Budget Watch
Managing Disruption
KPMG’s 2017 Tax Guide

Below is a summary of the tax proposals that were delivered by Finance Minister Pravin Gordhan at the National Budget address on 22 February 2017. This is a high level overview of the proposals.

Budget highlights:

- A new top personal income tax bracket of 45% has been introduced with effect from 1 March 2017 for taxable income above R 1.5 million.
- Trusts, other than special trusts, will also be subject to income tax at the rate of 45%.
- The default rate, at which dividends tax is to be withheld, has increased to 20%, with effect from 22 February 2017.

Business incentives

Mining rehabilitation funds:
Mining companies are allowed to deduct contributions made to mining rehabilitation trusts. Amendments are proposed to take into account recent National Environmental Management Act regulations for financial provisioning for the rehabilitation, management and effects of mine closures. Further measures are also proposed to curb abuse of tax-deductible contributions.

Land-reform initiatives:
Tax relief from donations tax and capital gains tax for land donated for land-reform initiatives, as part of the National Development Plan, will be extended to allow partial ownership of land to be transferred under certain circumstances.

Venture capital regime:
It is proposed that changes to the venture capital regime will be made to remove impediments to investment, including rules relating to investment returns and the qualifying company test.

***Clarifying the scope of relief for international donor funding organisations*:**
South Africa receives development assistance from international donor funding organisations. From a tax perspective the special relief provisions applicable to these organisations are not aligned. Changes will therefore be made to the Income Tax Act to align the tax treatment of these organisations.

General corporate tax proposals

Relaxation of debt waiver tax implications:

a. ***Mining companies:*** In terms of the current debt reduction provisions, a company is required to reduce the remaining base cost of an allowance asset where the company used debt to acquire the asset, the debt is reduced and the asset is still on hand at the time of the reduction. Where the waiver exceeds the CGT base cost, the excess is treated as a taxable recoupment. However, because mining companies include allowance assets in capital expenditure (even when acquired using debt), any debt reduction results in an immediate taxable recoupment. It is proposed that the tax treatment for mining companies be aligned with that of companies in other industries. While the wording of the proposal is rather vague, it appears that Treasury intends for mining companies to first reduce unutilised capital expenditure before reflecting any excess as a taxable recoupment.

b. ***Dormant companies or companies under business rescue:*** *A taxable recoupment arises in terms of section 19 where a company uses debt to directly or indirectly fund expenditure for which a tax deduction is claimed and the debt is subsequently reduced. Where the relevant company is dormant or under business rescue, this taxable recoupment could place an even greater burden on a company which already does not have the ability to pay the tax debt. Paragraph 12A of the Eight Schedule provides relief in respect of debt reductions between companies within the same group. It is proposed that the current relief for group companies available under paragraph 12A is extended to section 19.*

c. ***Debt compromises:*** To date there have been varying views as to whether the conversion of debt into equity (i.e. settlement of the debt through the issue of shares) constitutes full settlement of the debt or potentially contains a debt reduction amount. It is proposed that such conversion be allowed, with the limitation that any capitalised interest on the debt in respect of which a tax deduction had been claimed, be treated as a taxable recoupment.

Addressing the circumvention of anti-avoidance rules:

a. ***Avoidance schemes in respect of share buybacks:*** Following similar proposals during 2016, specific countermeasures are being considered to curb tax avoidance schemes involving a company buying back shares from its shareholders.

b. ***Avoidance schemes in respect of artificial repayment of debt:*** Specific anti-avoidance measures are proposed to prevent short term shareholding structures involving the artificial repayment of debt aimed at circumventing the debt reduction provisions.

c. ***Interaction between 'in-duplum' rule and low-interest or interest-free loan provisions:*** The *in duplum* rule is a common law principle which provides that interest ceases to accrue once the sum of the accrued interest equals the outstanding capital amount at the time. The application of the *in duplum* rule may undermine the anti-avoidance provisions connected with low-interest or interest-free loans. It is proposed that these anti-avoidance provisions specifically exclude the application of the *in duplum* rule to ensure effectiveness.

d. ***Circumvention of dividend-stripping rules:*** It is proposed that the anti-avoidance provisions associated with dividend stripping are expanded to include loans advanced from certain third parties prior to the company buying back shares from its shareholders.

e. ***Definition of contributed tax capital:*** It is proposed that the definition of contributed tax capital is amended to prevent schemes where companies with foreign parents increase their contributed tax capital in an attempt to avoid or reduce dividends tax.

Corporate reorganisation rules:

a. ***Tax implication on the assumption of contingent debt:*** In order to qualify for roll-over relief in terms of certain corporate reorganisation transactions, the only acceptable consideration for the acquisition of the assets is the buyer issuing shares to the seller or assuming the debts of the seller. Currently, only unconditional obligations are catered for. It is proposed that the assumption of future contingent liabilities also be considered as an acceptable consideration under the corporate reorganisation rules.

b. ***Interplay between real estate investment trusts (REITs) and the corporate reorganisation rules:*** It is proposed that the legislation be amended to make specific provision for the corporate reorganisation rules to apply to transactions involving REITs.

Industry specific corporate tax proposals - financial services

Extension of collateral and securities lending arrangement provisions: It is proposed that the current provisions of collateral and securities lending arrangements be extended to include listed foreign government bonds.

Amendments to third-party backed shares provisions

The current qualifying purpose exemption is considered to be too narrow and may impede legitimate transactions. It is proposed that the qualifying purpose exemption in relation to the application of the funds derived from the issue of preference shares be further refined to cover all qualifying purposes.

Tax amendments due to the Solvency Assessment and Management (SAM) framework for long-term insurers:

The Act has been amended due to the reforms introduced by SAM. It is proposed that the uncertainty around the interpretation and application of the tax amendments be addressed.

Changes in the tax treatment of banks and financial institutions:

a. **Introduction of IFRS 9:** Section 24JB, which deals with the taxation of financial assets and liabilities of banks and other financial institutions, currently follows the accounting treatment set out in IAS 39. IAS 39 will be replaced by IFRS 9 in 2018, and it is proposed that section 24JB be amended to align with IFRS 9, except for the treatment of impairments. SARS issued a directive in 2012 for the tax treatment of doubtful debts for banks, based on the accounting treatment described in IAS 39. With the introduction of IFRS 9 in 2018, it is proposed that the SARS directive be reviewed and incorporated into the Act. It is further proposed that the treatment of impairment adjustments under IFRS 9 is excluded from the proposed amendments to section 24JB as the impairment adjustments under IFRS 9 does not focus solely on the current losses in determination of taxable income as contemplated in section 24JB.

b. **Interaction between section 8F and section 24JB**: In terms of section 8F, interest on debt that exhibits certain equity-like features, is, inter alia, not allowed as a deduction for the borrower. Where the borrower is a bank or financial institution, it may be argued that the borrower may be entitled to a deduction of the interest in terms of section 24JB despite the application of anti-avoidance provisions in terms of section 8F. Treasury intends to clarify that section 24JB is subject to the provisions of section 8F.

c. **Mismatch in the application of the provisions of paragraph 12A and section 24JB**: In instances where a debt is provided by a financial institution to a group company and the loan is cancelled, waived, forgiven or discharged, an anomaly arises because the debtor will not be required to reduce the base cost of an asset (that was funded with the debt) while the financial institution may, in terms of section 24JB, still benefit from a deduction in respect of the loan amount forgiven. It is proposed that measures be introduced to curb mismatches in the tax treatment of reduced or waived loans between a financial institution and companies forming part of the same group of companies.

International tax

Taxation of dividends:

a. The default rate, at which dividends tax is to be withheld, has increased to 20% with effect from 22 February 2017.

b. The exemption and rates for inbound foreign dividends will be adjusted in line with the new dividends tax rate, with effect from years of assessment commencing on or after 1 March 2017.

Withholding tax on immovable property sales by non-residents: In order to align this withholding tax with the increase in the effective capital gains tax rate, as introduced in 2016, the tax to be withheld from payments to non-resident sellers has been increased to:

- 7.5% where the seller is a natural person;
- 10% where the seller is a company; and
- 15% where the seller is a trust.

Tax treatment of foreign member funds: A special tax dispensation will be introduced for "foreign member funds" (i.e. for funds established to manage investments outside of South Africa). Foreign investors investing in the funds for onward investment outside of South Africa will be exempt from withholding tax on interest. However, fees earned by local asset managers or collective investment scheme managers for services rendered to these funds will be subject to tax in South Africa.

Changes to the tax treatment of domestic treasury management companies: The qualifying criteria for domestic treasury management companies in relation to tax residence will be reviewed, as the criteria are regarded as being overly restrictive and thereby serve to unnecessarily exclude companies from benefiting from this dispensation.

Tax implications of acquisition of foreign intellectual property by South African multinationals: The relaxation of the limitations currently placed on the deductibility of payments made to a foreign person for the use or right to use tainted intellectual property will be considered.

Tax implications of controlled foreign companies held by offshore foreign trusts: Currently, it is arguably possible to circumvent the application of the controlled foreign company rules, by interposing a foreign trust. It is proposed that countermeasures be introduced in order to curb this perceived abuse.

Base erosion and profit shifting (BEPS) (including Transfer Pricing): The Budget Review document summarised South Africa's position on the proposed BEPS actions:

a. ***Treaty abuse – Principle Purpose Test:*** If it is concluded that one of the principal purposes of entering into an arrangement / transaction was to obtain a benefit in terms of a tax treaty, the benefit will be denied. In terms of anti-treaty abuse rules, South Africa has chosen to adopt the principal purpose test, which aligns with the domestic general anti-avoidance rules. The aim is to limit so called treaty shopping.

b. ***Multilateral instrument:*** In the last year, we have seen a number of BEPS related changes, including South Africa's commitment to sign the Multilateral Instrument on June 2017, which will implement tax treaty related measures without the need to renegotiate each tax treaty bilaterally.

c. ***Automatic Exchange of Information:*** South Africa has committed to adopt the Automatic Exchange of Financial Account Information with global revenue authorities as from 1 September 2017.

d. ***Transfer pricing guidance:*** The current transfer pricing guidance will also be updated to align with the OECD Transfer Pricing Guidelines and to incorporate new guidance on the arm's length principle and an agreed upon approach to the pricing of hard to value intangibles.

e. ***Country-by-Country Reporting (CbC Reports):*** For years of assessment commencing on or after 1 January 2016, South African MNEs meeting local filing requirements must submit their CbC Reports to SARS within 12 months from the end of the relevant year of assessment. The CbC Reports will provide SARS and other governments with the necessary information to identify transfer pricing risks.

Miscellaneous proposals

Employee share-based incentive schemes: Legislation was introduced in 2016 to combat the avoidance of tax by means of allocating restricted shares to employees through a share incentive scheme only to have the shares liquidated in return for a dividend. This legislation did not fully address the interaction of these shares and capital gains tax on vesting date. It is proposed that this treatment be clarified.

Refining measures to prevent tax avoidance through the use of trusts: Tax avoidance legislation has been introduced to deal with low-interest or interest-free loans made to trusts. This anti-avoidance measure deems any interest foregone in respect of the interest free loan to be a donation and subject to donations tax (20%). This legislation will be extended to take into account low-interest or interest-free loans made to companies owned by a trust. Further, it is proposed that the tax avoidance legislation should exclude trusts that are not used for estate planning purposes e.g. employee share scheme trusts.

Sugar tax: The implementation of a tax on sugary beverages, at a proposed rate of 2.1c/gram for sugar content in excess of 4g/100ml, has been proposed. 50% of the rate will apply to concentrated beverages. This tax is to be administered through the Customs and Excise Act.

Exchange control: It is proposed that Reserve Bank approval will no longer be required for intellectual property transactions, and that the "loop structure" restrictions for such transactions be lifted, where they are at arm's length and at a fair market price.

Tax administration

Employees' tax and reimbursement of travel allowance: To simplify the calculation of employees' tax, it is proposed that only the portion of travel expenses reimbursed by the employer that exceeds the rate or distance fixed in the Gazette (i.e. that exceeds 8 000 kilometres per year or a rate of R3.29 per kilometre), should be regarded as remuneration.

Application of the cap on deductible retirement fund contributions:
It is currently not clear how the overall annual cap of R350 000 on contributions to pension, provident and retirement annuity funds should be applied when determining monthly employees' tax. It is proposed that the amount of R350 000 be spread over the tax year when determining the monthly employees' tax.

Accrual of interest payable by SARS: It is proposed that interest payable by SARS should be deemed to only accrue to the recipient of the interest on the date payment thereof by SARS

VAT proposals

Expanding the VAT base: Government intends expanding the VAT base in 2018/19. It has proposed removing the zero-rating on fuel. However, this could be combined with either a freeze or decrease in the fuel levy. In addition, government is considering a VAT rate increase in the future but this will be balanced with measures aimed at providing relief to the poor.

BEPS and electronic services: Foreign businesses providing electronic services to South African consumers are currently required to register for VAT. The electronic services regulations are being updated to broaden the scope of electronic services that are subject to VAT and to remove some uncertainties and practical difficulties. Taxable services will, in the future, include cloud computing and services providing online applications.

Clarifying the VAT treatment on leasehold improvements: Amendments are being proposed to clarify the VAT treatment in respect of the time and value of supply of leasehold improvements on leasehold property.

Definition of "resident of the Republic": Currently, where a foreign company is effectively managed from South Africa, it will be regarded as a resident of South Africa in terms of the VAT Act which implies that goods or services supplied by a South African company to the foreign company will be subject to VAT. If the foreign company is not required to register for VAT, the VAT will become a business cost as it cannot be deducted as input tax. The definition of 'resident in the Republic' will therefore be amended to provide for such situations.

International travel insurance: The VAT Act currently only provides for the zero rating of insurance as part of an international transportation service. It is envisaged that the legislation be broadened to include the zero rating of certain aspects of an international travel insurance policy.

Services supplied in connection with securities and shares in a foreign company (i.e. movable property): It is proposed that changes be made to the VAT Act to clarify whether or not services supplied relating to securities or shares in a foreign incorporated company listed on the JSE may be zero rated.

Environmental taxes/levies

Carbon Tax: A revised Carbon Tax bill and revised carbon offset regulation will be published by mid-2017. There is no impact expected on electricity prices until the first phase (2020) and more clarity is expected from Government on aligning the Carbon Tax and carbon budgets after the first phase.

General Fuel Levy and Road Accident Fund Levy: The General Fuel Levy for 2017/2018 is increased by 30c/li to 315c/li and 300c/li for petrol and diesel, respectively. The Road Accident Fund Levy will increase by 9c/li to 163c/li.

These increases will take effect on 5 April 2017.

Customs and excise

Customs legislation: More delays can be expected in implementation of the proposed Customs Control Act (2014) and the Customs Duty Act (2014) due to amendments being considered resulting from further comments received from external stakeholders.

Specific Customs and Excise duties: With effect from 22 February 2017 specific customs and excise duties are increased. On most alcoholic beverages the rate increased by between 6.1% and 9.5% (excluding traditional African beer and beer powder which remain unchanged). The rate of duty on tobacco products and cigars increased by between 8% and 9.5%.

Customs and excise proposals:

- Amendments will be considered for the marking, tracking and tracing of locally manufactured and imported tobacco products to account for further implementation requirements.
- The 2015 Budget announced a comprehensive review of the administration of the diesel refund, which requires the delinking of the diesel refund from the VAT system and the creation of a standalone diesel refund administration. A discussion paper outlining the options for a simplified administration system was published for public comment on 15 February 2017. The legislative amendments to give effect to the separation of the diesel refund system will be developed following public consultations.

Personal income tax

Personal tax rebates:

- Primary: R13 635 (previously R13 500)
- Secondary: R 7 479 (previously R7 407)
- Tertiary: R2 493 (previously R2 466)

Tax thresholds:
Below age 65: R75 750 (previously R75 000)
Age 65 to 74: R117 300 (previously R116 150)
Age 75 and older : R131 150 (previously R129 850)

Medical tax credits: Increased from R286 to R303 for the first two beneficiaries and from R192 to R204 for additional beneficiaries.

Exemption of remuneration earned for foreign services rendered by South African residents: Currently, any remuneration earned by a South African resident for rendering services outside South Africa is subject to exemption from tax on the premise that the requirements are met i.e. absence from South Africa for a period exceeding 183 days of which more than 60 days must be continuous during a 12 month period. It is proposed that this exemption be amended to allow exemption of the remuneration earned for foreign services only where this remuneration is proved to be subject to tax in the foreign country.

Retirement reforms: Currently, the lump sum benefit on retirement will accrue to the individual on the date the individual elected to retire as opposed to the normal retirement age.

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