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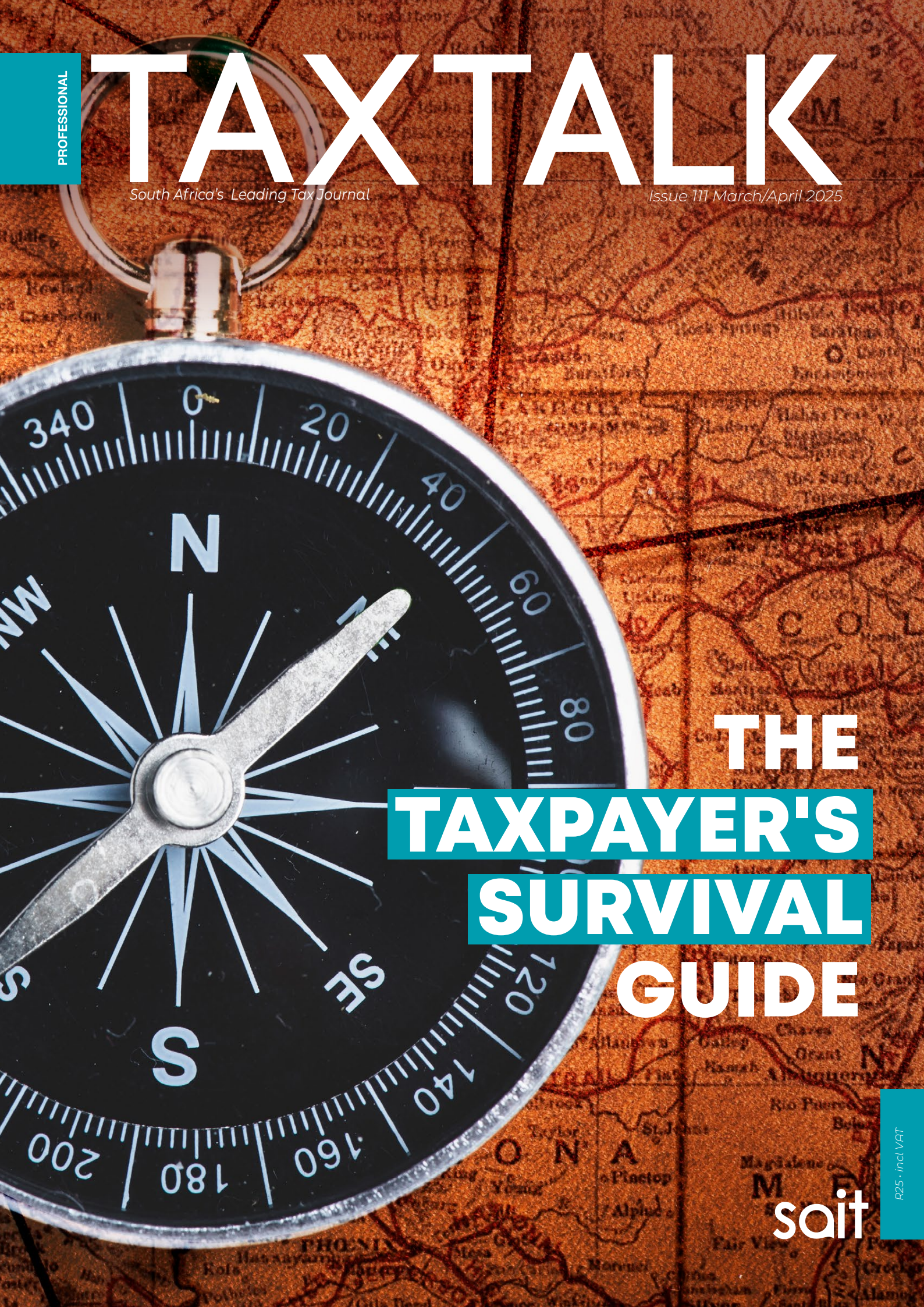

THE TAXPAYER'S SURVIVAL GUIDE

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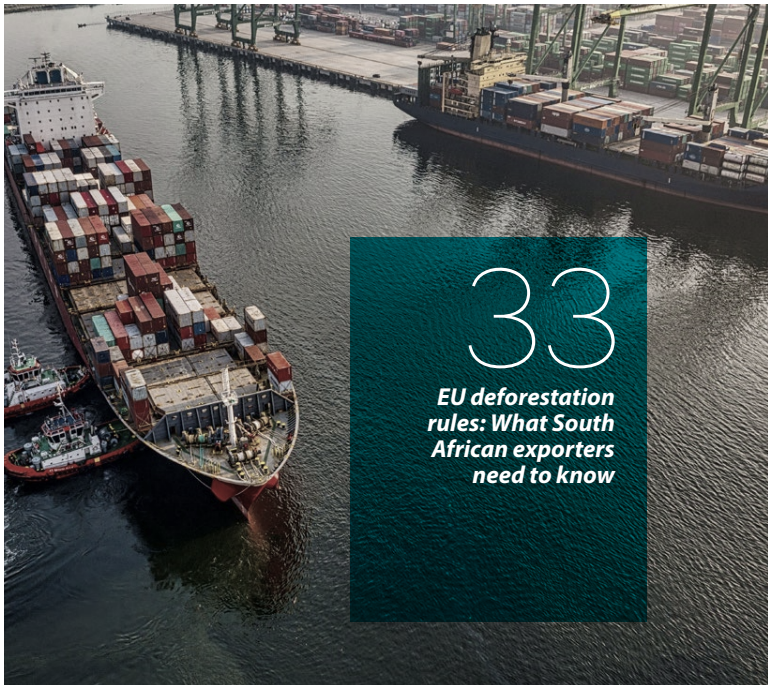

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THE 58 BILLION RAND QUESTION:

South Africa's budget battle

JERVIN NAIDOO, Political Economist at Oxford Economics Africa

Political background: The GNU's tightrope walk

South Africa's Government of National Unity (GNU) has faced questions of instability since its formation in July 2024, given that this is a first in democratic South Africa. With ten coalition partners, political disagreements have been inevitable, but the fiercest battle yet has been over the national budget. The dramatic collapse of Finance Minister Enoch Godongwana's budget speech on 19 February revealed the fault lines within the GNU and the complexities of coalition politics. At the centre of the controversy was the proposed two-percentage-point increase in VAT from 15% to 17%. Leaks before the speech indicated the Treasury's revenue shortfall made tax hikes inevitable, but the extent of the increase was only revealed hours before the speech—triggering immediate resistance. A last-minute cabinet meeting failed to resolve the dispute, forcing the budget's withdrawal. The GNU's major players—the African National Congress (ANC) and the Democratic Alliance (DA)—clashed over the proposal, with smaller coalition partners further complicating negotiations.

Since then, two emergency cabinet meetings (24 February and 3 March) have attempted to broker a solution. The outcome? A compromise: a more modest VAT increase of 0.5 percentage points to 15.5% in 2025, with another 0.5-point increase in 2026. However, this still leaves Treasury scrambling to plug the revenue gap through spending cuts, borrowing and increased taxes elsewhere. Deputy President Paul Mashatile who leads the Clearing House Mechanism (CHM), a tool used by the GNU partners to settle disputes within the coalition, has had the difficult task of finding consensus on the budget. The upcoming budget vote on Wednesday, 2 April, will be another important test for the CHM. There were some rumours late on Sunday, 30 March, that the ANC and DA had found some common ground on the budget, with leaks from these meetings indicating there is a 'good chance' the budget will be passed, but as this is politics, anything can change. The ANC no longer has a parliamentary majority, meaning opposition and coalition partners have significant leverage. Without their support, the budget—and the country's financial stability—could be in jeopardy.

What happens if the Budget is not passed?

Unlike the Constitution of the United States, South Africa's Constitution does not allow a complete government shutdown. If Parliament fails to approve the budget, the government will still function, but with serious constraints.

Legal consequences: Can South Africa function without a budget?

If the budget fails to pass, South Africa does not automatically enter a financial shutdown, but it does create severe governance challenges, as seen last year in Kenya, which faced similar issues related to its finance bill that triggered nationwide protests. The country's legal framework does provide a fallback, but only temporarily:

- Section 213(2) of the Constitution states that no money can be withdrawn from the National Revenue Fund unless authorised by an appropriation act, a direct charge allowed by law, or legislation like the Public Finance Management Act (PFMA).
- Section 16 of the PFMA allows for emergency spending, but this is strictly for unforeseen circumstances and cannot sustain government operations indefinitely.
- Section 15 of the PFMA permits Treasury to continue funding certain obligations based on previous budgets, but discretionary spending, new programs and infrastructure development will be frozen.

If parliament rejects the budget, a structured process follows to ensure the continuation of essential services

First, the finance minister revises the budget to address concerns and he resubmits. If rejected again, the Public Finance Management Act (PFMA) allows emergency interim funding for up to four months, covering essential services with up to 45% of the previous year's budget, but government salaries and infrastructure projects may face delays. If the deadlock persists, the President may mediate or reshuffle the Cabinet. If no resolution is found, the President can invoke Section 50 of the Constitution to dissolve Parliament and call a general election within 90 days. As a last resort, the Constitutional Court may intervene to provide legal guidance or compel Parliament to approve an emergency budget. Without an approved budget, Treasury will be forced to rely on short-term funding mechanisms. Essential services like healthcare, policing and social grants will continue, but government salaries, procurement and infrastructure projects can face significant delays. This will create a climate of economic stagnation, uncertainty and political instability.

The numbers: What is in the 2025 Budget? (Reference: Proposed Budget Speech)

The revised 2025 budget aims to raise R28bn in additional revenue, mainly through:

- VAT increases: From 15% to 15.5% in May 2025, then to 16% in April 2026, generating R14.5bn.
- No inflation adjustment for tax brackets: Effectively increasing the tax burden on middle- and high-income earners.
- Excise duty hikes: Above-inflation increases on alcohol and tobacco.
- Fuel levy adjustments: Potential hikes are still under discussion.

On the spending side, Treasury is juggling priorities:

- Social grants: Originally set for an R23.3bn increase over three years, they have now been trimmed to R8.2bn.
- Public infrastructure: R777.5bn over three years, focusing on energy (R219.2bn), water and sanitation (R156.3bn), and transport and logistics (R402.0bn).
- Debt servicing: up to R12.1bn due to rising borrowing costs.

Despite these efforts, South Africa's debt trajectory remains concerning. Treasury projects gross loan debt to stabilise at 76.2% of GDP in 2025/26, but many analysts expect it to exceed 80% due to persistent fiscal slippage.

Economic consequences: A risky fiscal future

If the budget passes, it brings tax increases and reduced government spending, which will slow economic activity. If it fails, the consequences could be even worse. Either scenario presents challenges:

Investor confidence and currency volatility

Uncertainty about the budget—and the broader political instability—could weaken investor confidence, leading to capital outflows and rand depreciation. A weaker currency would make imports more expensive, further fuelling inflation. South Africa is already grappling with stubbornly high costs of living and a prolonged budget impasse could make matters worse.

Higher borrowing costs and credit ratings risk

Credit rating agencies are watching closely. If the government fails to pass a budget or presents an inadequate fiscal plan, rating agencies could downgrade South Africa's credit rating, making borrowing more expensive. South Africa already spends a significant portion of its revenue on debt service—any downgrade would increase this burden and limit fiscal flexibility.

Slower Growth and Business Uncertainty

With the Treasury now leaning on taxpayers rather than spending cuts to raise revenue, businesses and individuals will bear the brunt of fiscal consolidation. Higher VAT and a lack of tax relief will reduce disposable income, slowing consumer demand. Combined with stagnant GDP growth (projected at an optimistic 1.9% for 2025), this could tip the country into an economic downturn.

- Businesses must prepare for higher tax burdens and potential disruptions:

    1. Monitor policy debates: The GNU's political manoeuvring could lead to changes in tax laws and enforcement.
    2. Strengthen compliance: SARS is likely to tighten audits and enforcement to maximise collections.
    3. Plan for cash flow disruptions: Delays in government payments and tax refunds could strain liquidity.
    4. Seek expert tax advice: Professional guidance can help businesses optimise tax strategies under the evolving fiscal framework.
    5. Adjust pricing and cost strategies: With inflationary pressures and tax increases, businesses may need to revise pricing models.

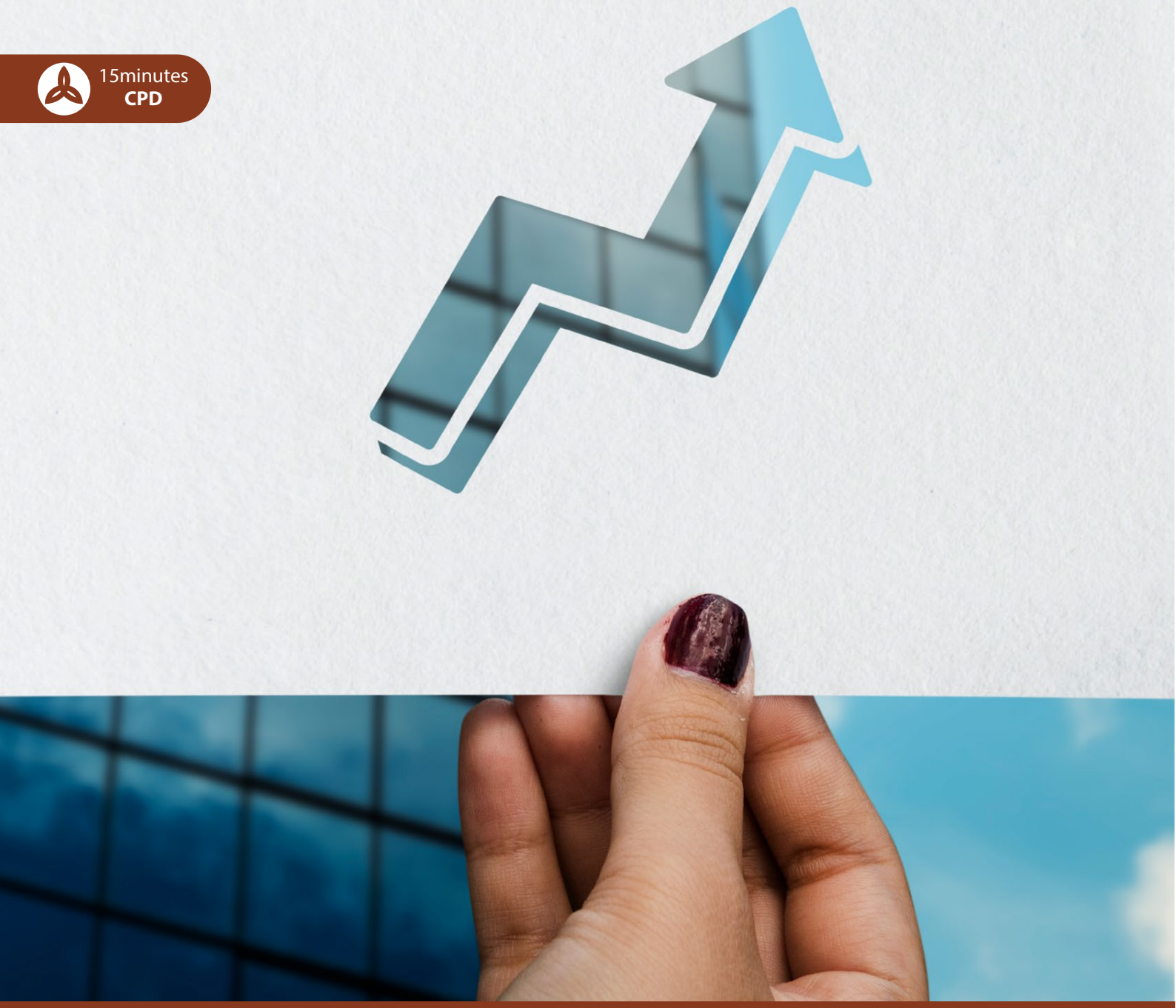
The verdict: 2 April will decide South Africa's fiscal future

After weeks of tense negotiations, reports from 29–30 March indicated that a compromise was close. Talks between the ANC and DA have led to agreements on broader expenditure reviews and economic decentralisation, particularly regarding ports and rail. According to an ANC insider, who spoke to the media on condition of anonymity, the deal included all GNU partners, not only the ANC and DA. While details remain unclear, ANC Secretary-General Fikile Mbalula confirmed progress after the ANC also held a National Executive Committee (NEC) meeting over the weekend. *With 159 seats in the National Assembly of 400 seats,* the ANC needs 201 votes to pass the budget. The easiest path is securing DA support, given its 87 seats. Without it, the ANC must rely on smaller GNU partners and possibly outside parties, making negotiations complex. The GNU controls 287 seats.

The fate of South Africa's budget now hinges on the parliamentary vote scheduled for 2 April. Despite being the dominant GNU player, the ANC does not have the numbers to push it through alone. Opposition parties and smaller coalition partners hold the key; they are likely to use this as leverage for political bargaining. The DA, which initially opposed the VAT hike, has offered vague alternatives but will need to clarify its stance. Meanwhile, smaller GNU partners may extract concessions in exchange for their support. If the vote fails, Treasury will have to revise its proposals again, deepening uncertainty. Ultimately, South Africa's economic stability depends on how this budget battle plays out.

"If the budget fails to pass, South Africa does not automatically enter a financial shutdown, but it does create severe governance challenges"

15minutes CPD



THE VAT HIKE DEBATE: A SHORT-TERM FIX OR A LONG-TERM MISTAKE?

▶ **DR KGATHANE PAULINA MAMOGOBO,** Chief Economist at Naamsa

Introduction: Are we asking the right questions?

Tax policy, at its core, is an exercise in trade-offs. Governments are tasked with balancing fiscal responsibility, economic growth and social welfare—rarely can all three be optimised simultaneously. However, knowing which lever to pull requires a clear understanding of a country's economic conditions. The recent decision to implement an incremental VAT increase from 15% to 16% over the next two years is a textbook case of this balancing act. Treasury expects the hike to generate an additional R13.5 billion annually, closing budget gaps and maintaining state spending.

But let's step back and ask a more fundamental question: Is the VAT increase truly the 'best bad' option or does it reflect a blurred economic vision?

It is important to acknowledge that taxation is never neutral—it actively shapes economic behaviour. It signals to businesses whether to invest, to consumers whether to spend and to global markets whether a country is forward-thinking or merely plugging fiscal holes. South Africa's VAT hike may be defensible from a narrow accounting perspective, but I would argue that it represents a policy of least resistance; one that risks dampening economic dynamism at precisely the wrong moment.

The unseen costs of VAT: Who really pays the price?

VAT is often praised for its efficiency—it is broad-based, difficult to evade and relatively straightforward to administer. However, this efficiency conceals deeper distortions. Unlike profit-based taxes, which fluctuate with economic performance, VAT applies regardless of whether consumers are thriving or struggling and whether businesses are expanding or barely surviving.

With a projected 1.8% economic growth rate from the SARB—ceteris paribus— the contrary would be that, given shifts in geopolitics and geo-economics, South Africa is likely to still fall short of this target. We must again ask: is the VAT increase truly the 'best bad' option or does it expose a blurred economic vision?

The business impact: Taxing before growth happens

For businesses, VAT is more than just a line item on an invoice. It affects pricing strategies, cash flow and competitiveness. Large corporations with diversified supply chains may adjust, but for small and medium enterprises (SMEs), the added burden could be detrimental—implying deferred expansion, thinner margins and, in some cases, closure. This is particularly concerning in an economy that requires all layers of the private sector to contribute to much-needed growth to address socio-economic challenges.

Think of it in this way: a struggling small manufacturer that barely breaks even still has to account for VAT on every sale. Unlike corporate tax, which adjusts based on profitability, VAT imposes an unyielding burden regardless of economic realities. How does this align with a country that should be prioritising entrepreneurship and industrialisation to spur growth?

Consumer spending: Squeezing the engine of growth

Household consumption accounts for over 60% of South Africa's GDP. When disposable income falls, people adjust—postponing purchases, cutting back on non-essentials and, in extreme cases, making do with less. The automotive industry, for example, is highly sensitive to affordability. A VAT increase makes new vehicles more expensive, dampens demand and slows down an entire value chain—from manufacturing to financing to after-sales services.

The broader economic consequence? Lower sales, potential job losses and a drag on industrial growth. While Treasury may raise revenue in the short term, what is the long-term cost?

The macroeconomic contradiction: One policy undermining another

Macroeconomic policy requires coherence. Right now, we are witnessing a clash between two fundamental schools of economic thought—Keynesianism and Monetarism. The South African Reserve Bank (SARB), following a more Keynesian approach, has been easing monetary policy to stimulate investment and consumer activity. Yet, at the same time, the VAT hike embodies a Monetarist logic—aiming to shore up public finances by curbing debt, even if it comes at the cost of reduced consumer spending.

It is as if one hand of policy is pressing the accelerator while the other slams on the brakes. The VAT increase reduces disposable income, making conditions tougher for households and dampening the very demand that monetary easing is meant to encourage. The question in this regard is then: are we trying to grow the economy or restrain it? And can an economy in need of expansion afford such internal policy misalignment?

So, which policy objective is paramount—growth or austerity? How does this align with the 3% growth target of the Medium-Term Development Plan (MTDP)? Can an economy in need of expansion afford policy misalignment?

Could we have taxed differently? Smarter alternatives

If the goal was revenue generation, was VAT the right tool? I would argue that South Africa had other, potentially less disruptive avenues to explore:

- A financial transactions tax: A small levy on high-frequency trading and large capital flows could generate billions without affecting ordinary consumers.
- Gambling and luxury taxes: South Africa's high-stakes gaming and luxury markets remain under-taxed. Should we not shift some of the burden onto high-value discretionary spending rather than taxing essential consumption?
- Digital economy taxation: The digital revolution has reshaped commerce, yet our tax system remains stuck in the brick-and-mortar era. Capturing tax revenue from e-commerce and multinational tech giants could be a forward-looking alternative.

These alternatives highlight an important truth: taxation should not only raise revenue—it should be a tool for economic strategy. If we tax in ways that inhibit growth, shouldn't we reconsider the framework itself?

Conclusion: The VAT hike is a policy of least resistance

Raising VAT may have been the easiest political option, but was it the smartest economic one?

I would argue that the VAT hike reflects a blind spot in reimagining South Africa's tax system for a modern, growth-driven economy. If we continue using taxation as a reactive tool to fix budget shortfalls rather than a proactive instrument to drive investment, we will find ourselves repeating the same cycle: sluggish growth, lower revenue and yet another tax hike in the years ahead.

The real question is not whether VAT was the 'best bad' option, but whether we had the courage to ask if it was necessary at all.

In my response, I also aim to spark thought for enlightenment—lest we continue to treat the current economic age as business as usual.

45minutes
CPD

THE CORONATION CASE:

Did we miss the real issue?

DR ANNELIZE OOSTHUIZEN, Subject Head of Taxation and Senior Lecturer at the University of the Free State

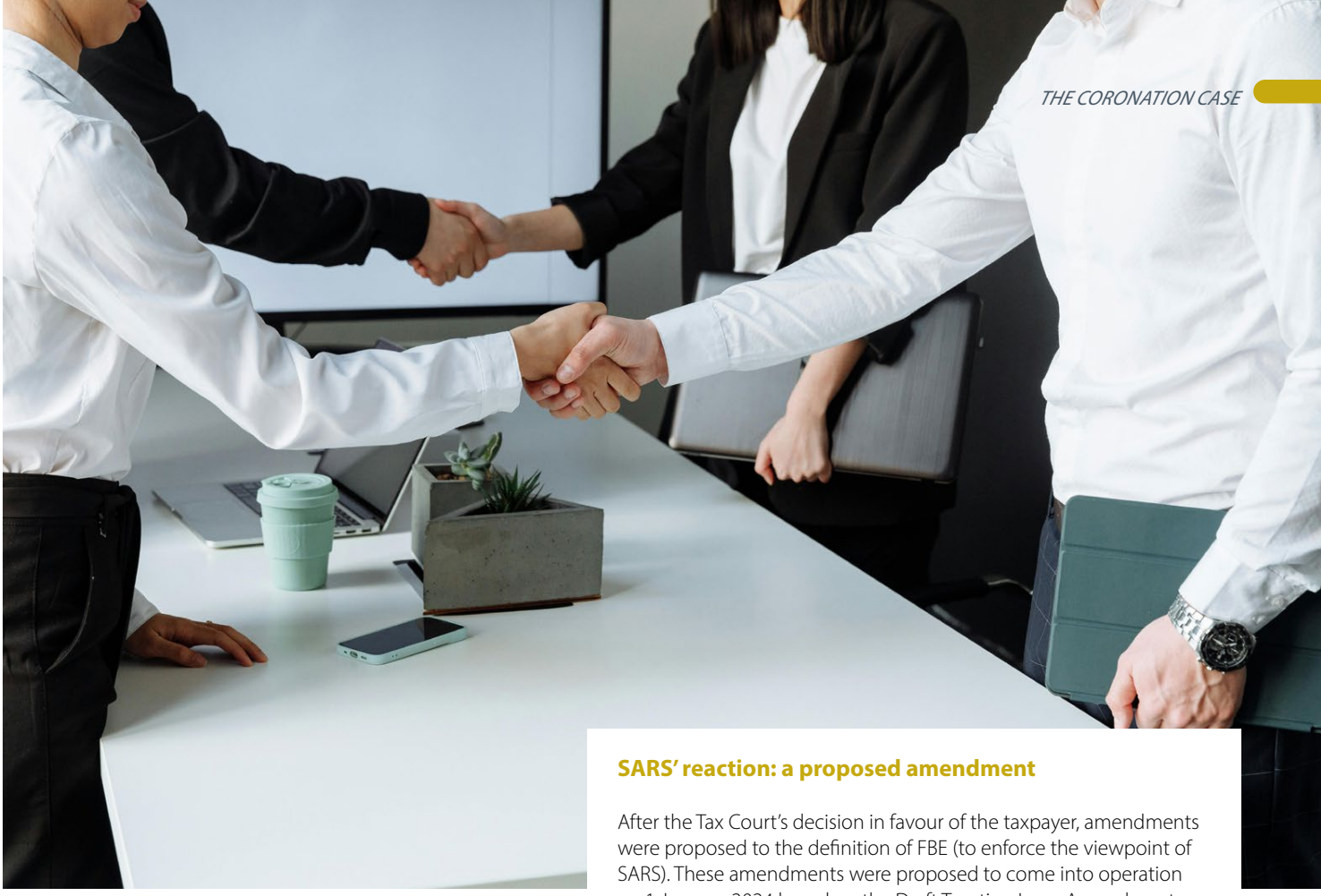
"What you see depends not only on what you look at, but also on where you look from"
– James Deacon

The Coronation Case has long been a contentious issue until finally decided by the Constitutional Court on 21 June 2024. The fact that the findings of the Supreme Court of Appeal differ from those of the Tax Court and the Constitutional Court raises concerns about objectivity in interpreting tax legislation. Compromised objectivity (especially from SARS) can adversely and unfairly affect taxpayers who do not have the funding to take a matter to a higher court and, ultimately, the Constitutional Court. This raises a concern as to which measures protect taxpayers who do not have external funding (such as income from taxes) to fund costly court proceedings from adverse and incorrect interpretations of both SARS and the courts.

Background to the case

The case was initially decided in the Tax Court in favour of the taxpayer during September 2021. Thereafter, the Supreme Court of Appeal decided in favour of SARS during February 2023 and, finally, the case was decided in favour of the taxpayer by the Constitutional Court on 21 June 2024 (*Coronation Investment Management SA (Pty) Limited v Commissioner for the South African Revenue Services [2024] ZACC11*).

Coronation Investment Management SA (Pty) Limited (CIMSA) is an SA-resident company with a 100% shareholding in two offshore companies (Coronation Global Fund Managers Limited (CGFM) in Ireland and Coronation International Ltd (CIL) in the United Kingdom. CGFM performed the fund management services. The investment management activities (investment trading activities) were carried out by another SA company in the group of companies as well as by CIL in the UK. CGFM qualified as a controlled foreign company (CFC) in terms of section 9D of the Income Tax Act, but CIMSA applied the foreign business establishment exemption (FBE) as contained in section 9D. CIMSA did not seek reliance on the proviso of the FBE in section 9D since it complied with the requirements in section 9D(1)(a)(i)-(v). CGFM, therefore, complied with the requirements relating to structures through which the business is conducted: requirements dealing with employees, equipment and facilities. However, much of SARS' focus was on the requirements of the proviso to the FBE definition, contending that the primary business of CGFM lacked economic substance since, according to SARS, it had outsourced its primary business to companies located in SA and in the UK.



As evident from the licensing agreement, the business plan as well as the testimonials, the main reason for creating CGFM was not to obtain a tax benefit but to gain access for clients to the financial markets in Ireland, specifically to Irish domiciled collective investment funds. One of the licensing requirements obtained from the Central Bank of Ireland was that a company (CGFM) needs to be incorporated in Ireland. SARS was, however, of the view that the FBE does not apply since the primary functions of CGFM (which SARS submitted were investment management and not fund management) were outsourced to the SA and UK companies and were not performed in the country of the controlled foreign company in question (CGFM being in Ireland). The Tax Court and ultimately the Constitutional Court decided in favour of CIMSA and commented that the Special Court of Appeal erred in applying the 'notional-business interpretation' instead of looking at the 'actual-business interpretation', that is, at what the business is entitled to do in terms of the license (in theory) instead of what the company actually does when determining the business and primary business of CGFM.

"Merely putting a bandage on one of the issues that was problematic to one party might cause another"

SARS' reaction: a proposed amendment

After the Tax Court's decision in favour of the taxpayer, amendments were proposed to the definition of FBE (to enforce the viewpoint of SARS). These amendments were proposed to come into operation on 1 January 2024 based on the Draft Taxation Laws Amendment Bill of 31 July 2023. Although the proposal was withdrawn after the Special Court of Appeal had decided in favour of SARS, the proposed amendment is still worth mentioning, illustrating SARS' reaction to the decision of the Tax Court.

It was proposed that the phrase 'conduct the primary operations of that business' be replaced with 'perform all the important functions of that business for which the controlled foreign company is compensated'. The purpose of the amendment (as explained in the Explanatory Memorandum on the Draft Taxation Laws Amendment Bill) would have been to ensure that, to qualify as an FBE, all important functions for which a CFC is compensated should be performed either by the CFC or by another CFC in the same group of companies located and subject to tax in the same country as the CFC's fixed place of business. It was stated that while it is permissible for a CFC to outsource other important functions and be compensated for it, the CFC must still comply with the proviso set out in section 9D(1) of the Act, the definition of FBE; each of the requirements in the subsections (aa), (bb) and (cc) of the proviso have to be met. These requirements relate to the company to which certain operations were outsourced and determine that the company must be subject to tax in the same country as the CFC; must form part of the same group of companies as the CFC; and the structures, employees, equipment and facilities must be located in the same country as the fixed place of business of the CFC.

However, the reaction to the Tax Court findings and the proposed amendment raises issues as to whether SARS adheres to the rules of interpretation laid down by the courts; not adhering to these rules could have detrimental effects on taxpayers.

Rules of interpretation

A case often referred to in the interpretation of legislation is *Natal Joint Municipal Pension Fund v Endumeni Municipality [2012] JOL 28621 (SCA)I*. Some of these aspects are considered below.

The apparent purpose to which it is directed and the material known to those responsible for its production

National Treasury issued a document in June 2002 named *National Treasury's Detailed Explanation to Section 9D of the Income Tax Act* detailing the purpose of the section. It is stated that the main reason for the introduction of section 9D was to act as an anti-avoidance measure to apply South African tax where "failure to tax foreign controlled company income will likely lead to an artificial flow of funds offshore . . .". Anti-deferral (immediate taxation obtained through including the income of the CFC in the taxable income of the resident shareholder) applies where the income stems from passive investments or from transactions that meet objective criteria with a high tax avoidance risk. Section 9D favours an approach that balances international competitiveness (by applying the FBE and not taxing the income in South Africa) where the income stems from active operations. With reference to what a 'business establishment' is, the document makes use of the word 'some' and refers to "some permanence", "some economic substance" and a "bona-fide non-tax business reason for operating abroad rather than in South Africa". The apparent purpose to which it is directed and the material known to those responsible for its production can, therefore, be summarised as ensuring that income from paper shell companies created offshore merely to avoid taxation in SA and without economic substance (i.e. without a non-tax business reason) is taxed in South Africa. Permanence and economic substance are present in the case of CGFM to a greater extent than merely 'some'.

A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document

The relevant requirements to qualify for the FBE are in section 9D(1)(a)(i)-(v). These requirements are: that the fixed place of business should be conducted through one or more offices or other structures; should be suitably staffed with on-site managerial and on-site operational employees of that CFC who conduct the primary operations of that business; should be suitably equipped for conducting the primary operations of that business; should have suitable facilities for conducting the primary operations of that business; and should be located outside the Republic solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in the Republic. The aim was not to have a list of requirements to determine or prescribe what the primary operations are but to ensure that, when complying with these requirements, it would indicate that the CFC is a real operational business and not merely a shell company created to avoid tax. Considering these requirements, it is important to take into account the facts of each case objectively based on the business model, the industry and the norms generally prevailing in the industry.

Consideration must be given to the language used in light of the ordinary rules of grammar and syntax

The judgment did not address the use of the word 'conduct' in referring to the primary operations of that business. Since 'conduct' is not defined in the act, the ordinary dictionary meaning of conduct (based on the online definition from Oxford Languages) is "the manner in which an organization

- or activity is managed or directed". Applying this to CGFM, it can be argued that CGFM conducted business in its duties as a fund manager (managing regulatory requirements, overseeing the outsourced activities, etc.). Interestingly, the proposed amendment would have replaced the word 'conduct' with 'perform' thereby narrowing the meaning of outsourcing to enforce SARS' view.

It is only stated in the judgment that CIMSA did not seek reliance on the proviso of the FBE exemption in section 9D since it complied with the requirements in section 9D(1)(a)(i)-(v), without providing specific reasons for not using the proviso. However, applying the rules of interpretation to the wording of the proviso according to the definition of FBE explains the reasoning. The proviso determines that (own emphasis added) *"Provided that for the purpose of determining whether there is a fixed place of business as contemplated in this definition, a controlled foreign company may take into account"*. The use of 'may' is different from 'should be taken into account', which is used elsewhere in the act. 'May' does not imply that it should. It does not appear that the proviso should be used to determine where the primary operations are conducted but merely to determine if there is a fixed place business. Therefore, to determine if there is a fixed place of business, outsourcing may be considered. It is therefore submitted that if it was determined that there is a fixed place of business without utilising the optional proviso factors, there is no need to consider the factors in the proviso.

Regardless, it is submitted that, if the intention of the legislator when drafting section 9D was for outsourcing not to be allowed, the Act should have and would have stated it clearly. Again, the proposed amendment discussed above intended to enforce SARS' view by disqualifying a company from using the FBE provision if the primary business was outsourced to a company in a different country than that of the CFC. This proposed amendment would have contravened the rules of interpretation of "*the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production*" that would have led to *"insensible or unbusinesslike results or undermines the apparent purpose of the document"*.

Concluding comments

Although the core issue pertaining to the case was properly addressed, a concern in tax policy design and development was raised. It is of concern for taxpayers that SARS immediately opted to amend the legislation after the judgment of the Tax Court. Due care should be taken in amending legislation that does not necessarily always favour SARS and its view but rather considers the intention of the law as well as the factors of a specific case objectively.

Merely putting a bandage on one of the issues that was problematic to one party might cause another. Since the initial introduction of section 9D, there have been many developments internationally that should also be considered collectively, such as whether apportioning should be applied if the CFC has different operations, of which some do not qualify for the FBE exemption since they are performed in other countries; the possible effect of double taxation in light of Pillar Two (the minimum tax taken into consideration) as well as the change in focus with the purpose of a double tax agreement (not only to address double taxation but also anti-avoidance); and the effect and interaction of transfer pricing rules. It may be time to reconsider the CFC provisions in their entirety.

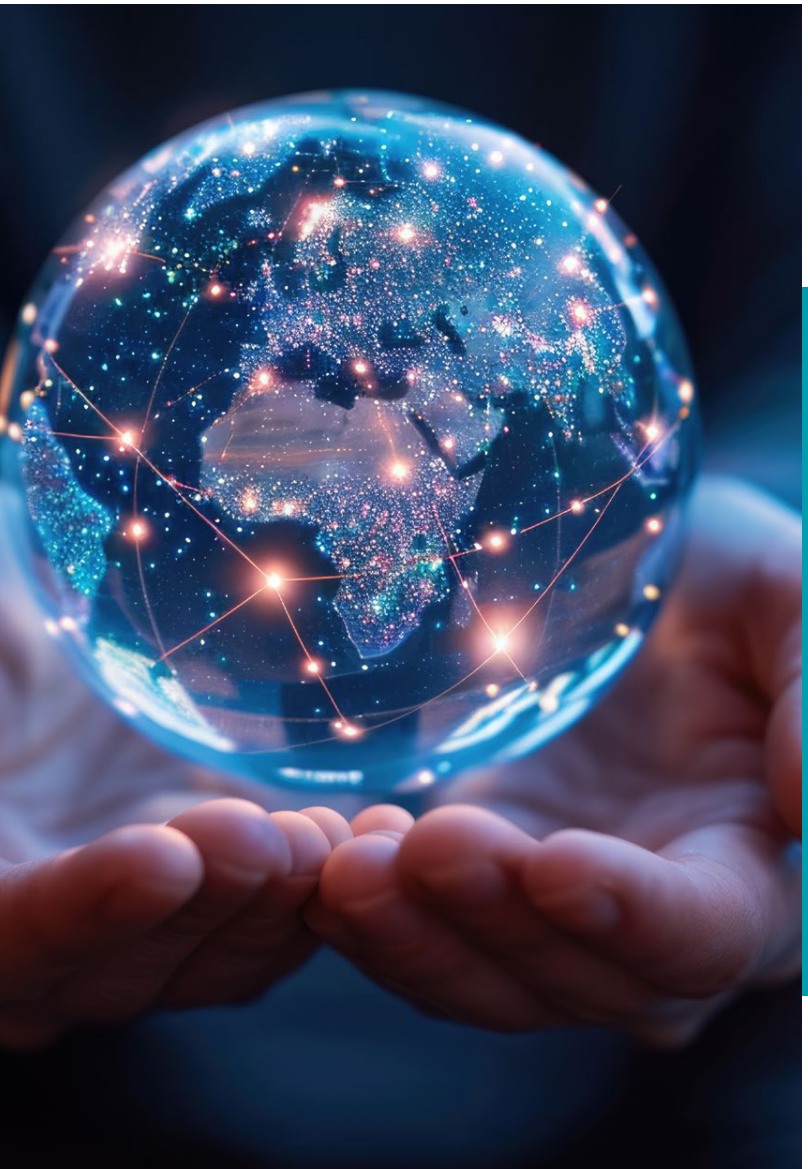
15minutes CPD

GLOBAL TAX DISRUPTION:

How the US exit from BEPS 2.0 could reshape digital taxation

ERIN SNYMAN, Chief Global Tax Officer at Sail International

There is set to be a significant shift in the international tax space following reports that the United States may reconsider its commitment to BEPS 2.0 (Base Erosion and Profit Shifting 'BEPS'), the OECD-led initiative aimed at addressing unequal tax in the digital economy.



This potential departure raises critical questions about the future of global tax cooperation and could lead to a resurgence of unilateral tax measures by other countries. The impact would be particularly significant for multinational corporations (MNEs), digital taxation policies and global trade dynamics.

MNEs generally prefer tax certainty. It is expensive for them to change structures to adapt to changes. The US exit will likely increase uncertainty for the foreseeable future, making it difficult for MNEs to plan for settled operational structures.

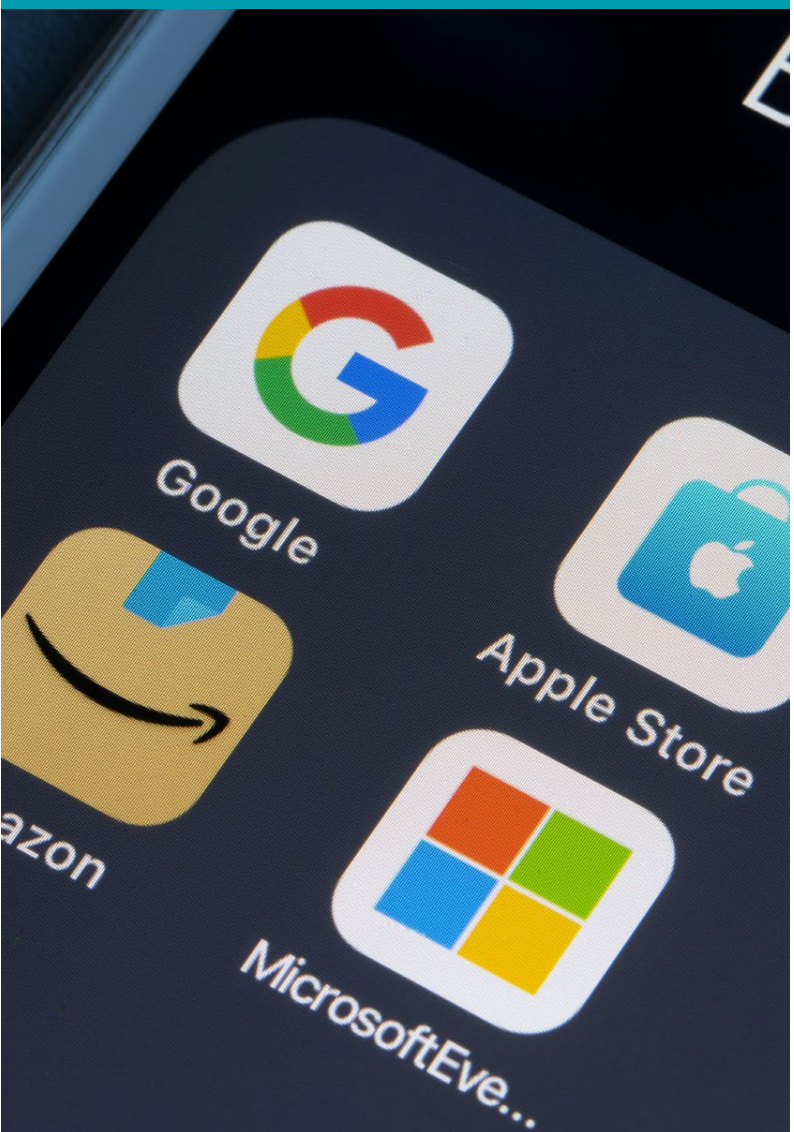
BEPS 2.0: An overview

The BEPS 2.0 framework was developed to modernise global tax rules and ensure that multinational enterprises pay a 'fair' share of tax in jurisdictions where they conduct significant business. The initiative consists of two key pillars.

- Pillar One: Designed to reallocate a portion of large MNEs' profits to countries where they generate significant revenue, even if they lack a physical presence there. This measure primarily targets digital businesses and large consumer-facing corporations.
- Pillar Two: Introduces a global minimum corporate tax rate of 15%, ensuring that large companies pay at least this baseline level of taxation regardless of where they operate. This provision aims to curb tax avoidance strategies that involve shifting profits to low-tax jurisdictions.

Over 140 jurisdictions have endorsed BEPS 2.0, seeing it as a way to address tax avoidance and increase fairness in global taxation. However, implementation has been slow, facing opposition from political groups, businesses and policymakers—particularly in the United States, where domestic concerns have stalled legislative progress.

"With uncertainty surrounding US participation in BEPS 2.0, businesses and policymakers must prepare for potential disruptions"



The US exit: What it means

A potential withdrawal by the United States from BEPS 2.0 would have far-reaching consequences, disrupting years of global tax negotiations.

Key implications include:

1. Weakened global consensus

The United States has played a crucial role in shaping the BEPS 2.0 framework. Its exit could significantly weaken international cooperation, leading other countries to reconsider their commitments. Without US participation, some governments may decide to abandon or delay implementation, undermining the OECD's effort to create a harmonised global tax system.

2. Resurgence of Digital Services Taxes (DSTs)

Many countries, including France, the UK, India and Italy, had introduced Digital Services Taxes (DSTs) to tax large technology firms before BEPS 2.0 was introduced. As part of the global negotiations, these countries agreed to pause or roll back their DSTs in anticipation of a fairer multilateral tax agreement under Pillar One.

However, if the US exits BEPS 2.0, these countries may feel compelled to reintroduce or expand DSTs, leading to heightened trade tensions. The United States has previously retaliated against DSTs with tariff threats and a renewed trade conflict could emerge.

3. US Multinationals at risk

A US withdrawal from BEPS 2.0 could have major implications for American tech giants such as Google, Amazon, Apple, Microsoft and Meta. If Pillar One collapses, these companies could face higher tax burdens in multiple jurisdictions due to the return of DSTs and other unilateral tax measures.

The lack of a coordinated global tax approach could result in increased double taxation, where multiple countries claim the right to tax the same income. This has the potential to create complex tax disputes and compliance challenges for US-based multinationals.

4. Impact on Pillar Two adoption

While some jurisdictions—including the EU, UK and Japan—are moving ahead with Pillar Two's global minimum tax, a US exit could slow global adoption. If the US does not participate, other countries may be reluctant to implement it fully, leading to an uneven global tax landscape. This could create distortions in international business operations where companies strategically shift profits to jurisdictions that refuse to enforce the minimum tax.

5. Increased tax competition and disputes

Without a strong multilateral agreement, countries may resort to more aggressive tax competition by lowering corporate tax rates to attract investment. This could reignite a global 'race to the bottom' in tax rates, undermining the OECD's efforts to curb profit shifting.

Moreover, with the US absent from BEPS 2.0, disputes between tax authorities over the allocation of taxing rights could increase. This could lead to more tax audits, disputes and litigation as different jurisdictions assert their right to tax profits generated within their borders.

What comes next?

The global tax community is now at a crossroads. With uncertainty surrounding US participation in BEPS 2.0, businesses and policymakers must prepare for potential disruptions.

Key considerations include:

- Reassessing tax strategies: Companies must stay informed about changing tax laws and prepare for a potential return of DSTs, varying corporate tax rates and increased tax disputes.
- Monitoring regulatory changes: Governments worldwide will respond differently to a US exit. Some may proceed with the implementation of BEPS 2.0, while others may choose unilateral tax measures.
- Preparing for increased compliance costs: With the likelihood of more complex tax regulations, companies should expect higher compliance burdens and potential tax disputes across multiple jurisdictions.
- Engaging in advocacy and negotiations: Businesses and trade organisations should actively participate in discussions with policymakers to shape future tax rules in a way that minimises disruptions and avoids double taxation.

Conclusion

The potential US exit from BEPS 2.0 represents a major turning point in international tax policy. While this could derail efforts to establish a fair and harmonised tax framework, it also creates uncertainty that could lead to a resurgence of unilateral taxation measures.

For multinational businesses, a proactive approach, close monitoring of global tax developments and strategic planning to mitigate risks will be necessary. However, future planning will be difficult in this uncertain environment.

The coming months will be key in determining the future of global digital taxation—and whether the world moves towards collaboration or fragmentation in international tax policy.

30minutes CPD

UNLISTED REITs:

Will Treasury ever deliver on its promise?

▶ **MARK BESTER,** Director, INNOV-A-TAX ADVISORY & SOLUTIONS PTY LTD

With the introduction of the 'New Treatment for Real Estate Investment Trusts' in 2013, National Treasury first alluded to the extension of this regime to unlisted REITs but only once they were subject to similar regulation as listed REITs.

"This form of regulation should initially be extended to w*holly owned entities of private and government pension funds, as well as long terms insurers*. Property syndication legislation is also proposed to protect investors from Ponzi schemes. REIT tax relief will similarly be extended to cover other real estate entities if they become subject to property syndication regulation." [own emphasis added] (2013 Budget Review; National Treasury.)

Then, in National Treasury's 2015 Budget Review, mention was yet again made about Government proposing that "unlisted property-owning companies *that are marketed to the general public or held by institutional investors*" should qualify for the same tax treatment (as listed REITs) if they become regulated and committed to developing a regulatory framework for unlisted property-owning companies. [own emphasis added]

In 2019, with the implementation of the Financial Sector Regulation Act (2017) and the establishment of the Financial Sector Conduct Authority now allowing for regulation of unlisted REITs, it was proposed that Government consider the regulation and tax treatment of unlisted REITs that are *widely held or held by institutional investors*.

Significantly and finally, in 2024, National Treasury proposed an amendment to the definition of REIT as contained in section 1 of the Income Tax Act no 58 of 1962.

The purpose of the proposed amendment (which has yet to become effective and which is still subject to amendment) is to provide a rule for the tax treatment of unlisted property companies and ensure that monitoring is done by the Financial Sector Conduct Authority (FSCA). (Explanatory memorandum 2024 to the Taxation Laws Amendment Bill)

Financial Sector Regulation Act No. 9 of 2017

The purpose of the Act is to achieve a stable financial system that works in the interests of financial customers and supports balanced and sustainable economic growth by establishing, together with the specific financial sector laws, a regulatory and supervisory framework that promotes certain principles and objectives including financial stability, the safety and soundness of financial institutions and the fair treatment and protection of financial customers.

The Financial Sector Conduct Authority (FSCA) is a regulatory body within the administration of the Financial Intelligence Centre (FIC); the objectives of the FSCA include promoting the fair treatment of financial customers by financial institutions.

Regulatory measures adopted by the FSCA include licenses: a person will only be able to provide, as a business or part of a business, a financial product, financial service or market infrastructure if he is issued with a licence under a specific financial sector law.

REIT definition for Income Tax purposes (section 1)

'REIT' means a company that is a resident—

(a) the equity shares of which are listed—
- ***i.*** on an exchange (as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act); and
- ***ii.*** as shares in a REIT as defined in the listing requirements of that exchange approved in consultation with the Director-General of the National Treasury and published, after approval of those listing requirements by the Director-General of the National Treasury, by the appropriate authority, as contemplated in section 1 of the Financial Markets Act, in terms of section 11 of that Act or by the Financial Sector Conduct Authority; *or*

(b) where that company meets the requirements and conditions set by the Minister of Finance by notice in the Gazette; [own emphasis added]

(Pending amendment: Definition of 'REIT' to be substituted by s. 1 (1) (f) of Act No. 42 of 2024 with effect from a date determined by the Minister of Finance by notice in the *Gazette*.)

It is proposed that the 'REIT' definition in section 1 of the Act be extended to cater for a company that is a South African company which is not listed on the South African Stock Exchange but is regulated by the FSCA through the published requirements approved in consultation with the Director-General of the National Treasury. (Explanatory memorandum 2024 to the Taxation Laws Amendment Bill.)

Currently, a South African REIT also needs to comply with the JSE Listings Requirements for REITs which, inter alia, require that a REIT:

- Owns property with a value in excess of R300 million,
- Maintains its debt below 60 per cent of its gross asset value,
- Earns 75 per cent of its income from rental or from property owned or investment income from indirect property ownership,
- Has a committee in place to monitor risk,
- Must not enter into derivative instruments that are not in the ordinary course of business, and
- Must distribute at least 75 per cent of its taxable earnings available for distribution to its investors each year.

Whereas the above listing requirements do not form part of the Income Tax Act legislation, they do form part of the regulatory framework that governs listed REITs and with requirements and conditions to be formulated for unlisted REITs in terms of the Financial Sector Regulation Act in conjunction with the FSCA, it is likely that similar conditions will prevail in order for an unlisted REIT to obtain a licence to operate as such, namely:

Gearing Limits

In particular, loan-to-value (LTV) restrictions such as the 60% imposed for listed REITs are likely to prevail given the fixation of National Treasury to limit interest deductions where the perception is that certain transactions are over-geared.

Minimum Asset Requirements

The only likely threshold that may be relaxed slightly may be the R300 million minimum investment in property.

Investors

Licencing requirements may also contain restrictions on investors in the unlisted REITs given that over the years National Treasury has indicated its preference for institutional investors and shares that are widely held by the general public.

Closely held family-owned property companies are unlikely to qualify for a licence unless similar rules to those contained in the Qualified Investor Hedge Fund regulations are enacted that require the shares to be made available to the general public; however, the general public may not want to invest therein given the bespoke mandates of each private/ unlisted REIT.

Liquidity

The FSCA is likely to impose stringent liquidity restrictions in order to afford investors the protection required. Investors must be able to exit when they want to; there is likely to be a requirement for a market maker that provides the necessary liquidity to enable exits—a potential solution would be that, according to the liquidity requirements, a specified percentage of assets is held in listed REITs shares which tend to be fairly liquid. This could result in cash being available to fund the required exit of investors on a day-to-day basis.

Taxation of REITs vs Property Investment Companies

Key Tax Considerations	REIT Structures				Non-REIT Structures	
Rental Income includes all amounts received or accrued:	**Legislation:**	**REIT:**	**Controlled Company:**	**Property Company:**	**Property Company:**	**Legislation:**
In respect of the use of immovable property, including a penalty of interest in respect of late payment of any such amount.	S25BB(1)	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	Gross Income
As a dividend (other than a dividend from a share buy back) from a company that is a REIT at the time of the distribution of that dividend.	S25BB(1)	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	S25BB(1)
As a qualifying distribution from a company that is a controlled company at the time of that distribution.	S25BB(1)	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	S25BB(1)
As a dividend or foreign dividend from a company that is a property company at the time of that distribution.	S25BB(1)	Included in taxable income computation	Included in taxable income computation	Exempt/ subject to s10B	Exempt/subject to s10B	Gross Income para(k) read with S10(1)(k)
Any amount recovered or recouped in terms of section 8(4) in respect of an amount of an allowance previously deducted in terms of section 11(g), 12B, 12BA, 13, 13bis, 13ter, 13quat, 13quin or 13sex	S25BB(1)	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	Included in taxable income computation	S8(4)
Qualifying distributions to investors	S25BB(2)(a)	Deductible	Deductible	Not Deductible	Not Deductible	S11(a) read with S23(f)
Dividends distributed to resident shareholders	S10(1)(k)(i)(aa)	Taxable no DWHT	Taxable no DWHT	Exempt subject to DWHT	Exempt subject to DWHT	S10(1)(k)(i)
Dividends distributed to foreign shareholders	S10(1)(k)(i)(aa)	Exempt subject to DWHT	Exempt subject to DWHT	Exempt subject to DWHT	Exempt subject to DWHT	S10(1)(k)(i)
CGT Relief for property interests (Disposal of:)	S25BB(5)					
Immovable property of a company that is a REIT or controlled company at the time of disposal	S25BB(5)(a)	Disregard	Disregard	Subject to tax	Subject to tax	Para2(1)(a) of 8th schedule
A share or a linked unit in a company that is a REIT at the time of that disposal	S25BB(5)(b)	Disregard	Disregard	Subject to tax	Subject to tax	Para2(1)(a) of 8th schedule
A share or a linked unit in a company that is a property company at the time of that disposal	S25BB(5)(c)	Disregard	Disregard	Subject to tax	Subject to tax	Para2(1)(a) of 8th schedule
Building allowances	S25BB(4)	Not allowed	Not allowed	Permitted	Permitted	S11(g), 12B, 12BA, 13, 13bis, 1 3ter,13quat, 13quin, 13sex
Securities Transfer Tax payable on transfer of shares	S8(1)(t) of STT Act No 25 of 2007	Exempt	Subject to STT	Subject to STT	Subject to STT	S2(1) of STT Act No 25 of 2007

Simply put, a REIT would provide for the flow-through principle to apply with income and capital gains being taxed solely in the hands of the investor and not in the hands of the REIT.

Advantages of Unlisted / Private REITs

- Tax Benefits:
  - No Capital Gains Tax on disposal of property interests—without the tax leakage, the REIT will have more funds to reinvest.
  - CGT liability resides with the owner of REIT shares and is triggered only on the sale of those shares.
  - Tax deductibility of qualifying distributions reduces the REITs tax obligations.
  - In the investors' hands, given the taxable nature of the dividends received from the REIT costs of gearing, the investment in the REIT is likely to be tax deductible, unlike a normal share portfolio held for investment purposes.
- Foreign investors' familiarity with the concepts of REITs could lead to an inflow of capital from global players who prefer the transparency provided by REITs rather than the complex structures that preceded them.
- Unlisted companies could benefit from lower costs of capital through the introduction of broad-based investors.
- Increased local and foreign investment could positively impact prices.

"The tax treatment of a REIT, whether listed or unlisted, will likely be the same and the playing fields will be level"

- Dividend flows from typical share investments are subject to the discretion of the boards of the issuer companies, whereas REIT legislation stating that qualifying distributions must be at least 75% of taxable earnings each year and would be tax deductible by REITs provides more certainty on distributions and investment returns; it allows for more effective gearing in acquiring the investments—a feature not necessarily available for typical share investments.
- It was anticipated that property investment companies and some historical property investment structures, such as property loan stock companies, which were all subject to capital gains tax, had provided for substantial capital gains tax in their accounts and which, upon conversion to REITs, would be released and reinvested providing stimulation to the economy. This point is also particularly relevant to the concept of a private or unlisted REIT; it could provide the required stimulation post-COVID to the property industry, which was particularly hard hit by that pandemic, should the provisions be reinvested in property.
- Listed REITs are akin to holding companies and historically listed holding companies trade at substantial discounts to a sum of the parts type valuation or net asset value—potentially unlisted REITs can avoid the deep discounts.

Disadvantages:

- A disadvantage of listed REITs is the cost of listing; it would be naïve to believe that unlisted REITs will not have regulatory costs in order to obtain a licence from the FSCA.
- Liquidity of unlisted REIT shares: the ability to sell or buy shares will not be as easy as is the case with listed REIT shares and there may be time delays in exiting an investment.
- Price discovery: the free market forces provided by the JSE are unlikely to prevail for unlisted REIT shares and prices are likely to track Net Asset Value Per Share rather than a willing buyer and willing seller type scenario—the devil will be in the detail of the regulations adopted.
- Dividends from listed REITs are currently taxable in the hands of resident taxpayers, whereas dividends from property investment companies are exempt from income tax, albeit they may be subject to DWHT and are likely to have been subject to corporate tax of 27%.

"A Regulatory framework for unlisted property owning companies will be developed. How long this will take is a matter for speculation. However, the formulation of such legislation is definitely a step in the right direction for the property sector, and is no doubt going to stimulate corporate activity in a sector which has seen much consolidation in the listed space over the last couple of years." (Webber Wentzel, article 26 February 2015)

Conclusion

The United Kingdom implemented a new 'private' REIT regime in April 2022, which allowed fund managers to take advantage of the various benefits of REITs without having to undertake the more onerous listing requirements imposed since the beginning of the REIT regime in 2007.

According to His Majesty's Revenue and Customs (HMRC), two years later, 29 private REITs were set up since the regime was amended and more are expected.

While the proposed unlisted/private REIT has been almost 12 years in the making, progress has at least been made with the proposed amendment to the REIT definition for income tax purposes.

Depending on the regulations and the licencing requirements to be imposed by the FSCA, it does not look like much more needs to be amended from a taxation perspective to roll out the unlisted REIT regime.

The tax treatment of a REIT, whether listed or unlisted, will likely be the same and the playing fields will be level.

The difference is likely to be in the listing requirements for listed REITs vs the licencing and regulatory requirements imposed by the FSCA on unlisted REITs.

Hopefully, the end is finally in sight.

30minutes CPD

THE CORONATION CASE: A TURBULENT JUDICIAL RIDE

▶ **JUDGE DENNIS DAVIS,** Honorary Professor of Law at the University of Cape Town (UCT) and the University of the Western Cape (UWC).

The decision by the Constitutional Court in *Coronation Investment Management SA (Pty) Ltd v CSARS*[1] put an end to considerable uncertainty regarding the scope of s 9 D of the Income Tax Act[2] as amended.

The central question which confronted the courts in this case was whether the net income of Coronation Global Fund Managers Island Limited (CGFM), a foreign subsidiary of the taxpayer, was exempt from tax for the 2012 year of assessment in terms of s 9 D of the Act. That exemption would have applied if at that time CGFM had met the requirements for constituting 'a foreign business establishment' as defined in s 9 D (9) (b) of the Act, it being common cause that it had been a controlled foreign corporation of the taxpayer as defined at the relevant time.

The tax court held that CGFM did constitute a foreign business establishment as defined and hence qualified for the exemption.

The Supreme Court of Appeal found to the contrary. It upheld SARS' appeal on the basis that the net income of CGFM for the relevant tax year was imputable to the taxpayer in terms of s 9 D (2) of the Act and that, on the facts , the taxpayer could not rely on the exemption in terms of s9D(9) of the Act.

The facts of the hotly contested case were hardly disputed in any of the courts. At all material times the taxpayer was a 100% subsidiary of Coronation Fund Managers Limited, a South African public company listed on the Johannesburg Stock Exchange. The taxpayer was also a 100% holding company of Coronation Fund Managers (in the Isle of Man) but this company had been deregistered.

[1][2024] ZACC 11
[2]Act 58 of 1962

Relevant to the case was that CGFM had been established in 1997 as a fund management company in Ireland to provide foreign investment opportunities in Irish collective investment schemes. It had done so because Irish law had not permitted it or any of its South African subsidiaries to manage Irish collective Investment Funds. It was a requirement that an Irish fund management company had to be set up to so do.

The evidence showed that the business model chosen by the taxpayer in relation to CGFM in Ireland was in essence a replica of the business model employed in South Africa insofar as the taxpayer fund management business was concerned where South Africa Coronation Asset Management (Pty) Ltd had been established as the manager for South African domiciled collective investment funds. It did not conduct investment trading activities because it had not been licensed to so perform. This would have required it to obtain a license from the South African Financial Services Authority. It contracted with Coronation Asset Management (Pty) Ltd, a company which was a specialist investment manager licensed to conduct investment trading activities within its jurisdiction.

The Constitutional Court[3] summarised the taxpayer's business plan as follows:

> 'In accordance with its business plan, presented as part of its licensed application CGFM employed a delegated business model through which it would conduct specified fund management functions and would delegate investment management trading activities (which it was not authorised by its license to perform) to competent third parties. CAM and CIL would retain overall supervision of a responsibility of the regulator for those functions.'

The Supreme Court of Appeal judgment noted[4] in upholding the appeal of SARS per Nichols JA had set out the purposes of s 9 D thus:[5]

> 'Section 9 D was introduced to address how South Africa taxpayers should be taxed on their income earned abroad especially income earned by South African owned foreign entities. A pure anti deferral regime would immediately deem back all the South African owned foreign companies income. As a result no foreign income would receive any advantage over domestic income. However international will only allow South Africa to tax foreign residents on their South African source income nor on their foreign source income even if the entities were completely owned by the South African resident. To address this, s 9 D imposes tax for South African owners on the income earned by their foreign entities as if those entities immediately repatriated their foreign income when earned.'

Nichols JA accepted that the taxpayer had met all the requirements of a foreign business establishment for the purposes of s 9 D save that of economic substance. She held that as CGFM was licensed to perform active investment managers that were inconsistent with the taxpayer's assertion that it is not licensed to perform investment management. Instead, it appears that the investment manager was integral to its license as an authorised management company.[6] In other words, great emphasis was placed by the court on the operating license which had been granted to the taxpayer by the Irish regulator and which enabled it to perform active investment management activities.

The Constitutional Court disagreed strongly with this approach. It found that the taxpayer had been adequately staffed to perform the functions which it sought to perform and the fact that the separation of fund management and investment trading was standard practice in the industry supported its contention that it was entitled to the FBE exemption. In summary, the court held that 'the licensed conditions, the prudential considerations and the uncontested evidence compellingly showed that at all material times CGFM had conducted the business of a fund manager. It performed the core functions of a fund manager including the management, oversight and supervision of the delegated investment management trading activities.'[7]

In essence the difference between the Supreme Court of Appeal's approach and that of the Constitutional turned on the notion of whether one could satisfactorily and with justification distinguish between the performance of investment trading activities and an entity which performed the functions of management, oversight and supervision of the delegated investment management trading activities.

This then turned on a very important aspect for the interpretation of s 9 D. The Constitutional Court effectively found that the taxpayer had employed a delegated business model to which it would conduct specified fund management functions and would delegate investment management trading activities to a competent third party.[8]

[3]At para 21
[4][2023] ZASCA 10
[5]At para 5
[6]Para 29
[7]Para 9
[8]Para 21

In essence, its finding was that the taxpayer is entitled to choose a justifiable business model which works for its operations as opposed to being 'second guessed' by a court which in the case of the Supreme Court of Appeal refused to accept that a delegated business model in substance would justify the management functions being regarded as a foreign business establishment as defined in s 9 D (9) (b) of the Act.

A further argument which was raised by Trevor Emslie[9] was that in terms of the double tax treaty (DTA) between South Africa and Ireland the net income of the taxpayer being the profits and enterprise carried on in Ireland where it was resident should have been protected from taxation in South Africa in terms of paragraph 1 of Article 7 of the DTA, which granted the taxing rights in respect of the profit of a company such as the taxpayer exclusively to Ireland. That paragraph provides for Ireland to have exclusive tax rights in relation to the profits of the enterprise carried on; in this case, by the taxpayer in Ireland and the identity of the taxpayer in his hands as profits are taxed is irrelevant. The exclusive Irish taxing rights relates to the profits referred to in the treaty not to any taxpayer. The point being made by Advocate Emslie is that what was critical is what is taxed rather than the person who was taxed.

There can be no doubt that the Coronation judgment is extremely important within the context of international tax planning. Were the Supreme Court of Appeal judgment to have been upheld by the Constitutional Court, it would have meant that our law had introduced an objective test for what constitutes an appropriate business model and therefore what entity could qualify for a foreign business establishment in terms of s 9 D (9). In other words the Supreme Court of Appeal's approach was that, in objective terms, there was one set of activities for the investment of funds which had the corollary of requiring management services in its view on the test for a business model the court imposed; the two functions were so inextricably linked together that only 'a form over substance approach' would justify a conclusion in favour of the taxpayer.

The fundamental take-home point of the Constitutional Court judgement is that taxpayers are entitled to choose an appropriate business model provided it is justifiable in terms of the context of the operations which are the subject of the dispute. In this case, it was that in South Africa alone the delegated model of management on the one side and investment of funds on the other was recognised and therefore, non constat, could it be contended that for the purposes of Ireland that distinction no longer would be justifiable.

The outcome of the Coronation case therefore continues to provide scope for international tax planning. True, the Revenue sought to introduce an amendment into the Taxation Laws Amendment Bill of 2023 to change the definition of FBE to require that fixed place of business must be suitable, staffed, equipped and have facilities to perform all the important functions of that business for which the controlled foreign companies compensated. This amendment was withdrawn but it remains uncertain as to whether this particular amendment would fix what SARS and Treasury regard as a mischief. The only important functions for which a business is compensated can be classified as management of funds in the manner in which the Coronation judgment did; hence, it remains difficult to see how the amendment which was proposed would alter the positions sufficiently significantly in order to bring about the result that SARS clearly desired in Coronation.

[9]2024 (73) The Taxpayer at 56

"There can be no doubt that the Coronation judgment is extremely important within the context of international tax planning"

15minutes CPD

SARS' DIGITAL TRANSFORMATION

Will a Funding Boost Improve Compliance or Burden Taxpayers?

▶ **NORMAN MEKGOE,** Head of Tax at Eversheds Sutherland (SA) Inc

The South African Revenue Service (SARS) has recently received a significant funding boost aimed at accelerating its digital transformation strategy. On 12 March 2025, the Minister of Finance announced in the budget speech that SARS will be allocated R3.5 billion in the current financial year and an additional R4 billion over the medium term.

SARS welcomed the additional R7.5 billion funding, emphasising that this will be used to modernise its technology capabilities by, among others, investing in data science, machine learning and artificial intelligence (AI) to improve its ability to respond to complex tax evasion schemes and the illicit economy.

This article explores whether these innovations are likely to improve compliance and revenue collection or whether they might introduce new administrative burdens for taxpayers.

Key initiatives in SARS' digital transformation

SARS will invest in advanced data analytics and AI to improve its ability to detect tax evasion and fraud. It is expected that these technologies will enable SARS to analyse large volumes of data more efficiently, identify patterns of non-compliance and take proactive measures to enforce tax laws.

The implementation of the data analytics and AI technologies require significant investment, not only in infrastructure but also in training. These changes may also pose initial challenges, including the need for taxpayers to update their records and systems, concerns about data privacy and security, as well as concerns about the accuracy of AI-driven decisions and the potential for false results.

Impact on compliance and revenue collection

The digital transformation initiatives at SARS are expected to have a profound impact on compliance and revenue collection. With the increased funding, SARS is expected to adopt a more 'aggressive' approach to enforcing tax compliance, especially in light of the fact that the National Treasury had anticipated a two percentage point increase in Value-Added Tax (VAT) in the current fiscal year but only a 0.5 percentage point increase has been realised, leaving a significant shortfall.

Investments in new technologies can be used by SARS to increase enforcement of tax compliance in several ways, including using advanced data analytics to identify patterns of non-compliance and detect anomalies in tax filings to enable SARS to target audits more effectively and reduce the incidence of tax evasion, as well as the use of AI to automate the analysis of large volumes of data, identifying potential cases of tax fraud and evasion. ▶

> **"By taking proactive steps, taxpayers can better prepare for the changes brought about by SARS' digital transformation and minimise potential disruptions"**

While the more aggressive approach to enforcement by SARS may enhance revenue collection, it could also lead to increased administrative burdens for taxpayers as it is likely that SARS will, once the new technologies are implemented, require more information from taxpayers. By streamlining processes and enhancing the accuracy of taxpayer information and verification and audit requests and/or queries generated using new technologies, SARS may be able to reduce the administrative burden on taxpayers and improve overall compliance rates.

Preparing for SARS' digital transformation

Taxpayers can take several steps to prepare for SARS' digital transformation initiatives and navigate the transition smoothly:

- Stay informed: Regularly check SARS' official communications and updates regarding the new systems and requirements. Participate in any training sessions or informational webinars offered by SARS or industry associations.
- Assess current systems: Evaluate current accounting and tax management systems to ensure they can integrate with the new single taxpayer identification system and support digital tax filing and compliance tracking.
- Employee training: Offer training sessions to help employees become proficient with new tools and processes.
- Consult professionals: Consult with tax professionals for guidance on how to comply with the new requirements and assistance with the transition if needed.
- Update records: With enhanced data analytics and AI, be prepared for potential audits by ensuring that all business records are accurate and up-to-date.
- Budget for transition costs: Set aside a budget for any additional costs associated with the transition, such as software upgrades or professional consultations.

By taking proactive steps, taxpayers can better prepare for the changes brought about by SARS' digital transformation and minimise potential disruptions.

Conclusion

The funding boost for SARS' digital transformation presents both opportunities and challenges. As SARS moves forward with its digital transformation, it will be essential to balance the goals of efficiency and compliance with the need to support taxpayers and maintain trust in the tax system. The key initiatives have the potential to streamline compliance and improve revenue collection. However, the success of these initiatives will depend on effective implementation.

30minutes
CPD

SIMPLIFYING SECTION 11(*nA*): NAVIGATING THE NEW PAYE ADJUSTMENTS

PROFESSOR HERMAN VIVIERS, Associate Professor and Head of Taxation at North-West University and **RENIER VAN DER MERWE,** Academic Trainee in Taxation at North-West University

Section 11(*n*A) of the *Income Tax Act 58 of 1962* ('the Act') allows a deduction for normal tax purposes against a taxpayer's income in respect of an amount required to be refunded by an employee to its employer which previously formed part of such employee's taxable income.

Even though section 11(*n*A) had already been introduced into the Act since 1 January 2009, this section was recently amended; it is effective from 1 March 2025 and applies to years of assessment starting on or after this date. This amendment to section 11(*n*A) was accompanied by the introduction of the new paragraph 2(4)(g) into the Fourth Schedule to the Act (with the same effective date), which now also allows an adjustment to be made to the remuneration of an employee where such employee makes a refund payment to the employer that could impact the PAYE calculation of such an employee.

The purpose of this article is to take a closer look at the purpose behind, and to explain the application of, the original and recently amended section 11(*n*A) deduction. In addition, this article also considers the impact which the s 11(*n*A) deduction might have on the PAYE calculation of an employee because of the adjustment allowed under the newly introduced paragraph 2(4)(g) of the Fourth Schedule to the Act. The article also evaluates the impact of this new paragraph on employers' Skills Development Levies (SDL) and Unemployment Insurance Fund (UIF) contributions and highlights the type of supporting evidence that an employee could use to prove and substantiate a claim for the section 11(*n*A) deduction.

Impact upon assessment: Section 11(*n*A)

The section 11(*n*A) deduction was introduced to afford an employee who previously included an employment-related award or benefit in taxable income and who is subsequently required to refund such employment-related award or benefit to its employer (or former employer) the opportunity to claim a deduction for such a refund upon the assessment of such employee's income tax return. In the absence of section 11(*n*A), employees were unable to claim any deduction under section 11*(a)* of the Act (also referred to as the 'general deduction formula') since such refunds would not have constituted expenses incurred in the production of income.

The repayment of an employment-related award or benefit could include so much of any amount received by, or accrued to, an employee by virtue of employment in respect of services rendered (or to be rendered) or the holding of any office. These refund payments could typically be triggered when an employee does not adhere to specific employment-related contractual terms and conditions to which the granting of a particular employment-related award or benefit was subjected.

Examples of such refund payments could include, but are not limited to, a sign-on or retention bonus and maternity or sick leave benefits, which were granted to an employee subject to specific employment-related terms and conditions. When an employee is unable to fulfil such pre-determined terms and conditions, the employee will be required to refund their employer (either in part or in full) in respect of such previously received or accrued employment-related award or benefit. Another example that could trigger the section 11(*n*A) deduction is when an employer erroneously overpaid an employee for services rendered and when, upon subsequent discovery of the error, the employee is required to repay the overpaid amount to their employer.

Before section 11(*n*A) of the Act was recently amended, the wording of this provision was problematic in that it only permitted an employee to deduct an amount that was refunded to an employer if such amount "*. . . was included in the taxable income of that person. . .*" [own emphasis added]. However, the wording of section 11(*n*A) has now been amended to explicitly clarify that all refunds of previously received or accrued employment-related awards or benefits will qualify for this deduction in the employee's hands, irrespective of whether such benefit "*. . . was or is included in the taxable income of that person. . .*" [own emphasis added]. This means that the section 11(*n*A) deduction will be allowed during a year of assessment in which the refund is paid, regardless of whether such amount was included in the employee's taxable income during either the same or any previous year of assessment.

"Before section 11(nA) of the Act was recently amended, the wording of this provision was problematic"

Impact on PAYE: Paragraph 2(4)*(g)*, Fourth Schedule

The purpose of paragraph 2(4) of the Fourth Schedule to the Act is to determine the 'balance of remuneration' that remains after specific deductions have been allowed against an employee's 'remuneration' as defined. Such balance of remuneration will be applied by an employer to determine the PAYE liability of an employee, which the employer needs to withhold from the employee's remuneration and pay over to SARS on behalf of the employee. This list of allowable deductions against an employee's 'remuneration' (previously listed as paragraphs 2(4)*(a)* to (f) of the Fourth Schedule to the Act) has now been extended with the addition of the new paragraph 2(4)*(g)* to this list. The newly introduced paragraph 2(4)*(g)* now also allows the following additional deduction to be set off against an employee's monthly remuneration, namely: *". . . any amount referred to in section 11(nA) as is actually refunded to the employer granting the deduction. . .*".

Based on this legislative wording as directly quoted from the Act, it is evident that an amount that was allowed as a deduction in terms of section 11(*n*A) may be allowed to be set off against the employee's remuneration only if such an amount was *"actually refunded"* (i.e. actually paid) by such an employee to their employer. Further, it is important to note that it is a requirement that the employer who receives the refund must be the same person who initially granted the employment-related award or benefit to the employee (or former employee) in respect of services rendered.

The purpose behind the introduction of the new paragraph 2(4)*(g)* into the Fourth Schedule to the Income Tax Act was necessitated by the employees' tax (PAYE) treatment uncertainty, which prevailed in respect of amounts previously paid to employees for services rendered that were subsequently refunded by such employees to their employers due to the non-satisfaction of specific employment-related terms and conditions. Prior to the introduction of paragraph 2(4)*(g)*, there was no legislative authority provided for in terms of the Fourth Schedule to the Act allowing employers to make an adjustment by way of a deduction against an employee's 'remuneration' during a month in which such an employee has refunded or repaid an amount to its employer that was previously subject to employees' tax (PAYE).

Furthermore, cognisance should be taken of the fact that the adjustment allowed to be made in terms of paragraph 2(4) *(g)* to correct the PAYE position due to a refund that was made and that enabled the employee to claim a section 11(*n*A) deduction, would need to be treated as an annual deduction amount in the PAYE calculation—similar to annual receipts such as a bonus or a gain realised upon the vesting of section 8C shares. This effectively means that the paragraph 2(4)*(g)* deduction amount cannot be converted into an annual equivalent amount before it is taken into account in determining the 'balance of remuneration' figure to which the normal rates of tax need to be applied to ultimately establish the correct amount of PAYE.

It is also important to note that the proviso to the new paragraph 2(4)*(g)* of the Fourth Schedule to the Act determines that if the section 11(*n*A) refund amount exceeds the employee's 'remuneration' during the specific month in which it needs to be deducted, such excess amount needs to be carried forward and that it will be allowed as a paragraph 2(4)(g) deduction against the remuneration of the employee in the next succeeding month. This effectively means that the paragraph 2(4)*(g)* deduction cannot create a negative 'balance of remuneration' figure and can only reduce remuneration to an amount of nil. The proviso further determines that the excess may only be carried forward and be deducted in the succeeding month if such succeeding month also falls within the same year of assessment. Hence, any unutilised portion of the paragraph 2(4)*(g)* deduction that could not be utilised in any succeeding month falling in the same year of assessment will not be allowed to be adjusted from an employee's tax perspective; such tax difference will only be corrected upon the final assessment of the employee.

Impact on SDL and UIF contributions

Skills Development Levies (SDL) and Unemployment Insurance Fund (UIF) contributions are both calculated based on 'remuneration' as defined in paragraph 1 of the Fourth Schedule to the Act. These are respectively regulated in terms of section 3(4) of the *Skills Development Levies Act 9 of 1999* and section 6 of the *Unemployment Insurance Contributions Act 4 of 2002*. However, since PAYE is calculated on the *balance of remuneration*, which comprises the 'remuneration' as defined after it has been adjusted with specific allowable deductions as listed under paragraph 2(4) of the Fourth Schedule, which now includes the newly introduced paragraph 2(4)*(g)*, it is important to note that SDL and UIF contributions will not be impacted by any amount required to be refunded to the employer by the employee. This is because such refund received by the employer will not impact the 'remuneration' which such employer paid to its employees, even though a part of that remuneration was recovered by the employer. No legislative provision currently exists allowing for the refund of SDL and UIF, even though a part of the amount of remuneration on which such levies and contributions have been based, has been refunded to the employer.

Supporting evidence

Where an employee's section 11(*n*A) deduction is subject to a compliance inspection, verification or audit conducted by SARS, the employee would be required (in terms of section 31, read with section 40 of the *Tax Administration Act 28 of 2011*) to furnish SARS with satisfactory proof that the amount was, in fact, refunded to the employer and that such an amount was previously included in the employee's taxable income.

Since the employer would be the only person to confirm that the amount was, in fact, received from the employee (or former employee) by way of a refund, it is submitted that the employer needs to provide the employee with some kind of evidence that the amount was previously included in the income of the employee and that it was subsequently repaid to the employer. This type of evidence could, for example, constitute a letter issued by the employer to the employee in terms of which the employer confirms that the section 11(*n*A) amount claimed as a deduction by the employee on its annual income tax return (ITR12) was previously included by the employer in the employee's taxable income (as reflected on the employee's issued IRP5) and that it was subsequently refunded (either in part or in full) to the employer.

Conclusion and take away

In terms of the recently amended section 11(*n*A), it has now been clarified that employees are allowed to claim this deduction for refunding any service-related employment benefit to their employers, irrespective of whether such benefit was included in the same or in any previous year of assessment of such an employee than the year of assessment in which the refund was made.

For employers, it is important to note that when they recover (either in part or in full) any service-related benefits that they have previously paid to any of their current (or former) employees and that have formed part of such employees' taxable income, such recoveries will not impact the SDL and UIF contributions that such employers are required to make. Finally, employers should be cognisant of the fact that they have a responsibility to assist their current (or former) employees in furnishing them with the necessary evidence when such employees are requested by SARS to provide supporting evidence for claiming a section 11(*n*A) deduction on their annual income tax returns.

"employers should be cognisant of the fact that they have a responsibility to assist their current (or former) employees"

15minutes
CPD

UNDERSTANDING THE EU DEFORESTATION REGULATIONS AND THEIR IMPACT ON SOUTH AFRICAN EXPORTERS

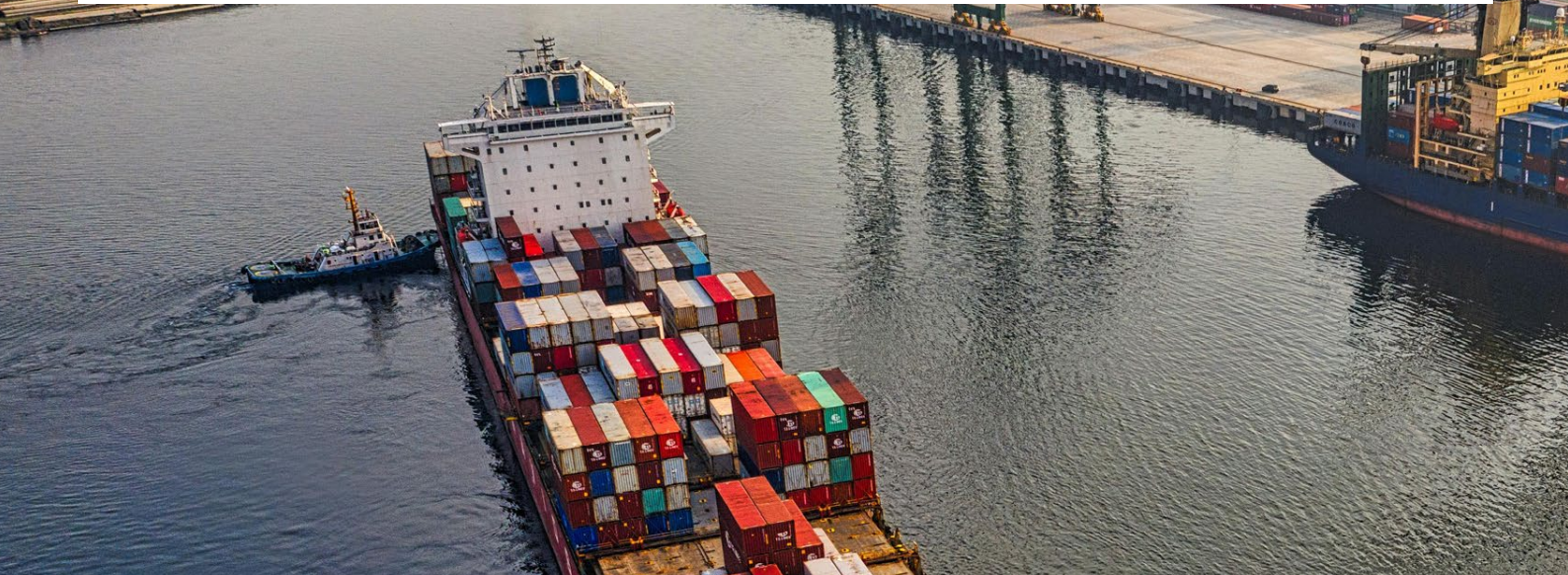
▶ **DR RODRICK VAN ROOYEN,** Customs and International Trade Advisor

South Africa's forestry industry is a multi-billion Rand sector, contributing 9.8% to the country's agricultural Gross Domestic Product (GDP) and 4.9% to its manufacturing GDP. With an export value exceeding ZAR 38.4 billion, it is a key economic driver and a major employer, indirectly supporting over half a million South Africans.

The preservation of indigenous forests is crucial for environmental health and climate change mitigation, especially as these forests store carbon. However, increasing land use pressures, along with economic and social factors, are leading to deforestation for agriculture, urbanisation, and infrastructure development.

According to the United Nations (UN) Food and Agriculture Organization (FAO), nearly four million hectares of African forests are cut down each year—nearly double the global deforestation average. This alarming statistic highlights the challenges faced by developing nations striving for economic growth and improved living conditions for their growing populations.

The European Union (EU) is Africa's largest trade partner, accounting for approximately 33% of African exports in 2020. However, an estimated 10% of global deforestation between 1990 and 2008 was linked to European demand for goods and services. In response, the EU has implemented proactive measures to combat deforestation.



The EU Deforestation Regulation (EUDR) 2023/1115, effective from 29 June 2023, introduces strict requirements for products linked to deforestation, which may impact South African exporters considerably. This regulation includes an 18-month transitional period for large companies and an additional six months for micro to small businesses, building upon the earlier EU Timber Regulation (EU) No 995/2010.

Overview of the EUDR

The EUDR aims to prevent commodities linked to deforestation from entering the EU market. The regulation defines a forest as land exceeding 0.5 hectares with trees higher than five meters and a canopy cover of over 10%. Deforestation is defined as the conversion of forested land to agricultural use, regardless of whether it is human induced. The EUDR specifically targets commodities such as coffee, cocoa, cattle, oil palm, soya, wood, and rubber, as well as their derivatives like chocolate, leather, and paper.

Under the EUDR, operators and traders must prove that their products do not come from land deforested after 31 December 2020 and that they comply with local laws regarding production.

In South Africa, a fragmented regulatory framework governs deforestation. Key regulations include the Management of State Forests Act and the National Environmental Management Act (NEMA), which require environmental authorisations for clearing indigenous vegetation. Local zoning laws, established under the Spatial Planning and Land Use Management Act, may also be applicable when converting forested land to agricultural use.

Countries will be categorised based on their deforestation risks and businesses must establish robust systems to verify that their supply chains are deforestation-free. EU Member States are tasked with imposing penalties for non-compliance.

Compliance requirements for South African exporters

The EUDR significantly impacts South African exporters by requiring them to prove that their products, such as timber, soy, and livestock (to name a few of the products) are not sourced from recently deforested land.

Exporters, such as South African exporters, must demonstrate the exact origin of their products, including geo-mapped locations, to prove that the land used for production was not recently deforested.

EU companies need to conduct thorough due diligence to ensure their suppliers comply with the EUDR regulations, including verifying local laws and practices regarding deforestation. For example, if South African exporters cannot meet these deforestation requirements, they may face difficulties selling their products to the EU market, potentially losing significant export revenue.

Understanding the risk categories

By June 2025, the EU will implement a country benchmarking system categorising nations based on their deforestation risks. South African suppliers must ensure their products meet the EU's deforestation-free criteria to retain access to this vital market.

Compliance with local regulations and obtaining certifications such as those from the Forest Stewardship Council (FSC) can help demonstrate adherence to EUDR requirements.

Potential penalties for non-compliance

Under the EU regulations, non-compliance can lead to several potential penalties for importers, which also pose risks for South African exporters. If an EU importer is found to have imported products that do not comply with the deforestation regulations, they may face substantial fines and legal repercussions. Importantly, these importers may opt to recover these costs from the South African exporter if the source of non-compliance is traced back to the exporter's practices.

In short:

- Products that do not comply with the EUDR cannot be sold in the EU market.
- Financial punishments for non-compliance will be wide-ranging, including punitive fines of at least 4% of a company's EU turnover.

Should these fines be imposed, the EU importers may seek damages from the South African exporter, leading to strained business relationships and potential financial losses for the exporter.

Relevant businesses will also have to publish reports relating to due diligence efforts annually, which means increased public scrutiny and an increased risk of reputational damage.

Certainty in the Customs supply chain

To navigate the complexities of the EUDR, South African exporters can seek to establish certainty within the Customs supply chain. One potential strategy is to investigate whether it would be possible to apply for an advance EU ruling to confirm compliance with the deforestation legislation. By obtaining this ruling, exporters can demonstrate that their practices align with EU standards, securing their sales to EU importers.

- Advance rulings: By proactively engaging with EU authorities for an advance ruling, South African exporters will be able to verify that their Customs supply chains are compliant before shipments are made. This process offers a level of assurance to both the exporter and the importer, enhancing confidence in the transaction and reducing the risk of penalties or shipment destruction.
- Building trust: Securing an advance ruling not only aids in compliance but also builds trust with EU importers. It signals that the exporter is committed to sustainable practices and is willing to adhere to regulatory requirements, which can be a significant competitive advantage in the market.

Challenges in compliance

While the EU imposes strict due diligence requirements, South Africa lacks explicit obligations for companies to prevent, for instance, illegal timber from entering the EU Customs supply chains. However, the duty of care under NEMA mandates that traders take reasonable measures to prevent environmental harm, implying that they should ensure timber is harvested legally. Non-compliance with local environmental laws could result in the inability to conduct business with EU-based companies.

Positive aspects of the EUDR

The EUDR can also present opportunities for South African exporters. By promoting sustainable practices, the regulation can incentivise producers to adopt more environmentally friendly methods to access the EU market. Demonstrating compliance with the EUDR can also help South African exporters attract environmentally conscious buyers in the EU, providing a market differentiation advantage.

Strategies for exporters

To address the challenges posed by the EUDR, South African exporters should consider the following strategies:

1. Conduct legal due diligence: Exporters must verify that their commodities are sourced legally and are not linked to deforestation. This will involve reviewing supply chains and ensuring compliance with local laws.
2. Enhance traceability systems: Implementing robust systems to track the origin of products, including geographic mapping of sourcing areas, will help monitor the origin of products and reduce the risk of non-compliance.
3. Collaborate with suppliers: Close collaboration with suppliers is essential to ensure they understand and comply with EUDR requirements.
4. Obtain certifications: Pursuing certifications like FSC can help demonstrate commitment to sustainable practices and compliance with EUDR standards.
5. Regular health checks: Conducting periodic assessments of operations and supply chains will help exporters identify potential compliance issues early. This proactive approach is essential for aligning with EU expectations and supporting EU importers in meeting their regulatory obligations.

Future Compliance Challenges for South African Exporters:

In the near future, South African exporters will increasingly need to comply with the EUDR and the Carbon Border Adjustment Mechanism (CBAM).

The CBAM will impose tariffs on carbon-intensive goods, incentivising exporters to reduce their carbon footprint. The cumulative effect of these regulations could severely impact South African exporters by increasing compliance costs, limiting access to the EU market for non-compliant products, and necessitating significant investments in sustainable practices to remain competitive.

Failure to adapt to these evolving EU and possible global standards may jeopardise South African exporters' ability to trade successfully and profitably in the EU and the rest of the world.

Conclusion

The EUDR presents both challenges and opportunities for South African exporters of high-risk commodities. Understanding compliance requirements and implementing effective strategies will be crucial for maintaining access to the European market.

By prioritising legal due diligence, enhancing traceability, and obtaining relevant certifications, exporters can navigate the complexities of EUDR and contribute to sustainable agricultural practices. Regular health checks will further assist in ensuring compliance, benefiting both exporters and EU importers.

"To navigate the complexities of the EUDR, South African exporters can seek to establish certainty within the Customs supply chain"

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