Responsible Tax for the Common Good

KPMG's 2016 BudgetWatch

Below is a summary of the tax proposals that were delivered by Finance Minister Pravin Gordhan at the National Budget address on 24 February 2016. This is a high level overview of the changes.

Capital gains tax (CGT)

- With effect from 1 March 2016, the inclusion rate for capital gains have increased:
  - For individuals, to 40% (previously 33,3%), maximum effective CGT rate 16,4% (previously 13,65%); The annual amount above which capital gains become taxable for individuals will increase to R40 000 (previously R30 000).
  - For companies, to 80% (previously 66,6%), maximum effective CGT rate 22,4% (previously 18,6%).
  - For trusts, to 80% (previously 66,6%), maximum effective CGT rate 32,8% (previously 27,3%).
- International agreements on information sharing and Relaxed voluntary disclosure rules: With reference to the OECD's Common Reporting Standard, the minister cautioned that international agreements on information sharing enables tax authorities, including SARS, to act more effectively against Base Erosion and Profit Shifting (i.e. abusive tax practices by multinational corporations and wealthy individuals). In view of the forthcoming changes, although in terms of the current voluntary disclosure regime, taxpayers may apply to have their South African tax affairs regularised, with effect from 1 October 2016, and limited to a period of 6 months, non-compliant individuals and companies will be given the opportunity to regularise foreign assets and income.

General corporate tax proposals

- Avoidance schemes in respect of share disposals: Potential tax consequences on the disposal of shares may be avoided, where the company buys back the shares from the seller and issues new shares to the purchaser, as in such instance the seller may receive exempt dividends and the amount paid by the purchaser may qualify as contributed tax capital. These transactions are to be reviewed in order to determine whether additional anti-tax avoidance measures are required.

Industry specific corporate tax proposals – financial services

- Transitional tax issues resulting from regulation of hedge funds: Currently, limited tax relief is available to hedge funds during the hedge fund industry's transition to a new regulated regime. This will be addressed.
- Securities lending arrangements: Currently, no income tax and securities transfer tax consequences result if a listed share is transferred as collateral in a lending arrangement for a limited period of 12 months. Concerns have been raised that the 12-month limitation rule is too restrictive. This is to be reconsidered. In addition, the tax treatment of securities lending arrangements in general are to be reviewed.
- Real estate investment trusts (REIT):
  - *Qualifying distribution rule:* It is proposed that the qualifying distribution rule be reviewed in order to address the anomaly that may arise because recoupments, such as building allowances, are to be included in gross income and this affects the 75% rental-income analyses.
  - *Interaction between REITs and section 9C:* Currently, dividends received from REITs are taxable, but expenditure incurred to produce such dividends is effectively not deductible. It is proposed that the legislation be amended to address this mismatch.
- Hybrid debt instruments: A loan that becomes subject to a subordination agreement, due to the borrower being in financial distress, may be regarded as a hybrid debt instrument, because the subordination suspends payments. It is proposed that a concession be introduced in such instance.
- Refinement of third-party-backed share provisions: SARS will attempt to balance a 'give and take' approach when it drafts amendments to the anti-avoidance provisions relating to third-party backed shares to:
  - Ensure that legitimate transactions entered into before 2012 are not caught in the net of this anti-avoidance provision of the Act; and
  - Close apparent loopholes whereby taxpayers circumvent the anti-avoidance provisions, for instance by using trusts that invest in preference shares.
- Solvency assessment and management framework for long-term insurers: The 2015 Taxation Laws Amendment Act provided for a new valuation method for the policyholder liabilities of long-term insurers which is based on an adjusted International Financial Reporting Standards method of valuation (effective when the Insurance Bill, 2016, comes into operation, anticipated in 2017). The Minister confirmed that this valuation methodology will be further considered during 2016.

Business incentives

- Venture capital funding for small businesses: Proposals are being considered in order to make the venture capital company regime, which was introduced in 2008, more attractive for investors.
- Urban development zones: It is proposed that the UDZ tax incentive be made available to more municipalities to promote urban renewal.

- **Small business corporations in special economic zones:** The SEZ tax incentive legislation is to be amended to clarify that small business corporations in SEZs are subject to corporate income tax at *either* the applicable graduated rate *or* 15%, whichever is *lower*. Small business corporations will still need to comply with the relevant SEZ requirements in order to be eligible for the 15% rate.
- **Oil and gas:** A 3-year accelerated depreciation allowance for qualifying capital expenditure incurred by oil refineries is proposed. This will facilitate necessary upgrades required to comply with clean fuels specifications and will be available for a limited period.
- **Renewable energy:** Currently, indirect infrastructure costs on, for example, roads and fences do not qualify for deduction by renewable energy companies. Existing incentives for the sector will be looked at to include these costs.
- **Mining:** Community-related expenditure incurred on, for example, hospitals and schools by mining companies, as part of their Mining Charter commitment, is currently not deductible. A tax deduction for such capital expenditure is being proposed.
- **Research and development tax incentive:** Following a decline in tax deductions claimed since 2012/2013, a task team, established by the Minister of Science and Technology, has been examining existing challenges. Following completion of this process in April 2016, proposals will be considered to improve the R&D tax incentive.
- **Land donated under land-reform initiatives:** The current tax relief for land donated for land reform is to be extended to other government land-reform initiatives, such as those set out in the National Development Plan.
- **Government grants:** It is proposed that all government grants, regardless of whether the grant is capital in nature, be included in gross income and that the Eleventh Schedule to the Income Tax, which lists those grants which are exempted from normal tax, be the sole mechanism for determining whether a grant is taxable.
- **Expansion of education and training-based public benefit activities:** It is being considered to expand the list of public benefit education and training activities. It is proposed that industry-based training organisations should be included as organisations exempt from tax.

International tax

- **Bad debt deduction:** It is proposed that the deduction for bad debts be extended to specifically include any exchange differences in respect of such debts that have been included in income.
- **Tax base protection and hypothetical foreign tax payable due to foreign group tax losses:** All controlled foreign company (CFC) income is exempt from tax in South Africa, where the CFC pays an amount of foreign tax equal to at least 75% of the tax that would have been payable in South Africa, had the CFC been tax resident in South Africa. It is proposed that the adjustment for foreign group losses be removed in the calculation to determine the high-tax exemption.
- **Withdrawal of withholding tax on service fees:** The proposed introduction of the withholding tax on services is to be withdrawn and related concerns are, instead, to be dealt with under the reportable arrangement provisions in the Tax Administration Act.
- **Foreign companies and collective investment schemes:** It is proposed that investments in foreign companies by collective investment schemes (CIS) be excluded from the application of the controlled foreign company (CFC) rules. Instead, the investor in the local CIS should be considered to be the holder of the participation rights in the foreign company.
- **Interest withholding tax where interest is written off:** A mechanism is being developed to allow for a refund of interest withholding tax paid on interest that was due and payable, but subsequently written off as irrecoverable.
- **Hybrid debt instruments:** Measures are to be implemented, effective 24 February 2016, to eliminate mismatches associated with hybrid debt instruments potentially resulting in double non-taxation, where the issuer is not tax resident in South Africa.

Environmental taxes/levies

- **Carbon tax:** The draft Carbon Tax Bill published in November 2015 is set to be revised in order to take into account comments received from the public. The anticipated introduction of the carbon tax in January 2017 remains unchanged for now.
- **Tyre levy:** With effect from 1 October 2016, a new levy of R2.30/Kg will be introduced in respect of imported and locally manufactured tyres. In respect of imports, this levy will apply on all imported tyres, whether or not fitted to wheel rims or vehicle. This levy will replace the current REDISA levy.
- **Plastic bag levy:** From 1 April 2016, the environmental levy payable in respect of plastic bags (shopping bags) will increase by 2 cents to be at 8 cents per bag.
- **Electric filament lamps levy:** From 1 April 2016, the environmental levy payable in respect of electric filament lamps will increase by R2 to be at R6.00 per globe.
- **Carbon dioxide emissions tax:** From 1 April 2016, the carbon dioxide emissions tax will increase to R100.00 and R140.00 per g/km CO^2 emissions exceeding 175g/km in respect of passenger cars and double cabs, respectively.

Customs and excise

- **Specific customs and excise duties:** With effect from 24 February 2016 specific customs and excise duties are increased. On most alcoholic beverages the rate increased by between 6.7% and 8.5% (excluding traditional African beer and beer powder which remain unchanged). The rate of duty on tobacco products and cigars increased by between 6.7% and 7%. A review of alternative and the existing measures for the taxation of tobacco products will commence this year, including the exploration of how new tobacco products such as e-cigarettes should be taxed.
- **General fuel levy and road accident fund levy:** The General Fuel Levy for 2016/2017 is increased by 30c/li to 285c/li and 270c/li for petrol and diesel, respectively. Both increases will take effect on 6 April 2016. The Road Accident Fund Levy will remain unchanged at 154c/li.

Value Added Tax (VAT) proposals

- Increase in the VAT rate: Although a VAT increase was not announced this year, it is clear that an increase is being considered. It is noted, however, that any increase would be accompanied by relief measures targeted at the poor.
- Taxation of non-executive directors' fees: The situation whereby non-executive directors' fees may be subject to both VAT and PAYE will be investigated.
- Loyalty programmes: Since the VAT Act does not have specific provisions pertaining to loyalty programmes and the redemption of loyalty points, it is proposed that the VAT implications of loyalty programmes be considered.
- Determined value of company cars: It is proposed that the method of calculating the determined value of company cars be aligned between the VAT Regulation and Income Tax Act in order to reduce the administrative burden of maintaining two calculations and two sets of records.
- Waivers and cancellations of debt: The VAT implications relating to the waiver and cancellation of debts have not been considered as part of the definition of financial services previously. It is proposed that it be determined whether legislative amendment is required in this regard
- Alignment of prescription periods: A vendor generally has five years to deduct input tax in respect of VAT incurred. It is proposed that the timing of this deduction be limited in certain instances to the time of supply, however, the specific circumstances are not noted.

Individuals, employment and savings

- Personal tax rebates: With effect from 1 March 2016, the following rebates will apply to individuals' tax liabilities:
  - Primary rebate R13 500 (previously: R13 257);
  - No change to secondary rebate (individuals 65 and older) - R7 407;
  - No change to tertiary rebate (individuals 75 and older) - R2 466.
- Tax thresholds: With effect from 1 March 2016, the tax thresholds have increased to:
  - Below 65: R75 000 (previously: R73 650);
  - 65 and older: R116 150 (previously: R114 800)
  - 75 and older: R129 850 (previously: R128 500).
- Retirement reforms:
  - *Deferral of annuitisation of provident funds:* Postponed for two years, until 1 March 2018. Contributions made by provident fund members before 1 March 2018 will not require annuitisation. Tax-free transfers from pension to provident funds are therefore also postponed and aligned with this date.
  - *Deduction for fringe benefit of employer contributions to defined pension funds:* With effect from 1 March 2016, the deduction allowed will be the full value of the employer contribution fringe benefit (subject to the available limits). This deduction was inadvertently limited to the actual employer contribution although the inclusion of the fringe benefit is valued in terms of a formula.
  - *Passive income deduction*: It is proposed that the current wording of the Act be amended to allow for retirement contributions to be deducted against passive income (as has been the case before 1 March 2016), subject to the available limits.
  - *Rollover of excess contributions prior to 1 March 2016:* The rollover of excess contributions made to retirement annuity funds and pension funds that accumulated up to 29 February 2016 will be allowed.
  - *Order of allowable deductions:* It is proposed that the allowable deduction for contributions to retirement funds be determined before the allowable public benefit organisation donations deduction.
  - *Treatment of vested rights within the context of divorce orders:* From 1 March 2018, provident fund members may be required to purchase an annuity using a portion of contributions made after that date. However, contributions made before 1 March 2018 will not be subject to annuitisation (referred to as vested rights). In the context of a divorce, the withdrawal of retirement benefits arising from divorce order settlements should be proportionally attributed as a reduction against the vested rights and non-vested right portions of the retirement fund savings.
  - *Vested rights for provident fund members:* From 1 March 2018, provident fund members above the age of 55 will be able to continue contributing to that provident fund without being required to purchase an annuity upon retirement. However, if they transfer to another retirement fund, then any future contributions to that fund would not be exempt from annuitisation. It is proposed that forced transfers (through the closure of a retirement fund) should not affect the member's ability to make further contributions, which can be taken as a lump sum.
  - *Foreign pension contributions, annuities and payouts:* In light of the retirement reforms related to contributions to South African retirement funds, the question of how contributions to foreign pension funds and the taxation of payments from foreign funds should be dealt with, raises a number of concerns. A review is therefore required to determine the way forward.
  - *Alignment of the definition of private travel:* It is proposed to clarify the definition of private travel for employees' tax purposes to ensure the correct calculation of employees' tax payable by employers on a travel allowance and company cars.
- Tax-free investments
  - *Alignment of estate duty treatment of tax-free investment:* It is proposed to amend the legislation in preventing endowment policy pay-outs to nominated beneficiaries, which are permitted through tax-free investments, from avoiding Estate Duty.
  - *Dividends tax returns in respect of tax-free investments:* It is proposed to remove the requirement for Investors receiving dividends from tax-free investments to submit an exempt dividend tax return to SARS.
  - *Transfers between service providers:* The implementation date to allow transfers of tax-free investments between service providers will be extended until 1 November 2016.
  - *Directives to be sought for all employment lump sums:* Currently, employers are not required to obtain tax directives in respect of certain lump sum payments. It is proposed that these exceptions are removed and that tax directives be requested by employers on all lump sums payments.
  - *Learnership and employment tax incentives:* Government may consider extending the learnership and employment tax incentives by one year depending on completion of a current review process. Currently these incentives are scheduled to expire towards the end of 2016.
  - *Medical tax credits:* The monthly medical scheme contributions tax credits will be increased from R270 to

R286 from 1 March 2016 for the first two beneficiaries and from R181 to R192 for additional beneficiaries.

- *Increasing the incentive for employers to provide bursaries:* The income eligibility threshold for employees to access the tax exemption relating to employer provided bursaries to relatives of employees will be increased from R250 000 to R400 000. The value of qualifying bursaries will be increased from R10 000 to R15 000 for NQF levels 1 to 4 and from R30 000 to R40 000 for levels 5 to 10.

Miscellaneous tax proposals

- Tax treatment of trusts: It is proposed that assets transferred through a loan to a trust be re included in the estate of the founder at death, and to re-categorise interest-free loans to trusts as donations. Further measures to limit the use of discretionary trusts for income-splitting and other tax benefits are also being considered.
- Reducing red tape for small business: SARS has rolled out small business desks, designed a mobile tools to help small firms register at their own premises and implemented a single registration process, avoiding the need to reregister for different taxes.
- Employee share-based incentive schemes:
  - *Removal of possible double taxation*: To avoid potential double taxation, it is proposed that the definition of gross income be amended so as to specifically exclude the acquisition of shares/equity instruments that are subject to the provisions of section 8C of the Income Tax Act share incentive rules.
  - *Addressing the circumvention of section 8C rules:* Specific anti-avoidance rules are to be introduced to address the situation, where restricted shares/equity instruments held by employees are liquidated in return for amounts that currently may qualify as tax exempt dividends.
  - *Inclusion of dividends in the definition of remuneration:* Certain dividends received from restricted shares/ equity instruments, in terms of share incentive schemes, are not exempt from income tax. It is proposed that these dividends be specifically included in the definition of "remuneration" and subjected to employees' tax.
- Mining royalties: The payment of mining royalties are currently run outside of the provisional tax and e-filing system. It is proposed to align this with the current provisional payment system, particularly with regards to penalties and interest, presumably in respect of late and underpayments. The automation of this payment system is welcomed.

Tax administration

- Voluntary disclosure programme: A person who is aware of a pending audit or investigation may not apply for voluntary disclosure relief. It is proposed that an amendment be considered to clarify what is meant by pending audit or investigation.
- Tax administration: Currently, an aggrieved taxpayer has 30 business days within which to lodge an objection to an assessment. A longer time-period for lodging objections is being considered.
- Removal of exclusion from provisional tax penalty calculation*:* It is proposed that the income used to determine the underestimation penalty in respect of provisional tax, should include all income, excluding income which is taxed under the lump-sum tax tables.
- Date on which estimate for second provisional tax payment must be submitted: Currently, should no second provisional payment be made by the due date, a taxpayer has until the next provisional tax period to correct this without incurring underestimate penalties. It is proposed that the period allowed for the correction be limited.

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