12 September 2018

Draft Response Document on Taxation Laws Amendment Bill, 2018 and Tax Administration Laws Amendment Bill, 2018

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

NATIONAL TREASURY

SARS

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1. BACKGROUND

1.1. PROCESS AND PUBLIC COMMENTS

Subsequent to the tax pronouncements made by the Minister of Finance (the Minister) as part of the 2018 Budget announcements on 21 February 2018, draft tax bills were published to give effect to the tax proposals announced in the Budget.

The draft tax bills are split into two separate categories. These include the money bills in terms of section 77 of the Constitution dealing with national taxes, levies, duties and surcharges – the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (the Draft Rates Bill) and the Draft Taxation Laws Amendment Bill (the Draft 2018 TLAB)) and an ordinary bill in terms of section 75 of the Constitution, dealing with tax administration issues – the Draft Tax Administration Laws Amendment Bill (the Draft 2018 TALAB).

The Draft Rates Bill was first released for public comment on the same day as the Budget (21 February 2018) and contains the increase in the VAT rate from 14 per cent to 15 per cent, monetary adjustments to the personal income tax tables, customs and excise duties and other tax instruments that were announced in Budget 2018. The National Treasury and SARS briefed the Standing Committee on Finance (SCoF) on the Draft Rates Bill on 25 April 2018. Public comments to the SCoF were presented at hearings that were held on 25 April 2018. Following the report of the SCoF and the Select Committee on Finance (compiled after public hearings) and the statement issued by the Cabinet on 28 February 2018, the Minister of Finance, through the Davis Tax Committee, appointed an independent panel of experts (the Panel) on 25 April 2018 to consider and review the list of zero rated food items. The deadline for the Panel to deliver the final report (Report) to the Minister of Finance was 31 July 2018. On 10 May 2018, the Panel invited the public to make written submissions for consideration. The deadline for public submissions was 1 June 2018. On 6 August 2018, the Panel submitted its report to the Minister of Finance. On 10 August 2018, National Treasury released the Panel's report for public comments. The deadline for public comments was 31 August 2018. On 28 August 2018, the Panel briefed the SCoF on the Report. The National Treasury and SARS will be making a report back on the public comments received on the Panel's Report to the SCoF on the date to be determined by the SCoF.

The Draft 2018 TLAB and the Draft 2018 TALAB contain the remainder of the tax announcements made in Chapter 4 and Annexure C of the 2018 Budget Review which are more complex, technical and administrative in nature. Due to the complex nature of these draft bills, greater consultation with the public is required on their contents. The Draft 2018 TLAB and the Draft 2018 TALAB were published for public comments on 16 July 2018. The closing date for public comments was 16 August 2018. The National Treasury and SARS briefed the SCoF on the Draft 2018 TLAB and the Draft 2018 TALAB on 16 August 2018. The public was given an opportunity to provide National Treasury and SARS with written comments.

1.2. PUBLIC COMMENTS

National Treasury and SARS received responses from 94 organisations and individuals (see Annexure A and B attached) on the Draft 2018 TLAB and the Draft 2018 TALAB. Public comments to the SCoF were presented at a hearing that was held on 21 August 2018. There were 11 organisations that submitted their comments to the SCoF for public hearings.

Subsequently, National Treasury and SARS held public workshops on the public comments on 4 and 5 September 2018. This Draft Response Document contains draft responses from Treasury and SARS officials to the key issues raised by the public during the public hearings and workshops. Once considered by Parliament, they will be presented to the Minister for approval, including to approve consequential amendments to the July 2018 Draft TLAB and TALAB, for introduction and tabling in Parliament in October 2018.

1.3. POLICY ISSUES AND RESPONSES

Provided below are the responses to the key issues raised by the public comments received in respect of the Draft 2018 TLAB and Draft 2018 TALAB from written submissions and during the public hearings. These comments will be taken into account in finalising the bills to be tabled. Comments that are outside the scope of the bills are not taken into account for purposes of this response document.

1.4. SUMMARY

This response document includes a summary of the key written comments received on the Draft 2018 TLAB and the Draft 2018 TALAB released on 16 July 2018 as well as other key issues raised during the public hearings held by the SCoF.

The main comments are:

- Clarifying the tax treatment of funds managed by Bargaining Councils;
- Removing taxable benefit in relation to low or interest free loans granted to low income earning employees for low cost housing;
- Addressing anomalies in respect of medical tax credits;
- Alignment of tax treatment of withdrawals from preservation funds upon emigration or repatriation on expiry of work visa;
- Tax treatment of transfers to pension preservation or provident preservation funds after reaching normal retirement age but before retirement date;
- Tax treatment of transfer of actuarial surplus between retirement funds;
- Loans or credit advanced to a trust by a connected person;
- Consequential amendments resulting from the application of debt relief rules;
- Refining anti-avoidance rules dealing with share buy backs and dividend stripping;

- Refining rules for debt financed acquisitions of a controlling interest in an operating company;
- Tax implications of fruitless and wasteful expenditure;
- Amendments to Mineral and Petroleum Resources Royalty Act, 2008
- Tax treatment of amounts received by or accrued to portfolios of collective investment schemes;
- Clarification of the tax treatment of doubtful debts;
- Review of Venture Capital Company Rules;
- Reviewing the write off period for electronic communication cables;
- Extension of the Employment Tax Incentive Scheme;
- Addressing an overlap in the treatment of dividends for income tax and transfer pricing purposes;
- Rules addressing the use of trusts to avoid tax in respect of controlled foreign companies;
- VAT treatment of cryptocurrency transactions;
- Insertion of the definition of "face value" under the provisions dealing with irrecoverable debt;

Draft Taxation Laws Amendment Bill

2. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

2.1. Clarifying the tax treatment of funds managed by Bargaining Councils

(Main reference: Paragraphs 2(m) & 12E of the Seventh Schedule to the Act: clauses 68 & 71 of the Draft Bill)

In 2017, changes were made in the tax legislation to grant tax relief to non-compliant bargaining councils. However, moving forward, bargaining councils are expected to be fully tax compliant and will not be afforded any relief. Based on public consultations held with bargaining councils and Department of Labour to discuss the way forward regarding the correct tax treatment of funds managed by bargaining councils, the following changes are proposed in the 2018 Draft TLAB:

- The employer is required to withhold PAYE from employer contributions to the funds administered by the bargaining councils in respect of employees who are members of those bargaining councils. Employee contributions directly to the funds administered by the bargaining councils will not be subject to PAYE withholding as such contributions can only be made from after tax income. As both employer and employee contributions to the funds administered by the bargaining councils will have been subjected to PAYE withholding, any payments made by the funds administered by the bargaining councils to their members will be tax free.
- Bargaining councils that did not get an official confirmation of income tax exemption from SARS should pay income tax in respect of amounts received or accrued to them.

Comment: The proposed amendments to the tax treatment of funds managed by Bargaining Councils do not clarify the year of assessment referred to (i.e. employer, employee or bargaining council).

Response: Noted. The proposed amendments refer to the employee's year of assessment which commences on 1 March and ends at the end of February of every year. In this regard, the proposed amendments will be effective from 1 March 2019.

2.2. Removing taxable benefit in relation to low or interest free loans granted to low income earning employees for low cost housing

(Main reference: Paragraph 11(4) of the Seventh Schedule to the Act: Clause 69 of the Draft Bill)

In 2014, changes were made in the Income Tax Act to remove the taxable fringe benefit in respect of employer provided housing for the benefit of low income earning employees, provided that the employees' remuneration does not exceed R250 000 per annum and the low cost housing has a market value not exceeding R450 000. However, the 2014 changes do not apply in cases where a low income earning employee receives a loan from the employer to fund the acquisition of low cost housing. In order to support Government's policy of the provision of housing, the 2018 Draft TLAB proposes to remove the taxable fringe benefit in respect of low/ interest free loans not exceeding R450 000 provided by an employer to a low income earning employee with remuneration not exceeding R250 000 per annum, provided that the loan is granted solely for the acquisition of housing.

Comment: The requirement that the market value of the immovable property acquired does not exceed R450 000 should be removed as the other monetary limit (remuneration proxy of R250 000) should suffice. Further to the above, it is often found that houses in remote areas such as mining town are valued higher due to scarcity of houses.

Response: Not accepted. When the legislation was first introduced in 2014, the policy intent was to afford low income earning employees the ability to acquire low-cost housing. Removing the limitation on the market value of the property deviates from the Government's initial policy intention as it would make it possible for all low income earning employees to acquire housing other than low-cost housing.

Comment: As the draft legislation currently reads, there is a loophole as there is no requirement that the employee actually occupy the property.

Response: Accepted. In order to close this loophole, the requirement with regards to whether the accommodation is required to be the employee's primary residence or whether it is sufficient for it to be occupied by the employee's relative(s) is being considered.

Comment: Unlike with current paragraph 5(3A) of the Seventh Schedule dealing with zero taxable fringe benefit in respect of employer provided low cost housing for the benefit of low income earning employees, there is no connected person exclusion in the proposed amendments in the 2018 Draft TLAB.

Response: Accepted. The connected person exclusion similar to the current paragraph 5(3A) of the Seventh Schedule will be included so as to avoid abuse.

2.3. Addressing anomalies in respect of medical tax credits

(Main references: section 6A of the Act: clause 5 of the Draft Bill)

There are instances where medical scheme contributions are proportionally shared by taxpayers, for example, children jointly contributing towards their parent's medical scheme contributions under a registered medical scheme. Although medical scheme contributions are being proportionally shared, there is an unintended anomaly in the tax legislation that currently allows each of the taxpayers (e.g. children) who proportionally share the medical costs for a single individual (e.g. mother) to independently claim the full medical tax credits for each of the shared dependants (e.g. their mother). In order to address this anomaly, it is proposed that amendments be made in the Income Tax Act so that where taxpayers (e.g. children) share medical scheme contributions in respect of their dependants (e.g. mother), medical tax credits should be allocated between taxpayers who made the payment of medical scheme contributions.

Comment: Will the employer be required to factor the medical tax credit in relation to the above mentioned proposal in their payroll calculation or will the credit be catered for only upon assessment.

Response: Noted. In terms of paragraph 9(6) of the Fourth Schedule, employers are given the discretion to decide whether or not to account for medical tax credits in their payroll calculation. The employer will apply its discretion whether to take the proposed medical tax credit into account in their payroll calculation. The apportionment requirement in the case where the contribution is made by more than one taxpayer may be dealt with on assessment of each individual taxpayer when filing an income tax return to SARS if not already catered for by the employer.

Comment: Clarity is requested with regard to how the splitting of the medical fees tax credits will be calculated.

Response: Noted. As discussed during the 2018 Draft TLAB workshops, SARS will provide clarification regarding the administrative requirement in relation to the proposed changes.

2.4. Tax treatment of transfers to pension preservation or provident preservation funds after reaching normal retirement age but before retirement date

(Main reference: section 1 of the Act: clause 1 of the Draft Bill)

In 2017, changes were made in the Income Tax Act to allow employees (who are members of the fund) to transfer their benefits from a pension or provident fund into a retirement annuity fund on or after reaching normal retirement age, as defined in the rules of the fund, but before an election to retire is made by such employee (member of the fund). Transfers to pension preservation and provident preservation funds were excluded as it was considered that it would be administratively burdensome. In order to address these aspects, it is proposed that amendments be made in the Income Tax Act to allow for transfers from a pension or provident fund to a pension preservation or provident preservation fund on or after reaching normal retirement date as defined in the rules of the fund, but before an election to retire.

Comment: Due to the fact that amounts transferred cannot be withdrawn as a single lump sum, fund members must be allowed to transfer from pension funds to provident preservation funds.

Response: Not accepted. The NEDLAC discussions regarding annuitisation for provident fund members are still ongoing. The prospect of considering transfers from pension funds to provident preservation funds can only be considered once the NEDLAC process is completed.

Comment: Clarity is requested as to whether or not the restriction on the ability to make a once-off withdrawal once retirement benefits have been transferred applies to both the capital and interest component as well.

Response: Noted. The restriction applies to both interest and capital.

Comment: Members must be afforded the ability to make multiple tax free transfers between preservation funds, provided they have not yet made the election to retire.

Response: Not accepted. It will be difficult to afford members the ability to make multiple tax free transfers between preservation funds as the ability to efficiently track multiple transfers remains a concern for Government.

Comment: Members must be afforded the ability to make tax-free transfers from a retirement annuity into an occupational retirement fund.

Response: Not accepted. The Government’s policy intention of disallowing tax-free transfers from a retirement annuity fund into an occupational retirement fund has not changed.

*Comment***:** Clarity requested as to when the provisions governing the annuitisation of provident funds are likely to come into effect. In the event that the effective date of 1 March 2019 still stands, further deferral is requested so as to provide industry ample time to make system changes as well as changes to fund rules.

Response: Noted. The 2018 Draft TLAB does not contain amendments related to annuitisation for provident fund members. The process of consultation with NEDLAC is still ongoing, and an interim agreement on an approach to retirement reform with timelines is expected shortly. Government will introduce further legislative amendments shifting the effective date of 1 March 2019 by one or two years, in line with the NEDLAC constituencies' recommendation. An agreement on this recommendation is expected to be reached before the end October 2018.

2.5. Tax treatment of transfer of actuarial surplus between retirement funds

(Main Reference: Paragraph 2(*l*) of the Seventh Schedule to the Act: clause 68 of the Draft Bill)

Currently, the provisions of the Income Tax Act inadvertently create a taxable fringe benefit in the hands of employees in respect of any transfers of actuarial surpluses between or within retirement funds of the same employer on behalf of employees. In principle, there should be no additional tax consequences for employees (who are members of the fund) if the transfers between or within retirement funds of the same employer refer to amounts that have already been contributed to a retirement fund. In order to address these unintended anomalies, it is proposed that retrospective amendments with effect from 1 March 2017, be made to the Income Tax Act to allow for transfers of amounts as contemplated in section 15E(1)(b) of the Pension Funds Act, 1956, between or within retirement funds of the same employer not to create a taxable fringe benefit in the hands of the employees.

Comment: It is requested that the proposed amendment be extended to apply to other paragraphs within section 15E(1) of the Pension Funds Act.

Response: Partially accepted. The proposal will be extended to sections 15E(1)(d) and 15E(1)(e) of the of the Pension Funds Act which deal with improvement of benefits payable to all members and transfers between employer-owned surplus funds.

2.6. Loans or credit advanced to a trust by a connected person

(Main Reference: section 7C of the Act: clause 9 of the Draft Bill)

An anti-avoidance measure aimed at curbing the tax-free transfer of wealth between family members and other connected persons to trusts through the use of low interest or interest-free loans, advances or credit was introduced in 2016. Under these tax avoidance schemes, a taxpayer would transfer assets to a trust with family member beneficiaries and the purchase price owed by the trust to the taxpayer in respect of the assets would be left outstanding as a loan owing to that taxpayer by the trust on which no interest or very low interest is charged. Alternatively, a taxpayer would advance a low interest or interest-free cash loan, advance or credit to a trust in order for the trust to use the money to acquire assets. The use of low interest or interest-free loans in this manner means that donations tax is avoided when the assets are transferred in exchange for a low interest or interest-free loan, advance or credit because such transfers are treated as sale transactions and not donations. In 2017, further amendments were made to also include instances where taxpayers advance interest free or low interest loans to companies in which shares are held by trusts as a way to avoid the anti-avoidance measure.

Comment: The proposed 2018 amendments seek to clarify the scope of application of the anti-avoidance measure in respect of companies held by trusts. However, the formulation of the proposed 2018 amendments results in the rules applying even though the trust does hold any shares at all. This is because the 2018 proposal for the rule for companies refers to instances where a low interest loan is made to company that if at least a 20 per cent interest in that company is held by a trust or a connected person in relation to that trust "whether alone or jointly with any person that is a connected in relation to that trust". This wording does not achieve the intended outcome that the trust should at least hold a shares in the company as it can mean if the connected person of the trust (i.e. the beneficiaries of the trust and their relatives) collectively hold at least 20 per cent of the shares of the company, the anti-avoidance measure applies. Changes should be made to ensure that the rules apply where the trust itself at least holds a share in the company.

> *Response*: <u>Comment misplaced.</u> The proposed wording of the draft 2018 TLAB already has that effect.

Comment: The term "connected person" in relation to a trust includes persons who are "connected persons", for example relatives, in relation to the beneficiaries. This proposed wording therefore broadens the proposal considerably and should be restricted to beneficiaries of the trust.

> *Response:* <u>Partially accepted.</u> The introduction of the anti-avoidance measure was as a result of family members structuring their affairs using trusts and companies that involved various family members in order to transfer assets or returns from those assets among themselves. Given these structures, avoidance is facilitated through beneficiaries holding shares in companies in which the family trust holds shares. However, in some instances a close relative of the beneficiary (i.e. father, uncle or son) that is not a beneficiary may hold shares in the company. It is, however, noted that the current definition of connected person in relation to trusts includes relatives or beneficiaries and that the term relative is defined for purposes of the Income Tax Act. Whilst the scenarios envisaged under the anti-avoidance measure includes relatives that are not beneficiaries of a trust, it is acknowledged that the current definition of a relative that includes all relations within the third degree of consanguinity may be too wide. A definition of

a relative will be considered for purposes of these rules to limit it to relatives within the second degree of consanguinity.

Comment: The anti-avoidance measure triggers a deemed donation on the difference between interest actually charged (if any) and the interest that would have been charged had interest free or low interest loans been subject to interest at the official rate of interest. Some technical questions remain unanswered around this determination of a deemed donation. To avoid taxpayers having to determine whether simple, annual, monthly or daily interest or a compounded interest method must be applied, and disputes arising with SARS as to whether the method used was reasonable, it is proposed that a calculation method be prescribed in the legislation for deemed interest. It is noted that section 64E(4)(*d*) of the Act has a similar problem. In this regard, it may be appropriate to rather amend s7D of the Act, which applies to the calculation of all deemed interest so that it covers both the *in duplum* rule and the calculation method. The current SARS practice for section 64E of the Act seems to be daily simple interest on the daily balance outstanding and it is proposed that this method be used.

Response: <u>Accepted.</u> Clarifications around the use of the official rate of interest as a benchmark across the various provisions of the Income Tax Act will be made. Similar to the practice around section 64E determinations, daily simple interest will be used.

3. INCOME TAX: BUSINESS (GENERAL)

3.1. Consequential amendments resulting from application of debt relief rules

(Main Reference: Section 19 and paragraph 12A of the Eighth Schedule to the Act: clauses 34 and 76 of the Draft Bill)

The Income Tax Act contains debt relief rules that give rise to tax implications for the debtor when a debt that is owed is waived, cancelled, reduced or discharged for less than the face value of the debt. In 2017, changes were made in the debt relief rules including the introduction of definitive rules dealing with the tax treatment of conversions of debt into equity. The 2017 changes resulted in unintended anomalies. In order to address these anomalies, the following amendments are proposed in the Income Tax Act:

- Debt relief rules should only apply upon realisation, for example when the debt is extinguished;
- Changes to the terms and conditions of a debt or substitutions of a debt should not trigger the application of debt relief rules;
- Debt relief rules should only apply when an interest bearing debt is converted into equity for less than face value, and should not apply to non-interest bearing debt;

- The 2018 proposed changes should apply retrospectively from 1 January 2018 (which is the date on which the 2017 changes came into effect), in order to ensure that the unintended consequences of the 2017 amendments do not negatively affect taxpayers.

In addition, further amendments are proposed in the Income Tax Act to close the donations tax and capital gains tax loopholes on the application of debt relief rules that have been identified during public consultation with taxpayers. In order to address the donations tax loophole, it is proposed that the donations tax exclusion under the debt relief rules should only be available to the extent to which donations tax was payable in respect of a donation arising from a debt relief arrangement. In addition, in order to address the capital gains tax loophole, it is proposed that debt relief rules should be triggered in respect of a debt that was used to fund a capital or allowance asset and the debtor sold the capital or allowance asset. It is proposed that these anti-avoidance measures should not apply retrospectively.

Comment: Paragraph (*a*)(*i*) of the definition of "concession or compromise" provides that cancellation, waiver or the remittance of a debt is a "concession or compromise". The term remit in the definition of a "concession or compromise" can mean the setting aside or cancellation of a debt but the term can also refer to payment. Given that the terms cancellation and waiver are already included in the legislation; it is not necessary to use the word remit. For clarity, the word "remit" should be removed as payment of a debt should not trigger negative tax consequences.

Response: <u>Accepted.</u> The word "remit" will be removed from paragraph (a)(i) of the definition of "concession or compromise".

Comment: Paragraph (*a*)(*ii*) of the definition of "concession or compromise" triggers the debt relief rules when a debt is redeemed or merger occurs as a result of the debtor or a connected person in relation to the debtor acquires the claim relating to the debt that the debtor holds. However, for merger to occur, the same person needs to hold the claim and owe the debt. It should be made clear in the definition of "concession or compromise" that the connected person element in para (*a*)(*ii*) of this definition applies only in respect of the redemption of a debt and not in respect of merger by acquisition.

Response: <u>Accepted.</u> Paragraph (*a*)(*ii*) of the definition of "concession or compromise" will be rephrased so that the connected person element can only be applied in respect of debt redemptions.

Comment: For purposes of applying paragraph (*a*)(*ii*) of the definition of "concession or compromise" consideration should be had for instances when other legislation does not allow a person to extinguish debt by way of merger. One such example can be found in section 35 of the Bills of Exchange Act, No.34 of 1964 where acquisition of negotiable instruments in respect of a debt (i.e. a document containing a promise to pay a debt to an assigned person) is precluded from merger. To do this, it is proposed that specific rules should be introduced for negotiable instruments

> *Response:* Comment misplaced. The rules in paragraph (*a*)(*ii*) of the definition of "concession or compromise" in respect of merger, do not deem a merger but only trigger the debt relief rules when merger occurs. As such, should a person be precluded, by law, from extinguishing debt owed, the debt relief rules will not apply.

Comment: The policy around paragraph (*b*) of the definition of "concession or compromise" that provides that interest bearing debt that is converted into equity should fall under the ambit of the debt relief rules is not clear. In this regard, it is not clear why the principal portion of a debt (whether interest bearing or not) that is converted into shares should result in negative tax consequences. Had a company been capitalised with equity from the beginning, the deductible expenses that that capitalisation funded would still be deductible.

> *Response:* Accepted. Paragraph (*b*) of the definition of "concession or compromise" will be amended to only include any interest that was deducted but not paid by the debtor that is subsequently converted or exchanged for shares.

Comment: The definition of "debt benefit" uses the term "effective interest" but the term is not defined. It is recommended that this term should be defined.

> *Response:* Partially accepted. The term "effective interest" in the definition of "debt benefit" will not be defined. However, under the definition of "debt benefit" the determination of a debt benefit when debt is converted into or exchanged for shares, will be clarified as the amount by which the face value of the debt before the arrangement exceeds the increase in the effective interest held by the creditor in the debtor by virtue of any direct interest or indirect interest in the debtor. Furthermore, as was agreed upon during the taxpayer workshops on Tuesday, 4 September 2018, the definition of "direct interest" and "indirect interest" will be removed as these are well understood concepts and do not require specific definitions.

Comment: Paragraph (*c*) of the definition of "debt benefit" applies to an arrangement described in paragraph (*b*) of the definition of "concession or compromise" which caters for when debt is converted into shares. Since the creditor did not hold any shares prior to entering into the contemplated transactions, the words "held or" should be removed.

> *Response:* Accepted. The word "held" will be removed from paragraph (*c*) of the definition of "debt benefit".

Comment: The redetermination of income tax recoupments, capital losses and/or capital gains which were determined and accounted for on the disposal of assets in a year prior to when a "debt benefit" arises is not clear. It should be clarified as to whether the proposed provision will apply to all capital assets or only allowance assets.

Response: Accepted. Amendments will be made to paragraph 12A of the Eighth Schedule to the Act to clarify that the redetermination rules apply to both capital and allowance assets. In addition, it will be clarified that even if the asset is disposed of in the same year of assessment that the "debt benefit" arises, a redetermination must be done if the asset was disposed of before the "debt benefit" arose.

Comment: The proposed amendment to close the donations tax loophole meant to ensure that donations tax is paid in order for a debt to be excluded, adds unnecessary complexity for individuals as it can lead to partial application in the instance that a donation exceeds the annual exclusion of R100 000. In addition, a similar amendment in the Estate Duty Act No. 45 of 1955 that requires that estate duty should be actually payable on a forgiven debt has not been included. This results in lack of symmetry.

Response: Not accepted. The requirement that donations tax should be paid on a donated debt for such a donated debt claim to be excluded from the debt relief rules will remain. Failure to put in this requirement will mean that no tax is levied on a donated debt claim. It is noted that a similar amendment has not yet been made in the Estate Duty Act. However, it should be noted that to make such amendment in the Estate Duty Act requires much more intensive changes. As a result, amendments to the Estate Duty Act in this regard will be considered in the 2019 legislative cycle.

3.2. Refining anti-avoidance rules dealing with share buy backs and dividend stripping

(Main Reference: Section 22B and Paragraph 43A of the Eighth Schedule to the Act: clauses 36 and 79 of the Draft Bill)

In 2017, changes were made in the Income Tax Act to strengthen the anti-avoidance rules dealing with share buy backs and dividend stripping. Under the new rules, exempt dividends received by a shareholder company are treated as proceeds or income in the hands of that shareholder company only when the shares in respect of which an exempt dividend is received are disposed of, if that shareholder company received extraordinary dividends within a period of 18 months prior to or as a result of that disposal. As part of the 2017 amendments, these provisions were included in the Income Tax Act. Firstly, a specific rule was included in the legislation defining what constitutes an extraordinary dividend in the case of preference shares. Secondly, a provision was included in the legislation in order to ensure that these anti-avoidance rules override the corporate re-organisation rules. This was done to ensure that taxpayers do not use the corporate re-organisation rules in order to avoid these anti-avoidance rules in respect of dividends stripped out of a target company.

It has come to Government's attention that the above-mentioned changes may affect some legitimate transactions and arrangements. In order to address these concerns, the following amendments are proposed in the Income Tax Act:

Preference Shares

It is proposed that a new definition of "preference shares" be introduced in the Income Tax Act for purposes of the anti-dividend stripping rules. In addition, a clarification has been inserted in the anti-dividend stripping rules to clarify the meaning of extraordinary dividend in respect of a preference share.

Interaction between anti-dividend stripping rules and corporate re-organisation rules

It is proposed that the anti-dividend stripping rules should override corporate re-organisation rules only in cases where the corporate re-organisation rules are abused by taxpayers. The anti-dividend stripping rules will in terms of this proposal apply only when a company disposes of shares within 18 months after acquiring those shares in terms of a re-organisation transaction. Dividends received in respect of those shares within the period of 18 months prior to that re-organisation transaction by persons that are connected parties in relation to that company will in terms of a claw-back provision be subject to the dividend-stripping rules.

Comment: The 2018 proposed amendments which cater for the interaction between the dividend stripping rules and the corporate reorganisation rules should be effective from 18 July 2017 (i.e. the commencement date of the 2017 rules that currently override the corporate re-organisation rules) and not 1 January 2019 as proposed in the 2018 Draft TLAB as the current rules were overly harsh.

Response: Not accepted. At the time when these rules were proposed in 2017, it was intended that the anti-dividend stripping rules should override the corporate re-organisation rules. The 2018 proposed amendments are a change to the 2017 policy position and will as such have a future effective date of 1 January 2019.

Comment: The proposed amendments to anti-dividend stripping rules are overly complex and cannot be easily understood. Therefore, the proposed amendments should be redrafted to make them readable and understandable.

Response: Noted. In order to ensure that the anti-avoidance rules dealing with dividend stripping do not affect legitimate corporate re-organisation transactions various different scenarios are covered by the 2018 proposals. The scenarios that taxpayers may use to avoid the anti-dividend stripping rules involve complex multi-step transactions. As a result, the 2018 proposals are a reflection of this complexity.

Comment: When a resident company disposes of shares it holds in another company in terms of a deferral transaction, the anti-avoidance rules dealing with dividend stripping will not be immediately triggered. However, it is proposed that specific claw-back rules should apply to exempt dividends received or accrued in respect of those shares or other shares acquired in exchange for those shares in respect of which such exempt dividends were received or accrued within 18 months of their acquisition. These claw back rules should be applied at the time when such shares are subsequently disposed of in terms of a transaction that is not a deferral transaction within 18 months of their acquisition. The proposed amendments consider dividends declared 18 months prior to a deferral transaction and the disposal of shares within a period of 18 months after the deferral transaction and therefore introduces an effective 36-month period. A 36-month period is not acceptable.

Response: Not accepted. In determining what constitutes an extraordinary dividend, the legislation requires that you look at the exempt dividends received over a period of 18 months before a deferral transaction in respect of which shares are disposed of. It is only after a deferral transaction that taxpayers will be required to observe the claw back requirement of the rules for 18 months after that deferral transaction. It is therefore inaccurate, that the rules apply for an effective 36 month period as the 18 months period prior to a deferral transaction is only taken into account for purposes of determining the amount of the extraordinary dividend. It is only during the 18-month period following the deferral transaction, that the rules can apply to trigger a claw back of extraordinary dividends.

Comment: The 2018 amendments introduced a definition of a preference share in order to clarify how the anti-dividend stripping rules will apply in the case of preference shares. In addition, the definition of "extraordinary dividend" was also expanded to include what is an "extraordinary dividend" in the case of preference shares. In terms of this amendment, an "extraordinary dividend" in respect of a preference share is the amount of any dividend received or accrued exceeding the amount that would have otherwise accrued with respect to that preference share if it was determined with respect to the considerations for which that share was issued by applying an interest rate of 15 per cent per annum. However, it is not clear whether the 15 per cent rate used to determine the extraordinary dividend should be applied on a simple or compounding basis.

Response: Accepted. It will be specified in the legislation that a simple basis of determination is applicable when determining an extraordinary dividend for preference shares.

3.3. Refining rules for debt financed acquisitions of a controlling interest in an operating company

(Main Reference: section 24O of the Act: clause 44 of the Draft Bill)

In 2012, a special interest deduction rule that allowed interest on a debt to be deductible when a company used that debt to acquire a controlling share interest in an operating company was introduced in the Income Tax Act. This special interest deduction is only available when a shareholder company uses debt to directly or indirectly acquire a controlling interest in an operating company. To qualify as an operating company, at least 80 per cent of a company's receipts and accruals should constitute income as defined (i.e. gross receipts and accruals less receipts and accruals that are exempt for tax purposes) and that income must have been generated from its business of providing goods and services. This means that for a company to qualify as an operating company, no more than 20 per cent of its receipts and accruals should constitute exempt income (for example dividends). It has come to Government's attention that the current provisions are not clear as to when during a year of assessment, the determination of whether a company meets the requirement of an operating company should be made. In order to address this concern, it is proposed that amendments be made in the Income Tax Act to clarify that a shareholder company will determine whether its subsidiary company qualifies as an operating company at the end of each year of assessment that the debt remains outstanding.

Comment: In order to address concerns that taxpayers raised regarding when a company that incurs interest on a debt used to fund the acquisition of an interest in another company must determine whether that other company meets the requirements for an operating company, the proposed 2018 amendments provided that this determination should be done at the end of the year of assessment of the shareholder company. To test whether a company is an operating company with reference to the year of assessment of the shareholder company is too complex when the operating company has a different year end to the shareholder company. It is proposed that consideration be given that the test should only be with reference to the company's year of assessment rather than that of the shareholder company

Response: Accepted. Amendments will be made in section 24O rules dealing special interest deduction rules in order to provide that a shareholder company may utilise the special interest deduction if the underlying company met the requirements of an operating company as at that operating company's immediately preceding year end.

Comment: There is a loophole in the operation of the current special interest deduction rules. Some taxpayers are claiming the special interest deduction in respect of debt raised to make equity investments in newly established companies. This loophole should be closed.

Response: Accepted. The special interest deduction was meant to provide for a deduction where debt is used to acquire shares in established and profitable companies. It was never intended to grant a deduction for all share acquisitions and particularly, not start-ups. As such, an anti-avoidance measure will be introduced to clarify this position.

3.4. Tax implications of fruitless and wasteful expenditure

(Main reference: Sections 10 and 23(o) of the Act: clauses 21 and 37 of the Draft Bill)

Generally, the Income Tax Act makes provision for the deduction of expenditure actually incurred in the production of income, provided such expenditure is not of capital nature. The Income Tax Act however limits the deductibility of certain types of expenditure including expenditure that relates to a corrupt activity as defined in the Prevention and Combating of Corrupt Activities Act or expenditure that constitutes a fine or penalty imposed as a result of an unlawful activity. However, the limitation of deductions in the Income Tax Act does not cover fruitless and wasteful expenditure. In order to ensure proper governance of public entities and encourage accountability, it is proposed that amendments be made in the Income Tax Act so that any expenditure determined and reported by a Public Entity as fruitless and wasteful expenditure in terms of section 55(2) of the Public Finance Management Act (PFMA) should not be allowed as a deduction in the determination of that Public Entity's taxable income.

Comment: During the determination of the taxable income of a public entity, the general deduction formula as contemplated in the Income Tax Act, is stringently applied to all expenditure including fruitless and wasteful expenditure as identified in the public entity's annual report. As such, the fruitless and wasteful expenditure incurred is split into groupings of allowable expenditure and disallowed expenditure which is subsequently either included or excluded for purposes of the calculation of taxable income. In light of the above it is suggested that no changes be made to section 23(o) of the Income Tax Act as is proposed in the draft legislation.

Response: Not accepted. As indicated in Chapter 4 of the 2018 Budget Review, the proposed amendments are meant to ensure proper governance of public entities and encourage accountability.

Comment: The proposed legislation serves to create a clear distinction between two types of taxpayers and the subsequent application of the Income Tax Act between them. If a difference in application of the Income Tax Act between public entities (e.g. Eskom), semi-public entities (e.g. Telkom) and non-state owned entities (private sector) is created it could be deemed as discriminatory in nature which in itself does not fit with the general concept of equality as contemplated in both the Constitution of South Africa and the Income Tax Act.

Response: Not accepted. As indicated in Chapter 4 of the 2018 Budget Review, the proposed amendments are meant to ensure proper governance of public entities and encourage accountability. The proposed distinction in the application of the Income Tax Act between different types of taxpayers continues to be done with due cognisance of the reasonableness of each provision and such justification which in this case concerns itself with the impact on government policy as a tool to ensure greater governance in public entities.

Comment: The draft Explanatory Memorandum to the Taxation Laws Amendment Bill, 2018 clarifies that the reason behind the proposed amendments to section 23(o) of the Income Tax Act is to create an additional measure to encourage governance within public entities. Although, the reason behind the proposed measure can to a certain degree be understood, it is questioned if the policy intent should not rather be done through measures that either strengthen or ensures better enforcement of current measures within the PFMA?

Response: Not accepted. The PFMA already contains provisions of accountability, disclosure and financial recourse.

3.5. Amendments to Mineral and Petroleum Resources Royalty Act, 2008

(Main reference: Section 6 of the Mineral and Petroleum Resources Royalty Act: clause 95 of the Draft Bill)

The proposed amendment in the 2018 Draft TLAB subsection (3)*(b)* seeks to clarify the original policy intent. When the Mineral and Petroleum Resource Royalty Act (MPRRA) was introduced in 2008, the policy intention was clear regarding the definition of the royalty tax base. The royalty tax base was generally defined both in the legislation and the explanatory memorandum as gross sales excluding the implicitly included costs incurred for transportation, insurance and handling (TIH) of the final product or mineral between the seller and the buyer as this would unintentionally and artificially increase gross sales leading to a higher royalty tax payable. In 2009, additional clarification was made in section 6(3) of the MPRRA dealing with gross sales. The 2009 changes resulted in the policy intent regarding the definition of gross sales not to be clearly expressed in the text of the legislative provision even though the policy intent was clear in the explanatory memorandum. In order to give certainty regarding policy intent, it is proposed that the meaning of gross sales be clarified in the legislation to take into account the policy rationale which is explained when the MPRRA was introduced by reverting back to the original wording prior to the 2009 amendment.

Comment: The proposed amendment to section 6 of the MPRRA seeks to replace the current wording "expenditure incurred" with the original wording "amount received or accrued" of the section before it was amended in 2009 as a measure to clarify the original policy intent. Neither terms are defined in the MPRRA and it needs to be pointed out that a declaratory judgement was recently issued in the Gauteng Provisional Division, Pretoria in *United Manganese of Kalahari vs CSARS (case no. 74158/2016)* (UMK Case) where the court specifically interpreted section 6(3)*(b)* of the MPRRA. It is submitted that the above-mentioned case now provides more certainty to taxpayers, in that it is supported by case law, as well as being in line with the policy intent, of excluding TIH and thus negating a need for a change.

Response: Not accepted. The proposed amendment is essentially aimed at government's concern of the impact of and suspected mismatch of implicitly included TIH costs in relation to both gross sales and the actual amount expended. The suggested legislative change now clarifies the original policy intent that only TIH, as definitive and proven cost factor in the increase on gross sales be excluded for purposes of the calculation of the royalty rate paid on the sale of a mineral resource.

Comment: Based on the policy intent as stated in the Explanatory Memorandum it is important to determine whether the proposed change takes into account the commercial reality of mineral resource sale transactions. Most mineral prices are determined with reference to an index price which itself are quoted with reference to incoterms (international commercial terms). It is quite clear that a portion of the index price would include the TIH costs, which should be excluded from gross sales. With the current wording as it stands, the burden of proof can be dispelled by referring to the incoterms which should satisfy the requirements for “expenditure incurred”. Therefore, there is a concern within the mining industry that the proposed changes might place an undue burden of proof on taxpayers and may not be in line with the commercial reality of physical contracts being executed between sellers and buyers that ultimately effects the value of gross sales.

Response: Not accepted. The majority of physical contracts for the sale of mineral resources is based on a discovery price as determined on the London Metal Exchange and even more so it is based on the last trade, on a specific platform within the London Metal Exchange, on a specific daily trading session between the last single buyer and seller of that session. The discovery price essentially discharges out all other variables and commits every other single market participant to a trade price between two random parties with no readily available indication as to the specific incoterms, if any at all, between the two parties. As such, the proposed amendment eases the burden of proof for both taxpayers and the South African Revenue Service.

Comment: The proposed amendment only seeks to make an amendment to unrefined mineral resources as contemplated in section 6(3)*(b)* with no similar proposed correction to refined mineral resources as contemplated in section 6(3)*(a)*.

Response: Accepted. The proposed amendment should apply to both refined and unrefined mineral resources.

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

4.1. Tax treatment of amounts received by or accrued to portfolios of collective investment schemes (CISs)

(Main reference: Section 25BA of the Act: clause 47 of the Draft Bill)

According to section 25BA of the Income Tax Act, distributions of amounts that are not of a capital nature that are made by a CIS to unit holders within 12 months after they accrued to or in the case of interest, was received by a CIS, follow the flow through principle and are deemed to accrue to unit holders on the date of distribution and are subject to tax in the hands of the unit holders. The Act does not provide a definition of what constitutes an amount of a capital nature and the concept depends on facts and circumstances as well as the tests enunciated in this regard in case law. It has come to Government’s attention that some CISs are in effect generating profits from the active frequent trading of shares and other financial instruments. These CISs argue that the profits are of a capital nature, and therefore, not subject to tax. They base this argument on the intention of long term investors in the CIS. The fact that the determination of capital or revenue distinction is not explicitly stated in the Act and reliance is based on facts and circumstances as well as the case law has led to different applications of the law and this has resulted in an uneven playing field regarding the taxation of CIS. In order to provide clarity and certainty with regard to the tax treatment of CIS, the following changes are proposed in the Act:

One year holding period rule

It is proposed that distributions from CIS to unit holders derived from the disposal of financial instruments within 12 months of their acquisition should be deemed to be income of a revenue nature and be taxable as such in the hands of the unit holders if distributed to them under current tax rules.

First in first out method

Where a CIS acquired financial instruments at various dates, the CIS will be deemed to have disposed of financial instruments acquired first. The first in first out method will be used to determine the period the financial instruments were held for the purposes of the one year holding period rule.

Treatment of losses

Deductions and allowances do not flow through to unit holders and amounts deemed to have accrued to unit holders are limited to amounts of gross income reduced by deductions allowable under section 11.

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

- the proposed amendment will cause unfairness between unit holders within a portfolio when a large unit holder decides to redeem units thereby triggering the sale of portfolio assets that have been held for less than 12 months resulting in a tax liability on distribution to all unit holders.
- the proposed time based rule affects all manner of transactions, including unit holder withdrawals, portfolio rebalancing, index tracking, hedging and transactions directed at efficient portfolio management (for example purchasing a derivative to gain economic exposure to a share in lieu of holding the physical).
- currently the industry has employed the services of an independent actuarial consulting firm to model transactions for the CIS industry to attempt a quantitative impact assessment which cannot be completed within the submission deadline. In addition, this study is crucial in the light of the economic climate and the objectives of attracting foreign investments.

Response: <u>Partially accepted.</u> As indicated in the 2018 Budget Review, Government has noted concerns regarding the frequent trading by some collective investment schemes and the argument that despite frequent trading, the profits are of a capital nature and should be taxable as such. In view of the fact that CISs are regulated by the Financial Sector Conduct Authority (“FSCA’), in order to avoid negative impact and unintended consequences as a result of the current proposed amendment in the 2018 Draft TLAB, the following is proposed:

- Government and industry be given more time to investigate and find solutions that may have less negative impact on the industry and holders of participatory interest before amendments are made in the tax legislation and that the legislative amendments in this regard be considered in the 2019 legislative cycle;
- Government continues to find ways to mitigate tax avoidance risks through regulation by the FSCA.

4.2. Clarification of the tax treatment of doubtful debts

(Main reference: Section 11(j) of the Act: clause 23 of the Draft Bill)

In 2015, amendments were made in the Income Tax Act to provide for the change to an income tax self-assessment system. As a result, the discretions given to the SARS Commissioner in administering some of the provisions of the Act, including section 11(j) were amended, some were removed and others reformulated. Section 11(j) of the Act that gives discretion to the Commissioner in respect of an allowance for doubtful debts is one of the provisions that were amended in 2015 in anticipation of the move to a self-assessment income tax system. Consequently, the discretion in section 11(j) is deleted with effect from a date to be announced by the Minister of Finance. A new provision was introduced for the allowance for doubtful debts to be claimed according to the criteria set out in a public notice issued by the Commissioner. However, the effective date for the removal of the Commissioner’s discretion on allowance for doubtful debts has not yet been announced and a public notice setting out the criteria for claiming the allowance for doubtful debts has not yet been formulated. In order to provide certainty, it is proposed that the following criteria for determining the doubtful debt allowance be specifically included in the provisions of the Income Tax:

Companies using IFRS 9 accounting standard for financial reporting purposes:

It is proposed that 25 per cent of the loss allowance relating to impairment as contemplated in IFRS 9 excluding lease receivables contemplated in IFRS 9 be allowed as deduction. The allowances allowed in a year of assessment must be added back to income in the following year of assessment.

Companies not using IFRS 9 accounting standard for financial reporting purposes:

It is proposed that an age analysis of debt be used in this regard. As a result, it is proposed that 25 per cent of the face value of doubtful debts that are at least 90 days past due date be allowed as deduction. The allowances allowed in a year of assessment must be added back to income in the following year of assessment. For example, debtor fails to make full payment for 90 days after due date of an amount that is payable. The debtor is 90 days in arrears and the full debt becomes doubtful then 25% of the debt is allowed as a doubtful debt in terms of the proposed section 11(j) of the Act.

Comment: The proposed amendment is overly prescriptive and it is recommended that the current discretionary legislation should be retained.

Response: Not accepted. Government took a decision in 2015 to move to self-assessment system and remove all discretions that were given to the SARS Commissioner through the tax legislation.

Comment: The proposed amendment should not differentiate between banks and non-bank lenders because these taxpayers use the same accounting standards and may use substantially the same methodologies to determine their doubtful debt provisions. The proposed amendment is anti-competitive because larger non-bank lenders must compete with bank lenders in a commercial space and yet bank lenders are receiving significantly higher tax allowances. It is therefore proposed that non-bank lenders be afforded the same tax treatment given to banks through section 11(jA) of the Income Tax Act.

Response: Partially accepted. Banks that are registered in terms of the Banks Act are regulated prudentially more intensively and intrusively than other financial service providers, including that they are subject to stringent capital, liquidity and reporting requirements. These regulations are formulated with the principal objective of protecting depositor's funds and ensuring the continued operating of critical economic functions including transaction and payment services. These regulations therefore seek to ensure the continued prudent operation (solvency) of banks through significantly intensive, intrusive and effective supervision. No such framework currently exists for non-bank lenders, which are regulated only by the Non Credit Regulator in terms of the National Credit Act,2005 currently not supervised by the Prudential Authority for safety and soundness nor the FSCA for market conduct. With regard to the banking sector, there is also integration between IFRS 9 impairment allowance calculation process with existing capital calculation and reporting requirements under Basel III standards. In the case of a bank, the expected credit loss is to be covered by provisions and unexpected loss is to be covered by capital. Therefore, at some point the doubtful debts provisions may have a result that lead to a reduction of the equity and retained earnings available for Tier 1 capital which in turn may reduce the Tier 1 capital ratio. Whilst Government is in the process of introducing appropriate prudential regulations for non-bank credit providers, and for tougher market conduct regulations for both bank and non-bank financial sector providers, in terms of the Financial Services Regulation Act, these will only be progressively implemented, and will require review as to their effectiveness.

In order to mitigate the impact of the proposals on non-bank lenders, who are not intensively and intrusively regulated prudentially the following is proposed:

- If a taxpayer is applying IFRS 9 for financial reporting purposes to determine a loss allowance relating to impairment in respect of debt:
  - 40 per cent of the IFRS 9 loss allowance relating to impairment that is measured at an amount equal to the lifetime expected credit loss; and
  - 25 per cent of the difference between the IFRS 9 loss allowances relating to impairment and the IFRS 9 loss allowance in respect of which the 40 per cent tax allowance is determined.

- If a taxpayer is not applying IFRS 9 for financial reporting purposes:
  - As a result, it is proposed that an age analysis of debt be used in this regard. 40 per cent of the face value of doubtful debts that are at least 120 days past due date be allowed as a deduction, and
  - It it is proposed that 25 per cent of the face value of doubtful debts that are at least 60 days past due date, but excluding doubtful debts that are at least 120 days past due date, be allowed as a deduction.

Comment: Many taxpayers had more favourable past rulings from SARS and this proposal will result in a material cost to the affected taxpayers due to the reduction of the allowance percentage to 25 per cent. It is proposed that a transition rule be considered in this regard.

Response: <u>Partially accepted.</u> It is understood that the rulings were given to these taxpayers based on the commercial realities at the time which may still exist even now. At issue is that these rulings were giving these taxpayers higher allowances rates (of up to 100 per cent of the doubtful debts for accounting purposes) which will disadvantage these taxpayers because the allowance will now be a lower percentage. In order to mitigate the impact of the proposed amendments with respect to those taxpayers who received rulings from SARS, it is proposed that transitional measures, for example, a phase-in period be introduced in the tax legislation.

Comment: In order to address some concerns submitted by taxpayers and the oral presentations made on the Draft 2018 TLAB workshop held on 4 September 2018, the non-bank lenders requested a separate meeting to discuss these issues in detail.

Response: <u>Accepted.</u> A follow-up meeting will be arranged with all organisations that submitted comments on this issue before the tabling of the bill to ensure that we come to an amicable solution. Over and above the issues raised above, taxpayers should also state the cash tax impact (by using last year's financial statement figures) after taking into account the proposed allowance so as to determine an appropriate phasing-in period.

5. INCOME TAX: BUSINESS (INCENTIVES)

5.1. Review of Venture Capital Company rules

(Main reference: section 12J of the Act: clause 27 of the Draft Bill)

Since the introduction of the Venture Capital Company (VCC) tax incentive regime in 2008, its uptake has grown significantly over the past two years leading to a meaningful investment into the economy. Currently, there are 124 approved VCCs of which 2 were withdrawn. In terms of the VCC regime, taxpayers investing in a VCC are allowed an upfront deduction equivalent to the expenses incurred by a taxpayer in acquiring shares issued to that taxpayer by a VCC. However, the deduction is reversed and included as a recoupment in a taxpayer's income should that taxpayer dispose of those shares in a VCC within 5 years after acquiring them.

Administrative and technical issues

It has come to Government's attention that there are some administrative and technical issues in the tax legislation that are an impediment to further uptake of theVCC tax incentive. As a result, it is proposed that amendments be made in the Income Tax Act to address these administrative and technical issues.

Closure of abusive schemes

In addition, concerns have been raised including reports in the public domain regarding alleged abusive tax structures using the VCC regime. For example, immediately before the 2018 Budget, some companies were advertising tax structures in the media using the current VCC regime. In an attempt to close these abusive schemes, it is proposed that the following amendments be made in the Income Tax Act:

- Limit the abuse of trading between an investor that invested in a VCC and a qualifying company in which the VCC takes up shares.
- Either a VCC or a qualifying company may not issue more than one class of shares from the year of assessment during which that company started trading and any time after that.

Comment: Administrative issues – The proposed amendment to the controlled company test does still not adequately address all the uncertainty in current legislation, because based on the new proposed wording, the legislation is still ambiguous whether the controlled company test only applies between VCC's and the target QC or if any other interest in the QC (directly or indirectly outside the VCC investment) will influence the outcome of the relevant test.

Response: Accepted. Proposed wording to the controlled company test will be amended to further clarify policy intent.

Comment: Administrative issues – The new proposed expansion of the investment income test for start-up companies is welcomed. However, the measurement of the investment income test from the point of commencement of trade could unintentionally exclude certain qualifying companies from the intended investment benefit of the VCC system if they had been trading before the VCC investment.

Response: Accepted. Proposed wording to the investment income test for start-up companies will be amended to further clarify policy intent.

Comment: Closure of abusive schemes – To limit the abuse of trading between an investor that invested in a VCC and a qualifying company in which the VCC takes up shares it was proposed that the definition of qualifying company be amended. It is submitted that the proposed amendment is too wide in its impact and might unintentionally limit legitimate business transactions, including but not limited to:

- essential BEE-related supplier development;
- scaling ability of current qualifying companies' businesses;
- administrative burden of unintentional and unbeknownst trading with a tainted party.

Response: Partially Accepted. The high risk of abuse of allowing trading between a VCC investor and a qualifying company in which the VCC takes up shares remains a concern. In order to limit the impact of the proposed 2018 amendments on legitimate transactions and target the mischief in question, it is proposed that changes be made in the 2018 Draft TLAB so that the amount received or accrued by the qualifying company from any transactions between a VCC shareholder (together with connected persons) be limited to less than 50 per cent of the aggregate amount received or accrued from the carrying of a trade. In addition, it is proposed that this limitation only be applied after a period of 36 months from the date that the VCC acquires an interest in a qualifying company. The 36 month waiting period is proposed to specifically assist enterprise supply chain development.

Comment: Closure of abusive schemes – It is submitted that the proposed limit on the ability of both the VCC and a qualifying company to issue a single class of share is overly restrictive and would guarantee the premature-end of the VCC incentive. Several paramount and internationally accepted reasons exist to justify the use of more than one class of share within the venture capital industry, including but not limited to:

- VCC
  - Different classes of shares being used within the VCC for the carried interest purposes of VCC management (no VCC deduction obtained

    - for it) after receiving a pre-determined return of investment for VCC shareholders;
    - Different classes of shares being used for different rounds of capital raising by the VCC to ensure a cash flow waterfall for qualifying companies; and
    - Different classes of shares being used to channel investments into different industrial sectors within a single VCC.

- Qualifying company
    - Different classes of shares being used to ensure a preferent right to recovery for the VCC;
    - Different classes of share for assurance of governance control in the qualifying company;
    - Different classes of shares that existed before the VCC investment;
    - Different classes of shares being used to avoid the dilution of the original entrepreneur's shareholding.

As such, it would not be appropriate to prohibit the accepted practice of using different classes of shares on both levels to either invest in VCC's or target qualifying companies.

> *Response*: Partially accepted. The risk of abuse in allowing VCC's and target qualifying companies in which the VCC takes up shares remains a significant concern. However, government recognises the unintended consequences that the proposed amendments could have on industry standard practices and as such it is proposed that changes be made to the 2018 Draft TLAB so that no shareholder (together with connected persons) in a VCC may hold, directly or indirectly, more than 20 per cent of the shares of any class in a VCC. In addition, it is proposed that the test regarding the class of shares be applied after a period of 36 months from the date those classes of shares are first issued by the VCC.

Comment: Closure of abusive schemes – The retrospective nature of the proposed closure of abusive schemes will abruptly end most if not the entire Section 12J VCC industry. The proposed amendment has created great uncertainty within the industry, including VCC investors and targeted qualifying companies. Many legitimate VCC's were set up based on current legislation and the proposed amendments would ensure that VCC's are heavily penalised in addition to adverse consequences for both VCC investors and target qualifying companies without a fair timeframe to restructure.

> *Response:* Accepted. Government recognises the unintended consequences of the proposed effective date of the amendments on the Section 12J VCC industry and the effective date will be changed to apply to any trading that commences or classes of shares issued during years of assessment commencing on or after 1 March 2019.

5.2. Reviewing the write-off period for electronic communication cables

(Main reference: sections 11(f) and 12D of the Act: clauses 23 and 26 of the Draft Bill)

The Income Tax Act contains rules that make provision for depreciation allowances in respect of electronic communication cables. However, the depreciation period over which taxpayers can claim allowances under these rules varies depending on whether the taxpayer owns or rents the electronic communication cables. In order to ensure that the tax legislation keeps up with technological advances and international practice, the following amendments are proposed in the Income Tax Act:

- The depreciation period for taxpayers should be aligned irrespective of whether the taxpayer owns or rents the electronic communication cables;
- The depreciation period in respect of electronic communication cables should be 10 years or the number of years in which the taxpayer is entitled to use the asset, whichever is the lesser.

Comment: In the 2018 Draft TLAB, the write-off period in respect of electronic communications cables contemplated in section 12D(1) owned by the taxpayer and used in South Africa has been reduced from 15 years to 10 years. However, an amendment has not been made to the Income Tax Act under section 11(o) to also allow for a scrapping allowance (a deduction of the amount by which the cost of an asset exceeds any money received as a result of its alienation, loss or destruction) of such electronic communications cables should they be alienated (i.e. withdrawn), lost or destroyed. Taxpayers are proposing that section 12D electronic communications cables should also be specifically included in section 11(o) as these cables will also now meet the expected useful life requirement of not exceeding 10 years as stipulated in section 11(*o*)(*ii*).

Response: Noted. A 10-year write-off period is not in of itself an automatic qualifying factor for a scrapping allowance. In the current scrapping allowance provision specific inclusion and as a result specific consideration must be made for an asset class to qualify. At present, the allowances are subject to review and further expansions of the current allowances should be part of the review process.

5.3. Extension of Employment Tax Incentive Scheme

(Main reference: section 12 of the Employment Tax Incentive Act: clause 100 of the Draft Bill)

The Employment Tax Incentive (ETI) scheme was introduced in January 2014 to promote employment, particularly of young workers. After the initial 3 years of the programme, it was extended for a further two years. This period is set to lapse on 28 February 2019. The first extension was based on a process of review and a consultation process with the National Economic Development and Labour Council (“NEDLAC”), which indicated (i) modest positive effects on growth rates of youth employment in claiming firms; and (ii) that significant negative effects did not materialize. As part of the ongoing monitoring and evaluation of this programme, another round of inputs will be collected from social partners through NEDLAC this year. An extension is proposed in light of the need to support youth employment, as indicated in the State of the Nation Address ("SONA") delivered on 15 February 2018. The ongoing review process may result in further proposals for amendments, which can be processed subsequently. As a result, it is proposed that the ETI end date should be extended for a further 5 years, from 28 February 2019 to 28 February 2024, with an interim report on its performance to be published after 3 years. Consultations on the extension of the ETI and on its impact on employment are currently taking place in NEDLAC.

Comment: It is suggested that the administration of the ETI is simplified so as to improve take-up of the initiative.

Response: Noted. Discussions with social partners at NEDLAC are in their final stages. A general consensus has been reached that the ETI be extended for at least 5 years – perhaps even a longer period. Issues including the administration of the incentive will be considered as a separate policy proposal for the coming budget.

6. INCOME TAX: INTERNATIONAL

6.1. Addressing an overlap in the treatment of dividends for income tax and transfer pricing purposes

(Main reference: sections 31 and 64D of the Act: clauses1and 59 of the Draft Bill)

Currently, there is a potential overlap between the treatment of a dividend as defined in the Income Tax Act and the treatment of an amount deemed to be a dividend under the transfer pricing provisions of the Income Tax Act. Consequently, an amount deemed to be a dividend in specie as a result of a transfer pricing secondary adjustment may, depending on the facts and circumstances of the case, already constitute a dividend as defined in the Income Tax Act. In order to address this anomaly, it is proposed that clarity should be provided in the Income Tax Act that an amount deemed as a dividend in specie as a result of a transfer pricing secondary adjustment is excluded from the definition of dividend in the Income Tax Act.

In turn, consequential amendments should be made in the Income Tax Act so that the above-mentioned amount deemed to be a dividend in specie as a result of a transfer pricing secondary adjustment should be regarded as a dividend subject to dividends tax at a rate of 20 per cent.

Comment: The draft Explanatory Memorandum 2018 indicates that the overlap may unintendedly result in tax treaty relief being available in respect of an amount deemed to be a dividend as a result of a transfer pricing secondary adjustment.

Firstly, the policy concern of the proposed amendment is not understood. The purpose of the secondary adjustment is to protect the dividends tax base. If an actual dividend would have qualified for treaty relief, there can be no quarrel with a secondary adjustment qualifying for treaty relief. Secondly, it is not clear how the proposed amendments will address this concern. Every treaty has its own definition of a dividend which will override the domestic definition. As a general principle, a transfer pricing adjustment would not meet this definition and would not qualify for treaty relief. Some treaties do extend the definition to certain deemed dividends (e.g. the SA/UK treaty). However, whether a secondary adjustment will qualify as a dividend for treaty purposes is a question of fact and the terms of the relevant treaty.

Response: Noted. The proposed draft explanatory memorandum will be revised to provide clarity on the policy concern the proposed amendment seeks to address and further expound how such concern will be addressed.

Comment: The proposed amendment in the draft TLAB includes no effective date for the proposed amendment to the definition of "dividend". It is proposed that the effective date should refer to the years of assessment commencing on or after 1 January 2019.

Response: Accepted. Changes will be made to cater for the effective date.

6.2. Rules addressing the use of trusts to avoid tax in respect of controlled foreign companies

(Main reference: sections 7(8), 25B(2A) and paragraphs 72 and 80 of the Eighth Schedule to the Act: clauses 8, 46, 85 and 86 of the Draft Bill)

In 2017, amendments were made to the Income Tax Act to extend the application of the Controlled Foreign Company (CFC) rules to foreign companies held through foreign trusts if the financial statements of those company's form part of the consolidated financial statements of a group company of which the parent company is resident in South Africa. The above-mentioned 2017 changes did not address the issue of South African resident individuals indirectly holding shares in a foreign company through foreign trusts. The 2017 Draft TLAB that was published for public comments on 19 July 2017 contained rules addressing the issue of South African resident individuals indirectly holding shares in a foreign company through foreign trusts. However, following oral presentations on the 2017 Draft TLAB at hearings held by the Parliament Standing Committee on Finance on 29 August 2017 and meetings held with stakeholders on 18 September 2017, the above-mentioned proposed rules were withdrawn due to the wide nature and complexity and were postponed to the 2018 legislative cycle. In order to address this issue, it is proposed that the following amendments be made tothe Income Tax Act:

- Disregarding the participation exemption in respect of foreign dividends for purposes of income inclusion in terms of section 7(8) of the Income Tax Act,

- Disregarding the participation exemption in respect of foreign dividends for purposes of income inclusion in terms of section 25B of the Income Tax Act,
- Disregarding the participation exemption in respect of capital gains derived from the sale of foreign shares for purposes of attribution of capital gain in terms of paragraph 72 of the Eighth Schedule to the Income Tax Act, and
- Disregarding the participation exemption in respect of capital gains derived from the sale of foreign shares for purposes of attribution of capital gains in terms of paragraph 80 of the Eighth Schedule to the Income Tax Act

Comment: It is recognised that the purpose behind these amendments is as an alternative to attempting to bring the underlying subsidiaries of offshore trusts into the CFC net. This is achieved by removing the participation exemption. Had it been possible to bring these companies within the ambit of the CFC legislation, then the exemptions contained in section 9D of the Act (for example, high tax exemption and foreign business establishment exemption) would have applied. If the exemptions apply, there would be no objection to the shareholder of a CFC enjoying a participation exemption in terms of section 10B(2)(a) of the Act. It is the taxpayers' view that the proposed amendments should be targeted at situations where the above-mentioned exemptions contained in section 9D would not have applied. However, in cases where those exemptions would have applied, there is no reason to deny the participation exemption.

> *Response*: Not accepted. CFC rules make provision for South African residents that have more than 50% participation or voting rights in a CFC to tax an amount equal to the net income of the CFC as if the net income of the CFC was immediately repatriated to South Africa when that income is earned by the CFC. In order to promote international competitiveness, CFC rules make provision for high tax exemption and foreign business establishment exemption. The proposed amendments in the 2018 draft TLAB do not seek to tax the net income of the CFC as if the net income of the CFC was immediately repatriated in South Africa, but seek to remove the participation exemption in respect of foreign dividends and foreign gains in the given circumstances.

Comment: The proposed amendment in paragraphs 72 and 80 of the Eighth Schedule to the Act should correspondingly include the 50 per cent participation requirement in the proposed in sections 7(8) and 25B of the 2018 Draft TLAB.

> *Response:* Accepted. The 50 per cent participation requirement in the proposed section 7(8) and 25B of the 2018 Draft TLAB will be extended to the proposed sections as to align the proposed amendments to section 7(8) and 25(2A).

Comment: In the proposed section 7(8)(aA)(i)(aa) the test is whether the participation rights are held by that person or by any one or more connected persons. For example, if the offshore trust held 30 per cent and a beneficiary held 25 per cent, the requirement of more than 50 per cent would not be met. As a result, it is proposed that, where it states "by that person or any one or more persons…", it should rather be read "by that person alone or together with any one or more persons…" or "by that non-resident or a connected person in relation to that non-resident".

Response: Noted. The suggested wording to the proposed amendments will be taken into consideration in order to refine the provisions of this section.

7. VALUE-ADDED TAX

7.1. VAT treatment of Cryptocurrency transactions

(Main reference: Section 2 of the VAT Act: clause 88 of the Draft Bill)

The proposed amendment in the 2018 Draft TLAB seeks to clarify the existing provisions dealing cryptocurrencies in the South African tax law and add cryptocurrencies under the provisions of section 2 of the VAT Act, dealing with Financial Services.

Comment: The proposal to include the following activities "*the issue, acquisition, collection, buying or selling or transfer of ownership of any cryptocurrency*" under exempt financial services is welcome. However, a definition of "cryptocurrency" needs to be added to the VAT and Income Tax Acts to avoid any possible confusion with loyalty schemes.

Response: Not accepted: There cannot be any confusion between cryptocurrency and loyalty schemes as these two have different features. Adding a definition of "cryptocurrency" in both the VAT and Income Tax Acts is not necessary since there is a general understanding of the meaning of cryptocurrencies.

Comment: Remove the word "collection" from the proposed new wording of exempt financial services in section 2 of the VAT Act so that the fees that may be charged by 3rd parties (for example debt collectors) may be taxable.

Response: Partially accepted: Section 2(1) of the VAT Act currently contains a proviso that excludes fees, commissions, merchant's discounts or similar charges from exempt financial services in section 2. An amendment will be proposed to this proviso to add a reference to such charges on cryptocurrencies.

Comment: If "the issue, acquisition, collection, buying or selling or transfer of ownership of any cryptocurrency" is exempt, then a vendor making 100 per cent taxable supplies who chooses to accept cryptocurrencies as a form of payment and then on-sells such cryptocurrency, will now no longer be making 100 per cent taxable supplies and will no longer be entitled to full input tax credits. The vendor will now also be making exempt supplies and will need to apportion input tax credits. National

Treasury should re-consider the proposed inclusion of cryptocurrencies into “financial services” contained in the 2018 Draft TLAB and should rather treat cryptocurrencies as or deem it to be “money”.

Response: Not accepted: South Africa has taken a policy position and the South African Reserve Bank has issued a policy document stating that cryptocurrencies is not considered to be legal tender in South Africa. As such, National Treasury cannot treat cryptocurrencies as money for tax purposes. That said, the proposed amendment to the VAT Act seeks to treat “the issue, acquisition, collection, buying or selling or transfer of ownership of any cryptocurrency” as an exempt financial services. If a vendor making wholly (100 per cent) taxable supplies opts to accept cryptocurrency as payment and then needs to sell them later on, then such vendor must accept the fact that the nature of its business has fundamentally changed from one making wholly taxable supplies to one making mixed supplies and the usual provisions of the VAT Act relating to mixed supplies and apportionment will apply.

7.2. Insertion of the definition of “face value” under the provisions dealing with irrecoverable debt

(Main reference: Section 22 of the VAT Act: clause 89 of the Draft Bill)

It has come to Government’s attention that some vendors (for example collection agents or banks) that buy the book debt in terms of the above-mentioned arrangement then attempt to claim a further VAT deduction if they write off all or part of this debt in future. This results in a double VAT deduction, which is against the intention of the legislation as seen in the definition of “face value” of a debt transferred in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 1997. The Explanatory Memorandum provides that the “face value” of a debt transferred is, for the purpose of section 22(1), the net value of the account receivable at time of transfer, after adjustments have been made for debit and credit notes and after taking into account the input tax claimed on the bad debt amount already written off by the (first / supplier) vendor. In order to address this anomaly and prevent the double VAT deduction, it is proposed that amendments be made in section 22 of the VAT Act by inserting a definition of “face value” to take into account the policy rationale explained in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 1997.

Comment: The inclusion of the word “net value” in the proposed definition of “face value” is confusing. Consider replacing the word “net value” with the word “amount”. Further, the word “bad debts” in the proposed definition of “face value” is not the normal wording that is generally used in the VAT Act. It is proposed that the wording “bad debts already written off as irrecoverable” should be replaced with the following wording “amounts already written off as irrecoverable”.

Response: Accepted. The amendments will be made

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8. Income Tax: Administration

8.1. No returns required for tax exempt dividends

(Main reference: section 64K; clause 2)

Comment: In terms of the proposed amendment it appears that taxpayers who receive partially exempt dividends are also not required to submit a return anymore. It is proposed that clarity is provided in the Memorandum of Objects that it was the intention to exclude partial exemptions as well.

Response: Noted. The Memorandum of Objects makes it clear that a recipient need not submit any return in respect of a dividend received, whether exempt or not i.e. the reporting duty on the recipient is removed.

8.2. Deletion of directors of private companies who do not receive remuneration from definition of "employee"

(Main reference: Paragraph 1 of the Fourth Schedule; clause 5(a))

Comment: It is unclear if it is the intention that payments to these directors will no longer be subject to employees' tax (e.g. salary payments to a director who is also a CEO, CFO, etc., would be subject to provisional tax) or whether it is the view of SARS that such taxpayers would in any event fall under paragraph *(a)* of the "employee" definition and it is therefore unnecessary to specifically refer to directors of private companies?

Response: Noted. The provision that is proposed to be deleted only refers to directors who do not receive remuneration. It is the intention that directors who do receive remuneration are subject to employees' tax in the same way as other employees.

8.3. Amendment of definition of 'provisional taxpayer'

(Main reference: Paragraph 1 of the Fourth Schedule; clause 5(b))

Comment: The proposed amendment will draw relatively unsophisticated taxpayer such as salary earners with moderate equity portfolios into the provisional tax system. The proposed amendment should be reconsidered in view of the additional administrative burden it will create for taxpayers.

Response: Accepted. The proposed amendment will be reconsidered for the 2019 legislative cycle.

8.4. Valuation of fringe benefits of a non-executive director under Seventh Schedule

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

Comment: Non-executive directors of companies were removed from the definition of 'employee' for purposes of the Fourth Schedule. Consequently, these directors are not subject to employees' tax in terms of that schedule. The proposed amendment aims to deem a non-executive director to be an employee as far as a taxable benefit in terms of the Seventh Schedule is concerned. These taxable benefits are included in the definition of remuneration and hence the non-executive director will be required to pay employees' tax on such taxable benefit. This creates a contradiction in that the VAT and employees' tax will now be determined not in relation to the nature of the appointment of director but by the means of payment for serving in this role.

Response: Noted. The proposed amendment is only made for purposes of the Seventh Schedule (valuation of the taxable fringe benefit). It does not affect the exclusion of fees paid to non-executive directors from the definition of remuneration for employees' tax purposes in the Fourth Schedule. The intention of the proposed amendment is to ensure that a proper valuation is placed on the benefit. The amendment will, however, be withdrawn in view of the fact that further analysis has demonstrated that the existing provisions of the Seventh Schedule are adequate to assign a value to the fringe benefit in these cases.

9. Customs and Excise: Administration

9.1. Application of Tax Administration Act to write off or compromise of debt

(Main reference: section 114A; clause 9)

Comment: The term "with the necessary changes" is vague therefore open to interpretation. The wording should be narrowed down to provide legal clarity.

Response: Not accepted. The principle of *mutatis mutandis* is a well-recognised legal principle under South African statutory law and is used in customs and excise legislation and tax Acts, for example the Income Tax Act, 1962, and the VAT Act, 1991. The concept "with the necessary changes" is merely a more modern use of the principle.

10. Value-Added Tax: Administration

10.1. Material error on tax invoice

(Main reference: section 20; clause 10)

Comment: The defined term in section 1(1) is ‘tax invoice’ and refers to a document provided as required by section 20(4) and (5). Although it seems clear what is meant by ‘original tax invoice’, such term could possibly give rise to interpretational difficulties as it is technically not a tax invoice as defined if it contains errors. As such, there is no concern of raising two tax invoices for the same supply as the original document was not a valid tax invoice by virtue of the material error. It is therefore recommended that the use of the term ‘original tax invoice’ be reconsidered.

Response: <u>Partially accepted.</u> The supplier is obliged to issue a tax invoice within 21 days of making a supply. The supplier will normally generate a tax invoice based on information supplied by the recipient which at that time constitutes a valid tax invoice, in the hands of the supplier. Where the supplier is subsequently informed by the recipient that information on the tax invoice is incorrect, the nature of the incorrect information may result in either the tax invoice still remaining valid or the tax invoice being invalid. Where the tax invoice becomes invalid, the view is that it is invalid from the date that the supplier is informed of the error. This view is adopted on the basis that the supplier should not be regarded as non-compliant with the 21-day requirement if the information provided by the recipient was captured correctly by the supplier.

Comment: The amendment proposes in subsection 1B(i) that the supplier or recipient must “cancel the original tax invoice and issue a tax invoice with the correct information”. In most cases, the accounting systems are designed such that once the invoice is created; the invoice can be cancelled by only the credit note. Such system controls are in place to prevent instances such as duplication of payments. The invoice of the same supply can be created twice but it would therefore result in unintended consequences such as duplication of output VAT. Guidance must be provided to vendors as to the manner in which the originally flawed document must be cancelled. Clarification is also sought pertaining to the manner in which changes can be made to the invalid document, for example, will a supplier be able to write on a tax invoice in order to ensure it is a valid document.

Response: <u>Partially accepted.</u> The proposed amendment has been reworded to substitute the term “correct” for “cancel”. Each vendor’s accounting system is unique to its business needs. Each vendor should, therefore, ascertain the manner in which the original tax invoice should be corrected.

Comment: Confirmation is required whether this materially-flawed document constitutes an additional event for the raising of a credit or debit note.

Response: <u>Noted.</u> For VAT purposes it does not create an additional event.

Comment: It must be clarified how the valid (corrected) tax invoices will be treated in the VAT returns for past periods.

> *Response:* Accepted. The new wording of the proposed amendment, reflected below, makes it clear that there is no change in the time of supply.

> Section 20 of the Value-Added Tax Act, 1991, is hereby amended by the insertion after subsection (1A) of the following subsection:
>
> "(1B) Where a tax invoice contains an error in the particulars listed in subsection (4) or (5) and the circumstances contemplated in section 21(1)*(a)* to *(e)* of this Act are not applicable, the supplier must—
>
> (i) correct that tax invoice with the correct particulars, within 21 days from the date of the request to correct it: Provided that the time of supply contemplated in section 9 of this Act remains unaltered; and
>
> (ii) obtain and retain information sufficient to identify the transaction to which that tax invoice and the corrected tax invoice refers."

Comment: The proposed amendment seems to be aimed at dealing with situations where some of the information reflected on the tax invoice may be incorrect or incomplete, thereby causing it not to be a valid tax invoice. It is proposed that the reference to 'material' error be reconsidered in this context, as any incorrect information may render the document to be an invalid tax invoice, whether the error is subjectively considered to be material or not.

> *Response:* Partially accepted. The proposed amendment has been reworded to reference the provision of section 20(4) or (5) that deal with the particulars to be included in a tax invoice.

Comment: The proviso pegs the time of supply to the date of the original tax invoice. There is a concern on what the position is where the time of supply was originally triggered by an event other than the invoice such as the receipt of consideration, or in accordance with some other event in terms of section 9 (for example connected parties in section 9(2), or due or received as contemplated in section 9(3)*(a)*). The proposed proviso in these circumstances may shift the time of supply to the original invoice date. It is proposed that this proviso be amended to achieve its purpose, which is that the original time of supply remains, notwithstanding the cancellation and issuance of a new tax invoice.

> *Response:* Accepted. The new wording of the proposed amendment will address this comment.

Comment: The proposed insertion of section 20(1B) includes sub-paragraph (ii) which requires that the supplier or the recipient (as the case may be) obtains and retains information sufficient to identify the transaction to which the original tax invoice and the corrected tax invoice refer. Guidance must be provided as to what will be accepted as "sufficient information", i.e. what will be the minimum requirement of documents to be kept. The practical implementation of this requirement should be considered in light of the ERP system limitations.

> *Response:* Noted. Maintaining adequate accounting and documentary evidence is a standard requirement for internal and external audit purposes. Such accounting and documentary evidence will suffice for purposes of meeting the "sufficient information" standard.

Comment: The proposed section 20(1B)(iii) requires the supplier or the recipient to document reasons for the cancellation of the original tax invoice and the issue of a corrected tax invoice. However, it is submitted that if the requirements of section 20(1B)(ii) are complied with and sufficient information is retained, such information should be sufficient to also determine the reasons for the cancellation of the original tax invoice.

> *Response:* Accepted. The new wording of the proposed amendment will address this comment.

Comment: The tax invoice is primarily used as supporting documentation of a supply, and SARS relies on the tax invoice for verification/audit purposes. It is proposed that the correct tax invoice must contain the reference to the original tax invoice that was cancelled/that it replaces, as well as the original date.

> *Response:* Comment misplaced. This comment is already catered for under paragraph (ii) of the proposed amendment.

Comment: The requirements proposed in subsection 1(B)(ii) and (iii) provide matching particulars contained in section 21(3)*(a)*(vi),(v) and *(b)*(vi),(v), where the supplier or the recipient must obtain and retain information sufficient to identify the transaction to which the credit note or debit note refers and document the reasons that gave rise to the issuance of a credit note or debit note. Hence, the current legislation already provides for subsection 1(B)(ii) and (iii) under section 21 of the VAT Act. Hence it is proposed that the amendment be moved from section 20 to section 21(1) as one of the circumstances that the credit or debit note can be issued under the new proposed subparagraph *(f)* as follows "an error has occurred in stipulating the details to comply with the valid tax invoice to deduct input tax in terms of section 16(2) of the Act." It is also proposed that subparagraph 1B(i) be deleted.

> *Response:* Not accepted. This would change the time of supply for the accounting of output tax, which would be inappropriate.

10.2. Credit notes in the context of a going concern

(Main reference: section 21; clause 11)

Comment: The proposed amendment is welcomed as it clarifies the VAT implications for the recipient of an enterprise as a going concern that subsequently accepts goods returned which were previously supplied to customers by the supplier of the enterprise as a going concern. However, the wording of the proposed amendment seems confusing, as it is not immediately clear who the 'vendor' is, as referred to in the proposed section.

> *Response:* Partially accepted. The proposed amendment will be reworded as reflected below.
>
> "(ii) a vendor, where a supply of an enterprise as a going concern, contemplated in section 11(1)*(e)* of this Act, was made to that vendor, the vendor in such case being deemed for purposes of this Act to have made the supply of the goods or services to the recipient, whether the supply was made by him or the other vendor that made the supply of that enterprise as a going concern;".

10.3. Retention of relevant material

(Main reference: section 29; clause 13)

Comment: The amendment is welcomed as it will indeed ease the administrative burden on vendors.

> *Response:* Noted. This is the intention.

10.4. Prescription on erroneous overpayments.

(Main reference: section 44; clause 15)

Comment: The position that the claim will not be considered merely because of invalid bank details is unfair and unjust but rather the claim should be considered on its merits and if incorrect bank details were provided, only a refund can be withheld pending the validation and provision of correct bank details.

> *Response:* Partially accepted. As a refund claim cannot be held open indefinitely, the new wording of the proposed amendments will provide for an additional 90 days, from the date the claim for the refund was made, to provide the banking details.

Comment: The proposed amendment is welcomed as it clarifies the time period within which any refund of VAT erroneously overpaid may be claimed.

> *Response:* Noted. This is the intention.

Comment: Although the proposed section 44(11)*(b)* refers to section 44(3)*(d)*, it is not fully aligned to that section. It is recommended that the proposed wording be amended.

Response: Accepted. The wording has been aligned in the proposed amendment.

10.5. Set-off and recovery of VAT in case of divisions or branches

(Main reference: section 50; clause 16)

Comment: The reason behind the proposed amendment is clear. However, it is submitted that the administrative burden coupled with the proposed amendment has not been taken into account. The practical implications of this provision should also be taken into account. It is proposed that this amendment be withdrawn. As an alternative, it is recommended that the alternative proposal regarding the wording of the new proposed section 50(7) be included as the wording of the alternative proposal is more precise and therefore the preferred option.

> *Response:* <u>Partially accepted</u>. The alternative proposal regarding the wording will be used. Measures will be put in place so that the branch whose refund is to be set-off, is notified of the set-off and in respect of which other branch.

10.6. Inclusion of joint ventures

(Main reference: section 51; clause 17)

Comment: The concept of a joint venture is not defined in the VAT Act. It is also not recognised in law as having a legal persona. It is often only identifiable based on the contractual arrangement among contracting parties. In practice it can take many shapes and forms and varies from very formal arrangements to informal collaborative arrangements. Due to the critical impact that this proposed amendment might have on the parties involved in joint ventures and similar contractual arrangements, it is recommended that a definition be inserted in the VAT Act as to the nature of a joint venture. Alternatively, the proposed amendment must be reconsidered.

> *Response:* <u>Not accepted</u>. The proposed amendment only applies to joint ventures, other than joint ventures carried on through companies that specifically register for VAT purposes as vendors. If the joint venture wishes to register for VAT but avoid joint liability for VAT purposes, it can register as a company to do business.

11. Tax Administration

11.1. Audit engagement letter

(Main reference: section 42; No proposed amendment contained in draft Bill)

Comment: The proposed amendment is welcomed as a step in the right direction. However, it is limited to the audit process. In order to enhance this provision, it is recommended that the proposed amendment be extended to apply to all SARS actions that may result in an assessment including verification or inspection processes. This will provide further certainty to taxpayers and ensure alignment with the recently published SARS Service Charter where SARS endeavours to notify taxpayers of verification within 15 business days of submission of a return.

> *Response:* Not accepted. For purposes of an inspection SARS may, under section 45 of the Act, without prior notice arrive at premises to determine the identity of the person occupying the premises, whether the person occupying the premises is conducting a trade or an enterprise and is registered for tax and keeps the required records. These inspections are typically used for tax base broadening purposes or verification, for example, of the existence of an enterprise for purposes of VAT registration. Advance notification would defeat this objective.
>
> Verification, in turn, is intended to be a short process and introducing additional steps in the process would simply delay the finalisation of such matters, including the payment of refunds where due. If pursuant to a verification the assessment is adverse, the taxpayer is entitled to grounds under section 96(2)*(a)* of the Act and should be in a position to understand why the outcome is adverse. An audit is generally a more detailed and protracted process which is why it involves audit progress reports, letters of audit findings and a pre-assessment opportunity to respond to the audit findings.

Comment: The term "audit engagement letter" is inconsistent with other provisions of the TAA and should be replaced with the wording used in section 226(2) being "notice of commencement of an audit". This will provide clarity as the stated intention of the proposed amendment i.e. to ensure that taxpayers are notified of the start of an audit in order to keep all parties informed.

> *Response*: Accepted.

Comment: It is recommended that the legislation should stipulate that SARS is obliged to issue the audit engagement letter within a specified time period before the commencement of the audit and that the subsequent progress reports are issued at 90 day intervals without any request from the taxpayer.

> *Response:* Not accepted. Notice of commencement of audit simply means SARS will use its information gathering powers, within the limits thereof including time periods where prescribed, under Chapter 5 of the TAA. Attempting to prescribe time periods in the audit context is problematic given differences between the types of audits, manner in which an audit is conducted (e.g. request for information vs field audit) and complexity. In the case of a field audit, given its more intrusive nature, advance notice of at least ten business days must be given by SARS, unless the taxpayer waives the notice. An audit progress report under section 42(1) must be provided by SARS in the prescribed manner and intervals and is not request driven.

Comment: It is proposed that legislation specifically includes the provision of an audit finalization letter, similar to the proposed audit engagement letter with reference to the date of commencement.

Response: Noted. It is implicit that, once the audit is finalised and no letter of findings is issued, the last ‘progress report’ will inform the taxpayer of this, as failing to do so means the obligation to provide ongoing audit progress reports will remain indefinitely.

11.2. Understatement penalties

(Main reference: sections 221 and 222; clauses 25 and 26)

Comment: The proposed replacement of the phrase ‘default in rendering a return’ with the phrase ‘failure to submit a return’ in the definition of an understatement needs to be clarified. SARS needs to clearly differentiate between the late filing of a return (which may result in administrative non-compliance penalties) and the ‘failure to submit a return’ and provide further guidance in this regard.

The Administrative Non-Compliance penalty in Chapter 15 is the appropriate penalty provision which is designed for and suitable for purposes of dealing with or penalising the non-rendition of a tax return and as a result of the proposal an artificial situation is created whereby ‘tax’ must be deemed to be nil. It is proposed that a notice be issued whereby the non-rendition of a return is made subject to an administrative non-compliance penalty and that it does not fall within the understatement penalty (USP) provision. Alternatively, should SARS still be of the view that the fixed penalty is insufficient, the law provides for appropriate remedies in the form of estimated assessments and jeopardy assessments which are for this exact purpose, namely failure to submit a return.

Response: Not accepted. The overlap between an administrative non-compliance penalty and an understatement penalty is a long standing one. It is necessary to ensure that in cases where no return is submitted and cases where a return is submitted but with an omission or incorrect statement, are subject to the same penalty. It would be incongruent if a person who did not submit a return at all is treated more leniently than a person who did submit a return. An estimated or jeopardy assessment without an understatement penalty would not address this incongruity. The behavioural requirements for the imposition of an understatement penalty are such that it is unlikely to find application in less serious cases. If an understatement penalty is imposed, current law provides that no administrative non-compliance penalty may be imposed to prevent duplication of administrative penalties.

11.3. Tax practitioner regulation

(Main reference: section 240; clause 27)

Comment: The principle that tax practitioners should have their own house in order before they provide tax services to the public is welcomed. However, the express concern is that the mere proposal to identify non-compliance with a specified time period does not appropriately address the matter.

Response: Not accepted. What is intended is a clear and proactive mechanism to determine non-compliance by a tax practitioner.

Comment: The meaning of 'repetitive' which is in the context of an alternative test to 'for a continuous period of at least six months' is entirely unclear and therefore open to interpretation and should be defined.

Response: Accepted. The new wording of the proposed amendment is as follows:

"*(d)* during the preceding 12 months has for an aggregate period of at least six months not been tax compliant to the extent referred to in section 256(3)*(a)* and *(b)* and has failed to—

(i) demonstrate that he or she has been compliant for that period; or

(ii) remedy the non-compliance,

within the period specified in a notice by SARS.".

Comment: The time period of the continuous non-compliance is not aligned to the period of non-compliance with respect to submission of tax returns in terms of which an administrative non-compliance penalty is imposed. In this regard, the penalty is imposed only on the second incidence of non-compliance. It is proposed that the non-submission of returns should be aligned to section 210 of TAA.

Response: Not accepted. Non-compliance in this context may involve other tax types such as employees' tax or VAT.

Comment: Tax practitioners' tax compliance as a requirement for Recognised Controlling Bodies affiliation and membership is done on an annual basis. There seems to be a mismatch to deregister a practitioner who has been non-compliant for three months during any six-month period.

Response: Partially accepted. See new wording of proposed amendment above.

Comment: It is submitted that the 6-month period is too short and should be extended to a year in order to cater for extraordinary circumstances.

Response: Accepted. See new wording of proposed amendment above.

Comment: There is a significant risk that tax practitioners may be disadvantaged as a result of the systemic SARS issues rendering such tax practitioner as being 'non-compliant' with no clear indication as to how the non-compliance arose or how the matter will be resolved, unless a fair procedure exists in relation to these contested positions.

Response: Accepted. Under the new wording of the proposed amendment, tax practitioners will be given the opportunity to show that they are in fact compliant.

Comment: It is not clear who deregisters practitioners. Will there be a distinction between a company or entity owned by the practitioner and his or her personal return considering that membership or registration is for the individual and not the entity he represents?

> *Response:* Noted. SARS will deregister the tax practitioner pursuant to the notice procedure set out in the new proposed wording. Tax practitioners are regulated under the Act in their personal capacity. The deregistration sanction will only apply in respect of the tax obligations of tax practitioners, although a case could be made that it should also apply in future to entities which they practice through or control.

Comment: What are the implications of deregistering a tax practitioner who has submitted a return but is unable to pay the tax debt, how is he or she expected to conduct business to make money to pay the debt if deregistered.

> *Response:* Noted. Section 256(3) makes provision for debt relief in respect of an outstanding tax debt and if the practitioner qualifies for such relief, no deregistration as a result of tax non-compliance will result.

Comment: It remains unclear that should SARS validly deregister a tax practitioner, how the clients of such tax practitioner are to be notified and treated fairly to ensure they don't suffer prejudice, which is arguably similar in nature when legal counsel is changed in court proceedings.

> *Response:* Noted. It is only the tax practitioner who has the details of all his or her clients and thus bears the responsibility to notify them. The purpose of the regulation of tax practitioners is taxpayer protection and it follows that a tax practitioner whose own tax affairs are not in order should not be responsible for those of others. During the notice period the clients of the non-compliant tax practitioner could change tax practitioner by means of a new mandate provided to SARS or, in a firm of practitioners, be transferred to another practitioner in that firm. Should the client not be timeously notified and the deregistration of a tax practitioner results in the imposition of penalties on the taxpayer, these circumstances may be taken into consideration by SARS for purposes of remitting penalties under Part E of Chapter 15 of the Act or by the tax board or tax court during a tax appeal.

Annexure A – Organisations

No.	Organisation	Contact person
1.	Actuarial Society	Wim Els
2.	Affinity Capital	Hugh Napier
3.	African Growth and Private Equity	Rob Goff
4.	AGRISA	Jana Robinson
5.	AJM Tax	Albertus Marais
6.	Anuva Investments	Neil Hobbs Larry Fitnum
7.	Assosiation for Savings and Investment SA	Peter Stephan Wagieda Poegenpoel
8.	Banking Association South Africa	Tshepang Kere Leon Coetzee Ian Cloete
9.	Benguela Fund	Gaurav Nair
10.	Blue Quadrant	Leandro Gastaldi
11.	Bluefields Capital	Ravi Naidoo
12.	BMW Financial Services	Lize-Marie Reyneke
13.	Bowmans	Aneria Bouwer Patricia Williams
14.	British American Tobacco South Africa	Lindsay Mervyn Martin
15.	BUSA	Olivier Serrao
16.	Capitis Equities	Emcee Nell
17.	Carican Fund Managers	Johann Carstens
18.	CCP Fund Limited	Paul Miller
19.	CFO Forum	Naidoo Gelishan
20.	CG Investment Holdings	Peta Chennells
21.	Cliffe Dekker Hofmeyr Inc.	Harriet Tarantino Gerhard Badenhorst
22.	De Beers Group	Innocent Mabusela
23.	Deloitte	Le Roux Roelofse
24.	Elgatone Financial Services	Hano Coetser
25.	Empowerment Capital	Mark Fitzjohn
26.	Euphoric Capital	Dean McLuckie
27.	Exponential Venture Capital	Alex Funk
28.	Food and Allied Workers Union	Katishi Masemola
29.	Futureneers Group	Jaco Gerber
30.	GAIA Venture Capital	Renier de Wit
31.	Grovest	Yonit Sher
32.	Harbour Energy	Adam Bekker
33.	Impact Investment Africa	Dave Humphrey
34.	Industrial Development Corporation	Jan Pienaar
35.	Infinity Fund Managers	Eli Friedman
36.	Institute of Retirement Funds Africa	Sizakele Khumalo

37.	JA Transaction Solutions	James Aitchison
38.	Jaltech Financial Consultants	Evaghn Naicker Jonty Sacks
39.	Johannesburg Stock Exchange	Anne Clayton
40.	Kigeni Ventures	Luvo Tyandela
41.	Kingson Capital Partners	Gavin Reardon
42.	KNF Ventures	Keet van Zyl
43.	KPMG	Lesley Bosman Beatrie Gouws
44.	Law Society of South Africa	Kris devan
45.	Liberty Holdings	Devenee Mudely
46.	LinkMakers Group	Carien Engelbrecht
47.	Lucid Ventures	Sara Reynolds
48.	Mazars	Greg Boy
49.	Minerals Council of South Africa	Ursula Brown
50.	MTN Group	Carel Gericke
51.	Nedbank	Lesedi Manchu Landman Christo
52.	Nolands	Graeme Saggers
53.	nReach	Johan Kritzinger
54.	Obsidian Capital	Royce Long
55.	Old Mutual	Zayaan Saban
56.	Open Window	Ferdi van Niekerk
57.	Optomise	Gadi Gohen
58.	Pallidus Venture Capital	Rolandi van der Westhuizen
59.	Payroll Authors Group of South Africa	Rob Cooper
60.	Peregrine Securities	Warren Chapman
61.	PKF	Paul Gering
62.	Priority Tax Solutions	Zweli Maboza
63.	PWC	Greg Smith Linda Mathatho
64.	QuadPara Association of South Africa	Ari Seirlis
65.	Razar Capital	Mohamed Cajee
66.	Real People	David Munro
67.	Richards Bay Industrial Development Zone	Keith Harvey
68.	Rootstock Investment Management	Andreas van der Horst
69.	Samaritan Healthcare	Johann Carstens
70.	Samgsung Electronics	Kayalethu Ngqaka
71.	Sanari Capital	Samantha Pokroy
72.	Sanlam Group	Isabeau Brincker
73.	Sareit Association	David Swarts
74.	Sentinel Trust	Madeleine Schubert
75.	Skye Education	Henri Papp
76.	SNG Grant Thornton	Bhavesh Govan
77.	South African Institute of Chartered Accountants	Christel Van Wyk Madelein Grobler

78	South African Institute of Professional Accountants	
79.	South African Institute of Stock-Brokers	Erica Bruce
80.	South African Institute of Tax Professionals	Adél Marx Erika de Villiers
81.	South African Maritime Safety Authority	Vusi September
82.	The Makings Corporate Services	Morrison Smith
83.	The Silo	Matthew Rosen
84.	The Tobacco Institute of South Africa	Una van Zyl
85.	Transnet	Helen Walsh
86.	Venture Management Partners RF	Alan Witt
87.	Vodacom South Africa	Johan van der Westhuizen
88.	Webber Wentzel	Joon Chong
89.	Werksmans Attorneys	Ernest Mazansky
90.	Wesgro	Karen Bosman
91.	Willie Towers Watson	Joanna Combrink
92.	Worldly Grand	Derrick Hyde

Annexure B - Individuals

No.	Individuals
1.	Dale Warren
2.	Evaghn Naicker