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How can SA's REVENUE GAP BE FILLED?

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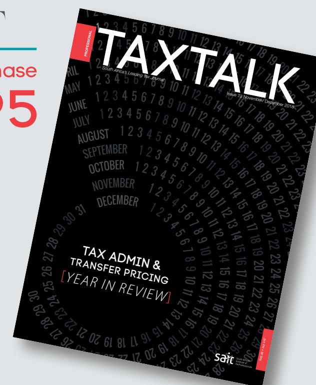

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Wishing you a successful 2019 from all of us at SAIT.

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I'm committed to serving our members and ensuring that they retain their specialist status in 2019.

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Provide all stakeholders with a "white glove" level of service.

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Receptionist
Nothing is impossible, the word itself says, "I'm possible!"

"Thank you for being a part of the SAIT family. Here's how we plan to make SAIT great for you in 2019"

Keith Engel - CEO

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Enjoy and seize every moment with contagious passion and spread it like a wild fire!

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Place emphasis on well-balanced articles so as to inspire and serve our members and the tax community at large.

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I'd like to gain greater tax knowledge in order to improve the quality of answers given on the Tax Helpline.

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Stay positive, work hard and make it happen!

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HOW CAN THE REVENUE GAP BE BRIDGED?

In the run-up to the South African national budget announcements, we look at ways to finance Government services without breaking the piggy bank.

We all know that Government needs money in order to provide services, and to maintain and expand the infrastructure that the economy relies on. If all goes well the economy will expand, generating greater profits and more revenue for Government in the form of taxes, and this in turn leads to better services and infrastructure. But what happens when the economy is growing slowly, thereby generating less revenue in the form of taxes, while a growing population requires more and better services? A gap forms between the amount coming in and the amount that has to go out.

In the short term, this gap can be filled by borrowing. Many households manage to survive the lean years by taking out credit. But what happens when the lean years do not end and the debt repayments become yet another drain on limited resources? And what happens in the case of Government where borrowing now can mean a huge burden for generations to come?

We asked a number of tax executives for their views on what can be done to bridge the revenue gap in South Africa.

"A decrease in corporate income tax rates and a more focused strategy towards utilising our SEZs will provide a much-needed stimulus to the economy."

GRAEME SAGGERS
Tax Director at Nolands

Q In your view, how can South Africa bridge the revenue gap?

1. Grow the economy
2. Raise additional tax revenue
3. Cut Government spending
4. Other

I believe that South Africa has already crested the peak of the Laffer Curve and any more increases in tax rates will result in a decline in tax revenue collections as the disgruntled taxpayer will resort to ulterior means for keeping their tax liability below a perceived ethical threshold. Taxpayers will either work less or declare less income if they believe tax revenue is being wasted. I believe a reduction in Government spending, and particularly a reduction in the size of the cabinet and reduced funding of SOEs, will go a long way in restoring the relationship between the taxpayer and the Government. However, I think it is unlikely Minister Mboweni (or whoever is the Finance Minister at the end of February) will announce any drastic austerity measures, especially considering the speech will be delivered in the midst of election campaigning season.

In my view, a combination of a significant decrease in corporate income tax rates (by at least 3%) and a more focused strategy towards utilising our Special Economic Zones will provide a much-needed stimulus to the economy and ultimately result in increased tax revenue. Such changes will accelerate the trend of shifting tax obligations from corporates to individuals, which should lead to increased employment and an expansion in the tax base.

Q In your view, how can South Africa bridge the revenue gap?

1. Grow the economy
2. Raise additional tax revenue
3. Cut Government spending
4. **Other**

DES KRUGER
Webber Wentzel Consultant

Essentially a combination of things is needed to bridge South Africa's revenue gap, such as growing the economy, reducing unproductive Government spending and improving tax collection.

Increasing taxation even further will place an enormous strain on the economy and taxpayers and would in fact be counterproductive in the extreme.

In order to grow the economy it is imperative that there be positive sentiment about the future of the country. Unfortunately, all the uncertainty around land expropriation, factionalism in the ANC and rampant corruption is causing great uncertainty and thereby impeding important and essential investment decisions. It is important that Government spends the tax revenue effectively, as it is clear that there is a lot of wasteful expenditure that is enriching a few at the expense of the many. Finally, it is apparent that SARS' capabilities have been adversely affected by the actions of the previous Commissioner. Getting rid of the previous Commissioner is insufficient. There are serious shortcomings in skills that need urgent attention.

"Essentially a combination of things is needed, such as growing the economy, reducing unproductive Government spending and improving tax collection."

TERTIUS TROOST
Senior Tax Consultant at Mazars

"The South African Government has acknowledged that growing and supporting small and medium enterprises is key to growing the economy."

Q In your view, how can South Africa bridge the revenue gap?

1. **Grow the economy**
2. Raise additional tax revenue
3. Cut Government spending
4. Other

Growing the economy is the only viable route left for South Africa to increase its tax revenue and close the revenue gap. A stronger economy leads to increased employment, which grows the taxpayer base and increases tax revenue.

It has become clear at this stage that all other forms of taxation, including VAT, personal income tax and corporate taxes, have reached their peak and that increasing taxes any further is likely to lead to a decrease in revenue earned. Cutting Government expenditure is also difficult, since salaries and jobs are inevitably the biggest casualties of Government cutbacks.

The South African Government has acknowledged that growing and supporting small and medium enterprises (SME) is key to growing the economy. As a firm that partners with many SMEs, Mazars can agree with this sentiment, and we also understand that SMEs still face a number of challenges that are severely hampering their growth.

The most notable of these is the fact that there is still too much red tape in terms of registration and tax requirements. It is very important that the admin for SMEs is simplified in order to provide them with an environment in which they can flourish.

Secondly, Government has hinted at appointing task teams to review the grants and incentives for SME growth in the country since the 2016 Budget Speech. However, very little has so far been done beyond this.

There needs to be a bigger involvement from the Department of Trade and Industry, and the SME sector now needs a concrete plan of action to outline how these interventions can be improved to promote SME growth.

"Eskom and the non-delivery of its core fundamental reason to exist – the provision of electricity for our economy – will once again have an impact on growth and the economy."

Q In your view, how can South Africa bridge the revenue gap?

1. Grow the economy
2. Raise additional tax revenue
3. Cut Government spending
4. Other

All four possible alternatives are reasonable steps to reduce the revenue gap. Option 4 (Other) would include raising debt by the Government to spend on the necessary expenditure of State. The issue, however, is not as simple as it might seem: We have raised significant debt over the last ten years, Ministers of Finance have tried to impose expenditure ceilings to reduce Government spending over time, Ministers of Finance have attempted to raise additional tax revenue by the VAT increase and increasing the bracket creep impact of the budget, and Ministers of Finance and the President have in fact attempted to grow the economy over the past few years.

Unfortunately, positive sentiment created on the one hand is almost instantaneously converted to negative sentiment on the other hand when conflicting statements and actions of Government give rise to negativity in the economy.

The uncertainty on the issue of the land debate and the consequences of that land debate on White, Indian and Coloured people, who may or may not be treated in a negative manner in relation to other South Africans in this regard, will impact on decisions that could stimulate growth.

Eskom and the non-delivery of its core fundamental reason to exist – the provision of electricity for our economy – will once again have an impact on growth and the economy.

How much blood can one get from a stone? Can the middle class survive further bracket creep without relief as a mechanism of raising additional tax revenue?

In an election year is it really possible that the Government will reduce Government expenditure to the levels necessary to restore confidence in the economy? A positive development was the fact that the President did not increase the remuneration levels for Cabinet.

What is needed is out the box collection activities by the Commissioner for SARS to raise tax collections beyond the levels of increases in the economy.

Over the years there has been some SARS audit provision to ensure that where Government expends funds, a private company records such funds received as taxable income. More needs to be done to ensure that all Government tenders are traced back to the recipient of such tenders, in order to ensure that the taxable income is disclosed correctly and timeously. This will keep the State expenditure in balance with the SARS taxable income.

Q In your view, how can South Africa bridge the revenue gap?

1. Grow the economy
2. Raise additional tax revenue
3. Cut Government spending
4. Other

Driving economic growth through increased public confidence and effective governance will increase investor confidence. This will ultimately result in revenue generation and job creation, which is key for South Africa. The Government must invest in the economy, build infrastructure and make it conducive for local business and foreign investors to invest in the country. The Government's recent investment drive and undertaking to improve the business climate have been encouraging.

With the country barely out of a recession and recent constraints on private consumption (with the increase in VAT rates and slow credit growth) it is not advisable for Government to make any further adjustments in an attempt to raise additional tax revenue. Job creation remains insufficient, which contributes to ever increasing income inequalities and high unemployment rates. Government needs to spend on projects that create employment.

It is imperative for Government to have credible institutions in order to promote cooperative compliance among taxpayers and to collect taxes effectively. In addition, Government needs to ensure fiscal prudence to curb Government expenditure. This may be done specifically by implementing realistic and measureable targets to reduce and eradicate wasteful expenditure highlighted by the Auditor General, thus creating transparency within Government and state-owned entities. Government also needs to regain the trust of the public in order to ensure that each member of the public pays its fair share of tax for use of public services such as roads and electricity.

MMANGALISO NZIMANDE
Director & Africa Tax Controversy Leader at EY

"The Government's recent investment drive and undertaking to improve the business climate have been encouraging."

WHAT ABOUT THE TAX COMPLIANCE GAP?

KYLE MANDY
Partner/Director: Tax Technical & Policy at PwC

Anecdotal evidence suggests that there is a tax compliance gap and the bulk of it lies with privately owned businesses. It would traverse all sectors of the economy but is particularly prevalent in the cash economy. This tax compliance gap would include both licit and illicit trade. In my view, there has been too much emphasis on the tax gap in large business (and multinational companies in particular). This has largely been driven by the OECD-led BEPS project and the attention given to this by the media, civil society and politicians. That is not to say that there is no tax gap when it comes to large business. However, the compliance gap in this area, in my view, is relatively insignificant when compared to the compliance gap elsewhere.

The IMF found that the VAT compliance gap between 2007 and 2012 amounted to between 5% and 10%, having peaked in 2009 in the wake of the global financial crisis. If one accepts that the South African economic and political environment is currently in a similar position to that in 2009, the VAT compliance gap is likely to be around 10% currently or some R35 billion. Very little of that would be attributed to large business, but rather to illicit trade and privately held small and medium businesses.

If one assumes that the corporate income tax (CIT) compliance gap is also in the region of 10% then that amounts to a further R25 billion. Insofar as personal income tax (PIT) is concerned, a 10% compliance gap for provisional taxpayers would amount to some R5 billion and a 5% CIT compliance gap for pay as you earn (PAYE) would be about R50 billion. The total compliance gap is therefore likely to amount to at least R100 billion, but could be more than R150 billion once other taxes are taken into account.

How can the tax compliance gap be lessened?

According to a recent report published by PwC (https://www.pwc.co.za/en/publications/placing-behavioural-insights-at-the-centre-of-taxation.html), there are five factors that drive tax compliance behaviour. These are:

1. Deterrence
2. Social norms
3. Fairness and trust
4. Complexity of the tax system
5. Economic conditions

A strategy to improve compliance levels should embrace all of these. That said, probably the two most important factors that SARS has control over are deterrence and fairness and trust in the tax authority.

Can tax rates be increased?

Government has probably run out of space for any significant increases in taxes. It is readily apparent that the large tax increases in the 2017 and 2018 fiscal years actually had the effect of increasing the tax gap. Despite these substantial increases the tax to GDP ratio actually fell, so the increases were self-defeating in the prevailing economic and political environment.

Considering the different tax instruments the following observations can be made.

Corporate income tax

CIT in South Africa amounts to 4.5% of GDP and 17.1% of total tax revenues. This level of tax burden on companies is well above the OECD average of 2.8% of GDP and 8.9% of total tax revenues. It is comparable only to a handful of countries such as Australia, Chile, Luxembourg and New Zealand. Our headline corporate tax rate of 28% is higher than average against a declining trend in such rates.

The high tax burden on companies is also borne out by the World Bank Paying Taxes study where South Africa's Total Tax and Contribution Rate on profit of 21.8% is well above the global average of 16.1%. It must also be borne in mind that corporate taxes are the most economically distortive of all taxes and are therefore not favourable for economic growth and investment, something which is desperately required.

Personal income tax

The PIT tax burden is forecast at 10% of GDP for the 2019 fiscal year. This is the same level it was at in 2000, before the significant tax decreases that were seen in the early to mid-2000s. Then the PIT to GDP ratio fell to 7.4% by 2007. All the PIT tax relief in that period has therefore been unwound but, significantly, also now rests on a far narrower tax base.

The PIT to GDP ratio can be compared to the OECD average of 8.4% and is largely in line with high-income countries, but well above other middle-income countries. Importantly, PIT is second only to CIT in its distortionary effects, and the large increases in 2017 and 2018 did not yield the predicted revenues. This suggests that further increases in PIT have become self-defeating. There is therefore little scope, if any, to further increase PIT tax rates.

It is possible that an increase in the effective CGT rates could be introduced, although this would be more symbolic and directed at enhancing progressivity in the tax system rather than raising significant additional revenues.

VAT

The 1% increase in the VAT rate in 2018 was a last resort for National Treasury. However, it is abundantly clear from the reaction across the political spectrum that there is no possibility of this mechanism being used again, despite its advantages from an economic and administrative efficiency perspective.

Other taxes

Over the past few years, Government has used the general fuel levy as a mechanism to raise additional tax revenues in support of PIT, which was used as the main instrument to raise additional taxes. Surprisingly, it took politicians and labour a while to realise that this tax has a similar distribution profile to VAT and a close eye is now being kept on it. It is therefore unlikely that the general fuel levy can be used going forward to raise additional revenues of any significance.

Specific excise duties on alcohol and tobacco (and now sugary drinks) have also been used as a means to raise additional revenues. However, these taxes are highly regressive and concerns with regard to growing illicit trade in alcohol and tobacco would likely constrain further real tax increases on such goods. It is notable that there have been calls for higher VAT rates on luxury goods. While National Treasury is not in favour of this (rightfully so), there is the possibility that the list of luxury goods subject to ad valorem excise duties could be expanded. However, this will not raise significant amounts of revenues and would therefore be largely symbolic by further extending the progressivity of the tax system.

Similarly, there is the possibility of further increasing tax rates for estate duty.

In summary, there is likely no scope for significant tax increases. Should such increases be introduced, they are likely to do more harm than good in the sense of harming economic growth and increasing levels of noncompliance. The focus now needs to be on improving compliance levels and reducing the tax gap rather than raising taxes. If the tax gap can be halved over the next three years, that could increase revenues by as much as R75 billion a year.

Addressing the tax gap

Given the tax gap, the focus should therefore be on rebuilding SARS's capability to address noncompliance in both the licit and illicit economies. SARS is already rebuilding its capacity to tackle the illicit economy. However, tackling the tax gap in the illicit economy will require SARS to adopt new strategies and redirect resources away from large publicly held business (where noncompliance is relatively small) and towards privately held small and medium business.

This will require both a change in mindset from targeting a relatively small number of taxpayers responsible for large amounts of tax to targeting a large number of taxpayers for (in most instances) relatively small amounts of tax as well as much greater use of technology to identify noncompliance.

If the tax gap can be significantly reduced, the possibility is there that, instead of raising taxes, taxes can actually be reduced in the medium term, creating a virtuous circle of higher economic growth, growing tax revenues, greater levels of compliance and reduced tax burdens.

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FOREIGN SERVICES EXEMPTION
WHERE ARE WE NOW?

TARRYN ATKINSON, tarryn.atkinson@firstrand.co.za

Over a year has passed since the bombshell dropped that rocked the expatriate community and advisors alike and yet there still seems to be little in the way of clarity around the operationalisation of the "new" section 10(1)(o)(ii) as it now stands.

Where did this all start?

Section 10(1)(o)(ii) of the Income Tax Act pre-amendment essentially allowed an exemption from tax in South Africa for remuneration earned while the resident renders services outside of South Africa, provided certain days are spent out of the country. The basic premise of section 10(1)(o)(ii) therefore was to provide for a domestic law remedy to prevent the double taxation of remuneration where the services were rendered in a foreign jurisdiction because at the time South Africa had a very limited treaty network.

In the 2017 National Budget Speech, the Minister of Finance highlighted concerns regarding the number of South African residents who were working abroad and were potentially, through using the exemption, enjoying the benefit of double non-taxation or were able to pay significantly lower tax rates in other jurisdictions. The targets of the proposed revisions were regarded as being those residents who worked in low or no tax jurisdictions. Practitioners and advisors envisaged that tax would be due only in South Africa where the rate in the foreign jurisdiction was significantly lower than South Africa's tax rates, in essence applying a high tax threshold such as that contained in section 9D of the Income Tax Act for corporate tax.

What was contained in the draft legislation presented in August 2017 was very far removed from that premise. The draft legislation sought to entirely repeal the section, thus leaving SA residents working abroad liable to full tax on their remuneration earned through the rendering of services in a foreign jurisdiction and having to rely on the foreign tax credit provisions in order to claim back taxes paid offshore. This would essentially subject all affected residents to double taxation.

The explanation provided for this repeal was that existing double taxation agreements allow for double taxation where the resident country allows for foreign tax credits. The draft legislation therefore appeared to many to be a significant deviation from the Budget Speech concerns raised. The public outcry was enormous in comparison to the response that draft tax legislation would normally elicit and National Treasury was inundated with submissions on the proposed repeal.

National Treasury then reconsidered a full repeal of the section and proposed retaining the exemption but imposing a threshold on the remuneration that would be eligible for exemption. The final version of the legislation therefore retains the exemption and the days test. However, the exemption will only apply to the first R1 million of foreign remuneration. The effective date was extended to 1 March 2020.

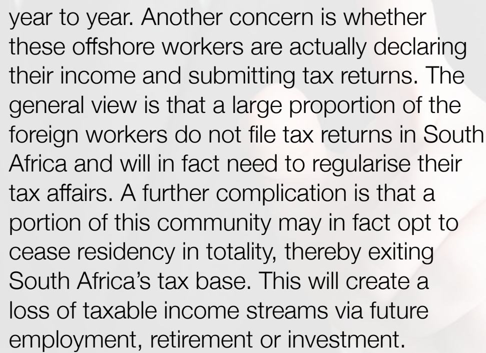
Where are we now?

Since the legislation was enacted in 2017, there has been little further discussion or workshops held to elaborate on how this legislation is going to be operationalised into the SARS processes.

There are multiple areas of concern in how the legislation is going to be implemented and whether further legislative amendment is required in order to operationalise the new dispensation.

There are two categories of residents affected by the amendments: those working overseas of their own volition, for example the teacher teaching English in Japan, and those seconded by a multinational employer to a foreign jurisdiction. While there are challenges common to both, there are also specific challenges inherent to each category.

A significant challenge for the voluntary offshore worker is determining whether they will meet the R1 million threshold and if the provision is likely to subject the remuneration being earned to tax in South Africa. The aim behind the R1 million threshold is to exclude those low-income earners working offshore. However, given changes in exchange rates this could vary from



year to year. Another concern is whether these offshore workers are actually declaring their income and submitting tax returns. The general view is that a large proportion of the foreign workers do not file tax returns in South Africa and will in fact need to regularise their tax affairs. A further complication is that a portion of this community may in fact opt to cease residency in totality, thereby exiting South Africa's tax base. This will create a loss of taxable income streams via future employment, retirement or investment.

For multinational employers, the lack of clarity around their obligations under the new legislation creates uncertainty and hampers planning going forward. The previous exemption allowed for employers to not withhold employment taxes if they were satisfied that the requirements for the exemption would be met. The introduction of a threshold complicates this. In a secondment model it is highly unlikely that a secondee would earn below the threshold, resulting in detailed calculations needing to be done to determine what is subject to tax and what is not. This is further complicated by trying to evaluate what will fall in remuneration in the first instance, taking into account the different jurisdictions that a secondee could work in.

The role of the employer in the secondment space has yet to be clarified and this largely impacts the collection of the tax. Will the multinational employer be expected to collect or withhold taxes on the remuneration of the employee, apply a foreign tax credit on payroll and then remit the difference to SARS? Should this approach be adopted, the challenge is that there often is no cash against which to withhold taxes in South Africa as the employee is remunerated in the foreign jurisdiction and foreign taxes are already being withheld against that remuneration. This will require the employer to fund the tax from its own funds, thereby creating a loan on behalf of the employee, which could also be subject to tax as a taxable fringe benefit.

The foreign tax credit system is likely to have its own challenges for both categories of taxpayers. Considerations such as different tax year ends in different tax jurisdictions and lack of final tax returns or assessments issued by the in-country revenue authorities, all create concerns regarding what will amount to sufficient proof of taxes paid in order for the taxpayer to access the foreign tax credit. There are questions around whether the employers' payroll records will be sufficient or whether a formal "receipt" is required from the relevant revenue authority to substantiate the value of the taxes paid.

"These discussions are critical to identify whether legislation needs to be amended or new legislation introduced in order to make the new section effective."

Where to from here?

There have been numerous discussions around workshops being set up to deliberate on the various concerns and to understand the implications of the legislation once it becomes effective on 1 March 2020. These discussions are critical to identify whether legislation needs to be amended or new legislation introduced in order to make the new section effective. Possible amendment may be needed to the Fourth Schedule provisions determining the withholding obligation of employers or to the provisional tax provisions to enable taxpayers to adequately disclose the foreign remuneration and to apply for credit on a provisional basis. This is largely dependent on which mechanism National Treasury and SARS is anticipating will be used to collect the taxes that may become due under the new section.

The discussions will also enable employers to adequately prepare and plan for changes in contracts and remuneration structures as well as reporting in order to assist their employees to comply.

Although the legislation is already enacted and the effective date is approaching, there remains much uncertainty regarding how the legislation will be applied and put into effect. Unfortunately, industry and taxpayers alike are struggling to find answers at the moment with very little guidance coming from National Treasury and SARS in this regard. It is hoped that the proposed upcoming workshops will clear up some of the many uncertainties that currently prevail.

INTEREST IN THE PRODUCTION OF INCOME

ESTHER VAN SCHALKWYK, evanschalkwyk@bdo.co.za

Since section 24O of the Income Tax Act came into effect in January 2013, interest incurred in respect of certain debts is deemed to be in the production of "income" and therefore tax deductible. Our article looks at subsequent changes and considers possible further amendments.

Interest incurred to acquire shares is generally not tax deductible as it does not comply with the general deduction formula, and would not constitute "income", as income excludes tax exempt amounts. Expenses incurred to acquire shares are attributed to dividends or exempt income and, as such, are not "income" and not tax deductible.

In the past this led to the restructuring of transactions (so-called debt-push-down structures) which were used in South African groups of companies. Debt-push-down structures resulted in an allowable interest deduction for debt used to acquire the income-producing assets of a target company and typically involved the following:

- The acquisition by an acquiring company of all the shares in a target company through a bridging loan.
- The acquiring company (or newly established subsidiary of acquiring company) would then enter into an intra-group transaction (under section 45, subject to rollover relief) to acquire the business assets of the target company using long-term debt.
- The acquiring company would then apply the long-term debt proceeds (or distributed by the newly established subsidiary to the acquiring company) to repay the bridging loan.

Introduction of section 24O

Interest on the long-term debt was generally treated as tax deductible, due to the link to acquire the income-producing assets of a company. In 2012 the legislature allowed interest deductions associated with direct share acquisitions occurring under circumstances similar to the debt-push-down structures. The law introduced a special provision relating to acquisitions occurring from 1 January 2013 (contained in section 24O). The law since deems interest incurred in respect of certain debts to be in the production of "income" and tax deductible. It only applies to debt used by companies to acquire controlling share interests in other companies which qualify as operating companies in a South African group context.

Effective 1 January 2016, an "operating company" means the following:

- A company of which at least 80% of the receipts and accruals comprise income for that company.
- A company of which the income contemplated is derived:
    - » from a business carried on continuously by that company; and
    - » in the course or furtherance of providing goods or rendering of services for consideration by that company.

> *"Section 24O allows taxpayers who have other sources of taxable income to deduct interest without having to incur unnecessary transaction costs."*

To qualify, the acquiring company must be a controlling group company (i.e., it must hold 70% or more of the equity shares) in relation to the operating company, or another company that is a controlling group company in relation to the operating company, and those companies must form part of the same South African group of companies. National Treasury explained that it only applies to domestic acquisitions since the debt-push-down structures only occurred locally.

Effective 1 January 2016, in the case of an indirect acquisition of shares in an operating company (i.e., the acquisition of equity shares in a controlling group company in relation to an operating company), the interest deduction is limited to the extent that the value of the shares held by the acquiring company in the controlling group company is derived from the value of the underlying shares in the operating company, subject to a 90% *de minimus* rule. In all instances (i.e., direct and indirect acquisitions of shares in an operating company), the deductible interest is limited in terms of a specified formula (under section 23N).

A further change was introduced with effect 1 January 2016, namely that a redetermination of share interests qualifying for the special interest deduction would be required in any of the following events:

- A controlling group company ceases to be a controlling group company in relation to any operating company.
- An operating company ceases to be an operating company.
- A company ceases to form part of the same South African group of companies in relation to an operating company or a controlled group company in relation to an operating company.

These changes created uncertainty as to when during a year of assessment, the determination should be made of whether at least 80% of the receipts and accruals of an operating company still constitute income in the hands of that company.

Welcome clarity

The Taxation Laws Amendment Bill of 2018 (passed by Parliament without any changes) gives some welcome clarity for years of assessment starting from 1 January 2019. The shareholder company must determine whether the operating company still meets the definition of an operating company at the end of the shareholder company's year of assessment. This assumes that the shareholder and subsidiary companies' years of assessment are usually aligned. If the years are not aligned, the redetermination is made at the end of the operating company's most recent year of assessment. The redetermination is made at the end of each year of assessment that the debt remains outstanding.

Section 24O allows taxpayers who have other sources of taxable income to deduct interest without having to incur unnecessary transaction costs previously required by debt-push-down structures. It aims to align the Income Tax Act provisions with the practice that income-producing assets of a target company can be acquired directly or through acquiring the shares in the target company.

Into the future

It is concerning that an increasing number of requirements have been introduced to limit the application of section 24O over the last few years. This should be no surprise since the provision was introduced to only allow interest deductions in the same limited circumstances that prevailed under the debt-push-down structure era (for example, limiting its operation to a domestic context).

Instead of restricting the wording of the provision to cover only a specific type of structure, it may make sense to reconsider the broad principles, namely that interest incurred to acquire income-producing assets (directly or through share acquisition) should generally be allowed as a deduction. This principle is in line with the general framework of the income tax system. Amendments that apply this principle, as opposed to recreating the debt-push-down rules, may bring some relief in future.

THE 12L energy efficiency tax incentive

15 minutes CPD

PIETER DE VILLIERS, pdevilliers@cova-advisory.co.za

Our article looks at the role of the energy efficiency tax incentive to encourage more efficient use of a scarce resource. Can it help businesses to save on energy costs and on their tax bills?

The carbon tax is due to come into force on 1 June 2019, and will mean an extra cost for South Africa's energy-intensive businesses.

But there is a way to minimise the pain and at the same time cut your energy costs. It is the 12L energy efficiency tax incentive.

While the carbon tax is the stick to force companies to cut their energy use, the 12L incentive is the carrot.

In announcing the amendment to section 12L of the Income Tax Act that came into effect in November 2013, the Government stated that it had become necessary to promote the efficient utilisation of energy, to safeguard the continued supply of energy, and to combat the adverse effects of greenhouse gas emissions – related to fossil fuel-based energy use – on climate change.

South Africa has signed up to climate change mitigation, but this will not happen by itself. There have to be active policies and measures to make it happen.

As well as the carbon tax, Government explained that "energy efficiency saving" may be considered as a potentially successful method to guarantee the efficient utilisation of energy.

It continued: *"Since the intended purpose of a carbon tax is to mitigate greenhouse gas emissions, and also to utilise (recycle) some of the revenue to be generated from such a tax to finance incentives to advance the further efficient utilisation of energy, therefore a tax incentive as contained in section 12L of the Income Tax Act, 1962, and these Regulations is devised to encourage the efficient utilisation of energy."*

The incentive was put in place even before the oft-delayed carbon tax is to happen. However, the expectation is that once cash starts pouring in to the fiscus from the carbon tax, there will then be more funds available for the incentive.

One snag with this is that the carbon tax receipts are not ring-fenced. This means that even though they say that the section 12L incentive is part of the revenue recycling initiative Government may – and probably will – be tempted to spend some of the cash on other urgent priorities.

We shall see.

Deductions afforded by section 12L

Section 12L of the Income Tax Act became effective in November 2013, with amendments effective from March 2015.

The 2015 amendments included an increase in the tax allowance from 45c/kWh to 95c/kWh.

Companies can claim savings for an individual project or for a combination of projects. The improvement of energy use across all energy sources potentially qualifies for a tax allowance.

Reporting requirements to qualify for 12L

The regulations for section 12L of the Income Tax Act set out the process and methodology for claiming an allowance for energy savings.

A baseline (benchmarking) model and report must be compiled and submitted to the South African National Energy Development Institute (SANEDI) for approval.

The baseline model determines what the energy use would have been if the energy savings measures (ESMs) were not implemented. Once the baseline is approved, the energy performance assessment report must be compiled which demonstrates the energy savings for the assessment year.

The baseline and performance assessment must be conducted by a certified measurement and verification professional (CMVP) performing measurement and verification (M&V) activities under the auspices of a South African National Accreditation System (SANAS)-accredited M&V body.

The energy savings must then be certified by SANEDI through issuing of a savings certificate. (Cova Advisory is an accredited M&V Body, one of the few currently working in this area.)

SANEDI has provided the basic application process for the tax allowance. The typical application-to-certification process for a project submitted under section 12L is shown below:

EXAMPLE OF 12L SAVINGS

A business could save R260 000 on its annual tax by saving 1 million kilowatt hours of energy. See how in the example below, which can be used to calculate your own project's savings estimate.

CALCULATE TAX INCENTIVE

Verified savings:	**1 000 000 kwh (example)**
Incentive rate:	**R0.95 / kwh**
Tax incentive amount:	**R950 000**

BUSINESS ANNUAL NET PROFIT

R 2 000 000 (example)

WITHOUT 12L:	USING 12L:
R2 000 000	R2 000 000
X28%	- R950 000
	R1 050 000
	X28%
R560 000 tax payable	**R294 000** tax payable

MONEY SAVED USING 12L

R560 000 – R294 000 = R260 000 saved

+ money saved on energy bills during the implementation of your project.

Source: *SANEDI*

The process, when simplified and made applicable to an applicant, would include the following:

- It needs to be established whether the company has implemented projects or changes that would result in qualifying energy savings to enable it to claim a tax allowance under section 12L of the Act.
- A project could include a single initiative or numerous initiatives implemented at the facility. The savings of numerous initiatives could typically be quantified with a whole facility approach where all initiatives are grouped together and defined as one project.
- The firm must engage with a SANAS-accredited M&V body that will perform the M&V activities according to the national M&V standard (SANS50010).
- The M&V body will then develop the baseline model and report to the SANEDI panel, which will assess the baseline model. If all goes to plan, SANEDI will then approve the baseline model.
- The M&V body will then measure the energy performance and prepare a performance assessment report. It will then submit the performance assessment report to SANEDI for approval.
- SANEDI will issue a section 12L Energy Efficiency Tax Certificate (the "tax certificate") for the project.

This is a highly detailed, technical and thorough process. It needs accuracy, honesty and proper planning. However, the rewards are there and companies, especially those which are high energy users, are urged to give section 12L serious consideration. The climate change challenge is not going to go away, and if there are tax savings on offer, why not go for them?

Can one safely assume these section 12L deductions will be allowed?

If you submit a thorough, honest and credible application, there is a good chance you will secure a section 12L tax allowance. Sometimes these can even work retrospectively, if an applicant can compile enough historic data.

As stated earlier, SANEDI is the body which reviews applications for a section 12L allowance. Once it is satisfied that the report on energy savings is an accurate reflection of actual or imminent energy savings, it should issue the savings certificate.

Clear this hurdle – and it is more than just a form-filling exercise – and you can safely assume the deductions will be allowed.

However, a further complication which may arise is that SARS also tends to evaluate the projects. You may see technical questions being asked which were already covered by the SANEDI certification process. Is SARS encroaching on SANEDI's turf? And does it have the expertise to do so? This is something we are watching closely.

SHARE REPURCHASES AND DIVIDEND STRIPPING: WHERE ARE WE?

HEINRICH LOUW, heinrich.louw@cdhlegal.com

We look at dividend stripping, anti-avoidance provisions and the state of play in disposing of shares in a deferral transaction.

"The fact that the corporate roll-over relief provisions were subject to the dividend stripping rules had the effect of bringing certain legitimate transactions into the ambit of the dividend stripping rules."

Company law

In terms of the Companies Act a "distribution" is defined as including any transfer by a company of money to a shareholder as consideration for the acquisition by the company of any of its own shares. Such a distribution requires the satisfaction of the solvency and liquidity test.

In addition, the repurchase by a company of its own shares requires a special resolution by shareholders, and may have to comply with certain provisions pertaining to fundamental transactions, if more than 5% of the shares in a particular class is being repurchased.

Tax law

In terms of the Income Tax Act a "dividend" is defined as any amount transferred by a resident company in respect of any share in that company. Specifically, it includes any amount transferred as consideration for the acquisition of any share in that company. However, it does not include any amount to the extent that the amount transferred results in a reduction of contributed tax capital. In the latter case the amount transferred would constitute a return of capital instead.

Where the amount constitutes a dividend, it would generally be exempt from income tax.

Such dividend may be subject to dividends tax, but not to the extent that the relevant shares are repurchased from a resident company.

Dividend stripping and tax avoidance

Dividend stripping is a practice whereby shareholders of a company reduce their tax liability in respect of the sale of their shares by first declaring dividends that are exempt in their hands. This reduces the value of the shares, and enables the shareholders to sell the shares at a lower price, realising less income or proceeds.

In 2009 anti-avoidance provisions were enacted to deal with dividend stripping, being section 22B of the Income Tax Act and paragraph 43A of the Eighth Schedule to the Income Tax Act. These provisions deemed certain dividends to be income or proceeds in respect of the sale of shares, specifically where the dividends were directly or indirectly funded by the purchaser.

However, subsequent to the introduction of the dividends tax regime, an avoidance practice developed whereby a "purchaser" would subscribe for new shares in a company, and the company would then use the subscription proceeds to repurchase the shares from the existing shareholders. The payment of the repurchase price would be exempt in the hands of the sellers, and not be subject to dividends tax to the extent that the sellers were resident companies.

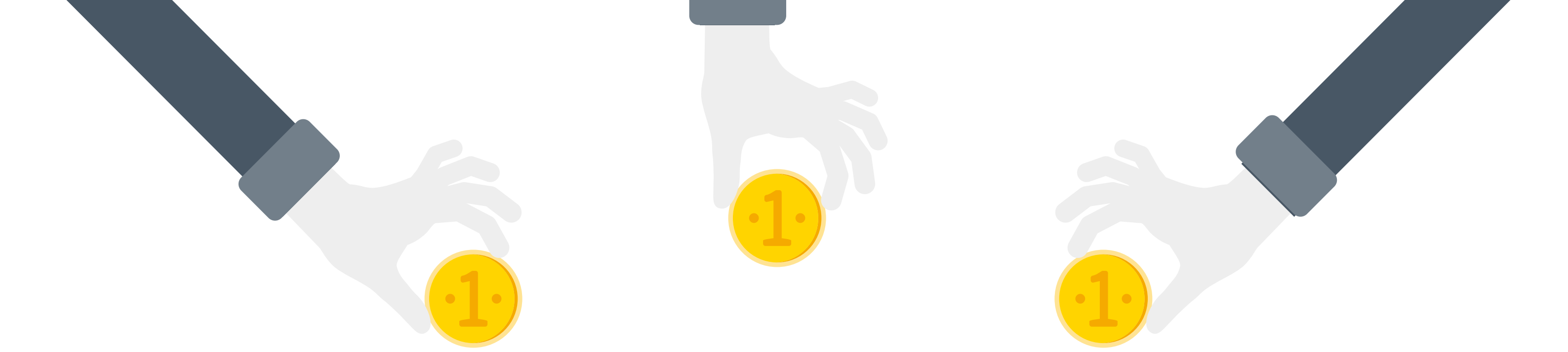
There were no specific anti-avoidance provisions dealing with such transactions, and they could only be attacked in terms of the general anti-avoidance rules or on the basis that they were simulated.

Certain subscription and repurchase transactions were made reportable arrangements in 2015.

2017 amendments

During the 2017 amendment process the dividend stripping provisions were substantially broadened. In terms of the amended provisions, a dividend arising from the repurchase of shares would also be caught by the rules, and the focus was removed from the source of the funding of the dividend.

The new rules classified any exempt dividend (both in terms of income tax and dividends tax) as income or proceeds to the extent that it constituted an extraordinary dividend and



the disposing company held a qualifying interest (during the preceding 18 months) in the company whose shares are disposed of.

An extraordinary dividend includes a dividend paid within 18 months prior to the disposal in relation to the disposal, as exceeds 15% of the value of the relevant shares (at the beginning of the 18-month period or at the time of disposal, whichever is the higher). In respect of a preference share, a dividend would be an extraordinary dividend if it exceeds an amount determined at a rate of 15%.

A disposing company would have a qualifying interest in a company if it holds at least 50% of the equity shares or voting rights, or at least 20% if no other person holds the majority of the equity shares or voting rights. The threshold is 10% in respect of a listed company.

The corporate roll-over relief provisions contained in sections 41 to 47 of the Income Tax Act were subject to the new dividend stripping rules.

2018 amendments

The fact that the corporate roll-over relief provisions were subject to the dividend stripping rules had the effect of bringing certain legitimate transactions into the ambit of the dividend stripping rules.

During the 2018 amendment process, this issue was addressed by restoring the full effect of the corporate roll-over relief provisions, subject to introducing specific claw-back provisions in section 22B and paragraph 43A of the Eighth Schedule to the Income Tax Act.

The intention of the claw-back provisions is to bring only certain specific transactions into the ambit of the dividend stripping rules: these are regarded as improper avoidance transactions within the context of dividend stripping and the corporate roll-over relief provisions.

A transaction to which the corporate roll-over relief provisions apply is now defined as a “deferral transaction”.

The claw-back provisions are quite technical, but essentially they would apply to a scenario where company A disposes of (or issues or distributes) shares to company B in terms of a deferral transaction (other than an unbundling transaction) (first disposal), and company B subsequently disposes of such shares in terms of a further transaction that is not a deferral transaction (second disposal).

First rule

In respect of the first new rule, two issues need to be determined. If the second disposal occurs within 18 months of the first disposal, then it should be determined whether, looking back 18 months from the date of the second disposal, any exempt dividend was paid to company A (or any other person who disposed of the shares in terms of a deferral transaction). It should also be determined whether company A (or the said other person) and company B were connected persons within that 18-month period prior to the second disposal or immediately after the first disposal. If both issues are determined in the positive, then the exempt dividend paid to company A (or the said other person) will effectively be deemed to be an exempt dividend paid to company B during the period starting from the first disposal. The other dividend stripping criteria should then be applied in order to determine whether that exempt dividend is an extraordinary dividend that should be included in the income or proceeds of company B upon the second disposal.

Second rule

In respect of the second new rule, two issues also need to be determined. It must be determined whether company B acquired the relevant shares (so-called new shares) in terms of the first disposal in return for other shares (for example, in terms of an asset-for-share transaction whereby company B was issued shares in return for disposing of the other shares) or by virtue of holding other shares (for example, a distribution in respect of such other shares), and such other shares (so-called old shares) were disposed of in terms of the first disposal. It must also be determined whether an exempt dividend was paid to company B in respect of the old shares (other than a dividend consisting of new shares), looking back 18 months from the date of the second disposal. If both issues are determined in the positive, then the exempt dividend paid to company B in respect of the old shares will be deemed to be an exempt dividend paid to company B in respect of the new shares, and the other dividend stripping criteria should again be applied in order to determine whether that exempt dividend is an extraordinary dividend that should be included in the income or proceeds of company B upon the second disposal.

Application

The above rules apply to disposals on or after 1 January 2019. Disposals occurring before that date in the context of the corporate roll-over relief provisions could still be subject to the previous dividend stripping rules.

HOW VIABLE ARE VCCs now?

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What happened in the 12J space in 2018? Our article takes a close look at the 2018 amendments to the VCC regime and gauges their effect on the viability of venture capital companies.

The Taxation Laws Amendment Bill [B 38–2018] was passed by Parliament at the end of 2018. The Bill contains wide-ranging amendments to section 12J of the Income Tax Act: the section that deals with venture capital companies (VCCs). The proposers of these amendments insisted that these measures were essential to end abusive VCC schemes. The critics of these amendments responded that the initial version of these changes were drafted so widely that they will choke off investment into VCCs. The public consultation process which followed the publication of these changes led to the development of a set of specific amendments which will boost rather than weaken investment into VCCs.

Objectives and general framework of section 12J

Section 12J came into effect on 1 July 2009. The explanatory memorandum which was presented to Parliament at the time sought to explain what section 12J was attempting to achieve. Several explanatory memoranda have since been published, explaining each amendment to section 12J. They serve as valuable tools in terms of understanding why section 12J was enacted, what it was designed to achieve and what it actually means.

These explanatory memoranda state that the problem which section 12J sought to fix is access to equity finance by small and medium-sized businesses and junior mining exploration companies. Such access was identified as one of the main challenges to the growth of these sectors of the economy. In order to assist small and medium-sized businesses and junior mining exploration companies in terms of equity finance, section 12J contains a tax incentive for investors in such enterprises provided that they invest indirectly in such enterprises through VCCs.

Taxpayers investing in a VCC generate an upfront deduction for the investment (whereas most equity investments are non-deductible) with a possible recoupment depending on the timing of the investor’s withdrawal from the VCC. Recoupment occurs where SARS recovers the upfront section 12J deduction allowed to the investor.

The VCC was intended to be a marketing vehicle to attract retail investors. It has the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector. It was intended to create a pooling mechanism for investors to channel funds into small businesses and junior mining operations.

The VCC itself was intended to act as an "angel investor" for these small businesses and junior mining companies by providing equity and supportive management services. The VCC was expected to typically acquire a major stake in these entities until these entities reach a certain level of growth, with the VCC selling these entities for profit upon the entity's maturity. The VCC model requires this incubation period to last between five and ten years. Most of the small businesses and junior mining operations involved are high risk – with a few large "winners" generating profits that should exceed the lack of profit in respect of the remainder.

In order to qualify as a VCC, the company must meet requirements as to form, structure and allocation of expenditures, amongst others. The VCC has three sets of requirements:

1. Investor-level requirements for the deduction
2. Criteria for determining whether the investor-pooling entity qualifies as a VCC
3. Criteria for determining whether the VCC is investing in a qualifying small business company or a junior mining company

How did it work in practice?

These requirements were initially very restrictive. As a result, the VCC regime took a long time to gain any traction. From 2009 to 2014 SARS only approved 7 companies as VCCs and 2 of these had their VCC status withdrawn. Successive relaxations of these requirements saw a rapid growth in the number of companies which SARS approved as VCCs: 18 in 2015, 17 in 2016, 45 in 2017 and 52 in 2018.

The growth in the number of VCCs saw the emergence of a new breed of VCCs. These VCCs, which came to be known as targeted funds or specialist acquisition funds, issued multiple share classes to investors. The share classes were linked or stapled to specific qualifying companies or groups of qualifying companies. Investors came to see these targeted VCCs as useful vehicles for BEE-related supplier development or specialist acquisition vehicles. Instead of investing directly in a particular company, investors could invest indirectly in that company through a VCC, thereby securing the upfront tax deduction and other non-tax benefits.

The emergence of these targeted funds alongside the more traditional pooled funds arose as a response to a demand from corporate investors and angel-type investors who sought a more active role in the identification and development of the qualifying company.

"The 2018 amendments should have the beneficial impact of making the rules of the game much clearer for VCCs."

What changed?

The 2018 Budget Review contained the fairly benign statement that section 12J will be tightened to reduce the scope for tax structuring. The nature of the tax structuring which concerned National Treasury became apparent when the initial version of the Taxation Laws Amendment Bill 2018 was published for comment during July 2018. The explanatory memorandum stated that concerns have been raised, including reports in the public domain regarding abusive tax structures using the current VCC regime. For example, immediately before the 2018 Budget, some companies were advertising tax structures in media using the current VCC regime.

The issue which National Treasury found abusive is trading between an investor in a VCC and a qualifying company in which that VCC takes up shares. Unfortunately no examples were provided of the types of abusive trading transactions. During the public comment phase on these provisions, it seemed that the type of transaction which concerned National Treasury involved an investor (usually a corporate investor) which injects equity funding in the VCC. The VCC then injects that equity funding into a qualifying company. The qualifying company then purchases assets from the investor which is followed by a high level of trading between the investor and the qualifying company. It was feared that these qualifying companies operated as captive units in that they functioned as an entity on their own while retaining close operational tie ups with the corporate investor in the VCC.

In an attempt to close these schemes, the Taxation Laws Amendment Bill 2018 proposed that amendments be made in the definition of "qualifying company" and the approval requirements for a VCC. The initial proposals were draconian. It was proposed that VCCs and qualifying companies may only issue single classes of shares. In other words, multiple share classes would be prohibited. It was also proposed that qualifying companies should derive substantially the whole of their trading income (which is about 85% to 90%) from transactions with persons who do not have an interest in the qualifying company. Many of the traditional pooled VCC funds as well as the targeted VCC funds are structured in such a way that there are different classes of shares at both VCC and qualifying company level. If the proposed amendments came into effect in their initial form, such VCCs would not comply with the provisions of section 12J. This could result in the Commissioner of SARS withdrawing approval of a VCC's status as a VCC if corrective steps were not taken. Were this to happen, the VCC would be subject to an inclusion in its income of 125% of the expenditure incurred by investors to acquire the VCC shares.

The public consultation process which followed the publication of the July 2018 draft version of the Taxation Laws Amendment Bill 2018 saw many submissions which set out compelling reasons why VCCs and qualifying companies would issue multiple classes of shares. These included providing the fund manager with its carried interest, to allow for different rounds of capital raising, to enable a VCC to invest in different sectors and for BEE supplier development purposes.

These comments resulted in substantial revisions to the initial proposed amendments. The Taxation Laws Amendment Bill 2018 which was introduced in Parliament on 24 October 2018 adjusted the initial proposed amendments which are much better targeted to abusive schemes. In essence, the effect of the key amendments are the following:

- A VCC may issue different classes of shares provided that the VCC achieves a spread of shareholders in each share class.
- The fund manager's shares will not be regarded as venture capital shares, which means that the fund manager shares are not subject to the shareholder spread requirements.
- A qualifying company may issue multiple classes of shares.
- A qualifying company may derive up to 50% of its aggregate amounts from an investor.
- An investor may not hold more than 50% of the participation rights or of the voting rights in the qualifying company.
- A qualifying company may not carry on any trade in relation to a venture, business or undertaking or part thereof that was acquired from an investor.

These amendments are subject to a number of requirements, which have the effect of limiting or expanding their operation. For instance, certain of these amendments apply where the transaction is with an investor or a person who is connected to that investor or they take effect after a grace period of 36 months has elapsed. The amendments will come into operation on different effective dates.

Clearer rules

The 2018 amendments should have the beneficial impact of making the rules of the game much clearer for VCCs. These amendments explicitly recognise that the VCC ecosystem is wide enough to cater for pooled VCC funds and targeted VCC funds and to contain reasonable parameters within which these funds should operate. The amendments contained in the Taxation Laws Amendment Bill 2018 do not threaten the viability of the VCC regime. The revised section 12J outlines more clearly the conditions under which investments may be made – in other words, to provide the clarity the current section 12J lacks.

The National Qualifications Framework (NQF) Act requires the South African Qualifications Authority (SAQA) to recognise professional bodies and register their professional designations on the NQF. This only happens if the professional body meets the SAQA Policy and Criteria for recognising professional bodies and registering professional designations.

Benefits of being a SAQA recognised professional body:

- Recognition as trusted professional bodies through an Act of Parliament
- Part of a national database of professional bodies that uphold high standards of competence and ethics
- Registration of professional designations on the most comprehensive national database of learner achievements
- Exposure to best practice through access to fora that improve professional bodies functions

SAQA recognises a professional body if it:

- Complies with, and adheres to, good corporate governance practices
- Protects the public interest in relation to services provided by its members
- Promotes professional development of its members to meet their relevant designation requirements
- Has a code of conduct for its members to adhere to
- Does not apply unfair exclusionary practices in terms of membership admission

These are the TRUSTED professional bodies recognised by SAQA

- Actuarial Society of South Africa
- Allied Health Professions Council of South Africa
- Association for Office Professionals of South Africa
- Association for Skills Development in South Africa
- Association for Supportive Counsellors and Holistic Practitioners
- Association of Accounting Technicians (South Africa)
- Association of B-BBEE Professionals
- Association of Certified Fraud Examiners
- Association of Chartered Certified Accountants South Africa
- Association of Christian Religious Practitioners
- Association of Southern African Professional Archaeologists
- Association of Southern African Travel Agents
- Batseta Council of Retirement Funds for South Africa
- Chartered Institute for Professional Practitioners and Trainers
- Chartered Institute of Government Finance Audit and Risk Officers
- Chartered Institute of Management Accountants
- Chartered Institute of Procurement and Supply
- Chartered Secretaries Southern Africa
- Coaches and Mentors of South Africa
- Compliance Institute Southern Africa
- Contact Centre Management Group
- Contractors Plant Hire Association
- Corporate Counsel Association of South Africa
- Council for Equine and Equestrian Professionals of South Africa
- Direct Marketing Association of South Africa
- Disaster Management Institute of Southern Africa
- Employee Assistance Professionals Association of South Africa
- Engineering Council of South Africa
- Estate Agency Affairs Board
- Federation of African Professional Staffing Organisations
- Financial Planning Institute of Southern Africa
- Forum of Immigration Practitioners of South Africa
- Health Professions Council of South Africa
- Independent Regulatory Board for Auditors
- Institute for Local Government Management of South Africa
- Institute for Timber Construction South Africa
- Institute for Work at Height
- Institute of Accounting and Commerce
- Institute of Bankers in South Africa
- Institute of Business Advisers Southern Africa
- Institute of Certificated and Chartered Statisticians of South Africa
- Institute of Certified Bookkeepers and Accountants
- Institute of Chartered IT Professionals
- Institute of Commercial Forensic Practitioners
- Institute of Credit Management of South Africa
- Institute of Directors in Southern Africa
- Institute of Information Technology Professionals South Africa
- Institute of Internal Auditors South Africa
- Institute of Loss Adjusters of Southern Africa
- Institute of Management Consultants and Master Coaches of South Africa
- Institute of Mine Surveyors of South Africa
- Institute of People Management
- Institute of Professional South African Mariners
- Institute of Risk Management South Africa
- Institute of Safety Management
- Insurance Institute of South Africa
- Law Society of South Africa
- Library and Information Association of South Africa
- Marketing Association of South Africa
- Ocularists Association of Southern Africa
- Plumbing Industry Registration Board
- Professional Hunters' Association of South Africa
- Project Management South Africa
- Public Relations Institute of Southern Africa
- Register of Exercise Professionals South Africa
- SAINT Professional Body for NDT
- South African Association of Health and Skincare Professionals
- South African Board for People Practices
- South African Chefs Association
- South African Chemical Institute
- South African Council for Natural Scientific Professions
- South African Council for Project and Construction Management Professions
- South African Council for Social Service Professions
- South African Council for the Architectural Profession
- South African Council for the Property Valuers Profession
- South African Council for the Quantity Surveying Profession
- South African Dental Technicians Council
- South African Facilities Management Association
- South African Geomatics Profession Council
- South African Institute of Chartered Accountants
- South African Institute of Financial Markets
- South African Institute of Occupational Safety and Health
- South African Institute of Physics
- South African Institute of Professional Accountants
- South African Institute of Tax Practitioners
- South African Institute of the Interior Design Professions
- South African Nursing Council
- South African Payroll Association
- South African Professional Firearm Trainers Council
- South African Professional Institute for Kinderkinetics
- South African Restructuring and Insolvency Practitioners Association
- South African Reward Association
- South African Sports Confederation and Olympic Committee
- South African Veterinary Council
- Southern African Asset Management Association
- Southern African Communications Industries Association
- Southern African Emergency Services Institute
- Southern African Institute for Business Accountants
- Southern African Institute for Occupational Hygiene
- Southern African Institute of Government Auditors
- Southern African Marketing Research Association
- The South African Council for Administrators
- The South African Pharmacy Council
- Turnaround Management Association Southern Africa
- Vehicle Damage Quantification Governance Body of South Africa
- Water Institute of Southern Africa

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VAT DEDUCTIONS BY HOLDING COMPANIES

▶ **GERHARD BADENHORST,** gerhard.badenhorst@cdhlegal.com

We look at the position of companies that acquire subsidiaries when it comes to the deductibility of VAT inputs in different scenarios.

The entitlement of holding companies to deduct VAT is an aspect that revenue authorities and vendors have been grappling with for decades. The uncertainty in South Africa is exacerbated by the limited case law we have in this regard. SARS has established certain policy principles which it seeks to apply to all holding companies. These policies have unfortunately not been challenged in our tax courts.

There have been a number of European Court of Justice cases that have dealt with the deduction of VAT by holding companies. These judgments have not been consistent, but they have established certain principles from which we can draw guidance. Our courts are not bound by these judgments, but the judgments can be of persuasive value in some instances.

Deduction of input tax

The European Court of Justice recently emphasised in the case of *Iberdrola Inmobiliaria Real Estate Investments* (Case C-132/16) that the right of a vendor making taxable supplies to deduct input tax is an integral part of the VAT system and should in principle not be limited. It stated that the deduction system is intended to relieve the vendor entirely of the burden of VAT paid in the course of all its enterprise activities. This is not any different in a South African context.

Accordingly, where a company only derives taxable income, it is entitled to deduct the total amount of VAT incurred as input tax. The question is whether the entitlement of the company to deduct input tax changes when it acquires a subsidiary and becomes a holding company.

"SARS often seeks to disallow the VAT on share acquisitions in a subsidiary on the basis that it is an investment from which only non-taxable dividends can be derived."

Firstly, the VAT on any costs incurred on the purchase of the shares in the subsidiary should be considered. If the shares in the subsidiary are acquired with the object to enhance or expand the taxable enterprise activities of the holding company, then the VAT incurred on the acquisition costs should be fully deductible. In the income tax case of *CIR v Drakensberg Garden Hotel* (23 SATC 251) the taxpayer, a hotel operator, purchased shares in a property company to gain control over property in which it carried on its business. The Special Court held that the link between the share purchase and the taxpayer's income was sufficiently close to enable the taxpayer to deduct the interest on the purchase cost. The same principles should apply in a VAT context.

In the United Kingdom case of *C&E Commissioners v UBAF Bank Ltd* (STC 372) the taxpayer acquired shares in three companies to extend its own leasing business. The Court held that the VAT on the professional fees paid in respect of the purchase of the shares was fully deductible as input tax.

More recently (October 2018), the European Court of Justice held in *Ryanair Ltd* (Case C-249/17) that the VAT incurred on professional services acquired in respect of the proposed purchase of shares in another company, where it was the intention of the vendor to render management services to the target company, was fully deductible as input tax. This was despite the fact that Ryanair was only able to purchase part of the share capital of the target company due to competition law restrictions.

Notwithstanding these authorities, SARS often seeks to disallow the VAT on share acquisitions in a subsidiary on the basis that it is an investment from which only non-taxable dividends can be derived.

The second issue to consider is whether a company that acquired a subsidiary is entitled to deduct the VAT on its on-going operating expenses. There does not seem to be any reason why a company making taxable supplies should be restricted in its deduction of input tax simply because it acquired a subsidiary. Where the holding company renders services to the subsidiary, such as management, administration, accounting and information technology services, then it expands its enterprise activities, which is further substantiation for deducting full input tax.

However, if the holding company also provides interest-bearing loans to the subsidiary, then the situation changes because the company then makes both taxable and exempt supplies. The VAT position is complicated further if the subsidiary pays dividends to the holding company. The holding company is then entitled to deduct only a portion of the VAT incurred on its expenses as input tax.

Apportionment of input tax

Where a holding company makes taxable supplies and provides VAT-exempt interest-bearing loans to the subsidiary, then the VAT incurred on overhead and general expenses may only be deducted to the extent that they are attributable to taxable supplies. The apportionment must be made in accordance with section 17(1) of the VAT Act, which is either in accordance with a turnover-based method as prescribed in Binding General Ruling 16 or a binding private ruling issued by SARS.

SARS has stated in its VAT 404 Guide for Vendors that in deciding whether the prescribed turnover-based method is appropriate, the vendor must apply a common-sense approach which would be applied by a reasonable person. The method must therefore achieve a "fair and reasonable" result which is a proper reflection of the extent of the intended use of goods or services acquired by the vendor for making taxable supplies (on the one hand) and for making non-taxable supplies (on the other). If the prescribed turnover-based method does not yield a fair result, the vendor must apply for a binding private ruling to use another method.

Inclusion of dividends

The problem facing South African holding companies is that Binding General Ruling 16 requires that dividends received must be included in the denominator of the formula. However, the inclusion of dividends in the apportionment formula will hardly ever achieve a fair result. There is no correlation between expenses and dividends received, and dividends are generally only received annually. That the standard turnover-based method is inequitable has been recognised in the *2013 Budget Review* and it was already then proposed that it be re-evaluated.

Even if the holding company applies for a binding private ruling, then SARS generally insists that the dividends, or a portion thereof, be included in the formula. In some cases, SARS even includes a notional amount where no dividends are received from subsidiaries. However, no notional amount is included where management services are rendered but no fee is charged because the subsidiary is in a start-up phase or unable to pay. A further hurdle is that a binding private ruling is only made effective from the commencement of the financial year in which the application for the binding private ruling is submitted.

The inclusion of dividend income in the apportionment formula is directly in contrast to a number of European Court of Justice judgments. In one such case, *Cibo Participants SA* (C-16/00), the European Court of Justice held that dividends paid by subsidiaries to a holding company, which is a taxable person and which supplies management services to the subsidiaries, must be excluded from the denominator of the apportionment formula. These judgments have been accepted and are applied accordingly by tax authorities worldwide. South Africa is an exception in this regard.

The rationale for the inclusion of dividends in the apportionment formula, according to SARS, is that there are "shareholder activities" that a holding company carries out in relation to its subsidiaries. These are not taxable activities and should be reflected in the apportionment formula. Unfortunately, SARS has never explained exactly what these activities are, or what taxable resources it considers the holding company to apply in this regard. If properly considered, any activity involving the provision of advice and direction by the holding company in relation to the products, technologies, markets, strategies

or business locations of the subsidiary is by its nature a taxable supply of services and would generally form part of the management services rendered to the subsidiary. The VAT incurred on resources applied for these activities, if they are "shareholder activities", should therefore qualify as input tax, whether or not a fee is charged.

In some instances, SARS requires that a dividend amount equal to the value of management services be included in the apportionment formula. There is, however, no scientific or logical basis for such an approach, but it is often accepted because it yields a higher ratio than the prescribed turnover-based method.

SARS also requires in certain instances that dividends be included in the apportionment formula based on the number of holding company directors or employees serving on the subsidiary's board. This is seemingly because such a director or employee serves the interests of the holding company. However, directors owe their duty of care to the company and not to its shareholder, even if the director is an employee of the shareholder. There is also no justification to include dividends in the formula on this basis.

Group companies with multiple intermediate holding companies may face substantial VAT leakage if dividends are included in the apportionment formula of each intermediate holding company and that of the ultimate holding company. The inclusion of dividends (or a portion thereof) in the apportionment formula means that each intermediate holding company is required to apportion its input tax, even if an intermediate holding company does not carry out any "shareholder activities". The more intermediate holding companies there are in a group, the higher the potential VAT leakage for the group.

Where a holding company acts as a loan intermediary in relation to its subsidiary companies, then it is appropriate to deduct the interest which the holding company pays to fund the loans to the subsidiaries from the denominator of the apportionment formula. This is similar to what is generally allowed for financial institutions. The interest margin as opposed to the gross interest received fairly represents the exempt lending activities of a loan intermediary. However, a binding private ruling is required to include only the interest margin. There does not seem to be any reason why Binding General Ruling 16 could not be amended accordingly.

Is the turnover-based method inequitable?

The VAT position of each holding company is unique and each transaction involving the acquisition or disposal of an interest in a subsidiary needs to be carefully considered. Without the proper attention to VAT, holding companies could suffer substantial amounts of non-deductible VAT.

As long as the prescribed turnover-based method requires dividends to be included in the formula, this method will remain inequitable for holding companies, and they are best advised to apply for a binding private ruling to use a more suitable method.

RECOGNISING THE STARS WHO MAKE SAIT GREAT

SAIT would not be where it is today without the dedication of various tax executives on the Technical Work Group, Operational Work Group and Tax Executives Forums. Thank you to all volunteers involved.

TECHNICAL WORK GROUPS

SAIT currently has eight work groups that deal with tax policy and tax interpretation issues. Most of these groups consist of tax practitioners from various accounting, law and boutique advisory firms with significant tax offerings. These work groups consist of Personal Income Tax, (Domestic) Business Tax, Business Tax Incentives, International Tax, Value-added Tax, Tax Administration and most recently Carbon Tax. SAIT also has a Mining Tax group, which consists exclusively of in-house tax specialists working directly for mining companies.

The main objective of these groups is to review legislative tax proposals from the National Treasury (in conjunction with SARS). Each group convenes at least twice per year (to review draft legislation in July and to make proposals for new legislation in November). Many of the Chairs, Vice-Chairs and other prominent members of the group use the SAIT work group system to directly engage with National Treasury and SARS. The work groups typically engage in National Treasury / SARS workshops and provide support for SAIT's presentations before the Standing Committee on Finance in the National Assembly.

PERSONAL TAX TECHNICAL WORK GROUP

Name	Organisation
Jaco La Grange (Chair)	Deloitte
Beatrie Gouws (Vice Chair)	KPMG
Marty Santana	WTS South Africa
Jackie Arendse	Rhodes University
Shohana Mohan	Tax Auditor Solutions
Nicoline Benzien	BDO
Vedika Andhee	EY
Barendine Duvenhage	NomadIQs
Gavin Duffy	PWC
Hugo van Zyl	FNB
Kristel van Rensburg	ENSafrica
Henry Hollingdrake	Amicorp

BUSINESS TAX TECHNICAL WORK GROUP

Name	Organisation
Lesley Bosman (Chair)	KPMG
Dawid van der Berg (Vice Chair)	PWC
Craig Miller	Webber Wentzel
Barry Garven	Bowmans
Brian Dennehy	Webber Wentzel
Hildegarde de Cronje	Deloitte
Pieter van der Zwan	NWU
Carmen Moss-Holdstock	VDMA Attorneys
Scott Berry	PWC
Des Kruger	Webber Wentzel
Mike Benetello	ENSafrica
Andrew Lewis	DLA Piper

BUSINESS INCENTIVES TAX TECHNICAL WORK GROUP

Name	Organisation
Duane Newman (Chair)	Cova Advisory
Marinda Fourie (Vice Chair)	EY
Newton Cockcroft	Deloitte
Tumelo Marivate	Deloitte
Darren Margo	Margo Attorneys
Christo Engelbrecht	Catalyst Solutions
Dov Paluch	Catalyst Solutions
Theo Meintjies/Izak du Toit	Dectra
Madelein Parsons	Sasfin
Theo van der Spoel	Nampak
Lizette Abbott	
Lynton Peters	KPMG
Mansoor Parker	ENSafrica
Melanie Harrison	ENSafrica
Nicole de Jager	KPMG

INTERNATIONAL TAX TECHNICAL WORK GROUP

Name	Organisation
Anne Casey (Chair)	Deloitte
Michael Honiball (Vice Chair)	Werksmans
Elandre Brandt	Imperial
Ryan Killoran	Werksmans
Ernest Mazansky	Werksmans
Carel Gericke	MTN
Caoilfhionn van der Walt	Regan van Rooy
Thabo Legwaila	Citibank
Dawid van der Berg	PWC
Joon Chong	Webber Wentzel
Mike Benetello	ENSafrica
Rob Stretch	Regan van Rooy
Henry Hollingdrake	Amicorp

VAT TECHNICAL WORK GROUP

Name	Organisation
Victor Terblanche (Chair)	VATit SA
Severus Smuts (Vice Chair)	Deloitte
Redginald de Swardt	EY
Andre Meyburgh	KPMG
Cliff Watson	Grant Thornton
Peter Franck	Franck Consulting
Ferdie Schneider	BDO
Des Kruger	Webber Wentzel
Anne Jenkinson	ENSafrica
Seelan Moonsamy	Baker McKenzie

TAX ADMINISTRATION TECHNICAL WORK GROUP

Name	Organisation
Patricia Williams (Chair)	Bowmans
Elle-Sarah Rossato (Vice Chair)	PWC
Betsie Strydom	Bowmans
Anton Lockem	Shepstone & Wylie
Roula Hadjipaschilis	KPMG
Ruaan van Eeden	Geneva Management Group (Africa)
Mmangaliso Nzimande	EY
Aakifah Louw	Massmart + Walmart
Althea Soobyah	EY
Lani Lombard	ABSA
Andries Myburgh	ENSafrica
Al-Marie Chaffey	PWC
Lesley Bosman	KPMG

MINING TAX TECHNICAL WORK GROUP

Name	Organisation
Andre de Klerk (Chair)	South 32
George Trollope	AngloGold Ashanti
Gelishan Naidoo	AngloGold Ashanti
James Jackson	Harmony
Karl Van Meersbergen	Sibanye Stillwater
Christa Goosen	Anglo American
Rudi Churr	Anglo American
Birt Coetzer	Glencore
Elize Cockrell	Exxaro

OPERATIONAL WORK GROUPS

As part of our continued effort to serve our members, SAIT regularly meets with SARS representatives at a regional and national level to raise pertinent operational issues affecting the tax community. The volunteer representatives act on behalf of the Institute at these meetings. The purpose of this work group is therefore to deal with operational matters as they arise per region. Members are able to raise their SARS-related issues upon receipt of an emailed Call for Comments relevant to their region.

EASTERN CAPE

Rodney Smith	Liandor Financial Accountants
Royden Whitfield	Whitfield Fintax
Claude Ackermann	FNB Trust Services
Damian W. Seeber	The Eye Centre
Ryan A. Odendaal	Kael Consulting

KWAZULU-NATAL

Natalie Wocke	Natalie Wocke Accounting & Tax
Shamit Bansi	Platinum Accounting
Teresa Seaton	Worldwide Tax Solutions

FREE STATE

Moeketsi Mokhethi	MS Mokhethi Holdings
Willie J. Burger	WJB Accountants / Rekenmeesters
Alfred Shabalala	ATS Tax Specialists
Hendrik van Vuuren	The Accountant

GAUTENG

Lesa-jo Cloete	Vernon Cloete Broker Services
Kumarie K. Moonsamy	Shakthi Account Solution
Kobie Stears	Nolands
Nikki Kennedy	NK Accounting Services
Kevin Asbury	BSA Financial Services
Jacques Botha	Botha du Preez Accountants

LIMPOPO

Matlhora T. Matloa	Mapmark Enterprise

MPUMALANGA

Tumelo G. Modipane	DKPJ Consulting
Khutso Kgaphola	Mashiloane Incorporated

NORTH WEST

Hendrik van Vuuren	The Accountant

NORTHERN CAPE

Cornelius A. Taljaard	AS Karstens

WESTERN CAPE

Jonathan H. Kounzie	JHK Consulting
Lynette A. Prinsloo	Skyblue Tax Services
Shahied Allie	Coral Business Consulting
Stef Lategan	Grant Thornton

TAX EXECUTIVES FORUM

The purpose of the Tax Executives Forum is to establish a separate discussion group for in-house tax staff of larger South African companies. The viewpoint of this in-house tax staff (e.g., in-house tax directors) differs from tax practitioners serving third-party clients. These in-house staff members are expected to cover a greater variety of tax issues but must only address the factual situation of a single company (or company group). In-house staff must take a long-term view of their compliance and interpretation decisions because positions must be consistent to be sustainable and corporate reputations are on the line.

The Forum meets several times per year with external advisors invited only as occasional guest appearances. Discussions invariably cover legislative pronouncements and policy trends. Operational enforcement and compliance issues are shared for group understanding. SAIT believes that this group is critical for SAIT's policy interaction because this group of tax professionals is often closest to the business facts – something government sorely needs for viable tax policy formulation.

Lazelle Terblanche	MultiChoice
Annette Brits	Altron
Christa Goosen	Anglo American
George Trollope	AngloGold Ashanti
Brenda Engelbrecht	Aspen Pharmacare
Cicelia Potgieter	Barloworld
Kabelo Shabalala	Bayer
Dharam Naidoo	Bidvest
Nikki Oberholzer	CCBA
Elize Cockrell	Exxaro
Birt Coetzer	Glencore
Rogers Reddy	Grindrod
James Jackson	Harmony
Elandre Brandt	Imperial
Tony Marcus	Liquid Telcom
Andre Botes	Lonmin
Trevor Rogers	Massmart
Carel Gericke	MTN
Theo van der Spoel	Nampak
Karen Rosingana	Naspers
Sebueng Mthembu	PPC
Hema Moodley	Sasol
Karl van Meersbergen	Sibanye Stillwater
Zaid Ismail	South African Airways
Andre de Klerk	South32
Tosca Dos Santos	Telkom
Chris Esterhuizen	Tiger Brands
Ana-Celia Mendes	Unilever
Shane Govender	Vodacom

HOW TO COMPLETE your provisional tax return

NICCI COURTNEY-CLARKE, nicci@taxtim.com

With the deadline for second provisional tax returns and payments fast approaching, we provide you with information and tips to help you prepare in good time.

Do you qualify as a provisional taxpayer?

The provisional tax payment system applies to all taxpayers who receive income that is not a salary or remuneration from an employer and that is not subject to monthly PAYE deductions.

This would include taxpayers who earn income from one of the following sources:

- Running their own business (i.e., freelancers, sole proprietors, independent contractors)
- Property rental
- Investments (i.e., dividends and interest)
- An unregistered employer (i.e., an employer who does not deduct PAYE from their salary)

If you are self-employed and earn taxable income above the annual tax threshold (for 2019 this is R78 150) you must always be registered as a provisional taxpayer (even if you earn a salary as well).

If you do not carry on a business but you earn rental income, investment income or income from an unregistered employer and your taxable income exceeds the annual tax threshold, you will also be a provisional taxpayer, unless your taxable income from these sources is less than R30 000 per year.

The deadline for the second provisional tax return for 2019 is 28 February 2019. This means that both the return (completed IRP6) as well as your tax payment (if applicable) must be submitted to SARS by this date.

When are provisional tax payments due?

- The first payment is due by the end of August (mid tax season)
- A second payment is due by the end of February (end of tax season)
- An optional third payment is due at the end of September only if the amount paid in previous payments was insufficient.

Documents you need in order to prepare an IRP6

In order to prepare a second provisional tax return, make sure you have the documents from the following list that are relevant to you:

- Your business's income statement which reflects the total income and expenses for the year
- Payslips for the year
- A schedule of your rental income and expenses
- Statements from financial institutions where you hold investments, which show the interest and capital gains earned for the year on any investments you hold
- Supporting documents (e.g., invoices) for any other non-salary income you earned during the year
- Your first IRP6 for 2019, as well as proof of tax paid

How to complete the second provisional tax return

Particulars of taxpayer
This section will already be completed. Check the details to make sure they are correct.

Period
Ensure the second period is checked. The second period for 2019 is for the 12 months ending 28 February 2019.

Turnover
This is your estimated gross income for the whole year (12 months) which includes: total business income, royalties, dividends, interest and all other income, including employment income (salary). Retirement fund lump sums, retirement fund withdrawal benefits and severance benefits must be excluded because these are taxed according to their own special tax tables.

Estimated taxable income
This is your gross income (indicated under *Turnover* above) minus your estimated business-related expenses for the 12-month period. You must include the taxable portion of your capital gains here too. You can subtract retirement fund contributions, donations to public benefit organisations and any exempt income (e.g., the annual interest exemption and local dividends).

Tax on estimated taxable income
This amount will automatically calculate when you hit the "Recalculate" button.

Rebates (primary, secondary and tertiary)
Depending on your age, this amount will already be populated on your tax return.

Medical scheme fees tax credit
This is a tax credit you receive if you contribute to a private medical aid. (2019: R310 per month for the first two members and R209 per month for every additional member).

> "The deadline for the second provisional tax return for 2019 is 28 February 2019. Both the return as well as your tax payment must be submitted to SARS by this date."

Additional medical expenses tax credit
If your medical aid costs exceed four times the above medical scheme credit (three times if you are over 65) then a portion of your costs plus out-of-pocket medical expenses can be claimed here as a credit.

Tax for the full year
This will automatically calculate and will equal the tax due (*Tax on estimated taxable income* discussed previously) less rebates and tax credits.

Employees' tax for this period
If you earned a salary, add up all the PAYE you paid per your payslips for the year and enter it here.

Foreign tax credits for this period
If you earned money offshore and tax was withheld or paid on this foreign income, include the foreign tax here.

Provisional tax paid for first period
This is the first provisional tax payment you made for 2019 (payment should have been made by 31 August 2018).

Tax payable for this period
This amount will automatically calculate.

Penalty outstanding from first period
If you paid your first payment after the deadline, SARS will automatically levy a penalty of 10% on your tax due. You need to calculate this amount and enter it here.

Interest outstanding from first period
SARS charges interest at 10.5% on payments after the deadline. If applicable, you need to calculate this amount and enter it here.

Amount payable
This amount will automatically calculate.

Penalty on late payment
If you made your second payment after the deadline, SARS will automatically levy a penalty of 10% on your tax due. You need to calculate this amount and enter it here.

Interest on late payment
SARS charges interest at 10.5% on payments after the deadline. If applicable, you need to calculate this amount and enter it here.

Total amount payable
This amount will automatically calculate.

Basic amount
This is your taxable income in your most recent, previous assessment. You need to be aware of this amount and how it impacts the calculation of the underestimation penalty in the event you underestimate.

Tips and common pitfalls

Listed below are some problems people regularly encounter, and tips to avoid them.

Underestimation penalty
You need to ensure the estimate of taxable income in your second return is reasonably accurate to avoid an underestimation penalty. This estimate should be more accurate than the one in your first provisional return because by year-end you should know your taxable income for the year and therefore less estimation is required.

The penalty amount is different for taxpayers whose taxable income is more than R1 million than for those earning less than R1 million.

If your taxable income for the year is R1 million or less, SARS will impose an underestimation penalty if your estimate in your second provisional return turns out to be less than 90% of your actual annual taxable income on your ITR12, and is also less than your "basic" amount.

The penalty amount will be calculated at 20% of the difference between the normal tax payable on your estimate and the lesser of:

- Tax on 90% of your actual taxable income
- Tax on your "basic" amount

If your taxable income is more than R1 million, you need to ensure that your estimate of taxable income on your second provisional return is no less than 80% of your actual taxable income. SARS does not consider the

"basic" amount when a taxpayer's taxable income is more than R1 million.

The penalty will be calculated at 20% of the difference between the normal tax payable for your estimate and tax calculated on 80% of your actual taxable income.

Late payments

SARS is very quick to levy a late payment penalty equal to 10% of the total tax payable (even if you are only a day late!). Not only that, SARS will lump on interest at their prescribed rate (currently 10.5% per annum) as well. Be sure to check the deadline on their website for both the August and February payment and set an alert on your calendar so you never pay late.

Also, bear in mind that if the last day for submission falls on a public holiday or weekend, the submission must be made on the last working day prior to the public holiday or weekend.

Late submission

If you file your IRP6 more than four months after the deadline, SARS considers you to have submitted a "nil" return (i.e., taxable income is equal to zero). Unless your actual taxable income is in fact zero, this will result in the 20% underestimation penalty being imposed.

Always submit a return

If you fail to submit a return, SARS may estimate your tax liability due based on prior returns. Therefore even if you owe no tax, you must still submit a provisional ("nil") return.

Keep supporting calculations

SARS may ask you to justify your estimate and can increase it if they are dissatisfied with the amount. The increase of the estimate is not subject to an objection or appeal.

Make a third "top-up" payment to avoid interest

If you realise after the year end that you have underpaid your tax for the preceding year, it would be wise to make a voluntary third payment by the end of September. Many people don't do this and opt to rather pay the balance due a few months later when they submit their tax return, but then receive a nasty surprise when they see interest on underpaid provisional tax on their tax assessment (under section 89quat of the Income Tax Act).

Don't overlook investment income and capital gains

If you own investments, it may be worth requesting a provisional statement from the financial institution in February to ensure you include your interest and capital gains in your year-end estimate of taxable income. Too often taxpayers are surprised by unexpected capital gains and interest when they receive their IT3(b) and IT3(c) after year end and then it is already too late to avoid the underestimation penalty on their second provisional payment.

Correcting a mistake after submission

If you realise that the provisional return you submitted is incorrect, you can pull it for correction at any time in SARS eFiling. To do this, you need to navigate to this return by selecting the menu item "Returns" and then "Returns History" and then click on the button "Request for Correction". You can then make the changes to your IRP6 and resubmit.

You may need to do this, for example, if an unexpected sale occurs at the end of February, which you had not factored into your estimate of taxable income for the 12-month period when you originally submitted your IRP6.

ITR14 MUST-KNOWS

▶ **MAYA NIKOLOVA,** maya@taxconsulting.co.za

This article takes us through the process of accessing and completing the ITR14 return on eFiling.

Companies that are incorporated in the Republic and are tax residents are subject to income tax in South Africa on all their South African sourced and worldwide income. Non-resident foreign companies that have a permanent establishment or operate a business through a branch are subject to income tax in the Republic on all their South African sourced income.

This is normally referred to as corporate income tax and it forms part of the gross national tax revenue. According to "Chapter 4: Revenue trends and tax policy" from the Budget Review for 2018/2019, the corporate income tax accounts for 15.51% of the estimated 2018/2019 consolidated budget.

Corporate income tax was also the subject of a report issued in March 2018 by the Davis Tax Committee on the efficiency of the corporate tax system in South Africa.

SARS is mandated to assess and to collect corporate income tax from corporate taxpayers, who must complete the ITR14 income tax return, which is specifically designated for companies. The ITR14 must be completed and submitted to SARS within 12 months after the financial year-end of a corporate entity.

Request the ITR14 return

SARS currently caters for corporate taxpayers to complete and to submit their ITR14 returns at a SARS branch, for those who are not registered eFilers, or via eFilling, for those who are registered eFilers. SARS encourages and promotes registration on eFiling for all taxpayers, as this enables faster and more efficient submission and processing of returns and respective payments. SARS no longer issues blank ITR14 returns.

We will review and discuss the ITR14 return in its electronic format, as issued on eFiling.

Maintenance of legal entity details

Once the company is registered on eFiling for the relevant tax type, such as corporate income tax, the ITR14 may be requested from the “Returns Issued” tab, after selecting the appropriate tax period for which the return is to be submitted. Once the return is generated, the eFiling user is routed to the Income Tax Work Page, where the return can be accessed and completed.

Before the ITR14 is opened, it is important to verify the legal entity details and to update, if necessary, any outdated information about the company. This may be done by eFiling users either by directly accessing the Registration Amendments and Verification (RAV01) form from the “Maintain SARS Registered Details” tab or, before capturing the ITR14, by selecting “Maintain Legal Entity Details” on the Income Tax Work Page.

It is very important that SARS has accurate company details, such as physical and postal addresses, contact numbers and email addresses, to ensure proper and timeous communication with and delivery of assessments to the taxpayer. As part of the Go Green Initiative to decrease the use of paper, SARS favours the use of electronic communications.

The details of public officers and the banking details of entities should always be maintained precisely, to guarantee that any tax refunds due by SARS are promptly reimbursed to the company. The provisions of section 252 of the Tax Administration Act clearly state how delivery of documents to companies is executed.

Company type

Company type questions refer to the nature of the business of the legal entity, and specifically whether the company is a body corporate or a share block company. If the answer is "No" then the "Gross income" and the "Total assets" sections are displayed and need to be completed with the respective information. If the gross income specified in the relevant questions does not exceed R1 million and the value of the total assets does not exceed R5 million, the company will be classified as a micro business. The classification takes place according to *IT-GEN-04-G01 - Comprehensive guide to the ITR14 return for companies*, published by SARS and available to download from the SARS website (www.sars.gov.za). If the gross income is in excess of R1 million and the total assets are in excess of R5 million, then the company will not be classified as a micro business, and the "Wizard" page will display additional questions for customisation of the income tax return.

SARS elaborates on their website, on the "Corporate income tax" page, that a customised ITR14 will be created according to the company type that you specify when completing your return. The below table is an extract from the website and sets out descriptions of company types:

TYPE	DESCRIPTION
DORMANT COMPANY	A dormant company is classified as a company that has not actively traded for the full year of assessment (i.e., if the company partially traded during the year of assessment, the company will not be regarded as a dormant company).
SHARE BLOCK	A share block company is defined in section 1 of the Share Blocks Control Act.
BODY CORPORATE	A body corporate is defined in section 1 of the Sectional Titles Act.
MICRO BUSINESS	A micro business is classified as a company with a gross income (sales / turnover plus other income) not exceeding R1 million and total assets (current and non-current) not exceeding R5 million, and that is not classified as a body corporate or a share block company.
SMALL BUSINESS	A small business is classified as a company with a gross income (sales / turnover plus other income) not exceeding R14 million and total assets (current and non-current) not exceeding R10 million, which is not classified as a body corporate, a share block company or a micro business. *Note: A small business is not the same as a small business corporation as defined in section 12E of the Income Tax Act.*
MEDIUM TO LARGE BUSINESS	If a company is not classified as a body corporate or share block company, micro business or small business, it will be classified as a medium to large business [i.e., gross income (sales / turnover plus other income) exceeding R14 million and / or total assets exceeding R10 million].

TIPS

COMPLETING AN ITR14 FOR A MINING COMPANY

Elize Cockrell, Group Manager Taxation at Exxaro

When completing an ITR14 for a mining company one has to take note of the following practicalities:

1. **Capital redemption:** There is no "capital redemption" option to choose from under the grouping "Special allowances not claimed in the income statement". Neither is there a specific line included in the tax calculation. The only option is to complete this as a deduction under "Other".

   For mining companies this is not in the correct order when calculating the amount to be redeemed as the redemption is calculated after all tax adjustments to the mining income, relating to the specific mine, have been done.

2. **Rehabilitation trust:** For accounting purposes the financial information of a rehabilitation trust is reported as part of the mining company's balance sheet and income statement. When completing the ITR14, the income potion relating to the trust should be reversed as the rehabilitation trust is a separate legal entity and must submit a separate income tax return. This too should be disclosed as "Other" in the tax calculation.

3. **Mineral and petroleum royalty expense:** In most cases the accrued expense differs from the actual expense as per the annual Mineral and Petroleum Resource Royalties (MPR3) return. A tax adjustment is required to claim the correct expense in the relevant year of assessment.

4. **Mining schedules:** All mining companies must complete and submit the mining schedules (Schedules A and B) with the ITR14. These schedules require the disclosure of capital expenditure and tax computations per mine. The schedules are available on the SARS website.

5. **Buy-ins:** If the company bought minerals for on-sale (not self-mined), the percentage turnover relating to the buy-ins must be specified. SARS does not view income from the sale of minerals bought in as mining income.

Completing the ITR14 return

Section 30 of the Companies Act requires all companies to prepare annual financial statements within six months after the end of their financial year. The annual financial statements form the basis for preparation of the corporate income tax return and must be submitted to SARS by small and medium to large businesses. They are therefore the primary source documents used for the completion of the ITR14 return.

Apart from the sections with general information, such as company and tax practitioner details, additional assessment information, contributed tax capital information and company structure, the ITR14 return essentially consists of:

- Balance sheet
- Income statement
- Tax computation

It is important to note that, with regard to contributed tax capital, the balance of the contributed tax capital at the end of the year of assessment must reconcile to the total amount of share capital and share premiums, stated under "Capital and Reserves" in the Balance Sheet section of the ITR14 return.

Balance Sheet section

The Balance Sheet section of the ITR14 return follows the layout of the Statement of Financial Position in the annual financial statements and relevant notes, and its completion should be relatively simple. The total non-current and current assets should balance to the total reserves and total non-current and current liabilities.

Income Statement section

The Income Statement section is divided into the following segments:

- Gross profit / loss
- Income items (only credit amounts)
- Expense items (only debit amounts)
- Net profit / loss

"The annual financial statements form the basis for preparation of the corporate income tax return and must be submitted to SARS by small and medium to large businesses. They are therefore the primary source documents used for the completion of the ITR14 return."

The layout of the above is very similar to the detailed income statement, which usually forms part of the company's annual financial statements. It is, however, more complex, as it contains typical items, in the light of the Income Tax Act, rather than just a reflection of the accounting treatment in the Statement of Comprehensive Income in the annual financial statements. The net profit amount is a calculated field and should reconcile to the net profit before tax in the Statement of Comprehensive Income reflected in the annual financial statements.

Tax Computation section

The Tax Computation section of the ITR14 return relates to the difference in the accounting and tax treatment of items during the tax period. This section is also closely related to the deferred tax computation in the annual financial statement, which prescribes the accounting treatment for income tax purposes, according to the International Accounting Standard IAS12 Income Taxes.

The Tax Computation section of the ITR14 relates to the tax adjustments of the accounting net profit before tax, as stated in the Statement of Comprehensive Income in the annual financial statements, in order to arrive at the taxable income of the entity. Normal tax is charged on that taxable income.

A common misconception is that the accounting treatment (as it appears in the annual financial statements) automatically aligns with the tax treatment, which is to be declared in the Tax Computation section of the ITR14. That this is a misconception has recently been confirmed by the Supreme Court of Appeal in *C:SARS v Volkswagen S A (Pty) Ltd* (1028/2017) [2018] ZASCA 116 (19 September 2018).

How to correct a mistake in the ITR14 after submission

Where a taxpayer discovers that the information contained in the ITR14 is incorrect or incomplete, the Request for Correction (RFC) option is available on eFiling or at a SARS branch. However, the Request for Correction will not be available in certain instances, such as:

- If there is a dispute in progress relating to the same source code
- If an audit case has been finalised for the same year of assessment

If the RFC option is not available, or a taxpayer disagrees with an assessment issued by SARS, the taxpayer can still follow the objection process.

Conclusion

The discussion above is general and the compilation of the corporate income tax return ITR14 requires the specialised professional and practical tax expertise of a registered tax practitioner. Sound knowledge of the taxation laws will ensure that allowable tax deductions, limitations and non-deductible items are accurately disclosed in the ITR14 return.

TIPS

COMPLETING AN ITR14 FOR A REIT

Joubert Botha, Head of Tax and Legal at KPMG

Listed below are some important points to note when completing an ITR14 for a REIT.

1. Classification of a REIT – The tax return contains a question "Is the company a REIT as defined by section 1 of the Income Tax Act?" It is not clear whether it is the intention to include all entities subject to section 25BB of the Income Tax Act in this question. In that case the entity would be both a REIT and controlled company. At the moment, if answered strictly in terms of section 1 of the Income Tax Act, only the listed entity, i.e., the REIT, should answer "Yes" and controlled companies should indicate "No". Management should make the appropriate determination.

2. A qualifying distribution deduction should be claimed in the tax computation under the "Special Allowances Not Claimed in the Income Statement" section and qualifying distributions by a REIT should be selected. Both a REIT and a controlled company may be entitled to the qualifying distribution deduction (provided all requirements set out in section 25BB of the Income Tax Act are met). The current description only refers to REITs. According to the strict definition in section 1 of the Income Tax Act, controlled companies are excluded. It is therefore unclear whether it was the intention to include or exclude controlled companies in the classification and whether the qualifying distribution deduction for controlled companies should be claimed in a different section in the ITR14.

3. The qualifying distribution deduction may not always be equal to the dividends (distributions made) as indicated in the annual financial statements. Therefore there may be differences between the distributions indicated in the annual financial statements and the distributions declared and disclosed in the ITR14.

4. The true nature of foreign investments held by REITs should be determined and clarified as this is important to answer the questions in relation to trusts and foreign trusts in the ITR14. This determination will also impact the availability of the section 10B exemption or partial exemption and the application of section 25BB(5) on the disposal of the investment.

5. The qualifying distribution deduction is determined before any capital gains that are not disregarded. As such the qualifying distribution deduction may not be applied to reduce the impact of taxable capital gains, resulting in potential cash tax.

SAVE THE DATES

BUDGET
REVIEW TRILOGY

FEBRUARY 2019

CAPE TOWN
20 FEBRUARY 2019

DURBAN
21 FEBRUARY 2019

JOHANNESBURG
22 FEBRUARY 2019

*Dates are subject to change and dependent on date of Budget Speech

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WE DO E-LEARNING SO YOU CAN DO LIFE

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DO YOU HAVE WHAT IT TAKES TO BE PROFESSIONALLY RELEVANT AFTER 2020?

For some time now, companies have had to turn to digital transformation to stay competitive. This has been visible to consumers in sectors such as tourism (e.g., Airbnb), travel (e.g., Uber), shopping (e.g., Amazon) and banking (e.g., FNB).

The attention has now shifted to the professional services industry, with the spotlight focussed on disrupting the delivery of tax services, whether it be services provided by independent accounting and tax practices or in-house tax departments of larger firms. FNB already offers a basic accounting software solution to micro enterprises, and the company's innovations will not end there.

Developments in technology, particularly automation and artificial intelligence, coupled with the ever-increasing volume of knowledge readily available through the internet challenges tax professionals to ensure their business model offers value to their client. With customers being more empowered than ever before, the question remains as to what it takes to survive the tax practice digital revolution where routine tax compliance is becoming increasingly automated. In fact, an Oxford University study ranked tax preparers as among the top ten roles most susceptible to digitisation out of more than 700 jobs analysed.

The benefits of digital transformation are abundant. The automation and digitisation of tax has the ability to drive efficiencies through enhanced standardisation of processes enabling the tax compliance function to be delivered at a lower cost and with fewer errors. In light of this, it is predicted by Grant Thornton that the future role of tax professionals is likely to be focussed on the interaction between human and artificial intelligence.

THE CORE EDUCATIONAL METHODOLOGY REQUIRED TO SURVIVE THE TAX PRACTICE DIGITAL REVOLUTION

The South African Institute of Tax Professionals (SAIT) founded The Tax Faculty as an independent tertiary learning provider and centre of excellence. Accredited by the Quality Council for Trades and Occupations, The Tax Faculty offers occupation-centric and competency-based qualifications.

The Tax Faculty also operates in partnership with Unisa and Wits University in bringing the latest short learning programmes to professionals in practice.

At the core of its educational methodology, The Tax Faculty equips students and professionals to approach business and tax problems using critical thinking skills. In responding to the changing landscape and digitisation, The Tax Faculty developed a first-in-class learning methodology to prepare future tax professionals with metacognitive skills, and with a tuition methodology that develops higher order thinking skills through analysis, evaluation and synthesis.

This unique tax learning methodology in tax education in South Africa ensures that course participants develop the requisite skills for sound reasoning, questioning and investigating, observing and describing, comparing and connecting, finding complexity, and exploring different viewpoints. Unlike traditional education, all courses are built upon practical simulations, ensuring the learning environment simulates reality in a tax practice.

The Tax Faculty

THE TAX FACULTY'S LEARNING ETHOS

1. We create an environment where our course participants are engaged and love to learn.
2. We identify individual development and learning needs against the ideal competency framework.
3. Our courses are learner-centred: We create a tailored and supportive learning journey based on individual learner needs.
4. We prepare our course participants for the future by developing higher order thinking skills.
5. Our learning interventions are premised on simulations for real tax practice.

OCCUPATIONAL QUALIFICATIONS

OCCUPATIONAL CERTIFICATE: TAX TECHNICIAN (NQF6)

START DATE 10 January 2019
PRESENTER Annelie Laage & Karen van Wyk
DURATION 2 years
DEPOSIT R 3 564

OCCUPATIONAL CERTIFICATE: TAX PROFESSIONAL (NQF8)

START DATE 21 January 2019
PRESENTER Annelie Laage & Prof. Piet Nel
DURATION 3 years
DEPOSIT R 3 792

INTRODUCING THE FACULTY TRUST BURSARY FUND.

The Tax Faculty is delighted to introduce The Faculty Trust Bursary Fund! Bursary applications are available to students registering for the Occupational Qualifications who are financially needy and/or academically deserving.

Applicants who are South African citizens or hold permanent residency in South Africa, may be considered for bursaries provided by The Faculty Trust NPO.

MINIMUM CRITERIA:

1. Occupational Certificate: Tax Technician

Applicants applying for the Occupational Qualification: Tax Technician require a minimum Grade 12 with the following grades:

- 60% average
- 70% in Mathematics (Maths Literacy does not qualify)
- 70% in English (as a first additional language) or 65% in English (home language)

2. Occupational Certificate: Tax Professional

Applicants applying for the Occupational Qualification: Tax Professional require the following as a minimum:

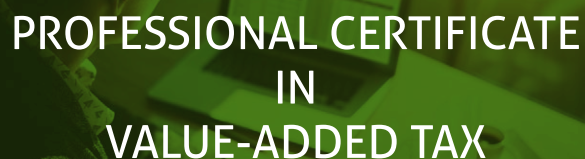
- Successful completion of Tax Technician Occupational Certificate; or
- Successful completion of at least 2nd year of a bachelors degree in tax, accounting or law (including a B.Tech degree) with a minimum of 60% average and 70% in either tax, law or accounting.

If you meet these minimum criteria and would like to apply please contact vfox@taxfaculty.co.za.

PROFESSIONAL CERTIFICATE PROGRAMMES

PROFESSIONAL CERTIFICATE IN TAXATION

START DATE	14 January 2019
PRESENTERS	Annelie Laage & Karen van Wyk
DURATION	1 year
DEPOSIT	R 3 975



PROFESSIONAL CERTIFICATE IN VALUE-ADDED TAX

START DATE	15 March 2019
PRESENTER	Di Seccombe
DURATION	1 year
DEPOSIT	R 3 950

ADVANCED PROFESSIONAL CERTIFICATE IN VALUE-ADDED TAX

START DATE	12 March 2019
PRESENTER	Christo Theron
DURATION	18 months
DEPOSIT	R 3 950

PROFESSIONAL CERTIFICATE IN ADMINISTRATION OF ESTATES

START DATE	4 March 2019
PRESENTERS	Prof Piet Nel & Dr Carika Frits
DURATION	1 year
DEPOSIT	R 3 950

PROFESSIONAL CERTIFICATE IN TAX OPINION & DISPUTE WRITING

START DATE	5 March 2019
PRESENTERS	Prof Piet Nel & Prof Keith Engel
DURATION	6 months
DEPOSIT	R 3 950

PROFESSIONAL CERTIFICATE IN PAYROLL TAXES & ADMINISTRATION

START DATE	5 March 2019
PRESENTERS	Dr Carien van Dijk & Penny Smith
DURATION	6 months
DEPOSIT	R 3 950

TAX BOOKS for 2019

TAX LEGISLATION

JUTA LAW EDITORS

R110.00 // JUTA *25% OFF*

This tax legislative compendium incorporates all promulgated and proposed amendments relevant as at 1 January 2019, aided by Juta's Prelex and Pendlex. Related supplementary material has been incorporated online in Volume 2. The Tax in Practice aids allow readers to easily navigate content within the different tax Acts.

JUTA LAW EDITORS

R750.00 // JUTA *25% OFF*

This annual subscription is a consolidated source of current indirect tax Acts and their relevant supplementary material as at 1 January 2019. Juta's Prelex and Pendlex present a comprehensive view of historic and proposed amendments of the legislation. Supplementary material to the indirect tax Acts is included.

LEXISNEXIS EDITORIAL STAFF

R1 081.00 // LEXISNEXIS

This set includes two comprehensive legislative handbooks which contain all the direct tax and VAT acts, regulations, practices and interpretation notes. Updated annually.

LEXISNEXIS EDITORIAL STAFF

R575.00 // LEXISNEXIS

This book is a concise and handy reference to the consolidated Income Tax Act and Tax Administration Act. It incorporates the legislative amendments made during the current tax year, as well as proposed amendments. Updated annually.

LEXISNEXIS EDITORIAL STAFF

R690.00 // LEXISNEXIS

This book comprises indirect tax acts, such as transfer duty and VAT, as well as tax administration law. It also includes the related regulations' interpretation notes and practice notes. Updated annually.

MOST-USED STUDENT TAX BOOKS

STIGLINGH, MD; KOEKEMOER, AD; VAN HEERDEN; WILCOCKS, JS & VAN DER ZWAN

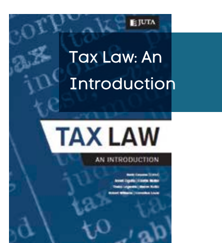
R848.86 // LEXISNEXIS

The objective of the authors and publishers is to provide a book that simplifies the understanding and application of tax legislation in a South African context for both students and general practitioners.

STIGLINGH, M; KOEKEMOER, A; VAN HEERDEN; WILCOCKS, JS & VAN DER ZWAN

R707.81 // LEXISNEXIS

The objective of the authors and publishers is to provide an authoritative and comprehensive, yet readily accessible, textbook on income tax in South Africa for use by students of the subject as well as people who work in the tax field.

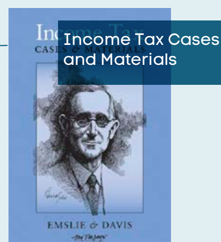


LEGWAILA, T; CROOME, B; OGUTTU, A; MULLER, E; WILLIAMS, RC; LOUW, C & SURTEES, P

R607.50 // JUTA *10% OFF*

This book covers the basic policy rationale for the Income Tax Act and other key tax acts. (2nd edition forthcoming.)

CASE BOOKS



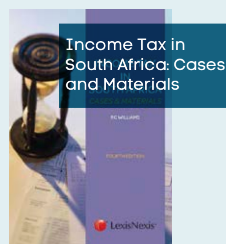
Income Tax Cases and Materials

EMSLIE, T & DAVIS, D

R1 071.60 // THE TAXPAYER

This book offers students abbreviated cases supplemented by notes.

**The above rate is a reduced rate applicable to students and academics only.*

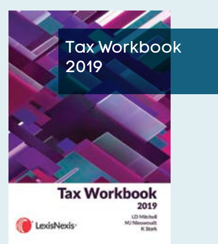


Income Tax in South Africa: Cases and Materials

WILLIAMS, RC

R923.49 // LEXISNEXIS

The primary objective in this work has been to assist students of income tax, including those studying at post-graduate level, not just to understand each judicial decision in isolation, but to gain insight into underlying (often unarticulated) general principles, and to grasp the inter-relationship between the Income Tax Act and the principles of common law.



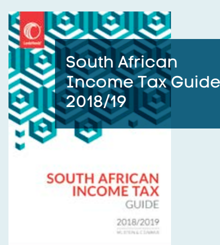
Tax Workbook 2019

MITCHELL, LD; NIEUWOUDT, MJ & STARK, K

R352.16 // LEXISNEXIS

The Tax Workbook has been designed to be used by students and lecturers, to provide the maximum benefit to each user. Each chapter deals with a specific topic or topics and the chapter contents progress from relatively easy questions to more difficult questions dealing with integrated problems.

HANDBOOKS, GUIDES, INTRODUCTIONS AND STUDENT-SPECIFIC APPROACHES TO TAX LEGISLATION

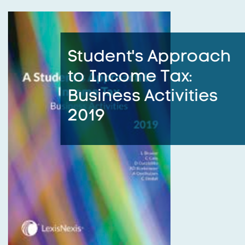


South African Income Tax Guide 2018/19

DIVARIS, C & STEIN, ML

R 546.25 // LEXISNEXIS

A concise and reliable guide to South African income tax law for the current tax year. All the taxes imposed by the Income Tax Act are dealt with, namely, income tax, capital gains tax, donations tax, the various withholding taxes, the turnover tax for micro businesses, employees' tax (PAYE) and provisional tax.



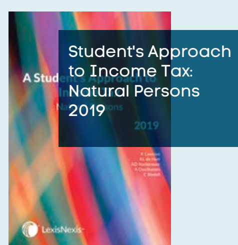
Student's Approach to Income Tax: Business Activities 2019

BRUWER, L; CASS, SC; CUCCIOLILLO, D; KOEKEMOER, A; OOSTHUIZEN, A & STEDALL, C

R636.26 // LEXISNEXIS

** Also available in Afrikaans*

This book was written with the specific purpose of combining in one concise volume the provisions of the Income Tax Act 58 of 1962 (the Act) as it applies to business activities.



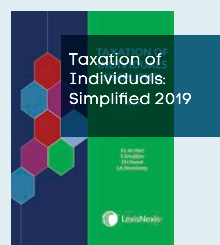
Student's Approach to Income Tax: Natural Persons 2019

COETZEE, K; DE HART, KL; KOEKEMOER, A; OOSTHUIZEN, A & STEDALL, C

R620.75 // LEXISNEXIS

** Also available in Afrikaans*

This book was written with the specific purpose of combining in one concise volume the provisions of the Income Tax Act 58 of 1962 (the Act) as it applies to individuals.

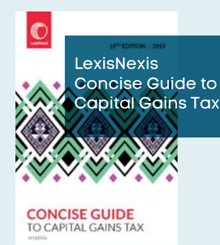


Taxation of Individuals: Simplified 2019

DE HART, KL; SMULDERS, S; HAMEL, E & STEENKAMP; LA

R628.56 // LEXISNEXIS

The publication is aimed at an entry level of Taxation studies. The title is ideal for more practical and rudimentary tax courses.



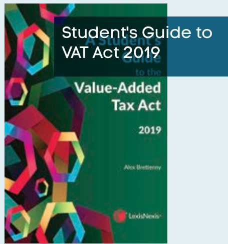
LexisNexis Concise Guide to Capital Gains Tax

CLEGG, D

R402.50 // LEXISNEXIS

Easy to understand guide to the complex subject of capital gains tax. Makes use of simple examples to illustrate and clarify key points. Starts with the basic principles and identifies frequently misunderstood areas, explains the law in clear, non-technical terms and cross-references every statement made through footnotes to the Act.

HANDBOOKS, GUIDES, INTRODUCTIONS AND STUDENT-SPECIFIC APPROACHES TO TAX LEGISLATION



Student's Guide to VAT Act 2019

BRETTENNY, A

R361.58 // LEXISNEXIS

The guide has been written with specific reference to the Examinable Taxation Pronouncements (the tax syllabus) for the Initial Test of Competence (ITC) of the South African Institute of Chartered Accountants (SAICA).

LexisNexis Concise Guide to VAT

CLEGG, D

R402.50 // LEXISNEXIS

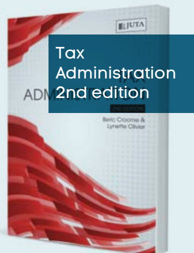
This is a quick and easy guide for finance and accounting practitioners, and is also simple enough for the uninitiated taxpayer to grasp the complexities of the VAT system. Fully cross-referenced to the VAT Act and extracts from the Act, as well as a detailed index, are included for additional reference and guidance.

Deloitte VAT Handbook 2019

SILVER, M

R695.75 // LEXISNEXIS

A comprehensive guide to the application of the provisions of the Value-Added Tax Act. It facilitates understanding of the mechanics of the VAT system. Also includes the VAT Act and regulations, as well as interpretation and practice notes, a list of private rulings, VAT forms and case law summaries.



Tax Administration 2nd edition

CROOME, B & OLIVIER, L

R1 254.00 // JUTA *20% OFF*

This book sets out the rules of tax collection, showing how areas of law interrelate and noting best international practice. It provides clear and authoritative guidance on aspects such as the registration and submission of tax returns, assessments, requests for information, penalties and interest, privilege, reportable arrangements, dispute resolution, advance tax rulings and remedies.

Street Smart Taxpayers A Practical Guide to Your Rights in South Africa

CROOME, B & CROOME, J

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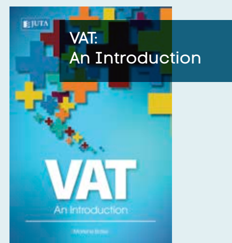

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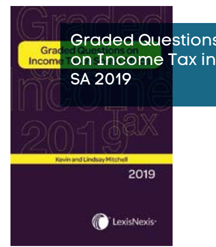

MITCHELL, K & MITCHELL, LD
R731.54 // LEXISNEXIS

The questions are based on the Income Tax Act 1962, the Tax Administration Act 2011, the Value-Added Tax Act 1991 and the Estate Duty Act 1955 – incorporating amendments up to and including the Rates and Monetary Amounts and Amendment of Revenue Laws Act 14 of 2018.

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Q&A

The Tax Helpline service is available exclusively to SAIT members. Log your tax-related technical queries via www.thesait.org.za

We present some questions and guidance around the taxation of income accruing to minor children from a trust, the treatment of employer contributions to a pensioner's medical aid, VAT input claims on staff transport vehicles and CGT on the transfer of assets between spouses.

Q A client has a family trust that sold a property in the 2018 tax year and subsequently distributed the income to the client's wife and two minor children. SARS has chosen the trust for audit and wants to know why section 7(3) should not be applied in this case. The property was funded with a mortgage bond and was thus not "donated" to the trust. The trust holds other assets as well (unit trusts and shares in their private company) and some of this income gets distributed as well. According to section 7(3) any income received by a minor child as a result of a donation, settlement, or (similar) disposition made by the parent of that child will be deemed, for income tax purposes, to be the parent's income. Can we argue that the property was not "donated" to the trust by the parent, but purchased by the trust? Would the distribution of the capital gain be regarded as a "donation", "settlement", or "other disposition" or does this just apply to the initial acquisition of the asset from which the income was derived?

You state that the trust owned and disposed of immovable property that was financed by way of a bond and that the trustees (we accept that they were acting within their mandate or discretion) "subsequently distributed the income" to the beneficiaries. This appears to have resulted in a capital gain, and not in income accruing to the trust (as would have happened if the property was held as trading stock). We are then surprised that SARS believes that section 7(3) may apply.

The capital gain, when vested in the beneficiaries by the trustees, is disregarded in the trust and is effectively taxed in the hands of the beneficiaries – paragraph 80(2). But this is subject to paragraphs 68 and 69 of the Eighth Schedule. Paragraph 69 is similar to section 69 and paragraph 68 similar to section 7(2), and all of them refer to "a donation, settlement or other disposition".

It is correct that, for paragraph 69 to apply, the donation, settlement or other disposition must have been made by a parent of the minor child, in whom the capital gain was vested.

Judge Froneman, in *CSARS v RM Woulidge*, said that "as long as the capital remains unpaid the failure to charge interest represents a continuing donation …" From the information provided we do not know if there was such a loan – where interest is payable at a rate below a market related rate.

With regard to your comment about the initial acquisition of the property by the trust, the following comments by Judge Trollip in *Ovenstone v SIR*, are relevant:

> *"… 'Donation' and 'settlement' have this further feature in common: the disposal of property is made gratuitously or (occasionally in the case of a 'settlement') gratuitously to an appreciable extent."*
> *"The critical phrase should, in other words, be read as 'any donation, settlement or other similar disposition.' So construed, 'disposition' means any disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer."*
> *"… it also covers any disposal of property made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity."*

Q My client wants to purchase a 16-seater for the transport of his employees to building sites. Will he be able to claim the VAT on the vehicle? If not, what vehicle (big enough to carry 16 people) will he be able to claim VAT on, should he purchase it?

Section 16(3)(a)(i) of the VAT Act allows a vendor to make a deduction of input tax in respect of supplies of goods and services made to the vendor during a tax period.

"Input tax" is defined in section 1(1) of the VAT Act as, amongst others, VAT paid on goods or services supplied to a vendor, to the extent that the vendor has acquired the goods or services for the purpose of consumption, use or supply in the course of making taxable supplies.

Section 12(g) of the VAT Act exempts from VAT the supply by any person in the course of a transport business of any services comprising the transport by that person in a vehicle operated by him of fare-paying passengers and their personal effects by road or railway.

Section 17(2)(c) of the VAT Act denies an input tax deduction in respect of the supply of a motor car to a vendor. Paragraph (a) of the definition of "motor car" in section 1(1) of the VAT Act excludes from the definition of a motor car "vehicles suitable for carrying more than 16 persons".

To determine whether a motor vehicle is suitable for carrying more than 16 persons an objective test must be applied. In this case, regard should be had to the manufacturer's specifications. If the manufacturer specifications state that the vehicle is suitable for the carriage of a driver and 16 passengers, then the vehicle will not be a motor car as defined. If the specifications state that the vehicle is suitable for a driver and 15 passengers (the specifications for a standard minibus), the vehicle will constitute a motor car as defined. In the above case, if the 16-seater includes the driver, the vehicle will be a motor car as defined in section 1(1) of the VAT Act and no input tax may be claimed on the acquisition of such a vehicle. If, however, the 16-seater excludes the driver (i.e. it is suitable to carry 17 persons), the vehicle will not be a motor car as defined in section 1(1) of the VAT Act. The VAT vendor will under these circumstances be entitled to an input tax deduction on condition that no fee is charged to the employees transported. If any fee is charged the vehicle will be used in the course of an exempt activity (the supply of fare-paying passengers) and no input tax deduction will be allowed.

Q An individual transfers 50% of his holiday house into his spouse's name without any monetary benefit, i.e., his spouse does not physically pay for her 50% portion of the house but the title deed of the house is changed to include that she is now 50% owner of the house. Does this result in a capital gain event?

The disposal of an asset between spouses is deemed to take place at base cost to the transferring spouse. In other words, there is no CGT event. The current reference is paragraph 67 of the Eighth Schedule, but in terms of the Taxation Laws Amendment Bill B38-2018 awaiting promulgation, paragraph 67 will be deleted and replaced by section 9HB.

Short answer: there is no CGT event in the transfer of 50% of the holiday home from the husband to the wife.

Q Contributions made by an employer in respect of a pensioner have been disallowed. Why are the employer contributions disallowed? Has this always been the case or when did it change that the employer medical contributions for pensioners are no longer deductible? Is the reason for the employer contributions being disallowed due to the fact that they are not reflected as a fringe benefit?

The Income Tax Act actually specifically deals with this. In general, a taxable benefit arises if "the employer has during any period directly or indirectly made any contribution or payment to any fund contemplated in paragraph (b) of the definition of 'benefit fund' in section 1 for the benefit of any employee or the dependants of any employee". Paragraph (b) of the definition of "benefit fund" in section 1(1) refers to a "medical scheme registered under the provisions of the Medical Schemes Act".

That benefit (or really the payment by the employer) is deemed to be an amount contributed by the individual concerned. But, when the benefit is given no value, no amount is deemed to have been paid by the individual. For ease of reference we copied the "no value" provision from paragraph 12A(5) of the Seventh Schedule. It reads as follows:

"No value shall be placed in terms of this paragraph on the taxable benefit derived from an employer by:

a. *a person who by reason of superannuation, ill-health or other infirmity retired from the employ of such employer; or*
b. *the dependants of a person after such person's death, if such person was in the employ of such employer on the date of death; or*
c. *the dependants of a person after such person's death, if such person retired from the employ of such employer by reason of superannuation, ill-health or other infirmity."*

Code 4493, according to the SARS Guides for codes applicable to Employees tax certificates 2018 (PAYE-AE-06-G06) Revision: 5, is to be used for: *"Employer's medical scheme fees (contributions) paid for the benefit of a retired / former employee who qualifies for the 'no value' provisions of the Seventh Schedule."*

These contributions then do not qualify for the section 6B rebate.

Case Law
Wrap-up

KELSEY JAYES, Tax Consulting South Africa

A case summary that deals with the timing of income accrual in the event of a sale of immovable property.

Milnerton Estates Ltd v CSARS

Issue
This matter addresses the question of whether the purchase price of erven in a township was deemed to have accrued to the seller ("the Appellant") in the year that the sale agreements in respect thereof were concluded, or in the year that the properties were transferred.

Facts
In 2013, the Appellant, being a property developer, concluded twenty-five sale agreements in respect of erven in the Parklands Residential Estate.

In a number of instances, the purchaser had to raise finance for the purchase and, accordingly, the contracts contained a suspensive condition providing for the eventuality of the finance not being obtained. However, in all these instances, the suspensive condition was fulfilled before the end of the 2013 tax year. Conditions also had to be fulfilled from the Appellant's side in order to effect the registration of the transfer, including obtaining rates clearance certificates for each of the erven.

The Appellant had contended that at the end of the 2013 tax year, its entitlement to the purchase price remained conditional on its performance of the remaining tasks necessary to effect transfer of the stands. It accordingly omitted the purchase prices of these stands from its gross income for that year. SARS' contention, however, was that the purchase price in each instance had accrued to the Appellant in the 2013 tax year, or alternatively that it was deemed to have done so by virtue of the provisions of section 24(1) of the Income Tax Act. SARS accordingly issued an assessment in which it included amounts totalling nearly R6.8 million in the Appellant's taxable income.

The Appellant argued that section 24(1) is not concerned with cash sale agreements of this type, but only with agreements for the sale of immovable property on credit. It drew a distinction between cash sales and sales of immovable property, where the purchase price was to be paid in instalments over time, with transfer only being given once the full purchase price had been paid.

Outcome
The taxpayer's appeal was dismissed with costs.

Core Reasoning
In reaching its decision, the court held that the Appellant's arguments are not sufficient to permit a restrictive interpretation of the language of section 24(1) of the Income Tax Act: confining its application to credit agreements, as opposed to all sale agreements, where ownership passes from seller to purchaser upon or after receipt by the taxpayer of the whole or a certain portion of the purchase price. It stated further that the guarantees provided by the purchasers of erven from the Appellant constituted payment of the purchase price, such payment being concurrent with transfer of ownership.

The agreements accordingly provided for the Appellant to pass ownership to the purchasers upon or after receipt of the whole of the purchase price in terms of section 24(1). The purchase price was therefore deemed to be received by the Appellant in its entirety in the 2013 tax year, when the sale agreement was entered into.

Take-away
This decision confirms the fact that section 24(1) is not limited to credit agreements, but applies to all sale agreements, despite the title of the section.

This case further provides clarity on cases where a bank guarantee is provided for payment of the purchase price and confirms that this will be in line with section 24(1), irrespective of whether payment has actually been made during that year of assessment.

Thus, taxpayers must take note and be vigilant in regard to their sale agreements when selling immovable property as the purchase price may be deemed to have accrued to them in the year that the sale agreement was entered into, despite the fact that payment may not have actually been made during that year.

BINDING RULINGS

TENIELLE PANTHER, CANDICE WRIGHT AND RUAN BOTHA, Tax Consulting South Africa

The featured rulings deal with the deductibility of costs relating to solar energy plants, income tax consequences of variation of employment contracts and of a share buyback by a non-resident company

BINDING PRIVATE RULING 311
PHOTOVOLTAIC SOLAR ENERGY PLANTS

Issue
The deductibility of expenditure to be incurred to install photovoltaic solar energy plants at sites owned and leased by a taxpayer in respect of sections 12B(1)(h)(ii)(bb), 12B(2)(b) and 12B(3).

Facts
The applicant is a resident company that installs photovoltaic energy plants ("the plants"). The applicant proposes to install solar power systems ("the systems") at each of its rental sites. These systems comprise the following:

- Photovoltaic solar panels
- AC inverters
- DC combiner boxes
- Racking
- Cables and wiring

The systems simply supplement, but do not replace, the electricity provided by the main grid. The applicant's systems will each generate less than one megawatt of electricity. The applicant will purchase the photovoltaic solar panels, appoint and pay independent contractors to attend to the installation planning, procure and purchase all other relevant equipment and actually install the systems at the applicant's rental sites.

The applicant proposes to incur related expenditure as part of the cost of the installation which includes:

- Installation planning costs
- Panels delivery costs
- Installation costs
- Installation safety officer costs

This ruling is not subject to any conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The applicant is entitled to claim deductions in respect of the following:
  - » Each of the photovoltaic solar energy plants to be installed at each of the sites, consisting of the photovoltaic solar panels, inverter, DC combiner box, racking, and cables and wiring, under section 12B(1)(h)(ii)(bb).
  - » The direct costs of the installation and erection of each of the plants, consisting of the installation planning costs, panel delivery costs and the cost of the installation safety officer to be appointed, under section 12B(3).
- The deduction of the expenditure, which is deductible under section 12B(1)(h)(ii)(bb), must be calculated under section 12B(2)(b).
- No opinion is expressed in relation to the estimation of the amount to be claimed in respect of any of the costs.

BINDING PRIVATE RULING 312
VARIATION OF EMPLOYMENT CONTRACTS

Issue

The income tax consequences of variation of employment contracts in respect of sections 1(1) – definition of "gross income" – and 11(a) read with sections 23(g), 11(cA), 11(nA) and 23H.

Facts

The proposed transaction comprises multiple parties: the applicant is a resident company and the first and second co-applicants are 100% held subsidiary resident companies of the applicant ("the subsidiaries"). The third co-applicant is Mr X and all other parties who receive cancellation payments in terms of the profit-share arrangement.

The applicant and Mr X previously entered into an employment agreement which included a profit-share arrangement ("the arrangement") between them. Mr X nominated certain employees to benefit from the arrangement.

The parties who would benefit from the arrangement concluded a cancellation agreement to terminate the arrangement, on the following terms:

1. The first and second co-applicants will pay predetermined cancellation fees to the third co-applicant.
2. The applicant will retain a cash portion as security for due compliance by Mr X of his obligations, which will be forfeited in the event of termination of Mr X's employment on grounds of dismissal.
3. The third co-applicants will remain employed by the subsidiaries of the applicant.
4. Restraint of trade agreements will be concluded between the applicant and its subsidiaries in terms of which restraint nominees will receive restraint payments.

This ruling is not subject to any conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

1. The cancellation fees and the payments to the other employees will be deductible by the subsidiaries under section 11(a) read with section 23(g).
2. The retained cash portion will be subject to section 23H.
3. The cancellation fee and retained cash portion will be included in the "gross income" of each of the third co-applicants under paragraph (d) of the definition of "gross income".
4. To the extent that any amount of the retained cash portion is forfeited by Mr X, such forfeited amounts may be deducted by him under section 11(nA) in the relevant year of assessment during which the forfeited amount is refunded by him.
5. The restraint payments will be included in the "gross income" of the Restraint Nominees under paragraph (cB) of the definition of "gross income".
6. The restraint payments will be deductible by the subsidiaries under section 11(cA).

The ruling is silent on the following:

- The apportionment between the subsidiaries of the cancellation fee in 1.
- The apportionment between the subsidiaries of the restraint payments mentioned in 5.

BINDING PRIVATE RULING 313
FOREIGN SHARE BUYBACK

Issue

The income tax consequences of a share buyback by a non-resident company from a resident trust in respect of sections 1(1) – definitions of “foreign dividend” and “foreign return of capital” – and 10B(2)(a) of the Income Tax Act and paragraphs 20(1)(a), 20(3)(a) and 64B(4) of the Eighth Schedule.

Facts

There are three different parties to the proposed transaction: the applicant, Company B and Company A. The applicant is a resident discretionary trust established for the benefit of an individual and his family. The applicant held shares in Company B, which is a resident company incorporated in South Africa, and previously disposed of the shares through an asset-for-share transaction in exchange for shares in Company A. Company A is a company incorporated in South Africa but a resident of the United Kingdom.

The bottom end of the asset-for-share transaction is that the applicant holds more than 10% of the total equity shares and voting rights in Company A. Company A will then repurchase the shares held by the applicant in exchange for shares it holds in Company B (“repurchase consideration share”).

The ruling was issued on the condition and assumption that Company A is indeed a resident of the United Kingdom at all material times.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- To the extent that the amount to be received by the applicant from Company A on the share repurchase will constitute a “foreign dividend” as defined in section 1(1), the amount will be exempt under section 10B(2)(a).
- To the extent that it will constitute a “foreign return of capital” as defined in section 1(1), any capital gain must be disregarded under paragraph 64B(4).
- The base cost of the repurchase consideration shares for the applicant as contemplated in paragraph 20(1)(a) will be an amount equal to the market value of the repurchase consideration shares on the date of the distribution of those shares to the applicant.

POLICY FORMULATION & THE 4 SEASONS OF TAX LAW

KEITH ENGEL, SAIT

The cyclic tax law process, much like the seasons, is ever changing, but how exactly it changes can seem mysterious. SAIT's CEO and former National Treasury insider explains the overall legislative process and then takes a closer look at how policy is formulated.

Besides being complex, tax law is ever changing. Experienced tax professionals have come to expect that South African tax legislation will change at least once per year. But, what is often not understood is how tax legislative changes are enacted. The purpose of this article is to outline the overall legislative cycle so that tax professionals have a stronger voice in the legislative process.

Before going into detail, one should first note that the legislative cycle can be broken down into the following four "seasons" (which will be outlined in detail in this article):

1. Budget
2. Initial draft release
3. Comment and finalisation
4. Completion and proposal renewal

1. Budget

The annual budget process lies at the heart of National Treasury's functions. Although the national budget may only be in the forefront of the public's attention twice a year, the budget process is actually a year-round process. This process picks up steam toward the second half of every year and reaches a crescendo every January and February after Government officials return from their Christmas holidays.

The budget process reaches culmination with the release of National Treasury's annual budget review, followed by a speech presented by the Minister of Finance before Parliament and the nation. Both the annual budget review and the speech are fully available on National Treasury's website. Both the Minister's speech and the budget review are typically released on Wednesday afternoon during the third week of February.

The core aspects of the budget process fall into the following three parts:

1. Expenditure allocation
2. Tax revenue
3. Borrowing

Like many treasuries, South Africa's National Treasury budget is led by expenditure needs. Tax revenue must be sufficient to ensure that the Government's borrowing capacity remains within reasonable bounds.

To achieve these aims, tax discussions within National Treasury fall into two general parts: Macro and micro considerations. Macro considerations focus on rates and large tax proposals that can be readily quantified in the budget process. Micro considerations typically include narrower proposals that have a smaller monetary effect, such as the closure of tax avoidance schemes, providing isolated incentives and remedying various anomalies. Tax proposals can be internally generated, but often include concerns raised by SARS and the private sector. In recent years, SARS has had a stronger influence over the legislative agenda.

Annual tax proposals are typically found in Chapter 4 and Annexure C of the *Budget Review*. Chapter 4 mainly contains macro changes, such as changes in rates and numerical thresholds as well as items related to people (e.g., changes impacting individual tax returns of salaried individuals). Annexure C mostly contains the micro items listed above.

In addition, National Treasury releases a Rates and Monetary Amounts and Revenue Laws Amendment Bill. This bill contains tax rate changes and changes to monetary amount thresholds, including medical credits and the primary rebates. The purpose of this immediate release is to ensure that rate and monetary changes can be placed into effect as soon as possible (e.g., 1 March or 1 April). Parliament regularly adopts this type of bill without any meaningful changes.

2. Initial draft release

Many officials within National Treasury become involved in a short media campaign immediately after the budget release. The core players, including certain officials within the tax team, often become part of the various post-budget events and press engagements. This post-budget period typically extends into the first and second week of March.

One key post-budget event during this period (besides the SAIT events, of course!) involves the Parliamentary process. The Standing Committee on Finance of the National Assembly holds a short series of post-budget committee hearings. These hearings include a session focused on tax that is open for public comment. The policy team of SAIT and other active private stakeholders attend these sessions.

"The annual budget process lies at the heart of National Treasury's functions."

Once the initial fanfare is complete, the tax teams within National Treasury begin the hard work of converting the budget announcements found in Chapter 4 and Annexure C of the *Budget Review* into a draft Bill. Most of the work during this phase has become internalised within National Treasury's tax teams and key SARS tax personnel who regularly engage in the tax policy process.

National Treasury tends to reach out to certain key stakeholders within the private sector when proposals seek to eliminate anomalies that adversely impact taxpayers and where the proposals provide tax incentives or general tax facilitation. On the other hand, National Treasury tends to avoid outside stakeholder engagement when imposing anti-avoidance rules and other proposals that are contrary to taxpayer interests. Overall, private sector stakeholder engagement during this period has become somewhat limited.

The draft tax bill preparation process reaches its peak in June and early July. National Treasury's tax teams, in conjunction with SARS, prepare a draft bill and an accompanying explanatory memorandum. These documents come along with an internal National Treasury submission that is transmitted through three levels:

1. The Deputy-Director General of Tax and Financial Sector Policy
2. The Director-General of National Treasury
3. The Minister of Finance

Once the submission is signed by the Minister, the draft tax bill and accompanying explanatory memorandum are released on National Treasury's website for public consultation. This release previously occurred in mid-June, but has recently shifted to early July.

One should note that the draft release technically involves two taxation laws amendment bills. The first is a draft taxation laws amendment bill which covers substantive changes to the tax acts. This draft bill is called a "money bill" with National Treasury driving the process. The second is a draft taxation laws amendment bill which deals with tax administration (known as a tax administration laws amendment bill). This second bill is typically driven by SARS.

3. Comment and finalisation

Tax practitioners and private sector professionals become most active in the tax process once the draft tax bills are released. Detailed words on a page tend to have a galvanising effect for the tax community. Draft legislation typically falls into a dual track: One for National Treasury and one for Parliament.

In terms of the first track, National Treasury formally seeks direct comment from the public via a two-day workshop. Taxpayers usually have a three- to four-week period to provide their written comments. National Treasury, with SARS attendant, also engages separately with specific industry bodies in terms of key sectors directly impacted by the draft bill. SARS may have a workshop of its own in respect of the draft bill dealing with tax administration.

In terms of the second track, the process begins with an initial briefing or presentation by National Treasury and SARS. This briefing occurs before the Standing Committee on Finance of the National Assembly. National Treasury and SARS use this initial briefing to fully present the public case for their proposals. Taxpayers may attend this briefing, but their practical ability to comment is very limited.

Taxpayers have an opportunity to directly engage with the National Assembly via the Standing Committee on Finance. Taxpayers must provide a separate set of submissions to the committee to be involved in hearings so the voices of the private sector and the public in general can be heard. The first round of public hearings typically occurs in late August with key National Treasury and SARS officials in attendance. Private stakeholders mainly include private accounting and law firms, professional bodies and trade associations. SAIT regularly attends these sessions.

Upon completion of the above consultations, National Treasury and SARS return to the Standing Committee on Finance to report back on the draft tax bills. This report-back typically occurs in early September during which National Treasury and SARS provide a response document in which they describe the plan to revise the tax bills in light of public comment. This response must be approved by the Minister before release. Taxpayer comments are listed in-depth with Government's response given under a heading which either says "Accepted", "Not accepted", "Partially accepted", "Comment misplaced" or "Noted," followed by a short explanation. The Chair of the Standing Committee on Finance has recently opened these proceedings so taxpayers have a limited opportunity to further respond.

The activities occurring within the period following the report-back are of an ad hoc nature. National Treasury and SARS largely work behind the scenes to revise the draft bills. These revisions are aimed at adjusting the draft bills in line with their statements in the report-back session and polishing the draft bills further for enhanced accuracy. National Treasury and SARS may also enter into a few select engagements with taxpayers on isolated issues.

National Treasury and SARS complete the process by submitting their finalised versions of the draft bills to the State Law Advisors. Once the bills are in the hands of the State Law Advisors, the bills are mainly checked for constitutionality (especially around issues such as effective dates). The draft bills are also briefly reviewed by the Parliamentary legal team. Few substantive changes are made once the bills have been reviewed by the State Law Advisors and the Parliamentary legal teams.

4. Completion and proposal renewal

As the draft bills find their way through the State Law Advisors and Parliamentary legal teams, the National Treasury and SARS tax teams transmit a final internal submission through the system which contains the final version of the bill. This submission must once again find its way through to the Commissioner's office as well as the Deputy Director-General (Tax and Financial Sector Policy), the Director-General and the Minister of Finance.

Once finalised, the Minister of Finance introduces the first formal version of the annual tax bills to the National Assembly as a whole. This formal introduction typically falls on the same day on which the Minister presents his Medium-Term Budget Policy Statement in preparation of the full budget process for the following February. The Minister typically comes before the National Assembly with these items towards the end of October.

Legislative completion

The formalised tax bills are then referred back to the Standing Committee on Finance for official committee approval. National Treasury and SARS make one final presentation to the Standing Committee on Finance, followed by committee approval. Little, if any, private sector comment is heard during this period. Once approved, the Minister of Finance comes back to the National Assembly as a whole for a political debate, followed by formal adoption.

The tax bills are then referred to the National Council of Provinces. At this point, National Treasury and SARS are called upon once again to present the tax bills – this time to the Select Committee on Finance under the auspices of the National Council of Provinces. The National Council of Provinces subsequently approves the tax bills.

It is rare for tax bills to be changed at this stage because changes require a formal Parliamentary process. However, some recent exceptions have occurred in respect of venture capital companies and retirement funds.

National Treasury and SARS also prepare the translated version of the tax bills at this time, given that Government is required to have a non-English version of all laws. We also note that National Treasury will release an explanatory memorandum during this period. This memorandum was previously released upon National Assembly's formal introduction in late October, but may now come as late as January.

The final leg of the legislative journey pertains to Presidential signature. The President must ultimately sign the bills for these bills to become law. Presidential signature may take place in December or in January. Once signed, the tax laws become formalised by way of *Government Gazette* a few days later. We do not know of any instances in which the President failed to sign a tax bill in the exact same form presented to him.

Renewal

During the final leg of the legislative tax journey, National Treasury's tax teams and SARS prepare themselves for the tax proposal process that leads into the next cycle. The economic tax team within National Treasury, along with the tax statistical teams of SARS, provide the interim tax revenue numbers that become part of the Medium-Term Budget Policy Statement. This Medium-Term Budget Policy Statement sets the economic scene and forecasts future total revenue needs required when the Minister of Finance presents the formal budget numbers for the following February.

"Tax practitioners and private sector professionals become most active in the tax process once the draft tax bills are released."

As the tax laws amendment bills wind their way through National Assembly and the National Council of Provinces, the tax teams within National Treasury and SARS make their initial preparations for the next year's cycle of tax proposals. National Treasury and SARS spearhead their own agendas while simultaneously providing taxpayer access for public comment. This process is informally referred to as the Annexure C process, whereby taxpayers are given a three- to four-week period to make submissions. National Treasury and SARS then provide a two-day workshop for discussion that involves the tax community as a whole. Smaller Government-private sector meetings may also be selectively held during this period.

South Africa has a sophisticated legislative process that includes a series of formal and informal procedures. Interested taxpayers must understand this process to be effectively engaged. We at SAIT regularly engage with the various Government stakeholders to ensure that the tax system is better aimed at representing the tax community as a whole.

HOW NEW TAXES ARE LEGISLATED

South Africa has introduced a few new tax instruments over the years, such as the Mineral and Petroleum Resources Royalty Act and the pending Carbon Tax. These new tax instruments follow a slightly different process than the taxation laws amendment bills.

National Treasury typically brings new taxes to the fore via discussion papers, followed by informal draft bills. Controversial taxes tend to be revised a few times by National Treasury on a unilateral basis upon initial entry into the public domain. These new tax instruments are sent to Cabinet for approval once or a few times, depending on the number of changes made during the initial stages; whereas Cabinet has little involvement in the annual taxation laws amendment process.

National Treasury begins the Parliamentary process once it believes that the newly proposed tax is sufficiently viable, after having undertaken the above consultative process. The newly proposed tax is first brought to Parliament as an informal draft (much like the taxation laws amendment bills) and then formally introduced in a similar fashion. New taxes typically come before Parliament as a separate set of engagements from the annual taxation laws amendment bills.

THE 4 SEASONS OF **TAX LAW CREATION**

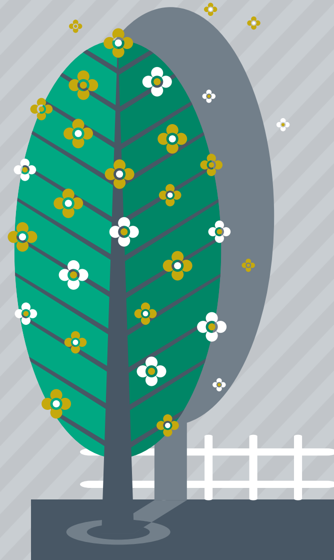
1. BUDGET

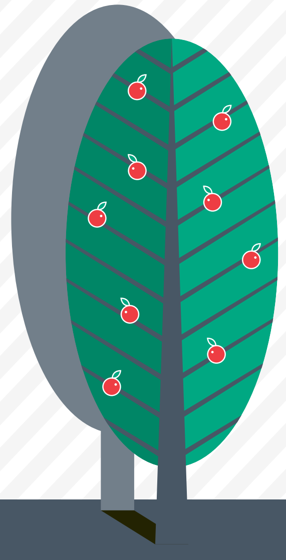
JANUARY

Potentially the month when the President signs last year's tax bills and they are gazetted.

FEBRUARY

Budget Speech and Budget Review, including major tax proposals.





2. INITIAL DRAFT RELEASE

MARCH

Officals engage in a media campaign. SCOF is briefed on budget. Private stakeholders address SCOF. Drafting of legislation begins.

APRIL

Drafting of legislation continues. Some engagement with key stakeholders.

MAY

Drafting of legislation continues.

JUNE

Drafting of legislation reaches its peak.

4. COMPLETION AND RENEWAL

OCTOBER

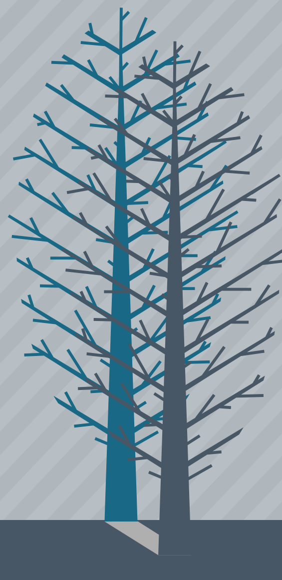
The final versions of the bills are introduced in Parliament, usually at the MTBPS.

NOVEMBER

Parliament finalises bills. Writing of the new Budget Review gathers steam.

DECEMBER

Public invited to submit Annexure C proposals. Potentially the month when the President signs the bills and they are gazetted.



3. COMMENT AND FINALISATION

JULY

Draft legislation is published in two bills with explanatory memo. Taxpayers usually have four weeks to comment to Treasury. Treasury and SARS present bills to SCOF.

AUGUST

Public hearings and workshops with the public continue.

SEPTEMBER

Treasury delivers a response document to SCOF on public comments. Officials work to revise the bills accordingly. State Law Advisors take control.

**Dates are not definitive for any of the events mentioned.*

POLICY FORMULATION – EVOLUTION OF IDEAS

Having looked at the formal legislative cycle from Budget Announcement to legislative finalisation (and beyond), we now take a closer look at policy formulation. This entails more than formal processes. Policy formulation is about harnessing conceptual ideas and eventually converting them into legislative enactment.

Where do ideas come from?

Tax policy ideas and their corresponding legislative formulation do not simply emerge from nowhere. While it is true that a dedicated team of Government officials from National Treasury (including the Minister of Finance) are at centre stage, the origin and impetus for tax proposals comes from many sources: various arms of Government, factions within the private sector as well as from academia. Ideas may have a local origin but often come from international sources, especially concepts representing larger policy trends.

Who are the tax policy role players?

There are various tax policy role players that operate within the South African environment and each of these role players contribute to tax policy formulation. These contributions are far more nuanced than one would expect. The role players are as follows:

- Government
- Private sector
- Academia and the international arena

GOVERNMENT

Government contains a diverse set of role players. While National Treasury and SARS have taken centre stage, other Government role players may have their own agendas, including incentives or attempting earmarking of funds to specific causes.

National Treasury - Centre Stage

All tax policy ideas must be channelled through National Treasury in order to be eventually announced in the annual Budget Review and tabled by the Minister of Finance. These ideas are mainly harnessed by the economic tax and legal tax teams, each of which is headed by a chief director under the direct supervision of the Deputy Director-General of Financial Sector and Tax Policy. A bureaucratic issue is whether tax requires more than a chief director mandate, seeing that the Deputy Director-General is not committed solely or mainly to tax.

Tax policy proposals are received from other parts of Government (e.g., SARS) and from the private sector. National Treasury may create tax proposals driven by its own internal agenda. These ideas often come from one of the following sources:

- Various forms of literature offered on the internet via academia, non-profits, and general news articles
- International trends from various multi-lateral institutions
- Proposals from other governments and non-profits with a global reach

The economic and legal tax teams work together to formulate the annual tax agenda. This is transmitted initially to the Deputy Director-General. Once approved, the agenda is then presented to the Minister with input from the Deputy Minister, Director-General, leading members of SARS and key parts of National Treasury (the Budget Office and Public Finance Office). Other parts of National Treasury may be driving particular proposals of their own: to balance the budget (tax increases), accommodate taxpayers (relief for individuals) and stimulate business (e.g., tax incentives). The budget and finance segments of National Treasury need to balance the budget and accommodate agendas from other Government departments (e.g., National Health Insurance).

SARS – Secondary Partner

While National Treasury sets tax policy and drafts the legislation, SARS is the collection agent and enforcer of the tax law. SARS accordingly has a strong secondary say in driving tax legislation. The National Treasury-SARS relationship is often consensual, with SARS having a soft veto over proposals deemed too risky from a revenue point of view.

SARS may initiate proposals of its own. Most of these proposals have a pro-revenue bias: seeking to close perceived tax loopholes (e.g., the recent closure of share-buyback schemes) and to simplify enforcement (e.g., imposing objective rules for doubtful debts). Some proposals initiated by SARS can benefit taxpayers, e.g. in reaction to complaints from taxpayers that enforcement is fundamentally unfair.

At this stage, proposals related to tax administration are driven almost exclusively by SARS. National Treasury is policy driven and hence lacks the skills to be involved in the administrative and collection process.

A role for the Tax Ombud?

One emerging player in the tax arena is the Tax Ombud. The Tax Ombud is active in the space of tax administration. The Tax Ombud has the authority to investigate systemic issues, with consent from the Minister of Finance. The Tax Ombud has a soft advisory role in the area of tax administration, but is kept separate from the tax legislative process.

Other Government departments / agencies

It goes without saying that National Treasury is not the sole policy arm of Government. Government entails a diverse range of departments, agencies and state-owned enterprises.

Forays by other Government departments into tax policy tend to be isolated with certain departments being more active than others. Examples of other Government departments involved in tax are:

- *The Department of Trade and Industry (DTI):* Tax incentives to facilitate DTI grant and loan schemes; to attract foreign investment; to encourage manufacturing (e.g., IPPs under section 12I and SEZs under sections 12R and 12S); incentives for local film makers under section 12F.
- *The Departments of Mineral Resources and of Energy:* Special taxes for mineral royalties and diamond exports; and incentives for oil and gas.
- *The Department of Transport (SAMSA):* The tax exemption for international shipping initiated along with the South African Maritime Safety Authority.
- *The Department of Health:* The National Health Insurance scheme with new funding expected from National Treasury (including the elimination of the medical tax credit for individuals).
- *The Department of Labour:* The Skills Development Levy and contributions to the Unemployment Insurance Fund.

Sometimes excise taxes are also used to influence taxpayer behaviour: a carbon tax to facilitate a cleaner environment (the main function of the Department of Environmental Affairs) and a sugar tax to facilitate the objectives of the Department of Health.

Parliament and the President – reactive players

Parliament naturally has a role to play in the legislative tax process because all law must go through Parliament. Parliament consists of two Houses: the National Assembly and the National Council of Provinces. In the case of the National Assembly, the Standing Committee on Finance is the force of engagement. Tax bills are usually approved with little debate. For the National Council of Provinces, the Select Committee on Finance is the main force of engagement. The Select Committee typically concurs with the National Assembly decision.

The bulk of the presentations, hearings and responses accordingly revolve around the Standing Committee on Finance of the National Assembly. The Standing Committee on Finance may occasionally hold further hearings and make suggestions for adjustments to tax Bills. Indeed, the Standing Committee is rarely a driving force for new proposals. Their role is usually to adjust what is being proposed. If an issue arises during the hearings, the Standing Committee may ask for a report-back and suggest delaying a controversial legislative change.

It should be noted that the Standing Committee on Finance covers a wide variety of matters outside of tax. Committee members largely deal with tax only when tax legislation is before them.

Once a bill has been approved by both Houses of Parliament, it is sent to the President for signature. The only ground on which the President may decide to return an unsigned bill to Parliament is if it is found to be unconstitutional.

In theory, all legislative proposals must go through Cabinet and the President before submission to Parliament. Indeed, tax bills containing wholly new taxes are sent to the Cabinet for initial approval. These bills have included new taxes such as the Carbon Tax and the Mineral and Petroleum Resources Royalty Bill. However, a silent exception exists for annual tax legislation (in the form of annual amendment tax bills). These are seen to give effect to Budget proposals that are generally passed earlier in the year by Parliament.

In years past, the Minister of Finance and the President have separately conferred on key tax matters shortly before the annual February budget release. Key issues typically entail overall revenue numbers and the occasional tax incentive (such as activating the special economic (tax) zones and the creation of the urban development incentive).

PRIVATE SECTOR

Like Government, the voices of the private sector are similarly diverse. In the world of tax policy, the many voices of tax come in several different layers:

- Taxpayers, including individuals, families and a diverse array of businesses ranging from micro-businesses to multinationals.
- Taxpayer representatives, including accountants, lawyers and other tax preparers.
- Associations and professional bodies: Associations typically support various trades and business interests of business taxpayers. Professional bodies (such as SAIT) typically support various segmented elements of taxpayer representatives.

Business or trade associations and professional bodies

Business or trade associations and professional bodies are the most vocal in the tax policy space. One of the main purposes of these organisations may be to voice the opinion of various subgroups in the regulatory and / or tax policy space.

In South Africa only a few professional bodies are active in tax policy. SAIT is a tax professional body and is accordingly committed to the tax engagement process. Accounting bodies are also active, especially the South African Institute of Chartered Accountants (SAICA) and the South African Institute of Professional Accountants (SAIPA). Both SAIT and SAICA have multiple volunteers providing support amongst various tax subspecialties with group substructures (i.e., workgroups and committees).

Other notable professional bodies engaging in tax are the Legal Practice Council / Law Society of South Africa (LSSA) and the Financial Planning Institute (FPI). All of these bodies are eligible to offer SARS registered status to their members.

Business / trade associations come in many forms but focus on taxpayers as opposed to taxpayer representatives. Many business / trade associations operate as umbrella bodies for many taxpaying businesses as a whole. The most active of these umbrella bodies are Business Unity South Africa (BUSA) and the South African Chamber of Commerce and Industry (SACCI) with BUSA having its own dedicated tax committee. Other business / trade associations have a narrower focus given their limited sector application. In terms of tax policy, financial sector associations tend to be the most vocal.

- *Financial Sector Associations:* Financial sector associations tend to be most active: perhaps because these associations have the greatest level of expertise in matters relating to tax. The most prominent voices are the Banking Council; the Association for Savings and Investment South Africa (ASISA), representing insurers, collective investment schemes and asset managers; and the SA REIT Association, representing listed property companies. The Institute of Retirement Funds (IRF) and the Pension Association also tend to be very active when retirement savings become an issue.
- *Other trade associations:* Other trade associations come into play depending on the strength of the sector. The Minerals Council South Africa (formerly the Mining Chamber) dates back many years and is vocal given its long history in South Africa. Other sectors include the Manufacturing Circle, American Chamber of Commerce, AgriSA and the South African Property Owners Association.

Active organisations tend to engage with the legislative process throughout the year. Meetings are held as tax legislation progresses through the system, and proposals are often submitted to National Treasury during the period before the Budget (i.e., from November to January). Less active organisations engage in the process mainly in reaction to adverse tax legislation.

ACADEMIA AND THE INTERNATIONAL SPHERE

- **Taxpayer representatives**
  A number of taxpayer representatives tend to be continually engaged with tax proposals and tax legislation throughout the year. The larger accounting firms and law firms tend to be most active, especially the firms in the Sandton, Johannesburg and Midrand areas. Certain independent and boutique firms have also marked this space. As a general matter, representatives in the tax advisory space tend to be more engaged in tax policy than those representatives engaged in tax compliance and preparation.

  Many taxpayer representatives tend to work through the professional bodies. For SAIT's workgroup structure, see page 30 and 31.

Taxpayers

Most individual and family taxpayers leave tax policy matters to their representatives. Most associations represent businesses as opposed to individual / family taxpayers. The only association of note in this regard is the Organisation Undoing Tax Abuse (OUTA). OUTA has made its name fighting e-tolls and other issues hitting the middle-income and lower-income classes.

Company taxpayers tend to be more engaged in tax policy depending on the size and nature of the company. Smaller companies and those companies outside the financial sector tend to rely exclusively on taxpayer representatives. Larger companies, banks and insurers tend to engage with Government more directly and often work through an association or professional body.

The third set of tax policy role players are in academia and the international tax sphere. These role players generally do not have a direct stake in the South African tax system and tend to be driven by underlying intellectual and philosophical considerations.

Academics

South Africa is the only country on the continent with a significant number of universities offering tax courses. These tax courses are mainly offered by the accounting faculty as opposed to the law faculty, which offers only one or two optional tax courses.

Most academics write tax articles dealing with international tax issues as opposed to domestic issues. Many of their efforts are directed toward assisting students with required papers. However, certain universities will drive tax conferences, work through professional bodies and may occasionally directly engage with Government. Limited resources prevent further commitments.

It should be noted that National Treasury tends to favour economists given that the department itself is mainly staffed with economists. National Treasury tends to enlist economists for tax policy reviews of larger tax issues (such as the review on the zero-rating of certain VAT items and the tax reform review by the Davis Tax Committee).

A third group of academics comes from abroad. These academics tend to visit South Africa upon request of academia or Government. Canadian, Australian and New Zealand professors are often viewed as valuable, given their colonial relation to the United Kingdom. British and US professors are occasionally drawn upon. The goal of this group is to provide advice on tax issues within the international framework and to provide "lessons-learned" from elsewhere.

International role players

Role players within the international tax sphere could be the subject of a whole article. There are a number of multilateral and donor organisations interested in advancing an international tax agenda so that taxation is fully collected by all countries and fairly distributed across the globe. These organisations tend to be engaged in the larger narrative of tax policy as opposed to being involved in particular legislative amendments.

The South African tax policy landscape is deep, large and diverse. The revenue collected from the tax system is what makes Government work. How and from whom that money is collected is no trivial matter. In South Africa, there are many locations to draw upon if you want to have your say.

Tax Annuals

It's been a year of change 2019

But you can always count on our trusted tax annuals for completely up-to-date insights into the intricacies of South African tax law. Updated to include the 2018/19 taxation laws amendments, our legislation handbooks and tax guides provide the most comprehensive solution to your most challenging tax questions.

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2019 PAYROLL MANAGERS' TAX YEAR END SEMINAR

PRESENTED BY ROB NOWICKI

THE 2019 BUDGET SPEECH COULD BE QUITE DAUNTING - FOR ALL STAKEHOLDERS!

With elections looming just after the budget speech and four major updates to some of our important Labour related Acts it's anyone's guess as to how all this is going to impact on day to day payroll management in the 2020 tax year.

Add to this the clean-up and streamlining of some of the old (and new!) IRP5 codes, the implementation of the new Minimum Wage, the extension (with its potential changes!) to the ETI Act and all the usual changes to tax tables, levies, rebates and other payroll related taxes – we are in for a busy year!

JOIN US AT OUR TAX YEAR END SEMINAR

for some tips, tools and useful information that will practically assist you in navigating through this minefield of compliance, payroll taxes and other related legislation.

DATES	VENUES
04 Mar '19	Cape Town - D'Aria
05 Mar '19	Cape Town - NH The Lord Charles
06 Mar '19	Durban - Southern Sun Maharani Tower
07 Mar '19	Durban - Gateway Hotel
08 Mar '19	Pretoria - CSIR Convention Centre
11 Mar '19	George - Protea Hotel King George
12 Mar '19	Port Elizabeth - Protea Hotel Port Elizabeth
13 Mar '19	Johannesburg Central - Killarney Country Club
14 Mar '19	Johannesburg East - Emperors Palace
15 Mar '19	Johannesburg North/West - The Forum I The Campus

FEES: R2 585.00 for one delegate and R2 350.00 for two or more delegates (from the same company) ***inclusive of VAT***

INCLUSIONS: Tea/Coffee/Snacks, Lunch and comprehensive course material will be provided

DURATION: 09h00-13h00

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