. Effective Date

The proposed amendments will apply in respect of any dividend or foreign dividend received or accrued during years of assessment commencing on or after 01 January 2017.

2.7. ADDRESSING CIRCUMVENTION OF ANTI-AVOIDANCE RULES DEALING WITH THIRD PARTY BACKED SHARES

[Applicable provisions: Sections 8E and section 8EA of the Act]

I. Background

During 2012 the tax legislation was amended by seeking to strengthen anti-avoidance measures on instruments with debt-like features. These anti-avoidance rules came in two forms. Firstly, the legislation targeted share issues where the dividends in respect of those shares were guaranteed by unrelated third parties. These third party guarantees effectively meant that the holder of the share had no direct or indirect meaningful stake in the risks associated with the issuer. Secondly, the legislation targeted share issues where the dividends in respect of those shares were fully secured by financial instruments (i.e. the secured financial instrument served as the basis for the dividend yield as opposed to a mix of assets associated with the issuing company as a whole).

II. Reasons for Change

Several schemes have been identified where investors structure transactions to circumvent the hybrid equity anti-avoidance rules. These schemes include, for example, the formation of trust holding mechanisms whereby investors acquire participation rights in trusts and the underlying investments of those trusts are preference shares. The formation of a trust effectively breaks the anti-avoidance link by interposing a trust between the investor and the tainted preference share to avoid activating any one of the anti-avoidance measures. The preference shares merely operate as a conduit for underlying debt instruments with the holder looking solely to the debt as collateral.

III. Proposal

In order to curb the circumvention of these specific anti-avoidance measures, it is proposed that amendments be made in the definitions of ‘hybrid equity instrument’ in section 8E as well as “preference share” in section 8EA to include any right or interest where the value of that right or interest is directly or indirectly determined by the underlying share that is either an equity share or a share other than an equity share. Provided that the value or any return on that share is accordingly based or determined with reference to a specified rate of interest or time value of money.

IV. Effective Date

The proposed amendments will come into effect on or after 1 January 2017 and applies in respect of years of assessment ending on or after that date.

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

3.1. TAX TREATMENT OF REITs- QUALIFYING DISTRIBUTION RULE

[Applicable provision: Section 25BB(1) of the Act, definition of "rental income"]

I. Background

As from 1 April 2013, a special tax dispensation for a listed company that is a Real Estate Investment Trust ("REIT") or a company that is a subsidiary of a REIT ("controlled company") that is a resident was introduced in section 25BB of the Income Tax Act (the Act). Under this special tax regime, a REIT or a controlled company that is a resident is entitled to deduct from its income the amount of any "qualifying distribution" incurred during that year of assessment by that REIT or controlled company that is a resident. "Qualifying distribution" is defined in section 25BB of the Act to include any dividend declared or interest incurred in respect of a debenture forming part of a property linked unit by a REIT or a controlled company, during a year of assessment, if more than 75 per cent of the gross income received by or accrued to such REIT or controlled company consists of rental income.

Based on this specific tax dispensation of a REIT or controlled company, a REIT or controlled company is not entitled to claim specific allowances in respect of immovable property in terms of sections 11(g), 13, 13*bis*, 13*ter*, 13*quat*, 13*quin*, or 13*sex* of the Act.

II. Reasons for change

At issue is the fact that a REIT or controlled company may have claimed the above-mentioned specific allowances in respect of immovable property before it become a REIT or controlled company. On disposal of such immovable property the general recoupment provisions of section 8(4) of the Act will apply to a REIT or controlled company in so far as that entity claimed the above-mentioned allowances in respect of immovable property. In terms of paragraph (n) of the definition of gross income in section 1 of the Act, the REIT or controlled company will therefore have to include the amount of recoupments in respect of allowances previously claimed in its gross income in the year of disposal. The inclusion of the amount of recoupment in the gross income of the REIT or controlled company could affect the 75 per cent rental income analysis for purposes of the qualifying distribution rule.

Example:

Facts*:* The REIT or controlled company disposes of property A, on which it had previously claimed commercial building allowances of R30 million during the 2016 financial year. The REIT or controlled company earns rental income of R70 million during the 2016 financial year.

Results: Based on current legislation

Gross income = R70 million + R30 million = R100 million

Rental income = R70 million

Qualifying distribution threshold = Rental income/Gross income = R70million/ R100million = 70 per cent

The net effect is that a REIT or controlled company that is a resident will not qualify for the qualifying distribution deduction (75 per cent).

III. Proposals

In order to assist those REITs or controlled companies that may have claimed the above-mentioned specific allowances in respect of immovable property before they obtained the status of a REIT or controlled company, it is proposed that the amount of recoupments in respect of allowances previously claimed be included in the "rental income" definition of section 25BB and form part of the 75 per cent rental income analysis for purposes of the qualifying distribution rule.

The proposed changes will only apply to those REITS or controlled companies that may have claimed the above-mentioned specific allowances in respect of immovable property before qualifying as a REIT or controlled company.

IV. Effective date

The proposed amendments are deemed to have come into effect on 1 January 2016 and applies in respect of years of assessment ending on or after that date.

3.2. INTERACTION BETWEEN REITs AND SECTION 9C

[Applicable provisions: Sections 9C and 25BB of the Act]

I. Background

In 2007, section 9C was introduced in the Act which currently makes provision for amounts in respect of equity shares that are held for a period of at least three continuous years to be deemed to be of a capital nature.

Section 9C(5) provides that when the equity share, held for at least 3 years, is disposed of there must be included in the taxpayer's income any expenditure or losses allowed as a deduction in terms of section 11 in any previous year of assessment: Provided that this subsection does not apply in respect of any expenditure or loss to the extent that the amount was recouped in terms of section 8(4)(a) or section 19.

Dividends received from a resident REIT or controlled company, as defined in section 25BB(1), are not exempt from tax in terms of paragraph *(aa)* of the proviso to section 10(1)(k)(i) but expenditure incurred to produce these taxable dividends and allowed as a deduction may be recouped on disposal of the equity shares in the REIT or controlled company.

II. Reasons for change

The current provisions of section 9C are inappropriate for equity shares in REITs and controlled companies that are residents. Dividends received from a REIT or a controlled company (as defined in section 25BB(1) that is a resident), form part of taxable income but allowable expenditure incurred to produce these taxable dividends that is recouped under section 9C(5) is then effectively not deductible. It is therefore proposed that a proviso be added to section 9C that subsection (5) does not apply to shares in a REIT or controlled company, as defined in section 25BB, that is a resident.

III. Proposal

In order to remove this anomaly, it is proposed that amendments be made in section 9C(5) to clarify that this section does not apply to shares in REITs or controlled companies.

IV. Effective date

The proposed amendments will come into effect in respect of years of assessment ending on or after 1 January 2017.

3.3. AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERS DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK

[Applicable provisions: Section 29A(1); new subsections 14 and 15 of section 29A of the Act]

I. Background

The insurance industry is undergoing changes to the manner in which it is regulated and financial reporting due to the introduction of the Solvency Assessment and Management (SAM) framework and the anticipated standard for insurance contained in International Financial Reporting Standards (IFRS), known as IFRS 4 Phase II. The current taxation method for taxable profits of a long-term insurer from insurance business are effectively determined as transfers from the Untaxed Policyholder fund, Individual Policyholder fund, Company Policyholder fund and Risk Policy fund to the Corporate fund. The taxable profits are determined as the difference between the market value of the assets allocated to the policyholder funds and the value of the liabilities of these funds. The value of liabilities is currently calculated on the basis determined by the Chief Actuary of the Financial Services Board (FSB) in consultation with the Commissioner for the South African Revenue Service. This basis of determination is based on the Statutory Valuation Method (SVM) with some adjustments.

In 2015, an announcement was made in the Budget Review to cater for the tax treatment of the long term insurance industry as a result of the introduction of the SAM Framework and the new Insurance Act, which will replace the current regulatory regime for the long term insurance industry. As a result, changes were proposed in the 2015 Draft TLAB that was released for public comment on 22 July 2015 and submitted to Parliament. During the parliamentary legislative process, Parliament recommended that due to the fact that the Insurance Bill enabling SAM still requires to be considered by Parliament, proposals relating to the tax treatment of long term insurers due to the introduction of SAM Framework should be removed from the 2015 TLAB and be considered in the 2016 TLAB.

II. Reasons for change

The introduction of the SAM framework will render the current adopted concepts on the valuation of policyholder liabilities for tax purposes to be obsolete. More-over the SAM framework recognizes all future income on a policy upfront and is therefore not suitable as a basis for calculating tax where the Income Tax Act generally includes income in gross income when the income is received or accrued to a taxpayer.

In addition, the International Accounting Standards Board is currently reviewing the policy liability valuation basis for long term insurers contained in IFRS and it is expected that the new IFRS 4 Phase II will be effective for financial years commencing on or after 1 January 2020. It is expected that that IFRS 4 Phase II will provide relevant and accurate recognition of insurance profit and insurance liabilities and the use of IFRS to value long-term insurer's liabilities is in line with international principles. Effectively, the divergences that currently exist between the valuation of liabilities using statutory basis that is reported to FSB and IFRS basis that is reported by the insurer to shareholders in their audited financial statements will be eliminated. Furthermore, eventually there will be comparability between insurers when all insurers use IFRS 4 Phase II as a basis.

III. Proposals

In order to cater for the tax treatment of the long term insurance industry as a result of the introduction of the SAM Framework and the new Insurance Act, the following is proposed:

A. Definition of "value of liabilities"

Currently, the Act has two separate rules in the definition of "value of liabilities", one applicable to the Untaxed Policyholder fund, Individual Policyholder fund and Company Policyholder fund and the other one applicable only to the Risk Policy fund. There is no policy rationale to have two separate rules of "value of liabilities" one applicable to the risk policy fund and the other one applicable to the three policyholder funds. It is therefore proposed that the definition of the "value of liabilities" sets out a single rule for both risk policy fund and the three policyholder funds and the current rule in the definition of "value of liabilities" applying to the three policyholder funds should be extended to apply to the risk policy fund.

B. Definition of "adjusted IFRS value"

Currently, the definition of "adjusted IFRS value", which would have applied to years of assessment commencing on or after 1 January 2016, reads as follows:

> *"**adjusted IFRS value"** means the amount of the insurance liabilities of the insurer determined in accordance with IFRS as annually reported by the insurer to shareholders in the audited financial statements adjusted so that no policy has a liability of less than zero.*

It is proposed that the definition of "adjusted IFRS value" should be made applicable to both the risk policy fund and the three policyholder funds and the current definition of "adjusted IFRS value" should be substituted with the new one which will take into account the following:

a. The IFRS policy liabilities amount will be net of reinsurance (gross amount less reinsurance amount) determined according to IFRS as annually reported in the audited financial statements.

b. The deferred tax liability amount for a fund is an amount determined according to IFRS as annually reported in the audited financial statements and will be added and an adjustment is made for the phasing-in amount. The "phasing-in amount" either increases or reduces the liabilities for tax purposes (see below). The result of the calculation is the "adjusted IFRS value".

c. It is proposed that a phasing in amount and the phasing in period of 6 years be introduced as a transitional measure aimed at stabilising the tax collections by SARS and minimising the financial impact on certain long term insurers due to these proposed changes. These rules are intended to cater for the differences in treatment of negative liabilities under the new regime (coming into effect when the Insurance Act of 2016 and SAM come into effect) and the previous rules, which apply during 2016 before the coming into effect of a new definition of *"value of liabilities"*, in so far as it relates to negative liabilities. Negative liabilities means the amount by which expected receipts from a policy exceed expected payment of claims and expenses under the policy – effectively expected profit from a policy. This fixed amount that will represent the difference relating to policies allocated to a fund between the liabilities for tax purposes and the liabilities disclosed in the insurer's published annual financial statements for 2016 will be phased in over six years.

Examples of calculating the phasing in amount:

Example 1

Facts:

Assuming the year of assessment ends after the Insurance Act, 2016 came into effect.

In respect of 2016 before the Insurance Act, 2016 came into effect the accounting net liabilities in respect of policies were R80 (taking into account negative liabilities of R20). However, for reporting to shareholders, liabilities in respect of policyholders were disclosed as R94, which mean negative liabilities of R6 have been recognised. In 2016 for statutory reporting and also for tax purposes the value of liabilities was R82 – therefore R18 negative liabilities have been recognised. The phasing-in amount is R12 (R18 – R6).

Results:

In respect of the first year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R110. After the phasing in the value of liabilities is R100 = (R110 – (0.833x 12)).

In respect of the second year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R125. After the phasing in the value of liabilities is R117 = (R125 – (0.667x 12)).

In respect of the third year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R150. After the phasing in the value of liabilities is R144 = (R150 – (0.5x 12)).

In respect of the fourth year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities (without the phasing in) results in an amount of R165. After the phasing in the value of liabilities is R161 = (R165 – (0.333 x 12)).

In respect of the fifth year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities (without the phasing in) results in an amount of R180. After the phasing in the value of liabilities is R178 = (R180 – (0.167 x 12)).

In respect of the sixth year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities results in an amount of R200. The negative liabilities have been fully phased in and no further adjustment applies.

Example 2

Facts:

Assuming the year of assessment ends after the Insurance Act, 2016 came into effect.

In respect of 2016 before the Insurance Act, 2016 came into effect the accounting net liabilities in respect of policies were R100 (taking into account negative liabilities of R20). However, for reporting to shareholders, liabilities in respect of policyholders were disclosed as R104, which mean negative liabilities of R16 have been recognised. In 2016 for statutory reporting and also for tax purposes the value of liabilities was R120 – therefore no negative liabilities have been taken into account. The phasing-in amount is R16 (R16 – R0).

Results:

In respect of the first year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R110. After the phasing in the value of liabilities is R123.3= (R110 + (0.833 x 16)).

In respect of the second year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R125. After the phasing in the value of liabilities is R135.7 = (R125 + (0.667 x 16)).

In respect of the third year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R150. After the phasing in the value of liabilities is R158 = (R150 + (0.5x 16)).

In respect of the fourth year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R165. After the phasing in the value of liabilities is R170.3 = (R165 + (0.333x 16)).

In respect of the fifth year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities definition (without the phasing in) results in an amount of R180. After the phasing in the value of liabilities is R182.7 = (R180 + (0.167x 16)).

In respect of the sixth year of assessment after the Insurance Act, 2016 came into effect the new value of liabilities results in an amount of R200. The negative liabilities have been fully phased in and no further adjustment applies.

IV. Effective date

The proposed amendments in relation to adjustment to the definition of "value of liabilities" will be deemed to have come into effect on 1 January 2016. The other amendments will come into effect on the date on which the Insurance Act, 2016, comes into effect and applies in respect of years of assessment ending on or after that date.

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4. INCOME TAX: BUSINESS (INCENTIVES)

4.1. REFINING THE ENABLING VENTURE CAPITAL REGIME FOR START-UP VENTURE CAPITAL COMPANIES

[Applicable provision: Section 12J of the Act]

I. Background

To encourage equity funders to invest in small businesses, the venture capital company (VCC) regime was introduced in 2008. Taxpayers investing in a VCC generate an upfront deduction for the investment (whereas most equity investments are non-deductible) with a recoupment upon withdrawal if the investment is not held for a minimum of five years.

The VCC has several sets of requirements including investor-level requirements for the allowable deduction in the hands of the investor. Included in the investor-level requirements is a connected person test provision (connected persons do not qualify for the VCC tax deduction) that ensures that a taxpayer cannot obtain a deduction merely by recycling funds among closely connected parties (as opposed to obtaining a new independent investment).

Concerns have been raised that at the initial stages of finding investors for a VCC, it may transpire that only a limited number of investors are able to provide seed funding. This could mean that these initial investors hold more than 20 per cent shares in the VCC, which could potentially put them in breach of the investor level requirements of the VCC. Due to the timing

issues typical of start-ups like new VCC's, initial anchor investors risk not meeting the investor level requirements. As a result, VCC's have indicated that several potential large investors have opted out of the VCC initiative, making it less likely that smaller investors will come on board as well.

II. Reasons for change

The current VCC regime makes provision for investors to obtain a tax deduction in respect of any expenditure incurred in acquiring shares in a VCC, subject to various limitations. At issue is the limitation imposed by the connected person test. The connected person test defines any person holding 20 per cent or more of shares in a company at the end of any year of assessment as connected. This connected person test provides that no deduction will be granted to taxpayers who acquire shares in a VCC, where immediately after the acquisition the taxpayer is a connected person in relation to the VCC. Currently, the Act makes provision for the connected person test to be performed at the end of every year of assessment of the VCC.

In an already challenging economic environment, it is believed that the additional risks associated with the application of the connected person test will prevent many VCC's from raising capital.

III. Proposal

A. *Timing of the connected person test:*

In order to create a more enabling environment for VCC, it is proposed that the timing of the connected person test be reviewed. It is proposed that the connected person test first be performed 36 months after the first shares are issued by the VCC and where after it is performed at the end of every year of assessment.

By only performing the first connected person test after 36 months from first shares being issued, it should enable the VCC's to find additional start-up/angel investors, and give them more flexibility in terms of when they issue the shares in the start-up phase of the VCC.

B. *Anti-avoidance:*

To address the concerns raised with regard to potential abuse regarding the proposed timing of the connected person test, the following measures are proposed:

a. Initial connected person test
   1. Should any taxpayer who is an investor in a VCC be a connected person in relation to that VCC, with effect from the day after the 36 months from the date of the first issue of shares expired and after due notice to the VCC by the Commissioner:

      i. the Commissioner must withdraw the approval of that company as a VCC, if corrective steps acceptable to the Commissioner are not taken by the company within a period stated in the notice; and
      ii. the VCC must include an amount equal to the expenditure incurred (which qualified for a deduction) for the issue of those shares held in that venture capital company in the income of that VCC during the year of assessment in which approval is withdrawn.

b. Subsequent connected person test
   1. Should any taxpayer who is an investor in a VCC or any person that incurs expenditure to acquire any share in a VCC be a connected person in relation to that VCC, during any year of assessment after the 36 months from the date of the first issue of shares expired and after due notice to the VCC by the Commissioner:

      i. the Commissioner must withdraw the approval of that company as a VCC, if corrective steps acceptable to the Commissioner are not taken by the company within a period stated in the notice; and
      ii. the VCC must include an amount equal to the expenditure incurred (which qualified for a deduction) for the issue of those shares held in that venture capital company in the income of that VCC during the year of assessment in which the approval is withdrawn.

IV. Effective date

The proposed amendments will come into effect from 1 January 2017.

4.2. URBAN DEVELOPMENT ZONES (UDZ) – ALLOWING ADDITIONAL MUNICIPALITIES TO APPLY FOR THE UDZ TAX INCENTIVE

[Applicable provision: Section 13*quat* of the Act]

I. Background

The urban development zone tax incentive was designed to encourage property investment in central business districts i.e. areas with high population carrying capacity and developed infrastructure for transport. The principal objective of the incentive is to address dereliction and dilapidation, and promote urban renewal by stimulating investment in the construction and renovation of commercial and low cost residential buildings. The incentive is in the form of an accelerated depreciation allowance under section 13*quat* of the Act. The incentive is aimed at promoting investment in 16 designated inner cities, 15 of which now have demarcated UDZs within its boundaries. The incentive was initially available from 2013 until March 2014, where after a review of its effectiveness it was extended to March 2020.

In 2015, changes were made in the Act to allow municipalities with a population of 1 million demarcate an additional UDZ area. Furthermore, where the municipality's population is below 1 million, the Minister of Finance (MoF) may approve the demarcation of an additional UDZ having regard to the provisions set out under section 13*quat* (6) and (7) of the Act.

II. Reason for change

Municipalities outside of the 16 designated UDZs areas have approached the Minister to broaden the scope of the UDZ incentive to cover additional municipalities, as they seek to integrate the incentive into existing urban renewal plans. Section 13*quat* of the Act only caters for the 16 municipalities (Annexure A) and makes no provision for municipalities not listed under subsection 13*quat*(6)(a) to be eligible for the incentive.

Given the continued state of underdevelopment and dilapidation in their inner cities, there is demand from municipalities to expand the scope of the incentive and allow municipalities to apply to the Minister to be considered for the UDZ tax incentive. Where this inner city dilapidation continues, it discourages new investment and increases disinvestment in property. There may thus be a case to expand the scope of the incentive as it is seen to stimulate investment in the construction and renovation of commercial and low-cost residential buildings in the inner city.

III. Proposal

A. Additional Municipalities

It is proposed that section 13quat of the Act be amended to provide a framework for the Minister to consider applications from municipalities currently not allowed to designate a UDZ area. The Minister's assessment criteria will be based on the current legislative requirements as contained in section 13*quat*(6) and (7), as well as the additional criteria contained in Annexure B below.

The application process will apply to all municipalities that are not listed under subsection 13*quat* (6)(a) – i.e. all municipalities not currently part of the original 16 that were eligible since the inception of the UDZ incentive. Such municipalities may apply directly to the Minister for a UDZ area to be demarcated

If the municipality's application is successful and the Minister issues the notice in the government *gazette*, the municipality will be added to the list of qualifying municipalities through a legislative amendment under subsection 13*quat* (6)(a).

B. Additional Criteria

The inclusion of the additional criteria contemplated in Annexure B is aimed at providing an assessment framework to consider when broadening access to the incentive, through prioritising urban renewal and development in a manner that counters spatial fragmentation. Essentially Annexure B prescribes several criteria items of differing significance, dependent on each application's facts and circumstances, which have to be applied in context of each application.

A broader target market for the incentive could potentially increase the associated fiscal cost, however, the additional criteria essentially focuses on high-performing municipalities that have significant growth potential. The demarcation of the UDZ should not put an additional strain on municipal finances, but contribute positively towards an increase in the generation of own revenues from the municipality.

The municipality must support its application with evidence that it meets all the requirements of subsections 13*quat* (6) and (7).

The additional criteria proposed in Annexure B should be issued as a separate document through the means of a regulation to guide both the Minister and municipalities when considering approving/applying (for) a UDZ area. These represent some of the factors that the Minister will use in assessing whether to allow the demarcation of a UDZ in that municipality.

The additional criteria contained in Annexure B will also be used to assist the Minister in assessing applications for additional UDZs from municipalities that have a population of less than 1 million [s13quat(7)(bA)].

IV. Effective date

The proposed amendments will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2016.

Annexure A

Municipalities Eligible for UDZ incentive

1	Buffalo City
2	Cape Town
3	Ekurhuleni
4	Emalahleni
5	Emfuleni
6	eThekwini Metro
7	Mahikeng
8	Johannesburg Metro
9	Mangaung
10	Matjhabeng
11	Mbombela
12	Msunduzi
13	Nelson Mandela Metro
14	Polokwane
15	Sol Plaatje
16	Tshwane Metro

Annexure B

SUGGESTED CRITERIA FOR NEW APPLICATIONS AND ADDITIONAL URBAN DEVELOPMENT ZONES

Category	Item	Motivation	Measurement
Urban renewal	Proposed area should contain derelict and dilapidated buildings that require rejuvenation.	Relates to the original purpose of the UDZ, i.e. to rejuvenate the inner cities.	Number of derelict buildings in need of upgrading.
Spatial Targeting	Proposed area should be located within/close to a spatially targeted node identified within the municipal spatial development	This criteria acts as a counter against urban sprawl and ensures that densification and focused, integrated interventions are addressed. It also	The following key elements need to be considered in evaluating the proposed UDZ: • A transport interchange in close proximity to the area;

	framework (SDF) and have proven locational potential.	ensures that the basic requirements for economic development are in place.	• Convergence of people; • The area should be linked to primary and/or at least secondary transport routes. • A conglomeration of mixed use activities and facilities should be present within the area.
Economic growth	Economic growth prospects and performance of the municipality as a whole	The overall economic output of the municipality needs to demonstrate positive growth over the last 2 years. Proven market performance should be evident.	Gross value added (GVA) to be more than the national average, but a minimum of 1.5% over the previous 2 years.
Municipal commitment	• Proven fiscal measures and plans towards improvements in the area. • Municipality should demonstrate current ability to generate own revenue.	-- Own revenue should be >=50% of total municipality income	Own revenue : total municipal income = 0.5: 1
Annual submission of progress reports on historically approved UDZ's	• Municipality must have submitted reports annually as required in section 13*quat* (9).	The reports will provide information regarding the current progress of the UDZ and whether an extension of the area is justified.	

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4.3. ACCELERATED CAPITAL ALLOWANCE IN RESPECT OF SUPPORTING INFRASTRUCTURE USED IN PRODUCING RENEWABLE ENERGY

[Applicable provision: Section 12U of the Act]

I. Background

South Africa as a party to the United Nations Framework Convention on Climate Change (UNFCCC) aims to reduce greenhouse gas (GHG) emissions and to incentivise investments in low carbon, clean energy. Renewable energy is prioritized by government as a viable alternative to the current carbon–intensive economy. Since 2005 targeted incentives for renewable energy have been introduced through the provisions of the Act, 58 of 1962.

II. Reasons for change

Currently, large scale renewable energy projects are not adequately catered for under the existing accelerated depreciation regime due to the capital intensive nature of supporting infrastructure whose tax treatment would need to be specifically targeted. Capital expenditures that indirectly support renewable electricity production, such as the construction of fences and roads, do not qualify for deductions under the Act. According to industry, this is one of the limitations that influence the viability of most large-scale renewable energy projects.

III. Proposal

It is therefore proposed that the provisions of the Act be broadened to include the supporting capital infrastructure in the form of capital expenditure actually incurred on roads and security fences for large scale renewable energy projects as follows:

A. Renewable energy projects qualifying for deductions:

It is proposed that only large scale renewable energy projects that generate electricity exceeding 5MW will qualify. Current evidence suggests that renewable energy projects within the band of 5 – 50MW are barely economically viable and as such this proposed incentive will assist in increasing the financial viability. The proposed amendment further took into account that all renewable energy projects approved under the auspices of the Renewable Energy Independent Power Producers Procurement Programme of the Department of Energy currently exceed 5MW.

B. Timing of proposed deduction:

Should the renewable energy production supporting capital infrastructure expense be incurred pre-commencement of trade, then similar to section 11A of the Act which provides for certain pre-trade expenditure to be allowed as a deduction, the capital expense will have to be:

a. Actually incurred prior to the commencement of and in preparation of carrying on that trade; and
b. Not have been allowed as a deduction in that year or any previous year of assessment.

C. Ring fencing and roll over:

As an anti-avoidance measure and with specific reference to the fact that the supporting infrastructure expense is of a capital nature, it is proposed that any supporting infrastructure capital expenditure that exceeds the income in any year of assessment be ring fenced to the specific trade of the production of renewable energy.

It is further proposed that the envisaged allowable supporting infrastructure capital expenditure that exceeds the taxable income to the specific trade of the production of renewable energy in any year of assessment be rolled-over as an allowable capital expenditure during the next succeeding year of assessment against income specific to the trade of the production of renewable energy.

IV. Effective date

The proposed amendments will only apply to large-scale renewable energy projects embarked during any year of assessment commencing on or after 1 April 2016.

4.4. CLARIFYING THE TAX RATE APPLICABLE TO SMALL BUSINESS CORPORATIONS LOCATED IN SPECIAL ECONOMIC ZONES

[Applicable provision: Section 12R of the Act]

I. Background

In 2013, the Department of Trade and Industry (DTI) together with the National Treasury proposed the introduction of special economic zones (SEZs) regime. The SEZ regime was intended to replace the Industrial Development Zones (IDZs) regime with the aim to further promote investment, growth and job creation in the South African manufacturing sector and the development of selected key zones. The SEZ regime (which will apply to the current IDZs and any newly designated zones approved by the Minister) differs from the IDZ regime in that it expands on the value-added tax and customs duty relief that are applicable within customs controlled areas in the IDZs. This expansion under the SEZ regime includes normal income tax incentives that will encourage higher levels of investments into the designated zones.

II. Reasons for change

For normal tax purposes, companies that qualify for the incentives under the SEZ regime will be taxed at a more favourable rate of 15 per cent and are also eligible for an accelerated capital allowance on buildings built within a designated SEZ. However, the current provisions of the Income Tax Act that provide for these incentives do not provide clarity on the tax rates applicable in the instance that the qualifying company is a small business corporation as defined in section 12E of the Income Tax Act.

At issue is that the current provisions of the SEZ incentives provide only for a flat tax rate of 15 per cent while section 5(2) and the annual Rates and Monetary Amounts and Amendment of Revenue Laws Acts provide for concessionary tax rates which follow a graduated marginal structure (0 per cent, 7 per cent, 21 per cent and 28 per cent). In instances that the small business corporation would have been taxed at an effective rate that is lower than 15 per cent, the flat rate of 15 per cent would not be advantageous. In addition, it is currently not clear in the

legislation which rate should apply in the instance that the small business corporation would have been taxable at an effective rate that is higher than 15 per cent (for example 21 per cent or 28 per cent).

III. Proposal

It is proposed that the legislation should be amended in order to clarify that small business corporations located within an SEZ should be able to benefit from the lower effective tax rate that they would otherwise qualify for under the graduated marginal structure and should, furthermore, also be able to benefit from the flat rate of 15 per cent in the instance that their effective tax rate would have exceeded the flat rate of 15 per cent. As such, a small business corporation will be subject to tax at the flat rate of 15 per cent or the effective rate determined in terms of the graduated marginal structure, whichever is the lower.

It should be noted that there is no policy change regarding qualifying companies that are currently excluded from benefiting from the preferential tax rates as a result of their activities.

IV. Effective date

These amendments are deemed to have come into effect from the date on which the Special Economic Zones Act, 2014 came into operation. The rates applicable are reflected in the 2016 Rates and Monetary Amounts and Revenue Laws Amendment Bill.

4.5. TAX EXEMPTION OF NATIONAL HOUSING FINANCE CORPORATION

[Applicable provisions: Sections 10(1)(t) and section 30(3)(b) of the Act]

I. Background

The Department of Human Settlements is currently consolidating all its Human Settlement Development Finance Institutions, namely, the National Housing Finance Corporation (NHFC), National Urban Reconstruction and Housing Agency (NURCHA) and the Rural Housing Loan Fund (RHLF) under one entity, namely, the NHFC, which is wholly owned by Government. Currently, NURCHA and RLHF qualify as Public Benefit Organisations (PBOs) in terms of the Income Tax Act and are exempt from normal income tax. On the other hand, NHFC is a taxable entity.

II. Reason for Change

The existing different tax treatment of Human Settlement Development Finance Institutions creates difficulties, more especially during consolidation. Before consolidation, the activities were performed by two entities (NURCHA and RHLF), which are tax exempt. After consolidation, the same activities will be performed by one entity (NHFC), which is not exempt from tax.

In turn, the consolidation of functions into one entity requires the transfer of assets and liabilities from the aforementioned two tax exempt entities to this single taxable entity, which triggers a tax charge. Given that these activities qualify as public benefit activities and were tax exempt before consolidation, consolidation should not deter public benefit activities that qualify for tax exemption.

III. Proposal

The Human Settlement Development Finance plays a key role in improving the delivery of adequate housing to the needy. It is proposed that the receipts and accruals of NHFC should be exempt from tax in terms of section 10(1)(t) of the Act.

In order to allow for tax neutral transfer of assets and liabilities from NURCHA and RHLF to NHFC, it is proposed that a further amendment be made to section 30(3)(b) of the Income Tax Act.

IV. Effective Date

The proposed amendments will be deemed to have come into effect on 1 April 2016 and will be applicable in respect of years of assessment commencing on or after that date.

4.6. TAX TREATMENT OF LAND DONATED UNDER LAND-REFORM INITIATIVES

[Applicable provisions: Section 56 of the Act, addition of a new provision in paragraph 64A of the Eighth Schedule to the Act]

I. Background

The Act makes provision for tax relief in respect of land donated under certain land reform programmes. For example, land granted in terms of the Land Reform Programme as contemplated in the White Paper on South African Land Policy, 1997 is exempt from donations tax. In addition, awards or compensations in terms of Restitution of Land Rights Act, 1994 are exempt from capital gains tax.

II. Reasons for change

The above-mentioned tax relief was introduced in the Income Tax Act in 1994 and 2002 respectively. Subsequent to this, Government has since introduced other land reform initiatives as stipulated in Chapter 6 of the National Development Plan (NDP). As the existing tax relief in the Income Tax Act was introduced prior to the publishing of the NDP, the relief does not extend to land reform initiatives aligned to Chapter 6 of the NDP.

III. Proposal

In order to provide relief to other land reform initiatives as stipulated in Chapter 6 of the NDP, it is proposed that:

1. Exemption from donations tax in section 56 of the Act be extended to include land reform initiatives under Chapter 6 of the NDP.
2. Exemption from capital gains tax in paragraph 64A of the Eighth Schedule to the Income Tax Act be extended to include awards in terms of land reform initiatives under Chapter 6 of the NDP.

    a. Introduction of new paragraph 64D of the Eighth Schedule to the Act to cater for exemption from capital gains tax in respect of land donated in terms of the land reform initiatives under Chapter 6 of the NDP.

IV. Effective date

The following effective dates are proposed:

- Extending the exemption from donations tax in section 56 of the Income Tax Act to include the land reform initiatives under Chapter 6 of the NDP.
  - The proposed amendment is deemed to have come into operation on 1 March 2016 and applies in respect of donations received or accrued on or after that date.

- Extending the exemption from capital gains tax in paragraph 64A of the Eighth Schedule to include awards in terms of land reform initiatives under Chapter 6 of the NDP
- Introducing a new exemption in terms of paragraph 64D of the Eighth Schedule to cater for exemption in respect of land donated in terms of land reform initiatives under Chapter 6 of the NDP.
  - The proposed amendment is deemed to have come into operation on 1 March 2016 and applies in respect of years of assessment ending on or after that date.

The proposed amendments are deemed to have come into effect from 1 March 2016 and will be applicable in respect of years of assessment commencing on or after that date.

4.7. CLARIFYING THE TAX TREATMENT OF GOVERNMENT GRANTS

[Applicable provision: Paragraph *(l)* of the “gross income” definition in section 1 of the Act]

I. Background

A uniform regime for the taxation of government grants was introduced under section 12P of the Act in 2012. Under this uniform regime, government grants can only be exempt if (1) they form part of the comprehensive legislative list set out in the Eleventh Schedule or (2) they are specifically identified by the Minister of Finance by notice in the *Gazette* as a mechanism to cater for grants originating in the middle of a legislative cycle for which there will be a delay in listing them in the Eleventh Schedule. These two mechanisms were introduced to ensure that the key determinations to be observed when seeking to exempt any government grant are properly considered. The intention is that these mechanisms would ensure that only genuine grants and not some forms of disguised consideration or transfer paid for or in exchange for goods and services required by Government would be exempt and that the financial and tax implications were borne in mind when deciding to grant an exemption.

II. Reasons for change

Under the current dispensation, a government grant that is neither listed in the Eleventh Schedule nor identified by the Minister in the *Gazette* may still avoid being taxed. This arises as a result of the grant falling outside the definition of gross income because that grant is meant to subsidise the procurement or acquisition of capital assets and is thus capital in nature.

III. Proposal

It is proposed that the legislation should be clarified and aligned in accordance with normal tax practices applicable to taxable receipts. Firstly, the amount must be included in the gross income

of the recipient. Any exclusion from tax should be made on the basis of a special exemption granted in terms of section 12P read together with the Eleventh Schedule. The proposed inclusion in gross income for all government grants will be included under paragraph (l) of the definition of “gross income”.

IV. Effective date

These amendments will apply to all grants received or accrued on or after 1 January 2017.

4.8. PROVISION FOR EXCEPTION TO THE RESEARCH AND DEVELOPMENT (R&D) INCENTIVE PRESCRIPTION RULES

[Applicable provisions: Section 11D of the Income Tax Act 58 of 1962 and section 93 of the Tax Administration Act 28 of 2011]

I. Background

The income tax system contains an incentive for research and development to promote R&D related job opportunities and economic growth in South Africa. The tax incentive is in the form of a 150 per cent deduction for non-capital R&D expenditure. Taxpayers seeking to benefit from this allowance are required to obtain pre-approval from the Minister of Science and Technology, who in turn decides whether to provide such approval based on the findings of a committee set up for this purpose. Management and administration of the pre-approval committee is essentially done by the Department of Science and Technology (DST), although the committee comprises people sourced from the DST, National Treasury and SARS.

Since inception of the R&D pre-approval system in 2012, the pre-approval adjudication committee has experienced teething, administration and capacity problems. These setbacks have led to delays and substantial backlogs in the processing of applications. The backlogs have resulted in calls by taxpayers and tax practitioners for a task team to be appointed to make recommendations on how the R&D tax incentive could be improved. The Minister of Science and Technology responded to these calls and appointed such a task team, consisting of expert representatives from academia, government and the private sector. The task team has completed its mandate and has provided the Minister of Science & Technology with its findings.

II. Reason for change

Amongst the issues raised by the task team was that delays in processing approvals could cause assessments to prescribe before an application is adjudicated upon. This situation is exacerbated because SARS has made it clear that submission of income tax and provisional tax returns should not be delayed pending pre-approval by the R&D committee. Further, taxpayers have been advised that when submitting such returns they should not assume a successful pre-approval as wrongfully doing so could result in them being subject to the imposition of interest and penalties.

Example:
Facts:
Company X has a 30 June year end. On 1 November 2012, Company X submitted a proposed research and development project to DST for pre-approval. On 1 August 2013 Company X

submitted its return to SARS for assessment and was duly assessed on that day (company has until 30 June 2014 to submit its return). In submitting its return the taxpayer claimed certain R&D expenditure to the value of R1, 000,000 (incurred between November 2012 and 30 June 2013). On 10 August 2016 the DST approved the pre-approval application of 1 November 2012.

Results:

At the time of submitting the tax return, the taxpayer did not claim an additional R500,000, which it anticipated it would be entitled to once its R&D project was approved by the Minister of Science and Technology. Given the approval date by DST on 10 August 2016, which is more than three years after the date of assessment, the taxpayer wanted to reopen its 2013 tax return to include a claim for an additional allowance of R500, 000. Since the authority to revise an assessment prescribes three years after a tax return has been assessed, the taxpayer has lost the benefit of the R&D allowance. In this case the taxpayer's return would have already been prescribed by 1 August 2016 before receiving the decision from DST.

III. Proposal

An amendment should be made to section 11D to allow for a reopening of assessments in the circumstances outlined above.

IV. Effective date

The proposed amendments should be made effective in respect of assessments raised after the date of promulgation of section 11D of the Taxation Laws Amendment Act, 2016.

4.9. ADDRESSING POSSIBLE ADMINISTRATIVE AND TECHNICAL CHANGES IN RESPECT OF INDUSTRY POLICY FOR SECTION 12I

[Applicable provision: Section 12I of the Act]

I. Background

Section 12I of the Act allows taxpayers an additional investment and training allowance in respect of industrial policy projects provided that the projects meet certain criteria prescribed by way of regulation. The additional investment allowance ranges from 35 per cent to 100 per cent of the cost of any new and unused manufacturing assets used for the project, depending on whether the project has qualifying status or preferred status, and whether the project is located in an industrial development zone (or designated special economic zone).

The additional investment allowance also has specific legislative requirements that requires the asset:

a. to be owned by the company claiming the additional allowance;
b. to be used for the furtherance of the industrial policy project carried on by that company;
c. to have been acquired and contracted for on or after the date of approval of the relevant project as an industrial policy project; and
d. was brought into use within four years from the date of approval of the relevant project as an industrial policy project.

II. Reasons for change

A. Status change of project

The current provisions of section 12I(12) only envisages the withdrawal of project approval when the company fails to comply with any requirements as set on approval.

It, however, does not account for the situation where the project was initially approved on preferred status, but the project status subsequently changes and becomes a qualifying status project by the end of the compliance period.

For example, the project may have scored 7 out of 8 points upon project approval and qualified as a preferred status project, but by the end of the compliance period, the project only scores 6 out of 8 points and is regarded as a qualifying status project. In this example, the approved project may not be disqualified as it still meets the minimum requirements for an approved industrial policy project, i.e. qualifying status project. Nonetheless, if it does not meet the scoring criteria for a preferred status project by the end of the compliance period, it should not be allowed to claim the preferred status allowance of either 55 per cent or 100 per cent of the cost of any new and used manufacturing assets, depending on whether the project is located within a special economic zone or not.

The risk to the fiscus is that the project which was approved as a preferred status but changes to a qualifying status before the end of a compliance period could be claiming a larger allowance value than it is allowed to claim, thereby reducing revenue collection over that period. This is a gap in the current legislation which needs to be addressed, because there is a risk that this may happen more frequently as many more projects near the end of the compliance period.

B. Extending period to bring assets into use

Given the estimates used at the approval stage and the nature of these large-scale manufacturing projects, start-up delays are a distinct possibility. In this regard the legislation does allow the Minister of Trade and Industry the discretion to extend the period within which assets are required to be brought into use, after taking into account the recommendations of the adjudication committee.

Current legislation contains a technical oversight in that the relevant discretionary enabling legislation does not extend to certain other provisions in the section. There is no policy rational for the Minister’s discretion in this regard to not extend to all the relevant provisions.

III. Proposal

A. *Status change of project*

It is proposed that section 12I be amended to enable SARS to recoup the difference in allowance claimed in respect of a project which was approved as a preferred status but changes to a qualifying status by the end of the compliance period. If a project was initially approved on preferred status and claimed allowances on that basis, but by the end of the compliance period the project only reaches qualifying status, the excess value claimed should be recouped from the taxpayer.

B. *Extending period to bring asset into use*

The discretion contemplated in section 12I(19)(a) should be extended to also include a reference to subparagraph (7)(c) of the same section.

IV. Effective date

The proposed amendments will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2016.

4.10. PROVIDING TAX RELIEF FOR MINING COMPANIES SPENDING ON INFRASTRUCTURE FOR THE BENEFIT OF MINING COMMUNITIES

[Applicable provision: Section 36 of the Act]

I. Background

The Mineral and Petroleum Resources Development Act, 2002, (Act No 28 of 2002) (MPRDA) has multiple purposes – one of which is to transform mining and production industries in South Africa. To ensure effective transformation, the MPRDA makes it compulsory for mining companies to submit a Social and Labour Plan (SLP). SLPs are entered into between the community, the mining company and the Department of Mineral Resources (DMR). One of the requirements is to assist with the development of mining communities, which typically involves a company agreeing to build infrastructure – ranging from roads and drainage systems to crèches, schools, clinics, housing, and recreational buildings – to benefit workers and communities surrounding the mine.

II. Reasons for change

Currently, section 36(11) of the Act enables mining companies to deduct certain capital expenditure in lieu of other sections in the Act. Mining companies can only deduct such capital expenditure if it relates directly to its employees, not the wider community. If, for example, a mining company builds a clinic purely to serve its employees, the mining company will be entitled to deduct the related capital expenses in equal amounts over a ten year period. If the clinic was built to serve the wider community instead, the mining company is unable in terms of the current provisions of the Act to deduct any of the capital expenditure incurred.

In particular, section 36(11)(e) of the Act makes provision for mining companies to deduct capital expenditure incurred pursuant to the MPRDA, but excluding capital expenditure incurred by mining companies in respect of infrastructure or environmental rehabilitation.

III. Proposal

To recognise the SLP requirements (of the MPRDA) for mining companies to meaningfully contribute toward community development, and because it has become practically and administratively difficult for mining companies or SARS to differentiate between whether employees or people from the wider mining community are using developmental infrastructure (for example a clinic), the following is proposed:

a. To extend the current relief provided to mining companies (for capital expenditure incurred in respect of infrastructure for the benefit of employees) to capital expenditure incurred by mining companies on infrastructure in terms of the SLP requirements of the MPRDA, for the benefit of the people living in mining communities (other than employees).

b. To be eligible for the capital expenditure deduction, the infrastructure erected or developed by the mining company should reflect what was agreed to between the mining company and the DMR in terms of SLP requirements of the MPRDA.

c. The DMR will improve effective monitoring and oversight of such plans and the Tax Administration Act allows SARS to request the SLP and associated annual reports.

d. That current ten year period for deductions applicable to mining companies in respect of capital expenditure incurred on infrastructure for the benefit of employees be applicable in respect of capital infrastructure expenditure incurred by mining companies in terms of the SLP requirements of the MPRDA. The primary rationale for using the same time period for deductions is simplicity as it is often the case that a clinic or road will be used by both employees and the wider community. Having different write-off periods will create unnecessary complexity in determining the use ratio of employees and community members.

IV. Effective date

The proposed amendments will be effective for years of assessments commencing on or after 1 April 2017.

4.11. TAX EXEMPTION OF PUBLIC BENEFIT ORGANISATIONS PROVIDING INDUSTRY BASED EDUCATION AND TRAINING ACTIVITIES

[Applicable provision: Part I of the Ninth Schedule to the Act]

I. Background

The Act contains provisions in sections 10(1)*(cN)* and 30, and the Ninth Schedule that provide exemption for public benefit organisations if they meet certain requirements as set out in the Act, including the carrying on of public benefit activities. Paragraph *(a)* of the definition of public benefit activities refers to activities listed in Part 1 of the Ninth Schedule. In turn, paragraph 4 of

Part I of the Ninth Schedule lists qualifying education and development public benefit activities. Tax exemption is not automatic and public benefit organisation must still apply to SARS in order to obtain the tax exemption status.

II. Reasons for change

It has come to Government's attention that certain industries establish special associations to promote the common interest of members in that particular industry or profession. These associations also provide training to employees of that particular industry as well as implementing industry based standards. The associations also develop certification schemes for employees working in that specific industry in line with best international practice. The main source of funding is derived from training courses and other related income which is analogous to tuition fees received by a University. Industry based associations such as these are directed by the requirements of the industry and are linked for accreditation to the Quality Council for Trades and Occupations (QCTO).

Although the principal object of these associations is to carry on educational and training activities for the benefits and needs of the public, these associations do not qualify for tax exemption as they do not meet the requirements set out in sections 10(1)*(c*N*)* and 30, and paragraph 4 (dealing with exemption of education and development) in Part 1 of the Ninth Schedule.

III. Proposal

In order to encourage the industry to provide education and development, which play a key role in increasing not only more skilled individuals in the workplace but also to the poor and needy persons who seek cost effective/affordable quality industry based education and training, it is proposed that amendments be made in the Act to extend the list of public benefit activities qualifying public benefit organisations for tax exemption to education and training activities to benefit industry based training organisations.

It is therefore proposed that:

a. receipts and accruals of industry based public benefit associations providing education and training programmes and courses for the development of persons or employees in that particular industry be exempt from normal taxation by including the activities performed by them under "Education and Development" in paragraph 4 of Part I of the Ninth Schedule to the Act provided that those qualifications are compatible with the type of qualifications in the Quality Council for Trades and Occupations.

b. Receipts and accruals of industry based public benefit associations administering examination and providing certification programmes for the benefit of that particular industry be exempt from normal taxation by including the activities performed by them under "Education and Development" in paragraph 4 of Part I of the Ninth Schedule to the Act, provided that that association is accredited to conduct those activities by the South African National Accreditation System (SANAS), South Africa's member of the International Accreditation Forum.

IV. Effective date

The proposed amendments will come into operation on the date of promulgation of the Taxation Laws Amendment Act of 2016.

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5. INCOME TAX: INTERNATIONAL

5.1. REPEAL OF THE WITHHOLDING TAX ON SERVICES FEES REGIME

[Applicable provisions: Part IVC of Chapter II and Sections 51A to 51H of the Act]

I. Background

In the 2013 Budget Speech, the Minister announced and introduced a withholding tax on cross-border services. This withholding tax is a final tax in respect of fees payable by a resident to a non-resident for technical, management and consulting services rendered by that non-resident to a resident. The main aim of the introduction of this withholding tax was to identify and collect revenue from non-resident taxpayers who provide technical, management or consulting services and earned fee income from a South African source. It was also aimed at preventing the potential for the erosion of the South African tax base.

The tax rate for the withholding tax on services is 15 per cent of the gross amount of fees paid to a non-resident (subject to tax treaty relief). The liability to withhold the tax is with the payor of the service fees to or for the benefit of the non-resident taxpayer.

II. Reasons for change

In June 2015, SARS issued a draft public notice listing a reportable arrangement in terms of section 35(2) of the Tax Administration Act, 2011 for public comment. This dealt with arrangements in terms of which certain service fees are paid by a resident to a non-resident. On 3 February 2016, SARS issued in Notice 140 of the Government Gazette no 39650 a revised list of reportable arrangements. According to this Notice an arrangement for the rendering of consultancy, construction, engineering, installation, logistical, managerial, supervisory, technical or training services to a South African resident or a non-resident having a permanent establishment in South Africa, in terms of which arrangement a non-resident was, is, or is anticipated to be physically present in South Africa in connection with or for purposes of rendering the services and the expenditure incurred or to be incurred in respect of the services exceeds or is anticipated to exceed R10 million, is a reportable arrangement in terms of the Tax Administration Act provided that it does not qualify as 'remuneration' for employees' tax purposes.

If the reportable arrangement regime were to be applied concurrently with the withholding tax on services regime, it would have resulted in additional administrative functions for SARS and a compliance burden for taxpayers. The two regimes are virtually aimed at achieving the same goal (i.e. identifying and collecting revenue from non-resident taxpayers who provide technical, management or consulting services).

Further, concerns have been raised that the application of withholding tax on services regime will give rise to uncertainty on the application of domestic tax law and limited revenue due to limited taxing rights under tax treaties.

III. Proposal

In view of the above, it is proposed that the withholding tax on services be repealed from the Act. Therefore, payment of certain service fees by South African residents to non-residents will now be dealt with under the provisions of Reportable Arrangements in the Tax Administration Act.

IV. Effective date

The proposed amendments will be effective to all service fees that are paid or that become due and payable on or after 1 January 2017.

5.2. EXEMPTION OF COLLECTIVE INVESTMENT SCHEMES IN SECURITIES FROM CONTROLLED FOREIGN COMPANIES RULES

[Applicable provision: Section 9D of the Act]

I. Background

A. Controlled Foreign Companies

The South African tax system has controlled foreign company (CFC) rules that are anti-avoidance rules generally aimed at preventing South African residents from shifting tainted forms of taxable income offshore by investing through CFCs. The CFC rules make provision for the net income of a CFC to be attributed and included in the income of South African shareholders.

Section 9D of the Act defines a CFC as any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies. Section 1 of the Act defines a foreign company as any company which is not a resident. In turn, the definition of a company in section 1 of the Act includes portfolios of foreign collective investment schemes in securities.

The amount of income which is included in the net income of a CFC is subject to various exemptions such as the foreign business establishment, high-tax and related party exemptions. These exemptions seek to strike a balance between protecting the tax base and the need for South African multinational entities to be competitive.

B. Collective Investment Schemes and Securities

Paragraph (e)(ii) of the definition of a company in section 1(1) of the Act includes any portfolio of a foreign collective investment scheme that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in

pursuance of any arrangement in terms of which members of the public are invited or permitted to contribute or hold participatory interest in that portfolio through shares, units or any other form of participatory interest.

A collective investment scheme is an investment vehicle used by investment managers to pool investors' funds to enable them to access investments which they might not otherwise be able to access in their individual capacities. In South Africa, collective investments schemes are generally established as vesting trusts, with investors in such schemes being the beneficiaries of the trust. The assets of a collective investment scheme portfolio are held by the trustees on behalf of the holders of participatory interests. The taxation of these vesting trusts holders of and participatory interests is regulated by section 25BA. These collective investment schemes are regulated by the Collective Investment Schemes Control Act. No 45 of 2002.

II. Reasons for change

When funds are invested in a collective investment scheme in securities portfolio, an investor acquires a portion of the participatory interests in the total collective investment scheme in securities portfolio. In turn, investors get to share the risks and benefits of their investment in a collective investment scheme in securities in proportion to the participatory interests in that scheme.

At issue is the application of the CFC rules in cases where the South African collective investment scheme in securities invests in a global fund, which is a foreign fund. Concerns have been raised that as South African collective investment schemes in securities invest in a global fund, South African collective investment schemes in securities should be considered to be the direct holders of the participation rights in that global fund. On the other hand, there is an argument that as South African collective investment schemes in securities are established as vesting trusts, the units in the global fund are beneficially owned by the investors in the South African collective investment schemes in securities in proportion to their effective interests in such global fund.

In addition, there is uncertainty as to whether the global fund is comparable to a portfolio of collective investment scheme in securities as envisaged in the above-mentioned paragraph (e)(ii) of the definition of a company of section 1(1) of the Act.

More specifically, the uncertainty arises in the determination of whether:

a. the global fund can be regarded as a CFC;
b. a South African collective investment scheme or investors in a South African collective investment scheme in securities should be treated as holders of the participation rights in that global fund;
c. as South African collective investment scheme in securities or investors in a South African collective investment scheme in securities should be considered to directly or indirectly exercise voting rights in that global fund.

III. Proposal

In order to eliminate the uncertainty and potential double taxation described above, it is proposed that:

a. South African collective investment schemes in securities investing in a global fund should be excluded from applying the CFC rules (section 9D) to investments made in that global fund;
b. a South African collective investment schemes in securities are established as vesting trusts, the conduit principle should apply when South African collective investment schemes in securities invest in a global fund and that tax should ultimately arise in the hands of investors in the South African collective investment schemes in securities in proportion to their effective interests in such global fund.

IV. Effective date

The proposed amendments will apply in respect of years of assessment commencing on or after 1 January 2017.

5.3. EXTENDING THE BAD DEBT DEDUCTION RULE TO EXCHANGE DIFFERENCES ARISING ON FOREIGN CURRENCY DENOMINATED LOAN

[Applicable provision: Section 11(i) of the Act]

I. Background

Section 11(i) of the Act permits a deduction of the amount of any debt due to the taxpayer to the extent that such debt has become bad during the year of assessment. However, In order to get the deduction under section 11(i) of the Act, the amount of the debt in question must have been included in that taxpayer's income either in the current year or previous year of assessment. The determination as to whether a debt is bad must be made at the time that the debt is claimed as bad.

II. Reasons for change

Currently, exchange differences arising on a foreign currency denominated loan by a South African taxpayer, who is not a money-lender to another person are taken into account in the determination of a taxable income as either an inclusion of deduction.

However, where that loan becomes bad, a taxpayer is not allowed to claim a deduction in terms of section 11(a) of the Act in relation to the exchange gains that were included in the income. The loss reflects a loss of fixed capital rather than floating capital. Further, a taxpayer is not allowed to claim a deduction under section 11(i) of the Act because the amount of the debt, being the foreign currency denominated amount, was not included in income. Consequently, the current tax provisions do not give a taxpayer any relief in relation to irrecoverable amounts on which it has been subjected to tax.

III. Proposal

In order to provide relief in relation to exchange differences that are included in taxable income, it is proposed that the provisions of section 11(i) of the Act be extended to apply to any exchange difference in respect of a debt that has been included in income during the year of assessment.

IV. Effective date

The proposed amendments will apply in respect of the years of assessment ending on 1 January 2017

5.4. INTEREST WITHHOLDING TAX WHERE INTEREST IS WRITTEN- OFF

[Applicable provisions: Part IVB of Chapter II of the Act: Sections 50G of the Act]

I. Background

On 1 March 2015 a new withholding tax on interest was introduced. The withholding tax on interest applies in respect of interest paid by a South African resident to or for the benefit of any foreign person to the extent that the interest is from a South African source. The withholding tax is levied at a final withholding tax rate of 15 per cent of the amount of the interest paid to a foreign person. However, the withholding tax is subject to some exemptions.

The withholding tax on interest rules have deeming provisions and deems interest to be paid on the earlier of the date on which the interest is paid or becomes due and payable.

II. Reasons for change

In circumstances where interest withholding tax is paid on interest that becomes due and payable, but the interest is subsequently written-off as irrecoverable, there is no mechanism for SARS to refund the interest withholding tax already paid. For example, if a foreign person provides unsecured interest-bearing loan to a South African resident, withholding tax on interest is paid on interest that accrues to that foreign person monthly on the basis that the interest becomes due and payable monthly. The interest is for the purposes of determining the withholding tax on interest liability therefore deemed to have been paid.

It has come to our attention that based on the nature of the debt and the profile of the lenders, a high level of default on interest payments is experienced, with the result that a large portion of the accrued interest is written-off monthly as irrecoverable. Due to the application of the deeming provisions that deem interest to be paid on the earlier of the date on which the interest is paid or becomes due and payable, interest withholding tax is suffered on interest that has not been paid and will never be paid without there being any mechanism available to the foreign person to obtain relief for the withholding tax suffered. This is in contrast to the more equitable approach in respect of income tax where, if the foreign person had been a taxpayer in South Africa, that foreign person would have paid income tax on accrued interest. However, the foreign person would have been able to claim a deduction in terms of section 11(i) of the Act in respect of any irrecoverable interest.

III. Proposal

In order to provide relief in cases where interest withholding tax is paid on interest that becomes due and payable, but interest is subsequently written-off as irrecoverable, it is proposed that interest that is subject to withholding tax on interest monthly will be interest that accrues to the foreign person in a particular month excluding any interest which becomes irrecoverable in the same month, to the extent that the interest withholding tax was paid in respect of such irrecoverable interest.

IV. Effective date

The proposed amendment will be effective for years of assessment commencing on or after 1 March 2015.

5.5. ADJUSTING THE CALCULATION FOR HIGH TAX EXEMPTION IN RESPECT OF CONTROLLED FOREIGN COMPANIES

[Applicable provisions: Section 9D(2A) of the Act]

I. Background

The 2009 tax legislative amendments introduced the CFC high-tax exemption. The purpose of the exemption is to disregard tainted CFC income, if little or no South African tax was at stake after taking into account the South African tax rebates.

The CFC will qualify for the high-tax exemption if it's net income as an aggregate is subject to foreign tax of at least 75 per cent of the amount of normal tax that would have been imposed had that CFC been fully taxed in South Africa.

The high-tax exemption is based on a calculation of a hypothetical amount of the global level foreign taxes imposed by all foreign spheres of government. The global foreign tax is calculated after disregarding foreign tax carryover and carry-back losses as well as group losses.

II. Reasons for change

Generally, the income tax does not allow foreign tax rebate on notional taxable income. However, in the calculation of the hypothetical amount of foreign taxes some CFCs within a group of companies that are in a loss making position benefit from the high tax exemption. This creates an anomaly because in these circumstances, no foreign tax is actually paid or payable by the CFC.

Example:
Facts

SA Company, Co A owns all the shares in CFC 1, CFC 2 and CFC3 and CFC 4. All these four CFC's are resident in country Y. CFC 1 generates a loss of $ 100, CFC 2 generates a loss of $ 200, CFC 3 generates income of $ 1500 and CFC 4 generates a loss of $ 5000.

Result in Country Y

Country Y has group taxation provisions and the group of companies gets treated as a single entity for tax purposes, which is referred to as a fiscal unity. The result is that the profit of CFC3 will be offset with the losses of the three CFC's resulting in an overall loss of $ 3800. As a result, the fiscal unity does not get to pay any tax in country Y.

Result in South Africa

In terms of SA tax law, the net income of CFC 3 will be translated to a rand amount in order to be imputed into South African resident, Co A's income. The high tax exemption calculation will then be performed in order to establish as to whether the income is exempt from imputation or not. The actual foreign tax imposed in country Y is at a rate of 25%.

The comparison will be as follows:

Net Income of CFC 3 - $1500 x 15 exchange rate = R22 500
Tax deemed to be payable in county Y - R22 500 x 25% = R5 625
SA Tax payable as if the CFC was a SA resident – R22 500 x 28%= 6300
High tax exemption calculation =R5 625/R6 300 = 89%

Because the 89% is more than the 75% the R22 500 will be exempt from imputation.

The anomaly then arises because CFC 3 did not pay any tax in country Y as a result of the overall group loss. However in performing the high tax exemption, a notional tax of R5 625 is calculated as though the CFC paid tax in its country of resident.

In the absence of the high tax exemption no section 6quat tax rebate would have been granted to the controlled foreign company.

III. Proposal

In view of the above, it is proposed that the adjustment for foreign group losses be withdrawn in the determination of foreign tax for high tax exemption purposes.

IV. Effective date

The proposed amendments will come into effect on 1 January 2017

5.6. TAX EXEMPTION OF MULTILATERAL DEVELOPMENT FINANCIAL INSTITUTIONS

[Applicable provisions: New section 10(1)(*bC*) and sections 50A and 50D of the Act]

I. Background

After 1994, South Africa became a signatory to a number of agreements with multilateral development financial institutions. In this context, a multilateral development financial institution refers to a financial institution created by a group of countries that provides financing and professional advice for the purpose of development.

These institutions have large memberships including both developed donor countries and developing borrower countries. They finance projects in the form of long-term loans at market rates, very-long-term loans (also known as credits) below market rates, and through grants.

Multilateral development institutions provide financial assistance to developing countries in order to promote economic and social development. They primarily fund large infrastructure and other development projects and provide loans tied to policy reforms by the government.

In particular, the multilateral development financial institutions which South Africa has signed agreements with include the following; the World Bank, the International Monetary Fund, the African Development Bank, the European Investment Bank, the African Export-Import Bank and the New Development Bank (formerly known as the BRICS Development Bank). The agreements with these institutions provide for blanket exemptions from all taxes, including income tax, withholding taxes on interest and dividends, value added tax and capital gains tax.

Further, these institutions are also granted diplomatic immunity status in terms of the Diplomatic Immunities and Privileges Act 37, 2001 which gives the Minister of International Relations and Cooperation the power to, *inter alia*, grant immunities and privileges to any organisation recognised by the Minister of the International Relations and Cooperation

II. Reasons for change

Currently, section 10(1)(*bA*) of the Act makes provision for exemption from income tax in respect of all receipts or accruals of any institution or body established by a foreign government to the extent that that body or institution is appointed by that government to perform its functions in terms of an official development assistance agreement that is binding in terms of section 231(3) of the Constitution of the Republic of South Africa, 1996 (the Constitution). In addition, such official development assistance agreement must provide that the receipts and accruals of that institution or body are exempt from normal tax. This exemption is also extended to apply to multinational organisations providing foreign donor funding in terms of the official development assistance agreement that is binding in terms of the Constitution.

There is a disconnect between the current tax exemption provisions of the Act and the articles dealing with the tax treatment of these multilateral development financial institutions in the agreements signed by South Africa with these institutions. While these agreements provide for exemption of these multilateral development financial institutions from all taxes, the Act does not have a specific provision enabling the tax exemption of these multilateral developmental financial institutions.

Section 10(1)(*bA*) of the Act does not cover these multilateral development financial institutions because the application of the provisions of section 10(1)(*bA*) of the Act is limited only to institutions or bodies appointed by foreign governments to perform functions of such foreign government in South Africa in terms of an official development assistance agreement or to multinational organisation providing foreign donor funding in South Africa in terms of an official assistance development assistance agreement. On the other hand, the agreements signed by South Africa with these multilateral development financial institutions are not regarded as official development assistance agreements, hence they don’t qualify for tax exemption in terms of the current provisions of section 10(1)(*bA*) of the Act.

The disconnect between the current tax exemption provisions of the Act and the articles dealing with the tax treatment of these multilateral development financial institutions in the agreements signed by South Africa with these institutions also extends to withholding tax on interest, that was introduced on 1 March 2015. According to these agreements, interest paid by South African residents to these multilateral development financial institutions is exempt from withholding tax

on interest; however, the Act does not make specific provision for similar exemption in respect of withholding tax on interest.

III. Proposal

In order to take into account the spirit of these multilateral development financial institution agreements and in order to eliminate any potential confusion regarding the tax exemption status of these multilateral development financial institutions, the following is proposed:

a. the current income tax exemption applicable to institutions or bodies appointed by foreign government to perform functions in South Africa in terms of an official development assistance agreement or to multinational organisations providing foreign donor funding in South Africa in terms of an official assistance development assistance agreement, be extended to apply only to the following multilateral development financial institutions that South Africa has signed agreements with, namely, the World Bank, the International Monetary Fund, the African Development Bank, the European Investment Bank, the African Export-Import Bank and the New Development Bank.

b. In view of the fact that the main aim of these multilateral development financial institutions is to provide finance to specified projects in terms of the agreement signed with South Africa, it is proposed that interest paid by South African residents to the multilateral development financial institutions in terms of the agreement should be exempt from withholding tax on interest. The withholding tax on interest exemption will only apply to the following multilateral developmental financial institutions that South Africa has signed agreements with, namely, the World Bank, the International Monetary Fund, the African Development Bank, the European Investment Bank, the African Export-Import Bank and the New Development Bank.

IV. Effective date

With regard to the proposed amendment in respect of income tax exemption on receipts or accruals of the listed multilateral development financial institutions that South Africa has signed agreements with, it is proposed that the amendment will come into effect on the date of promulgation of the Taxation Laws Amendment Act, 2016.

On the other hand, with regard the proposed amendment in respect of withholding tax on interest exemption in respect of interest paid by South African residents to the listed multilateral development financial institutions that South Africa has signed agreements with, it is proposed that the amendment is deemed to have come into operation on 1 March 2015 and applies in respect of income and/or interest that is paid or becomes due and payable on or after that date.

5.7. CLARIFYING THE NON-APPLICATION OF THE RE-ORGANISATION RULES TO DEFERRED EXCHANGE GAINS AND LOSSES

[Applicable provisions: Sections 24I(10A) and 41(2) of the Act]

I. Background

For income tax purposes, gains and losses in respect of exchange items in foreign currency (i.e. a unit of currency, debt, forward exchange contracts and foreign currency option contracts) are

governed by special rules. These rules annually account for the unrealised gains and losses in respect of exchange items in the income of the taxpayer. However, specific rules exist for the tax treatment of exchange differences arising from exchange items entered into between related parties. Exchange differences in respect of related-company exchange items are not taken into account in the income of the taxpayer on an annual basis. These exchange differences are deferred until the exchange item is realised (i.e. settled).

Since 2001, the Act has catered for the tax-free transfer of assets through the corporate reorganisation rules. The objective of these rules is to facilitate transactions between companies in the same economic unit by ensuring that the transactions inherent in any restructuring occur on a tax neutral basis. This is achieved mainly by allowing for rollover of the gains and losses that typically arise upon the disposal of assets (i.e. normal tax and capital gains tax). In variably, the potential gains and losses from the disposal of assets are not triggered because the provisions seek to put the transferee in the same shoes as the transferor by deeming them to be one and the same person.

II. Reasons for change

The specific rules dealing with exchange differences between related parties envisage that any deferred exchange gains or losses will be recognised in the income of a taxpayer when the exchange item to which they relate is realised. However, it has come to Government's attention that when an exchange item is realised through its transfer using the reorganisation rules, the intended trigger for the recognition of the deferred exchange differences may not be achieved when applying the provisions of the reorganisation rules, which deem the transferor and the transferee to be one and the same person.

It was never intended that the exchange differences between related parties should be deferred through the use of the reorganisation rules. This treatment would be in line with that of accrued or incurred interest in respect of debt instruments that are transferred to a transferee under the reorganisation rules. The accrued and incurred amounts of interest are never rolled-over to the transferee. Similar consequences were intended for exchange differences, irrespective of whether they arise in respect of exchange items between related parties or not.

III. Proposal

It is proposed that the current rules governing deferred exchange gains and losses in respect of exchange items between related parties should not be transferred to transferee companies as a result of the application of the roll-over provisions. This will result in the deferred exchange gains and losses being included in or deducted from the income of the transferor of any exchange item to which they relate on the date that the reorganisation transaction is entered into and the exchange items are realised from the perspective of the transferor.

IV. Effective date

The proposed amendments will come into effect on 1 January 2017 and applies in respect of transactions under Part III of Chapter II of the Act concluded on or after that date

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6. VALUE ADDED TAX

6.1. REVISION OF THE 2014 AMENDMENT RELATING TO NOTIONAL INPUT TAX ON GOODS CONTAINING GOLD

[Applicable provisions: Section 1(1) of the Value-Added Tax Act of 1991 (VAT Act) – proviso (ii) of the definition of "second-hand goods"]

I. Background

In 2014, changes were made in the VAT Act to amend the definition of "*second-hand goods"* to specifically exclude "gold" and "goods containing gold" from the definition and thereby denying the notional input tax credit on these goods. The policy rationale for the 2014 amendments was to curb fraudulent notional input tax deductions on the acquisition of gold and gold jewellery. The amendment was not intended to have a negative impact on legitimate transactions within the second-hand goods industry.

II. Reasons for change

Concerns have been raised that the 2014 amendments have led to unintended consequences whereby the notional input tax credit on all goods containing gold is denied to vendors that are dealers in second-hand goods. The denial applies where those goods which were acquired are sold either exactly as they were acquired or with minor modifications to make them suitable for resale in essentially the same state, irrespective of whether the gold content is substantial or negligible.

At issue is, for example, when a second-hand dealer purchases a computer from a non-vendor, based on the 2014 amendments, the notional input tax credit is denied because some of the components in the computer contain an element of gold. Another example is when a second-hand dealer purchases an expensive watch from a non-vendor, the notional input tax credit is denied because the watch contains a certain amount of gold. There is an argument that the value of the gold content on the above-mentioned items, i.e. computer and watch, are insignificant compared to the intrinsic value of the items itself. The values of the computer and watch are to a large extent based on the mechanism, the design and the make which are the main intentions for trading with these items, and not the presence of a small fraction of gold in these items.

III. Proposal

In order to address the above-mentioned unintended consequences, it is proposed that the 2014 amendments be revised. In this regard it is proposed that, paragraph (ii) of the definition of "second-hand goods" in section 1(1) of the VAT Act be amended to allow the deduction of the notional input tax credit on goods containing gold, provided that the goods are sold in the same or substantially the same state as when those goods were acquired.

IV. Effective date

The proposed amendments will come into effect from 1 April 2017.

6.2. ALLOWING MUNICIPAL ENTITIES TO ACCOUNT FOR VAT ON THE PAYMENT BASIS WHERE THE SUPPLY IS R100 000

[Applicable provision: Section 15(2A) of the VAT Act]

I. Background

The VAT Act makes provision for certain persons, including public authorities and municipalities to register and pay VAT on a payments basis. The provisions of the VAT Act require those vendors who are registered on the payments basis to account for VAT on the invoice basis in respect of any supply where the consideration is R100 000 or more. However, only public authorities and municipalities are allowed to deviate from this rule and account for VAT on the payments basis on supplies where the consideration is R100 000 or more.

II. Reasons for change

Municipal entities (envisaged in section 15(2)(a)(iv) of the VAT Act render services similar to municipalities and are regulated under the Municipal Systems Act and the Municipal Finance Management Act. Therefore, there is no policy rationale not to extend the same dispensation, currently available to public authorities and municipalities, to municipal entities.

III. Proposal

It is therefore proposed that section 15(2A) of the VAT Act be amended to allow municipal entities, referred to in section 15(2)(a)(iv) of the VAT Act, to account for VAT on the payment basis in respect of any supply where the consideration is R100 000 or more.

IV. Effective date

The proposed amendments will come into effect from 1 April 2017.

6.3. VAT EXEMPTION IN RESPECT OF IMPORTED GOODS THAT ARE LOST, DESTROYED OR DAMAGED THROUGH NATURAL DISASTERS

[Applicable provision: Schedule 1 of the VAT Act]

I. Background

In terms of Schedule 4 of the Customs and Excise Act, a taxpayer is exempt from paying customs duty and fuel levy (if applicable) on the importation of goods if those goods are subsequently lost, destroyed or damaged through natural disasters or under such circumstances as the Commissioner deems exceptional.

This relief is applicable to circumstances where the customs duty amount and the fuel levy (if applicable) is not less than R2500 on any single occasion while such goods are in any customs and excise warehouse, in any appointed transit shed, under the control of the Commissioner, being removed with deferment of payment of duty, under rebate of duty from a place in the Republic to any other place in terms of the provisions of the Customs and Excise Act or being stored in any rebate storeroom (subject to certain provisos, including that the goods did not enter into home consumption).

II. Reasons for change

At issue is the fact that the VAT Act does not have an exemption similar to Schedule 4 of the Customs and Excise Act, in respect of goods that are imported, if those goods, after importation and before being entered for home consumption, are lost, destroyed or damaged through natural disasters or under such circumstances as the Commissioner deems exceptional. This creates uncertainty in the interpretation and application of both the provisions of the Customs and Excise and the VAT Acts.

III. Proposal

In order to remove the ambiguity and provide certainty, it is proposed that Schedule 1 of the VAT Act be aligned to Schedule 4 of the Customs and Excise Act by introducing an exemption from the tax imposed in terms of section 7(1)(b) of the VAT Act, where those goods are lost, destroyed or damaged through natural disasters or under such circumstances as the Commissioner deems exceptional, as contemplated in the Customs And Excise Act, provided that such goods have not yet been entered for home consumption.

IV. Effective date

The proposed amendments will come into effect from 1 April 2017.

7. CLAUSE BY CLAUSE

CLAUSE 1

Transfer Duty: Amendment to section 2

Sub-clause (a): The proposed amendment aligns the tax charging provisions of all the tax Acts.

Sub-clause (b): The proposed amendment aligns the tax charging provisions of all the tax Acts.

CLAUSE 2

Estate Duty: Amendment to section 4A

The proposed amendment gives SARS the ability to request additional documentation in support of the unutilised abatement allowance between spouses for purposes of calculating the duitable amount of an estate.

CLAUSE 3

Estate Duty: Amendment to section 11

The proposed amendment is consequential and deletes subparagraph (iA) of paragraph (b). This subparagraph (iA) still makes reference to section 3(3)(a)*bis* which was deleted with effect from 2009.

CLAUSE 4

Estate Duty: Amendment to the First Schedule

Sub-clause (a): The proposed amendment aligns the tax charging provisions of all the tax Acts.

Sub-clause (b): The proposed amendment aligns the tax charging provisions of all the tax Acts.

CLAUSE 5

Income Tax: Amendment to section 1

Sub-clause (a): Definition of paragraph (*b*A) of "connected person" – The proposed amendment deletes the word "includes" in paragraph (*b*A) of the definition of "connected person" as a matter of style and consistency.

Sub-clause (b): Definition paragraph (*c*) of "gross income" – The proposed amendment clarifies that amounts referred to in sections 8B and 8C are specifically excluded in paragraph (*c*) of the definition of "gross income" so as to avoid possible scenario of double taxation.

Sub-clause (c): Definition of paragraph (*e*A) of "gross income" – The proposed amendment is consequential and related to the retirement reforms to include amounts referred to in paragraph

(*d*) of the definition of "pension fund" as well as paragraph (*b*) or (*c*) of the definition of "provident fund" in paragraph (*e*A) the definition of "gross income".

Sub-clause (d): Insertion of new paragraph (*lC*) of the definition of "gross income" – See notes on **CLARIFYING THE TAX TREATMENT OF GOVERNMENT GRANTS**

Sub-clause (e): Definition of "identical share" – See notes on **REVIEW OF TAX IMPLICATIONS ON OUTRIGHT TRANSFER OF COLLATERAL PROVISIONS**

Sub-clause (f): Definition of "pension preservation fund" – The proposed amendment in subparagraph (*i*) of paragraph (*b*) of the proviso to the definition of "pension preservation fund" proposes to standardise reference to the Pension Funds Act in the Income Tax Act.

Sub-clause (g): Definition of "remuneration proxy" – The proposed amendment clarifies that for purposes of definition of remuneration proxy, the cash equivalent value contemplated in paragraph 9(3) of the Seventh Schedule of the Income Tax Act is only excluded in the application of paragraph 9 of the Seventh Schedule.

Sub-clause (h): Definition of "retirement annuity fund" – See notes on **INCLUSION OF EMIGRATION FOR EXCHANGE CONTROL PURPOSES REQUIREMENT FOR OF WITHDRAWAL FROM RETIREMENT FUNDS BY RESIDENTS**

CLAUSE 6

Income Tax: Amendment to section 5

Sub-clause (a): The proposed amendment aligns the tax charging provisions of all the tax Acts.

Sub-clause (b): The proposed amendment is consequential and deletes now obsolete provisions of subsection (7) due to the amendment to align the tax charging provisions of the all tax Acts.

CLAUSE 7

Income Tax: Amendment to section 6

The proposed amendment corrects a grammatical error and changes the word "shall" to "must".

CLAUSE 8

Income Tax: Amendment to section 6A

The proposed amendment seeks to correct the anomaly by aligning the opening wording in subsection (1) dealing with medical tax credit provision with the opening wording in section 6 (1) dealing with normal tax rebates.

CLAUSE 9

Income Tax: Amendment to section 6B

The proposed amendment seeks to correct the anomaly by aligning the wording in subsection (2) dealing with additional medical expenses tax credit provision with the opening wording in section 6 (1) dealing with normal tax rebates.

CLAUSE 10

Income Tax: Amendment to section 6*quat*

Sub-clause (a): The proposed amendment seeks to correct the anomaly by aligning the wording in subsection (1)(f) dealing with rebate or deduction in respect of foreign taxes on income with the opening wording in section 6 (1) dealing with normal tax rebates.

Sub-clause (b): The proposed amendments clarify that amounts deducted in terms of subsection (1C)*(b)* are deducted from income, and any refunds received or amounts discharged for deductions allowed under subsection (1C)*(b)* should not be deemed to be an amount of normal tax payable but must be deemed to be an amount of income recovered or recouped under section 8(4)*(a)*.

CLAUSE 11

Income Tax: Amendment to section 7A

The proposed amendment to the definition of "salary" deletes reference to subsection (4) as this subsection was deleted in 1991.

CLAUSE 12

Income Tax: Insertion of new section 7C

See notes on **INTRODUCING MEASURES TO PREVENT ESTATE DUTY AND DONATIONS TAX AVOIDANCE THROUGH TRANSFER OF ASSETS TO A TRUST USING INTEREST FREE LOANS**

CLAUSE 13

Income Tax: Amendment of section 8C

See notes on **ADDRESSING THE CIRCUMVENTION OF RULES DEALING WITH EMPLOYEE BASED SHARE INCENTIVE SCHEMES**

CLAUSE 14

Income Tax: Insertion of new section 8CA

See notes on **ADDRESSING THE CIRCUMVENTION OF RULES DEALING WITH EMPLOYEE BASED SHARE INCENTIVE SCHEMES**

CLAUSE 15

Income Tax: Amendment of section 8E

Sub-clause (a): Proposed amendment of the definition of “hybrid equity instrument” in subsection (1) - See notes on **ADDRESSING CIRCUMVENTION OF ANTI AVOIDANCE RULES DEALING WITH THIRD PARTY BACKED SHARES**

Sub-clause (b): Proposed insertion of new subsection (2A) - See notes on **REFINEMENT OF THIRD-PARTY BACKED SHARES: PRE-2012 LEGITIMATE TRANSACTIONS**

CLAUSE 16

Income Tax: Amendment of section 8EA

Sub-clause (a): Proposed amendment of the definition of “preference share” in subsection (1) - See notes on **ADDRESSING CIRCUMVENTION OF ANTI AVOIDANCE RULES DEALING WITH THIRD PARTY BACKED SHARES**

Sub-clause (b): Proposed insertion of new subsection (2A) - See notes on **REFINEMENT OF THIRD-PARTY BACKED SHARES: PRE-2012 LEGITIMATE TRANSACTIONS**

CLAUSE 17

Income Tax: Amendment of section 8F

Sub-clause (a): Proposed amendment of the definition of “hybrid debt instrument” in subsection (1) - See notes on **HYBRID DEBT INSTRUMENTS SUBJECT TO SUBORDINATION AGREEMENTS**

Sub-clause (b): Proposed amendment of the definition of “instrument” in subsection (1) - See notes on **CROSS-BORDER HYBRID DEBT INSTRUMENTS**

Sub-clause (c): Proposed insertion of the definition of “third-party backed instrument” in subsection (1) - The definition of third party backed instrument is inserted to align the proposed exclusion of third party backed shares from the re-characterisation rule in sections 8F and 8FA.

Sub-clause (d): Proposed amendment to subsection (2) - See notes on **HYBRID DEBT INSTRUMENTS SUBJECT TO SUBORDINATION AGREEMENTS**

Sub-clause (e): Proposed amendments to subsections (3)(c)(i) & (ii) correct referencing to the Short-term Insurance Act and Long-term Insurance Act..

Sub-clause (f) Proposed insertion of new subsection (3)(e) – The proposed amendment excludes third party backed instrument from the application of this section to ensure that the re-characterisation rule available in section 8EA that re-characterises dividends to income applies to instruments that meet the definition of third party backed instruments, despite any attempt by a taxpayer to avoid such characterisation by using the provisions of section 8F to retain dividends treatment for the yield of third party backed instruments as a result of the re-characterisation rule of section 8F that re-characterises interest into dividend in specie.

CLAUSE 18

Income Tax: Amendment of section 8FA

Sub-clause (a): Proposed amendment of the definition of "instrument" in subsection (1) - See notes on **CROSS-BORDER HYBRID DEBT INSTRUMENTS**

Sub-clause (b): Proposed amendments to subsections (3)(c)(i) & (ii) correct referencing to the Short-term Insurance Act and Long-term Insurance Act.

Sub-clause (c): Proposed insertion of new subsection (3)(e) – The proposed amendment excludes interest owed in respect of third party backed instrument from the application of this section to ensure that the re-characterisation rule available in section 8EA that re-characterises dividends to income applies to instruments that meet the definition of third party backed instruments, despite any attempt by a taxpayer to avoid such characterisation by using the provisions of section 8FA to retain dividends treatment for the yield of third party backed instruments as a result of the re-characterisation rule of section 8FA that re-characterises interest into dividend in specie.

CLAUSE 19

Income Tax: Amendment of section 9

Proposed amendment to subsection (2)(i) and (3) - See notes on **CLARIFYING SOURCE RULES FOR RETIREMENT ANNUITY FUNDS**

CLAUSE 20

Income Tax: Amendment of section 9C

Proposed amendment to the proviso in subsection (5) - See notes on **INTERACTION BETWEEN REITS AND SECTION 9C**

CLAUSE 21

Income Tax: Amendment of section 9D

Sub-clause (a): Proposed amendment to the proviso in subsection (2) - See notes on **EXEMPTION OF COLLECTIVE INVESTMENT SCHEMES IN SECURITIES FROM CONTROLLED FOREIGN COMPANIES RULES**

Sub-clause (b): Proposed amendment to the further proviso of paragraph (ii)(bb) of subsection (2A): See notes on **ADJUSTING THE CALCULATION FOR HIGH TAX EXEMPTION IN RESPECT OF CONTROLLED FOREIGN COMPANIES**

Sub-clause (c) Proposed deletion of subparagraph (iii) of subsection (9)(d) - See notes on **REPEAL OF THE WITHHOLDING TAX ON SERVICE FEES REGIME**

CLAUSE 22

Income Tax: Amendment of section 9H

Proposed amendments in section subsection(3)(c) and (d) remove the incorrect cross references to paragraphs *(a)*(i) and *(a)*(ii) and change them to paragraphs *(a)* and *(b)*.

CLAUSE 23

Income Tax: Amendment of section 9HA

The proposed amendments in subsection (2)(a) and (2)(b)(i)&(ii) are consequential as a result of the introduction of new section 9HA in the Income Tax Act in 2015 and clarify the tax consequences for the surviving spouse regarding allowable deductions and allowances in respect of those assets (e.g. deductions and allowances in respect of mining, farming and forestry assets) as well as the subsequent capturing of any recoupments in the hands of the surviving spouse.

CLAUSE 24

Income Tax: Amendment of section 10

Sub-clause (a): Proposed insertion of new subsection (1)(bB) - See notes on **TAX EXEMPTION OF MULTILATERAL DEVELOPMENT FINANCIAL INSTITUTIONS**

Sub-clause (b): Proposed amendment to subsection (1)(gC) - See notes on **DISALLOWING THE EXEMPTION FOR A LUMP SUM, PENSION OR ANNUITY FROM A RETIREMENT FUND THAT IS LOCATED WITHIN THE REPUBLIC**

Sub-clause (c): Proposed deletion of subsection (1)(hB) - See notes on **REPEAL OF THE WITHOLDING TAX ON SERVICE FEES REGIME**

Sub-clause (d): Proposed deletion of subsection (1)(k)(i) proviso of paragraph (dd) - See notes on **ADDRESSING THE CIRCUMVENTION OF THE RULES DEALING WITH EMPLOYEE BASED SHARE INCENTIVE SCHEMES**

Sub-clause (e): Proposed amendment of subsection (1)(k)(i) proviso of paragraph (ii) - See notes on **ADDRESSING THE CIRCUMVENTION OF THE RULES DEALING WITH EMPLOYEE BASED SHARE INCENTIVE SCHEMES**

Sub-clause (f): Proposed amendment to subsection (1)(q)in paragraph (ii) of the proviso for subparagraph (aa) - See notes on **INCREASE ON THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES**

Sub-clause (g): Proposed amendment to subsection (1)(q) in paragraph (ii)(bb)(A) of the proviso - See notes on **INCREASE ON THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES**

Sub-clause (h): Proposed amendment to subsection (1)(q) in paragraph (ii)(bb)(B) of the proviso - See notes on **INCREASE ON THRESHOLDS FOR EXEMPTION OF EMPLOYER PROVIDED BURSARIES**

Sub-clause (i): Proposed insertion on new subsection (1)(t)(xvii) - See notes on **TAX EXEMPTION OF NATIONAL HOUSING FINANCE CORPORATION**

CLAUSE 25

Income Tax: Amendment of section 10A

The proposed amendment in paragraph (c) of subsection (7) is a consequential amendment as a result of the removal of the Commissioner’s discretion in order to support self-assessment for Income Tax.

CLAUSE 26

Income Tax: Amendment of section 10B

The proposed amendment to section 10B(5) clarifies that all amounts paid out of all types of previously exempt foreign dividends and amounts paid out in the form of annuity do not qualify for a foreign dividend exemption.

CLAUSE 27

Income Tax: Amendment of section 11

Sub-clause (a): Proposed insertion of new paragraph (iA) - See notes on **EXTENDING THE BAD DEBT DEDUCTION RULE TO EXCHANGE DIFFERENCES ARISING ON FOREIGN CURRENCY DENOMINATED LOAN**

Sub-clause (b): Proposed amendment in the proviso to paragraph (k) in subparagraph (aa) in paragraph (i)(bb) (B) seeks to correct the ordering rule for calculating allowable deductions in the determination of taxable income and provides that the allowable deduction in terms of section 11(k) be determined before the allowable deduction in terms of section 18A.

Sub-clause (c): Proposed insertion of new paragraph (v) to the proviso to paragraph (k) - See notes on **RETIREMENT FUND CONTRIBUTION DEDUCTION AGAINST PASSIVE INCOME**

CLAUSE 28

Income Tax: Amendment of section 11D

Proposed insertion of new subsection 20 - See notes on **PROVISION FOR EXCEPTION TO THE RESEARCH AND DEVELOPMENT (R&D) INCENTIVE PRESCRIPTION RULES**

CLAUSE 29

Income Tax: Amendment of section 12B

The proposed amendment to paragraph (c) in subsection 2 deletes an obsolete provision.

CLAUSE 30

Income Tax: Amendment of section 12E

Proposed amendment of the definition of "small business corporation" in subsection 4 - See notes on **EXTENDING THE SMALL BUSINESS CORPORATION REGIME TO PERSONAL LIABILITY COMPANIES**

CLAUSE 31

Income Tax: Amendment of section 12I

See notes on **ADDRESSING POSSIBLE ADMINISTRATIVE AND TECHNICAL ISSUES IN RESPECT OF INDUSTRIAL POLICY PROJECTS IN SECTION 12I**

CLAUSE 32

Income Tax: Amendment of section 12J

Proposed amendment to subsection (3A) - See notes on **REFINING THE ENABLING VENTURE CAPITAL REGIME FOR START-UP VENTURE CAPITAL COMPANIES**

CLAUSE 33

Income Tax: Amendment of section 12P

Sub-clause (a): The proposed amendment to the definition of "government grant" in subsection (1) inserts the word "local" to ensure that grants from all spheres of government in the Republic are considered for the section.

Sub-clause (b): Proposed amendment to subsection (2A)(b) deletes superfluous wording.

CLAUSE 34

Income Tax: Amendment of section 12R

See notes on **CLARIFYING THE TAX RATE APPLICABLE TO SMALL BUSINESS CORPORATIONS LOCATED IN SPECIAL ECONOMIC ZONES**

CLAUSE 35

Income Tax: Amendment of section 12S

Sub-clause (a): Proposed amendment to subsection (1) - See notes on **CLARIFYING THE TAX RATE APPLICABLE TO SMALL BUSINESS CORPORATIONS LOCATED IN SPECIAL ECONOMIC ZONES**

Sub-clause (b): Proposed amendment to section (8) – The proposed amendment corrects referencing to ensure that subsection (8) refers to the provisions related to Assessments in Chapter 8 and not Confidentiality of Information provisions in Chapter 6 of the Tax Administration Act.

CLAUSE 36

Income Tax: Insertion of new section 12U

See notes on **ACCELARATED CAPITAL ALLOWANCE IN RESPECT OF SUPPORTING INFRASTRUCTURE USED IN PRODUCING RENEWABLE ENERGY**

CLAUSE 37

Income Tax: Amendment of section 13

The proposed amendment in subsection (1)(f) removes reference to the Commissioner's discretion in order to support self-assessment for Income Tax.

CLAUSE 38

Income Tax: Amendment of section 13*quat*

See notes on **URBAN DEVELOPMENT ZONES (UDZ) – ALLOWING ADDITIONAL MUNICIPALITIES TO APPLY FOR THE UDZ TAX INCENTIVE**

CLAUSE 39

Income Tax: Amendment Insertion of section 20

The proposed amendments in subsections (1)(a), (1)(b) and (2A) replaces the word "taxpayer" with the word "person" as a matter of style consistency.

CLAUSE 40

Income Tax: Amendment of section 22

Sub-clause (a): The proposed amendment in subsection (8)(b)(ii) is consequential as a result of the introduction of new section 9HA in the Income Tax Act in 2015 and clarify the tax consequences for the surviving spouse regarding allowable deductions and allowances in respect of those assets (e.g. deductions and allowances in respect of mining, farming and forestry assets) as well as the subsequent capturing of any recoupments in the hands of the surviving spouse.

Sub-clause (b): Amendment of subsection 9(c) and (d) - See notes on **REFINING THE TAX IMPLICATIONS ON OUTRIGHT TRANSFER OF COLLATERAL PROVISIONS**

CLAUSE 41

Income Tax: Amendment of section 23M

The proposed amendment to the heading of section 23M addresses the concern that many taxpayers may not be subject to tax by virtue of treaty protection and treaty relief falling outside Chapter II.

CLAUSE 42

Income Tax: Amendment of section 23N

The proposed insertion of new subsection (5) seeks to clarify that the provision of section 23N do not apply to interests accrued to REITS, long term insurer, pension fund, provident fund or short term insurer if they meet the stipulated requirements in this subsection.

CLAUSE 43

Income Tax: Amendment section 23O

Sub-clause (a): The proposed insertion of the definition of "base cost" in subsection (1) for purposes of section 23O to mean a base cost as defined for capital gains tax purposes in the Act. .

Sub-clause (b): The proposed insertion of new subsection (5) to prevent a double reduction of tax attributes in respect of expenditure funded using exempt funding from small business funding entities.

CLAUSE 44

Income Tax: Amendment of section 24J

The proposed amendment in paragraph (a) of the definition of "interest" in subsection (1) replaces the word "related" with the word "similar" to clarifies the policy position that this applies to finance charges of the same kind or nature.

CLAUSE 45

Income Tax: Amendment of section 24JB

The proposed amendment in paragraph (a) of the definition of "covered person" in subsection (1) clarify the policy position that the provisions of section 24JB apply only at financial service providers as defined and does not apply to entities conducting treasury operations.

CLAUSE 46

Income Tax: Amendment of section 25

The proposed amendment in subsections (2)(a) and (4) are consequential as a result of the introduction of new section 9HA in the Income Tax Act in 2015 and clarify the tax consequences for the surviving spouse regarding allowable deductions and allowances in respect of those assets (e.g. deductions and allowances in respect of mining, farming and forestry assets) as well as the subsequent capturing of any recoupments in the hands of the surviving spouse.

CLAUSE 47

Income Tax: Amendment of section 25BB

Sub-clause (a): Proposed amendment to the definition of "qualifying distribution" in subsection (10) corrects punctuation.

Sub-clause (b): Proposed insertion of new paragraph *(e)* in the definition of "rental income" in subsection (1) - See notes on **TAX TREATMENT OF REITS - QUALIFYING DISTRIBUTION RULE**

Sub-clause (c): The proposed amendment in subsection (2A) for the words following paragraph (a)(ii) inserts the word "on income" to remove ambiguity and clarify the provision of this paragraph.

Sub-clause (d): The proposed amendment in subsection (2A)(b) clarify that the deduction of foreign tax under paragraph (a) should be limited to the amount of normal tax that is attributable to the interest of the REIT or controlled company. In essence no deduction of foreign withholding tax paid should be allowed if the amounts from which it is withheld are exempt from normal tax.
Sub-clause (e): The proposed amendment to subsection (6)*(a)* deletes the word "company" as a matter of style and consistency

Sub-clause (f): The proposed amendment to subsection (6)*(c)*(i) inserts the words "that is a resident" to remove ambiguity and clarify that the controlled company should be a resident in this regard.

CLAUSE 48

Income Tax: Amendment of section 29A
Sub-clause (a): Proposed amendment to the definition of "adjusted IFRS value" in subsection (1) - See notes on **AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERES DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK**

Sub-clause (b): Proposed amendment to the definition of "value of liabilities" in subsection (1) - See notes on **AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERES DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK**

Sub-clause (c): Proposed amendment to the proviso to subsection (11)(a)(iii) - In cases where the income is not sufficient in the policyholder fund, the transfer deduction relief will not be allowed. However, the policyholder fund is still in a taxable income position and has to pay additional tax. This adverse result, stems from the current wording of section 29A (11)*(a)*(iii) referring to income as opposed to taxable income. It is proposed that the wording of section 29A(11)*(a)*(iii) limit the deduction to taxable income in the policyholder funds as opposed to income.

Sub-clause (d): Proposed amendment to subsection (11)(h) - The application of mark-to-market taxation (section 29B) in respect of long-term insurers to real estate assets and other assets was intended not to trigger recoupment of prior depreciation allowances when long-term insurers immediately recognise all unrealised gains and losses arising before the 1 March 2012 effective

date in respect of policyholder funds (i.e. untaxed policyholder fund, individual policyholder fund and company policyholder fund). More-over, going forward, depreciation allowances for real estate assets and other assets were not allowed in respect of years of assessment commencing on or after 1 January 2013.

As stated above that the mark-to-market taxation provisions only apply to assets held by the insurer with respect to policyholder funds and not corporate fund. However, the specific rules for determination of the taxable income derived by an insurer in respect of the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund are confined in section 29A(11). Therefore, section 29A(11)*(h)* which disallow any deduction by way of an allowance in respect of an asset as defined in the Eighth Schedule inversely affect the corporate fund and the risk policy fund. It is proposed that the provision of section 29A(11)*(h)* of the Act exclude assets allocated and held in the corporate fund or risk policy fund of an insurer.

Sub-clause (e): The proposed amendment to subsection (12) clarifies that in the "build-up" of the assets allocated to the policyholder funds and risk policy fund payments must also be allocated to the funds. This means a Balance Sheet Approach must be followed in order to comply with the requirements of section 29A(4), (6), (7) and (12) and the definition of "value of liabilities", signifying a shift from the practice of calculating the market value of assets using the Statutory Income Statement as a starting point.

Sub-clause (f): The proposed amendment to subsection (13B)(d)(ii) for the words preceding item (aa) deletes the word "that" as a matter of style and consistency.

Sub-clause (g): Proposed insertion of new subsection (14) - See notes on **AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG-TERM INSURERES DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK**

CLAUSE 49

Income Tax: Amendment of section 30

Sub-clause (a): The proposed amendment to subsection (3)*(f)* corrects a grammatical error and changes the words "it has" to "those funds have".

Sub-clause (b): Proposed insertion of new item (dd) in subsection (3)(b)(iii) - See notes on **TAX EXEMPTION OF NATIONAL HOUSING FINANCE CORPORATION**

CLAUSE 50

Income Tax: Amendment of section 36

Sub-clause (a): Proposed insertion of new paragraph *(eA)* to the definition of "capital expenditure" in subsection (11) - See notes on **PROVIDING TAX RELIEF FOR MINING COMPANIES SPENDING ON INFRASTRUCTURE FOR THE BENEFIT OF MINING COMMUNITIES**

Sub-clause (b): Proposed insertion of definition of "social and labour plan" in subsection (11) - See notes on **PROVIDING TAX RELIEF FOR MINING COMPANIES SPENDING ON INFRASTRUCTURE FOR THE BENEFIT OF MINING COMMUNITIES**

CLAUSE 51

Income Tax: Amendment of section 37D

Sub-clause (a): The proposed amendment to subsection (2) corrects the alignment of this provision so that it applies to all the subparagraphs of paragraph *(b)*.

Sub-clause (b): The proposed amendment to subsection (2)(b)(iv) of the formula updates the percentages to reflect changes made to the capital gains inclusion rate effective 01 March 2016.

CLAUSE 52

Income Tax: Amendment of section 41

Sub-clause (a): The proposed amendment in subsection (1) deletes the definition of "hold" which was linked the concept of shareholder which was removed from the Income Tax Act in 2014 following the introduction of the new Companies Act.

Sub-clause (b): Proposed amendments to subsection (2) - See notes on **CLARIFYING THE NON-APPLICATION OF THE RE-ORGANISATION RULES TO DEFERRED EXCHANGE GAINS AND LOSSES**

CLAUSE 53

Income Tax: Amendment of section 42

Proposed amendment to paragraph *(a)*(i)*(bb)*(B) of the definition of "asset-for-share transaction" in subsection (1) - See notes on **ASSET-FOR-SHARE TRANSACTIONS FOR NATURAL PERSONS EMPLOYED BY A COMPANY**

CLAUSE 54

Income Tax: Amendment of section 44

The proposed amendment to paragraph *(c)*(i) of the definition of "amalgamation transaction" in subsection (1) corrects an oversight in the 2014 changes to the Act that expended on the assets an amalgamated company is allowed to retain when disposing of its assets as part of an amalgamation transaction. Amalgamated companies are required to dispose of all their assets in anticipation for their termination following the amalgamation transaction but are allowed to retain assets to settle any debts incurred by it in the ordinary course of its trade and, as part of the 2014 changes, assets required.

CLAUSE 55

Income Tax: Amendment of section 50D

Proposed insertion of new paragraph (d) in subsection (1) - See notes on **TAX EXEMPTION OF MULTILATERAL DEVELOPMENT FINANCIAL INSTITUTIONS**

CLAUSE 56

Income Tax: Amendment of section 50E

The proposed amendment to subsection (2)*(b)* inserts the words 'an agreement for the prevention of double taxation" in order to allow exemption granted in terms of the tax treaty from the payment of withholding tax on interest.

CLAUSE 57

Income Tax: Amendment of section 50F

Sub-clause (a): The proposed amendments to subsection (1) insert a requirement that a foreign person liable for any amount of withholding tax on interest must pay that amount of withholding tax and also submit a return in respect of such payment.

Sub-clause (b): The proposed insertion of new subsection (3) makes a requirement for a withholding agent or any person who pays withholding tax on interest in respect of interest that is due and payable, but not yet paid to submit a return.

CLAUSE 58

Income Tax: Amendment of section 50G

See note on **INTEREST WITHHOLDING TAX WHERE INTEREST IS WRITTEN-OFF**

CLAUSE 59

Income Tax: Repeal of Part IVC of Chapter II of Act 58 of 1962

See notes on **REPEAL OF THE WITHHOLDING TAX ON SERVICE FEES REGIME**

CLAUSE 60

Income Tax: Amendment of section 56

Proposed amendment to subparagraphs (i) and (ii) of subsection (1)*(o)* - See notes on **TAX TREATMENT OF LAND DONATED UNDER LAND-REFORM INITIATIVES**

CLAUSE 61

Income Tax: Amendment of paragraph 1 of the Second Schedule

The proposed amendment to the definition of "public sector fund" in paragraph 1 is a consequential amendment related to the retirement reforms to include in the definition of "public sector fund" funds referred to in paragraph (d) of the definition of "pension fund" as well as paragraph (b) or (c) of the definition of "provident fund".

CLAUSE 62

Income Tax: Amendment of paragraph 4 of the Second Schedule

The proposed amendment to paragraph 4(3) replaces the word "person" with the word" fund" to clarifies that the application must be made by a fund not an individual, as it is a fund that applies for a directive.

CLAUSE 63

Income Tax: Amendment of paragraph 1 of the Sixth Schedule

The proposed amendment to paragraph *(b)* in the definition of "qualifying turnover" is consequential to the introduction of the small business funding entity regime in 2014. This amendment ensures that amounts received by a micro business from a small business funding entity do not inflate the turnover of the micro business beyond the R1 million threshold and disqualify it from benefitting from the micro business regime.

CLAUSE 64

Income Tax: Amendment of paragraph 7 of the Sixth Schedule

The proposed amendment to subparagraph *(b)* is consequential to the introduction of the small business funding entity regime in 2014. This amendment ensures that amounts received by a micro business from a small business funding entity do not inflate the turnover of the micro business beyond the R1 million threshold and disqualify it from benefitting from the micro business regime.

CLAUSE 65

Income Tax: Insertion of paragraph 2A of the Seventh Schedule

The proposed insertion of new paragraph 2A of the Seventh Schedule provides clarity that for purposes of the application of fringe benefit tax, a partner is deemed to be an employee of a partnership.

CLAUSE 66

Income Tax: Amendment of paragraph 7(4) for the words preceding paragraph *(a)* of the Seventh Schedule

The proposed amendment to paragraph 7(4) of the Seventh Schedule clarifies the meaning of definition of the term "private travel" so as to remove ambiguity.

CLAUSE 67

Income Tax: Amendment of paragraph 9 of the Seventh Schedule

Sub-clause (a): The proposed amendment to subparagraph (2) includes reference to subparagraph 3C for purpose of determination of the cash equivalent of the value of taxable benefit derived from the occupation of the residential accommodation.

Sub-clause (b): The proposed amendment to subparagraph (5) corrects the reference to subparagraph (3) instead of subparagraph (3)(a) and ensures gender neutrality in the wording of the provision.

CLAUSE 68

Income Tax: Amendment of paragraph 12D of the Seventh Schedule

Sub-clause (a): Proposed amendment to paragraph *(a)* of the definition "retirement funding income" in subparagraph (1): - See notes on **USING THE CORRECT DEFINITION OF INCOME FOR THE FORMULA TO DETERMINE THE FRINGE BENEFIT FOR DEFINED BENEFIT CONTRIBUTIONS AND ELIMINATING A POTENTIAL LOOPHOLE**

Sub-clause (b): Proposed amendment to paragraph *(a)* of the definition "retirement funding income" in subparagraph (1) - See notes on **USING THE CORRECT DEFINITION OF INCOME FOR THE FORMULA TO DETERMINE THE FRINGE BENEFIT FOR DEFINED BENEFIT CONTRIBUTIONS AND ELIMINATING A POTENTIAL LOOPHOLE**

CLAUSE 69

Income Tax: Amendment of paragraph 11 of the Eighth Schedule

Proposed amendment to subparagraph (2)*(n)* - See notes on **REVIEW OF TAX IMPLICATIONS ON OUTRIGHT TRANSFER OF COLLATE**

CLAUSE 70

Income Tax: Amendment of paragraph 38 of the Eighth Schedule

The proposed insertion of new subparagraph (2)*(f)* aims to prevent a double taxation problem that exists between section 37D and the Eighth Schedule. Section 37D grants a person an allowance of 4% a year over 25 years for land declared as a nature reserve but this deduction is reduced by the taxable capital gain that would have arisen at the time of donation. Thus in effect SARS is recovering the taxable capital gain over 25 years. The problem that arises is that the granting of the rights to the government for 99 years is an actual disposal under paragraph 11 and the proceeds would be determined under paragraph 38 by virtue of the donation.

CLAUSE 71

Income Tax: Amendment of paragraph 43 of the Eighth Schedule

The proposed amendment in subparagraph (5)(b) is consequential as a result of the introduction of new section 9HA in the Income Tax Act in 2015 and clarify the tax consequences for the surviving spouse regarding allowable deductions and allowances in respect of those assets (e.g. deductions and allowances in respect of mining, farming and forestry assets) as well as the subsequent capturing of any recoupments in the hands of the surviving spouse.

CLAUSE 72

Income Tax: Amendment of paragraph 47 of the Eighth Schedule

The proposed amendment to words following subparagraph *(b)* clarifies that the amount of R2 million (primary residence exclusion) is not apportioned and it is the capital gain or loss that should be apportioned.

CLAUSE 73

Income Tax: Amendment of paragraph 49 of the Eighth Schedule

The proposed amendment to words following subparagraph *(b)* clarifies that the amount of R2 million (primary residence exclusion) is not apportioned and it is the capital gain or loss that should be apportioned.

CLAUSE 74

Income Tax: Amendment of paragraph 50 of the Eighth Schedule

The proposed amendment to subparagraph *(b)* replaces the word “beneficiary” with the word “special trust” to clarify that the special trust owns the property not the beneficiary.

CLAUSE 75

Income Tax: Amendment of paragraph 64A of the Eighth Schedule

See notes on **TAX TREATMENT OF LAND DONATED UNDER LAND-REFORM INITIATIVES**

CLAUSE 76

Income Tax: Insertion of new paragraph 64D of the Eighth Schedule

See notes on **TAX TREATMENT OF LAND DONATED UNDER LAND-REFORM INITIATIVES**

CLAUSE 77

Income Tax: Amendment of paragraph 66 of the Eighth Schedule

The proposed amendment to subparagraph (1)*(d)* corrects a cross-reference to the source rules in section 9 by inserting a reference to section 9(2)(j). It ensures that immovable property situated in South Africa or any interest or right of whatever nature to or in such property contemplated in paragraph 2 of the Eighth Schedule will qualify as a replacement asset.

CLAUSE 78

Income Tax: Amendment of paragraph 76B of the Eighth Schedule

The proposed addition of the proviso to subparagraph (1) ensures that the market value rule works properly as current legislation did not take into account that shares trade *ex div* during the five business days preceding the record date. The amendment now ensures that the ruling price of that share at the close of business on the record date increases by the value of the distribution.

CLAUSE 79

Income Tax: Amendments of paragraph 4 of Part I of the Ninth Schedule

Sub-clause (a):

The proposed amendment to subparagraph *(c)* replaces the words “adult basic education and training” with “adult education and training”, which is a correct referencing used in Higher Education and Training Laws Amendment Act, 2010.

The proposed amendment to subparagraph *(d)* replaces the word “further” with “continuing”, which is a correct referencing used in Further Education and Training Colleges Amendment Act, 2013.

Sub-clause (b): Proposed insertion of new subparagraphs (p) and (q) - See notes on **TAX EXEMPTION OF PUBLIC BENEFIT ORGANISATIONS PROVIDING INDUSTRY BASED EDUCATION AND TRAINING ACTIVITIES**

CLAUSE 80

Customs and Excise Act: Insertion of new section 119B

The proposed insertion of new section 119B introduces a general anti-avoidance provision to the customs and excise legislative framework in order to enhance, facilitate and coordinate enforcement and compliance efforts for customs duties and excise taxation. This anti avoidance provision is in line with similar provisions in other indirect taxes, for example section 73 of the VAT Act.

CLAUSE 81

Customs and Excise Act: Amendment to certain Schedules

The proposed amendments make provision for the continuation of certain amendments of Schedules to the Customs and Excise Act.

CLAUSE 82

Value-Added Tax Act: Amendment to Section 1

Sub-clause (a): The proposed amendment to subparagraph (ix) of the definition of "enterprise" in subsection (1) corrects punctuation.

Sub-clause (b): Proposed amendment to subparagraph (ii) of the definition of "second-hand goods" in subsection (1) _ See notes on **REVISION OF THE 2014 AMENDMENT RELATING TO NOTIONAL INPUT TAX ON GOODS CONTAINING GOLD**

CLAUSE 83

Value-Added Tax Act: Amendment to 7

The proposed amendment align the tax charging provisions of all the tax Acts.

CLAUSE 84

Value-Added Tax Act: Amendment to Section 15

Proposed amendment to subsection (2A) - See notes on **ALLOWING MUNICIPAL ENTITIES TO ACCOUNT FOR VAT ON THE PAYMENT BASIS WHERE THE SUPPLY IS R100 000 OR MORE**

CLAUSE 85

Value-Added Tax Act: Repeal of Section 77

The proposed I amendment is consequential and deletes now obsolete provisions of section 77 due to the amendments made in section 7 aligning tax charging provisions of the all tax Acts.

CLAUSE 86

Value Added Tax Act: Amendment of Schedule 1

Proposed insertion of new item 412.09 Goods Lost, Destroyed or Damaged - See notes on **VAT EXEMPTION IN RESPECT OF IMPORTED GOODS THAT ARE LOST, DESTROYED OR DAMAGED THROUGH NATURAL DISASTERS**

CLAUSE 87

Skills Development Levies Act: Amendment to Section 3

The proposed amendment aligns the tax charging provisions of all the tax Acts.

CLAUSE 88

Unemployment Insurance Contributions Act: Amendment to Section 6

The proposed amendment aligns the tax charging provisions of all the tax Acts.

CLAUSE 89

Securities Transfer Tax Act: Proposed amendment to definition of “collateral arrangement” in subsection (1)

See notes on **REFINING THE TAX IMPLICATIONS ON OUTRIGHT TRANSFER OF COLLATERAL PROVISIONS**

CLAUSE 90

Securities Transfer Tax Act: Amendments to sections 2 and 3

The proposed amendments align the tax charging provisions of all the tax Acts.

CLAUSE 91

Mineral and Petroleum Resources Royalty Act: Amendments to section 2 and 3

The proposed amendments align the tax charging provisions of all the tax Acts.

CLAUSE 92

Taxation Laws Amendment Act, 2013: Amendment to section 13

The proposed amendment postpones the effective date for sections 8F(3)(b)(ii) and 8F(3)(c)(ii) from 1 January 2017 to 1 January 2018.

CLAUSE 93

Taxation Laws Amendment Act, 2013: Amendment to section 15

The proposed amendment postpones the effective date for section 8FA(3)(b)(ii) and 8FA(3)(c)(ii) from 1 January 2017 to 1 January 2018.

CLAUSE 94

Taxation Laws Amendment Act, 2013: Amendment to section 62

The proposed amendment postpones the effective date of the amendments made to section 23M from 1 January 2017 to 1 January 2018.

CLAUSE 95

Taxation Laws Amendment Act, 2014: Amendment to section 47

Proposed amendment deletes paragraph (a) of the definition of "Adjusted IFRS value in subsection (1) and reference to paragraph (a) in subsection (2) – see notes on **AMENDMENTS TO THE TAX VALUATION METHOD FOR LONG TERM INSURERS DUE TO THE INTRODUCTION OF SOLVENCY ASSESSMENT AND MANAGEMENT FRAMEWORK**

CLAUSE 96

Taxation Laws Amendment Act, 2015: Amendment to section 63

The proposed amendment clarifies that the effective date dealing with changes in respect of the transitional tax issues resulting from the regulation of hedge funds is 1 January 2016 and applies in respect of years of assessment ending on or after that date.

The proposed amendment clarifies that the effective date dealing with changes in respect of debtor's allowance relating to trade debts is 1 April 2015.

CLAUSE 97

Taxation Laws Amendment Act, 2015: Amendment to section 103

The proposed amendment clarifies that the effective date for this provision applies in respect of any asset reacquired as a result of the cancellation or termination of an agreement during any year of assessment commencing on or after that date.

CLAUSE 98

Taxation Laws Amendment Act, 2015: Amendment to section 104

The proposed amendment clarifies that the effective date for this provision applies in respect of any asset reacquired as a result of the cancellation or termination of an agreement during any year of assessment commencing on or after that date.

CLAUSE 99

Taxation Laws Amendment Act, 2015: Amendment to section 108

The proposed amendment clarifies that the effective date for this provision applies in respect of any asset reacquired as a result of the cancellation or termination of an agreement during any year of assessment commencing on or after that date.

CLAUSE 100

Taxation Laws Amendment Act, 2015: Amendment to section 128

The proposed amendment corrects the effective date in respect of consequential amendments to the definitions of "connected persons" in paragraph (b) and "shareholder" in paragraph (h) of subsection (1) of the VAT Act from 1 April 2016 to 1 April 2012 (which is the date in which the definition of shareholder was removed from the Income Tax Act).

CLAUSE 101

Short title and commencement