Briefing to Standing Committee of Finance

Draft Taxation Laws Amendment Bills, 2012

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national treasury
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National Treasury
REPUBLIC OF SOUTH AFRICA

Overall 2012 Tax Process

- February 2012
  - Budget Speech
  - Release of Budget Review
- Monetary Rates and Threshold Bill (still pending within the National Council of Provinces)
  - March release
  - May briefing/hearings
  - June National Assembly passage
- Taxation Laws Amendment Bills, 2012
- Conclusion of year
  - Gambling Tax Bill release
  - Retirement Discussion documents (including Post-Retirement Annuity Bill dialogue)

2012 Budget Tax Objectives

- The 2012 tax proposals support a sustainable fiscal framework over the medium term, while facilitating economic growth and a more competitive economy
- The proposals seek to retain the balance in the system
  - By promoting fairness within the tax system so that tax applies according to each person's economic means
  - Removal of blockages so that tax does not impede otherwise commercial transactions
  - Anti-avoidance so as to prevent an undue drain on the fiscus (which will eventually create an upward pressure on overall rates)
- In terms of the budget, tax revenues must be maintained to fund key expenditure priorities, while ensuring that public debt and debt-service costs are contained

Tax Bill Process Requirements

- Twin Bills
  - The main bill (i.e. the money bill/section 77 of the Constitution) covers issues relating to the tax liability calculations (e.g. the tax base and the rate)
  - The administrative bill (section 75 of the Constitution) covers incidental matters, such as enforcement, compliance, timing of payments and penalties)
- Money Bill
  - The money Bill may only be amended after formal introduction through the formal process required by the Money Bills Amendment Procedure and Related Matters Act, 2009
  - In order to facilitate consultation, the annual tax Bills are always brought before the Standing Committee on Finance before formal introduction (where extensive changes are routinely made)

TLAB Process

- 6 July: Taxation Laws Amendment Bills released on website (and public request for comment)
  - 1st and 2nd Bills
  - Explanatory memorandum
  - Media statements
- 13-30 July: Meetings with special group for items of concern (e.g. REITs, banks and insurers)
- 1 August: Individual and Savings Taxpayer workshop
- 31 July: Presentation before the Standing Committee on Finance
- 1-2 August: Business and International Taxpayer workshops
- 3+ August: Further meetings and internal review
- 22 August: SCOF public hearings
- 4 September: NT & SARS response before Standing Committee on Finance
- 11 September: Minister formal introduction before National Assembly

Main Themes of TLAB (Individual)

- Minor issues (and carryovers from prior year)
- Individuals
  - Completion of medical credit regime
- Savings
  - Relief for annuities funded by taxed contributions
  - Completion of clean-break of pensions upon divorce
- Employment
  - Streamlining variable employment payments (e.g. commissions)
  - Employee use of employer-provided rental vehicles

Main Themes of TLAB (Business)

- Debt/share distinction
  - Outgrowth of section 45 process
  - Classification of instruments
- Merger and Acquisitions
  - Prevention of value mismatches
  - Rollover for share-for-share swaps
  - Deductible interest for debt incurred to finance share takeovers
- Tax relief for debt cancellations
- Financial intermediaries
  - Mark-to-market for banks and long-term insurers
  - REIT flow-through treatment
  - Short-term insurer reserves (and reclassification of disguised investment contracts)
  - STT relief for market-making in derivatives

Main Themes of TLAB (International)

- Offshore reorganisation
  - Expanded offshore reorganisations
  - Tightened participation exemption
- Disposals upon loss of tax residence
- Gateway
  - Easing of HQ criteria
  - Relief for foreign funds managed by local South African managers
- Offshore investment
  - Relief from effective management and transfer pricing rules in the case of foreign subsidiaries operating in “normal” taxed countries
  - Currency relief for certain cross-border loans representing investment
- Inbound withholding
  - Completion of the cross-border withholding interest regime
  - Enactment of the cross-border withholding royalty regime

Individuals, Employment & Savings

Medical credits - Background – current position (Sections 6A, 6B and 18)

Regime driver →	Taxpayer	Taxpayer, spouse, child	All others
Type of deduction ↓	65 years + older	Person with a disability	All others
Standard monthly medical scheme fees	- R230 monthly tax credit for taxpayer & first dependant - R154 monthly tax credit for each additional dependant		
Excess medical scheme fees	Deduct 33.3% of the amount by which medical scheme fees exceed 3 x the credit		Deduct 25% of the amount by which the aggregate of the medical scheme fees that exceed 4 x the credit and all qualifying medical expenses exceed 7,5% of taxpayer's taxable income
All qualifying medical expenses	Deduct 33.3% of all qualifying medical expenses		

- It is proposed that the new regime be effective in respect of years of assessment commencing on of after 1 March 2014.

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Exemption for Compulsory Annuity Income Stemming from Non-Deductible Retirement Contributions (Sections 10C,11(n),paragraphs 5(1) and 6(1)(b) of the Second Schedule)

- Non-deductible contributions will be exempt from income tax in respect of retirement interests, regardless of whether these interests are withdrawn as part of a lump sum or by way of compulsory annuity.

- As a default rule, the proposed exemption will apply on a "first come, first serve" basis.

- Lastly, the exemption will apply regardless of whether the entire retirement interest or only two-thirds thereof was used to purchase the annuity.

Completion of the "Clean Break Principle" when dividing Retirement Interest in Divorce
(Definition of "formula C" in paragraph 1,paragraphs 2(1)(b)(iA), 2A and 2B of the Second Schedule)

Current tax regime

SCENARIO	TAX PAYABLE
Clean-break divorce orders issued pre - 13 September 2007 + election on or after 1 March 2009	No tax payable
Clean break divorce order issued 13 September 2007 onwards + election on or after 1 March 2009	Non-member taxpayer
No clean-break or no election pre-fund exit (death, resignation or retirement)	Member taxpayer (member with a right to recover) on the portion of the pension/retirement interest that is paid to the non-member upon death, resignation or retirement.

Completion of the "Clean Break Principle" when dividing Retirement Interest in Divorce (Definition of "formula C" in paragraph 1,paragraphs 2(1)(b)(iA), 2A and 2B of the Second Schedule)

Proposed tax regime: Accrual or receipt on or after 1 March 2012

SCENARIO	CURRENT DISPENSATION		RESULTS OF PROPOSED AMENDMENTS
	Election in time on/after 1 March 2009	**No election on/after 1 March 2009 or no clean break**	**Election or no election; whether the fund has incorporated clean break or not**
Divorce pre-13 September 2007	No tax	Member taxed	No tax
Divorce on/after 13 September 2007	Non-member taxed	Member taxed	Non-member taxed

Streamlined Timing for certain forms of Variable Cash Remuneration (Sections 7B and 23E)

- The obligation to withhold PAYE arises when an employer has an unconditional liability to pay an employee (e.g. accrual).

- The current accrual/receipt determination for employers is often hard to track on a monthly basis (e.g. annual leave, bonuses and commissions); this problem often gives rise to unnecessary disputes and penalties

- It is proposed that in the case of variable remuneration, the timing of receipt of the listed items will be deemed to occur only when the underlying amount is <u>paid</u> by the employer to the employee.

- Employer deductions will also be moved to the same payment date so employer deductions match employee income so as to ensure a proper "push-pull" in the system.

Rented Employer–Provided Vehicles (Paragraph 7 of the Seventh Schedule)

- Employer-provided company-owned vehicles + **private use** in conjunction with business use = taxable fringe benefit

- However, the calculation of the value of the employee's fringe benefit in respect of any private use, assumes that the vehicle is owned or purchased (financed) via a finance lease by the employer.

- The calculation is excessive if the employer rents the vehicle pursuant to an operating lease.

- It is proposed that in instances where the vehicle provided via an operating lease from an unconnected third party at an arm's length price, the value of the benefit for the employee is the actual leasing cost to the employer.

Business (General)

Importance of Rules Relating to Debt: Need for a Careful Balance

Fiscus

- Tax impact
  - Payor can deduct interest
  - Payee must include
  - Inclusion not relevant in the case of exempt entities (e.g. foreign residents and pension funds)
- Risk
  - Complete erosion of the tax base
  - Effective extension of exemptions into the company sphere

Business

- Need for conduits
  - REITs
  - Other investment funds (e.g. hedge funds)
- Need for flexibility
  - Many instruments have a mix (embedded features)
  - Lack of standard finance, thereby requiring alternatives

Debt Versus Shares: Key Commercial Features

Debt

- Redeemable within a reasonable period
- Fixed Claim on Cash Flows (e.g. based on time-value of money)
- High priority on cash flows/collateral often required
- No management control over payor unless default

Shares

- Generally non-redeemable
- Variable claim on cash flows (payments based on profits)
- Low priority on cash flows/no Collateral required
- Management control.

Generic Options for Tax Systems

- Form
  - Label (essentially taxpayer elective)
  - Commercial law (again essentially elective in South Africa)
- Anti-avoidance approach
  - GAAR not really designed for this issue (more about preventing multi-step transactions)
  - Business purpose issues (business purpose of overall transaction versus debt/equity choice)
- Features
  - Key features (redemption, yield, subordination)
  - Often a combination as opposed to a single feature
  - Judicial or administrative discretion
- Thin-cap ceilings
  - What level (current 3:1 way too high)? May depend on industry
  - European EBITDA approaches

New Debt/Share Paradigm

Label	Features	Tax Impact Issuer	Tax Impact Holder
Debt	Pure amount owing	Deductible	Ordinary revenue as interest
Debt with hybrid yield	Non-redeemable or convertible by issuer	No deduction on applicable yield	Dividends Tax on applicable yield
Hybrid debt			
Hybrid or third-party backed shares	3-year redeemable or guaranteed by third parties	No deduction	Ordinary revenue
Non-equity shares	Full participation with redemption features	No deduction	Dividends Tax but not reorganisations and certain other three year rules (e.g. 3-year CGT rule)
Equity shares	Full participation profits with no redemption features	No deduction	Dividends Tax and all equity shares rules

"Hybrid Debt Instruments" Proposal (Sections 8F and 8FA)

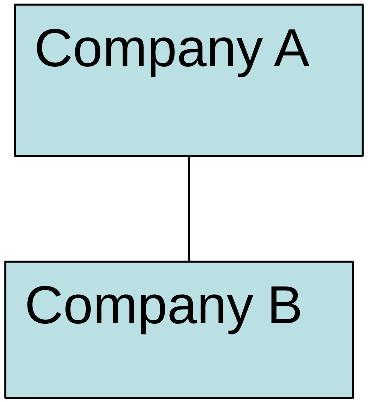
- Two-fold regime
  - Rules focusing on the nature of the instrument itself (the corpus)
    - The proposal characterises the debt as equity if the debt has –
      - features indicating that redemption is unlikely within a reasonable period (i.e. 30 years);
      - Redemption is conditional upon solvency or liquidity of the issuer; or
      - features requiring a conversion into shares
  - Rules focusing on the nature of the yield
    - The proposal characterises the yield as dividends if the yield is
      - not determined with reference to the time value of money
      - the yield is conditional on solvency or liquidity
      - The yield is payable in shares
- 2014 effective date

Suspended Interest/Royalty Deductions
Sections 23L

- The tax system largely looks to actual payment/receipt and incurral/accrual partially to match accounting/tax and partially to prevent avoidance
- Interest
  - Section 24J spreads income/deductions based on economic yield versus payment (accrual vs. realisation/payment)
  - The rule operates as an avenue for avoidance with exempt payees
- Royalty
  - Royalties are incurred before payment
  - However, withholding is based on cash under the revised rules
- Proposal
  - Interest and royalty deductions are deferred until cash payment (or due and payable) if an exempt payee is involved (e.g. pension fund and foreign investors)

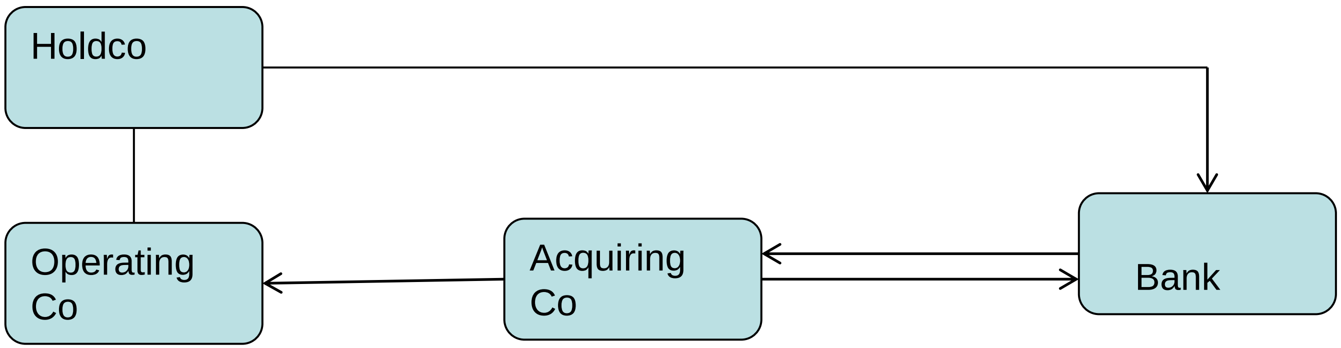
Revised Hybrid Equity Instrument Proposal (clause 11 of Bill substituting section 8E) : Example

Example of proposed results



- **Facts**:
  - Company A subscribes for preference shares redeemable in 3 years + 1 day, from Company B, a foreign entity. The only assets held by company B are bonds.
  - The dividends ("economic interest"0 payable are based on JIBAR + 3%, per annum. Furthermore, the repayment of the preference share capital is guaranteed by Company B's bonds.
- **Result**:
  - Notwithstanding that the preference share is redeemable **after** 3 years, they are still treated as dividends despite the economic likeness to interest.

"Third party backed/guaranteed shares" Exemption Example



- **Facts**:
  - Acquiring Company acquires ordinary shares in Operating Company with funding from a bank. Acquiring Company issues preference shares to the bank as a funding mechanism.
  - As security for the loan amount, Holding Company of the Operating Company issues a guarantee in favour of the bank that is exercisable upon default by the Acquiring Company on its preference share obligations
  - **Result**: Funding received by Acquiring Company is utilised to acquire shares in a Operating Company. The Holding Company of Operating Company guarantees performance by Acquiring Company on the preference shares issued. Consequently the deeming rules do not apply, and the dividends received by the funding bank retain their nature

Substitutive share-for-share transactions (New Section 43 and paragraph 78 of the Eighth schedule)

Shareholder of Company A

Base cost of new shares
= base cost of old shares
in Shareholder's hands

Substitution, subdivision or consolidation of shares held by Shareholder.

100%

Company A

NOTE:

- It is proposed in the new section 43 that share recapitalisations should have roll-over relief.
- This proposal should also be extended to apply to shares held as trading stock.
- However, this rule will not apply in respect of share to debt conversions and shares that have debt features (i.e. hybrid shares).

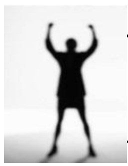
Value Mismatches: Reasons for Change (Sections 24B, 24BA, 24BB, 40CA and 41(2))

- Provisions of section 24B generally assume that asset-for-share transactions are performed on a value-for-value basis
- Tax planning schemes with uneven exchanges allow for value to be transferred without allegedly triggering the appropriate tax due
- Debt issues can result in similar mismatches
- Value shifting anti-avoidance rules contained in the CGT regime have proven to be ineffective in regards to companies
- Under the proposal, excess value shifts will result in capital gain or Dividends Tax

Value Mismatches

Current tax consequences

B



1 1) B transfers assets with a market value of R1m to Company ABC.

ABC

2 2) ABC issues 100 000 shares with a market value of R1.5m as consideration for the assets

B and ABC are not connected persons and value shifting rules will not apply. Under the “barter” principle. The base cost of the shares in B’s hands will be R1m (the market value of the assets transferred.

Proposed tax consequences

B

1 1) B transfers assets with a market value of R1m to Company ABC.

ABC

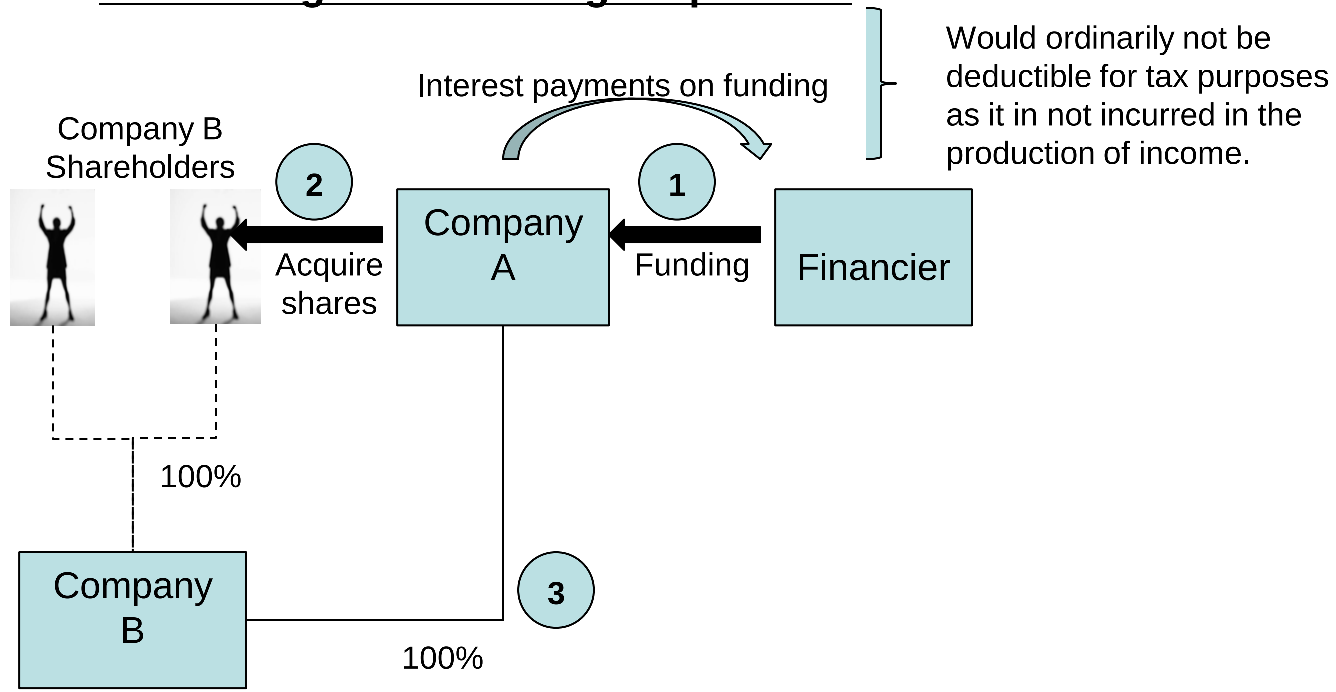
2 2) ABC issues 100 000 shares with a market value of R1.5m as consideration for the assets

B will deemed to have received an in specie dividend of R500 000, representing the value shifted to him (whether connected or not).

ABC would be liable for Dividends Tax as a dividend *in specie*.

Debt Financed Acquisitions Example (Section 24O and 23K)

Controlling Shareholding Acquisition



It is proposed that the interest incurred on funding used to acquire a controlling interest in an entity. Such controlling interest is benchmarked at 70% (in line with the "controlling group company" definition). However, deductions will be subject to SARS discretion in the same fashion as indirect section 45 acquisitions

Debt Reduction/Cancellations (Sections 8(4)(m), 20, paragraphs 3(b)(ii), 12(5), 13(1)(g), 20(3)(b), and 56(2) of the Eighth Schedule) Background/ Reason for change

- **Background**
  - Income Tax Act has various provisions dealing with debt cancellations, forgiveness and/or reductions
  - These provisions basically subject the amount of the debt cancellation/forgiveness/cancellation to tax by inclusion as revenue or capital proceeds

- **Reasons for change**
  - With the recent global financial crisis, the number of companies that are experiencing financial distress have increased
  - Relief for these companies is deemed appropriate to encourage risk taking and entrepreneurship
  - The tax system appears to discourage risk-taking and view insolvency as a failure, thereby impeding the recovery of companies and other parties in financial distress
  - Relief from taxes owed can even give rise to a subsequent tax liability

Debt Reduction/Cancellations
Capital Debt Relief System

- Applies where the debt is used to finance capital assets
- Tier 1
  - Base cost reduction (the capital debt reduced or cancelled will firstly reduce the base cost of the capital assets held by the debtor)
- Tier 2
  - Reduction of assessed capital losses (if the amount cannot be traced to an asset so held or there is an excess after taking into account tier one, the debt will be applied to reduce the capital losses of the debtor).
  - If the base cost and the capital assessed losses are fully reduced, no further capital gains arise

Debt Reduction/Cancellations Proposal:"Ordinary/Revenue" Debt Relief System

- Applies where the debt was used to trading stock or prior section 11 deductions
- Tier 1
  - Cost price reduction (the debt reduced or cancelled will firstly be applied against the cost of the depreciable assets of trading stock of the debtor).
- Tier 2
  - Reduction of assessed losses (if the debt cannot be traced to trading stock, the balance is applied against the assessed losses of the debtor).
- Tier 3
  - Ordinary revenue or recoupment (lastly, any excesses will result in ordinary revenue and will be subject to normal tax in the debtor's hands).

Exemption for Government Transfers and Subsidies

Applicable provisions: sections 10(1)(zA), 10(1)(zH), 10(1)(y), new section 12P, 23(n); paragraphs 20(3)(c) and 64A of the Eighth Schedule

- **Background**
  - National funding (by way of a grant) is allocated to various governmental entities and to the private sector.
  - The Income Tax Act provides an exemption for certain grants but not all grants under tax legislation or that are approved by Ministerial notice.
- **Reasons for change**
  - The income tax rules for grants require further streamlining
  - Although a tax exemption exists, the policy rationale for exempting certain grants (and not others) is unclear
  - As a general rule, grants should be exempt from income tax where a grant is deemed to be an incentive and not payment (in full or in part) for goods and services provided to the government
- **Proposal**
  - Shift of presumption in favour of exempting rather than taxing genuine grants
  - Exemption covers grants in a revised and extended legislative list
  - Exemption can also be achieved via approved by Ministerial notice
  - Exemption will now include provincial grants

Anti-Double Dipping Rules for Government Transfers and Subsidies

- Policy
  - Taxpayers should not be allowed to obtain tax offsets (e.g. deductions) for exempt grants
- Proposal
  - Exempt grants received in kind (as assets or services) will have a zero tax cost
  - Purchases funded with exempt grant will result in:
    - Reduction of tax cost; or
    - Reduction of deductions

Technical Correction: Cessions

- 2011 legislation
  - All cessions generate ordinary revenue for a company payee (despite the general exemption for company-to-company dividends)
  - Ends a variety of asset/income for dividend swap schemes (including disguised interest schemes involving CISs)
  - Problem: All dividends are transferred by way of cession because all shares transferred by way of cession
- 2012 Proposal
  - Taxpayer must “hold” the share
  - Word hold can be misread as only covering registered share owners
  - Real goal: Taxpayer must have an underlying profit/loss stake in the share when accruing the dividend
  - Second option: Taxpayer sellers of cessions when they retain an interest in the underlying share

Business (Financial Intermediaries and Vehicles)

Annual Fair Value Taxation: Background (sections 24J(9); new section 24JB)

- Income tax systems generally impose tax on a realisation basis
- A growing trend is towards notional realisation of gains and losses in respect of liquid financial instruments. i.e.
  a. Listed and over-the-counter shares
  b. Listed and over-the-counter bonds and
  c. Derivatives in respect of the above
- Accounting (IFRS IAS 32/39 or IFRS 9) is the key driver behind this trend.
- Banks and other large financial institutions have adopted this method in their systems and expect similar tax treatment.
- Two problems
  - Compliance burden of maintaining two separate systems (one for IFRS and one for tax)
  - Audit much harder to follow books no longer have any bearing to tax (e.g. extensive reconciliations)

Annual Fair Value Taxation: Background

- IFRS fair value assets will be taxed annually on gains/loss:
  - Trading assets; and
  - Assets to be treated at fair value to prevent mismeasurement
- The new rules essentially place financial assets and liabilities into an IFRS framework for all gain/loss purposes
- The new regime applies to:
  - Banks (including local branches of foreign banks)
  - Brokers (i.e. authorised dealers)
- The new regime does not apply to unhedged intra-group derivatives
- A one-off transitional charge will apply
  - Transitional charge to be spread over 4 years
  - The charge applies to the deferred tax difference currently existing between tax and accounting

Mark-to-market of long term policyholder funds (Sections 29A and new 29B)

Background

- Insurers as “tax” trustees of policyholder investments must not only collect income tax but must also properly allocate tax to each policyholder investment.
- Insurers achieve this allocation amongst policyholders by applying continual mark-to-market approach (subtracting notional tax from the gain or loss policyholder investments on a continual basis)
- Any change in effective capital gains tax rates for policyholder funds creates complications for insurers as trustees (especially if higher rates apply only from a later date)

Proposal

- The realisation principle for the taxation of disposals is becoming outmoded for financial institutions, including insurers.
- It is proposed that a deemed disposal and re-acquisition approach be applied to all policyholder fund assets that mimics mark-to-market taxation
- The character of the gain/loss remains unchanged (section 9C unaffected)
- The gain or loss is spread over 4 years
- A transitional charge exists as of close of February 2012 (this too is spread over 4 years)

New Deduction Formula for Long-term Policyholder Funds

- Old Individual Policyholder formula
  - $\underline{I + R + F}/I + 2.5R + 4.75F + 4.75L$
- Purpose
  - Deductions for indirect (and selling/administration expenses) should be limited to amounts dedicated to the production of gross income
  - Done on a formula basis as opposed to a “purpose” basis
  - The old formula took into account an implicit capital gain charge
- New formula
  - Taxable income; over
  - Taxable income plus dividends (less withholding taxes) plus capital gains without partial inclusion

Real Estate Investment Trust (REITs): Background (sections 1 (“REIT” definition) and 25BB)

- Property investors directly invest in immovable properties for rental streams or indirectly through property investment entities
  - A steady rental stream acts as a substitute for interest income, and growth in the underlying property as relatively stable method of achieving appreciation.
  - Ownership in property investment schemes is highly liquid
- Two main types of property investment schemes exist that operate as international REIT – the Property Unit Trust (PUT) and Property Loan Stock (PLS)
  - Both the PUT and the PLS are subject to the same listing requirements for the purposes of the JSE.
  - Only the PUT is subject to FSB regulation
- Two different tax dispensations
  - PUTs have an explicit flow through of rentals and an exemption for capital gains
  - PLSs have a “homemade” flow-through via dual linked units with debenture interest
  - Debenture interest really operates as disguised “deductible” dividends that will violate the new debt equity rules (sections 8F and 8FA)

REIT Proposal

- It is proposed that a unified approach for the property investment schemes will be adopted for financial regulatory and tax purposes.
  - The new entity will be called a Real Estate Investment Trust (REIT) in line with the international norms.
  - The purpose of the proposed REIT regime is to treat investors roughly similar to the situation in which these investors invested in immovable property directly.
- New regime
  - All distributions will be deductible if the entity mostly (i.e. 75%) generates rental and similar income (or REIT dividends from subsidiaries)
  - Capital gains from immovable property will be exempt
  - Financial instruments will generate ordinary revenue (other than REIT interests)
  - REIT classification to be maintained by JSE rules
- Coverage
  - Only listed PUTs and PLSs plus their subsidiaries
  - Unlisted PLSs to be the subject of discussion in 2013

Short-Term Insurance Reserves
sections 1 “gross income”, 28(2), (5), (6) and (9)

Background

- Short-term insurers are highly regulated by the FSB so that the public has certainty that actual funds are in reserve to pay claims. These deviations justify a deduction for reserves when most entities are not allowed to deduct reserves (section 23(e))
- The tax rules associated with short-term insurers are partially aligned with the system of regulatory reserves.
- It is proposed that the tax system will use the regulatory regime as a comprehensive starting point for all reserve calculations (especially since SAM no longer favours “over-reserving”).

Proposal

- The proposed tax rules will have an enhanced co-ordination with FSB reserving (and better co-ordinate the specific reserving system and the general tax principles of gross income and deduction)
- The new rules will basically follow FSB reserving, but for
  - Unapproved reinsurers
  - Formula cash-back cash reserves (but best estimates are ok)
- SARS discretion for denying deductible reserves will be removed

Investment Contracts Disguised as Short-Term Insurance (new section 28A)

- Current law
  - Under the general deduction formula, taxpayers can deduct premiums paid or incurred for risk insurance.
  - The deduction for “risk” insurance premiums is to be contrasted with payments for investments products e.g. endowment policies, bank deposits and debt instruments
- Investments products should not be deductible because they represents a conversion of cash into investment assets.
- The proposal seek to remedy the distortion (i.e. the unintended deduction) by following IFRS standard
  - Contracts viewed as investment insurance contract under IFRS will not be allowed as a deduction by the insured policyholder
  - Repayment of non-deductible contributions will not includible by the insured policyholder
  - However, section 28 reserving will continue to be allowed for short-term insurer (query whether these policies should be within a short-term insurer from a regulatory perspective)

Securities Transfer Tax (STT)

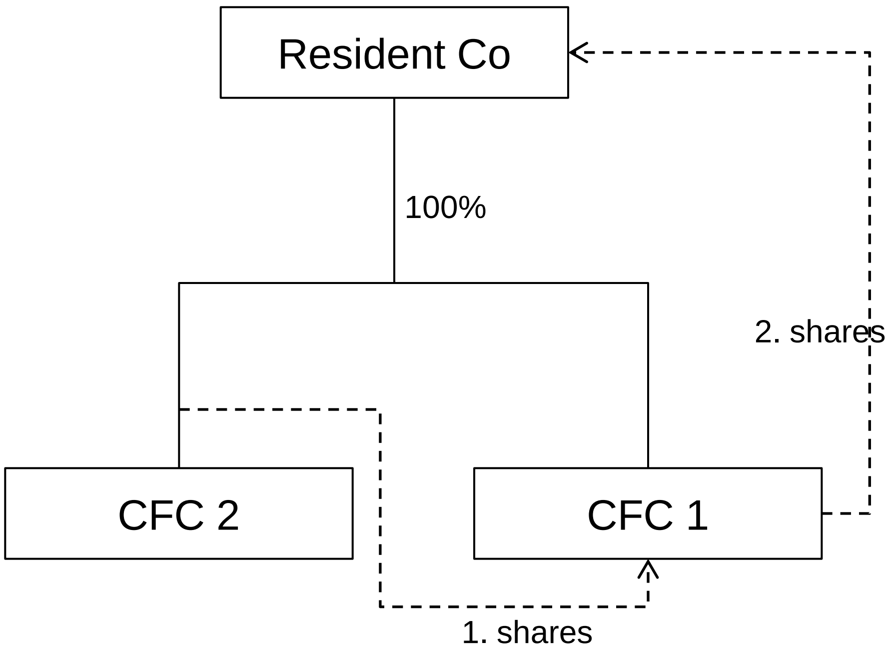
- General rule
  - STT applies at a rate of 0.25 per cent.
  - This tax generally applies when a person acquires beneficial ownership of a share (i.e. STT exemption exists if the broker acquires the share as principal)
- Role of brokers
  - All shares on the JSE must be traded through JSE members (i.e. stock brokers)
  - Brokers can act as agents or as principal (but the JSE rules prevent banks from acting as brokers)
- Broker exemption has long existed for brokers acting as principal so as to promote liquidity but any transactions blur the agent/principal distinction with
  - the broker being the owner with the risk passed on via derivatives
  - Banks additionally have indirect control over shares in brokerage subsidiaries with indirect control over the ability to sell
- The new rules will allow for brokers as market-makers in derivatives, thereby ensuring that the principal/agency principal is otherwise maintained

International
(Outbound and Inbound)

CROSS BORDER REORGANISATIONS
clauses 80(1), 82(1), 83(1), 84(1) and 85(1)

- Purpose or reorganisation rules:
  - Current rollover of gains and losses (with deferred gains/losses potentially triggered at later stage)
- Current forms of restructuring transactions:
  - Asset for share transaction
  - Amalgamation transaction
  - Unbundling transaction
  - Liquidation distributions
- Proposed coherent demarcation of each reorg type into the following broad categories:
  - Domestic to domestic transactions
  - Inbound transactions
  - Foreign to foreign transactions

ASSET FOR SHARE TRANSACTION
clause 80(1); section 42



NB: Revision limited to foreign to foreign share for share transactions

QUALIFYING CRITERIA:

Assets:

- Equity shares
- Capital asset
- Gain or breakeven

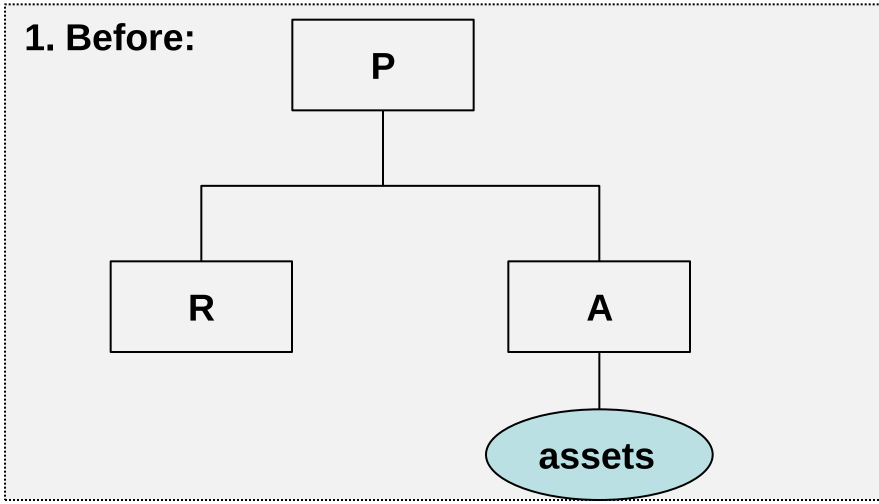
Parties BEFORE transaction:

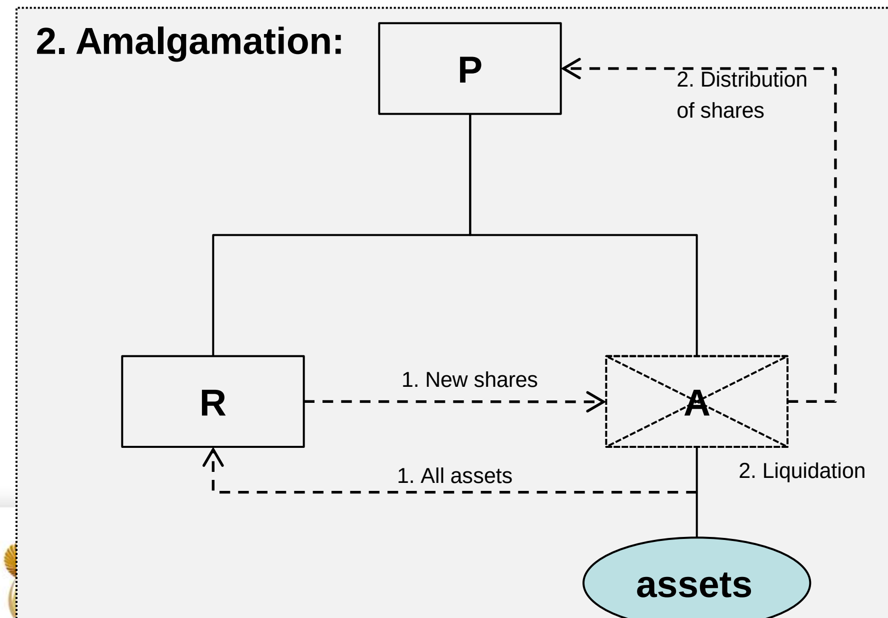
- Transferor and Transferee same section 1 group
- Transferee must be CFC in relation to same group

Parties AFTER transaction:

- 50% of Target owned by R or Resident's group [maintain for 18 months]; or
- All equity shares of Transferee owned by Resident or Resident's group [maintain for 18 months]

AMALGAMATION TRANSACTION
clause 82(1); section 44





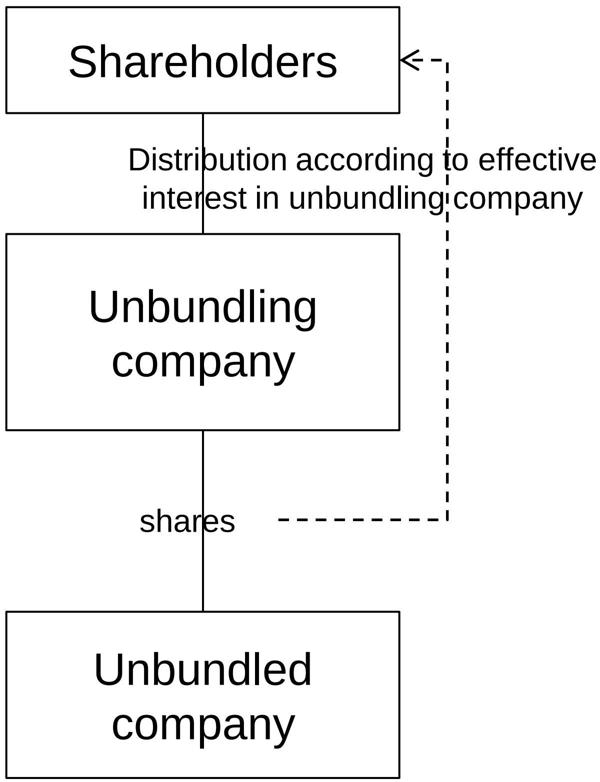
Qualifying criteria (inbound and foreign to foreign):

1. Amalgamated company [A] disposes all its assets to a resultant company [R] in exchange for equity shares or non tainted liabilities of A
2. Shares in “A” held as capital assets
3. Relief only available to “A”s assets that are equity positive or breakeven
4. “A”s existence terminated

Additional criteria for foreign to foreign:

1. BEFORE transaction A and R must be members of same group of companies **and** R must be CFC in relation to same group.
2. AFTER transaction, > 50% of equity shares in R must be held by Residents

UNBUNDLING TRANSACTION
clause 84(1); section 46



Qualifying criteria (inbound and foreign to foreign):

- Resident shareholder must form part of same group as Unbundling
- Non resident shareholder must be CFC in relation to a Resident that forms part of same group as Unbundling

Before test:

- Unbundled company > 50% owned by Unbundling company
- Unbundled shares held as capital assets
- If Unbundling is a non-resident, it is a CFC in relation to a Resident that forms part of group as that Unbundling

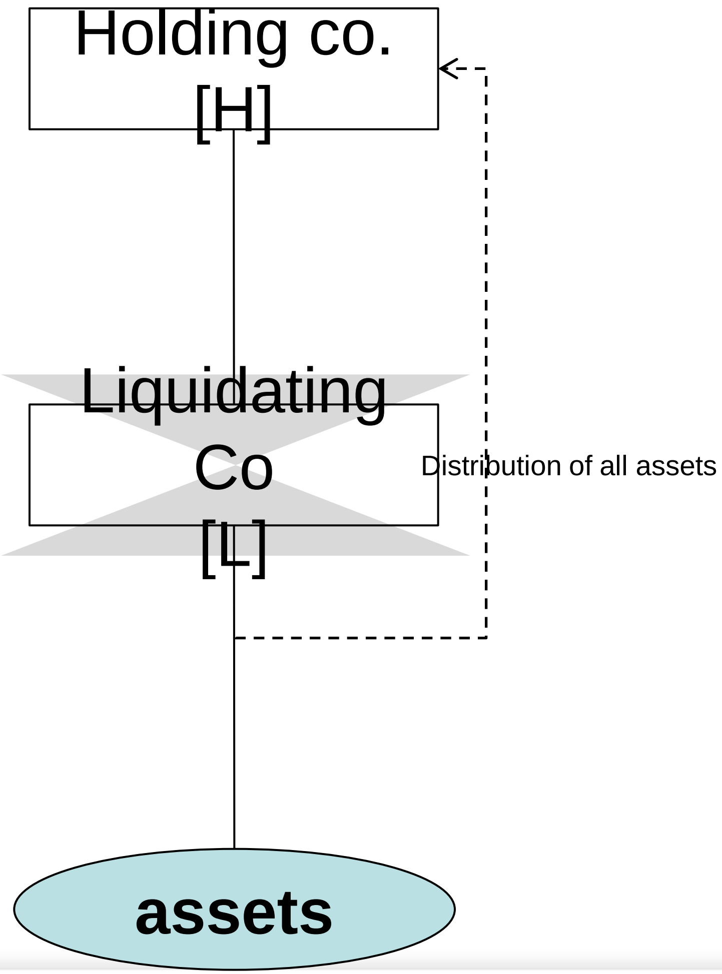
After test (Unbundling is non-resident):

- > 50% equity shares in Unbundled company held by Residents

Disqualified persons:

- After transaction ≥10% held by non-residents other than CFC

LIQUIDATION DISTRIBUTION
Clause 85(1); section 47



Qualifying criteria (inbound and foreign to foreign):

- If H is Resident, it forms part of same group L
- If H is non-resident, it is a CFC in relation to a Resident

Before test:

- Shares in L held as capital assets

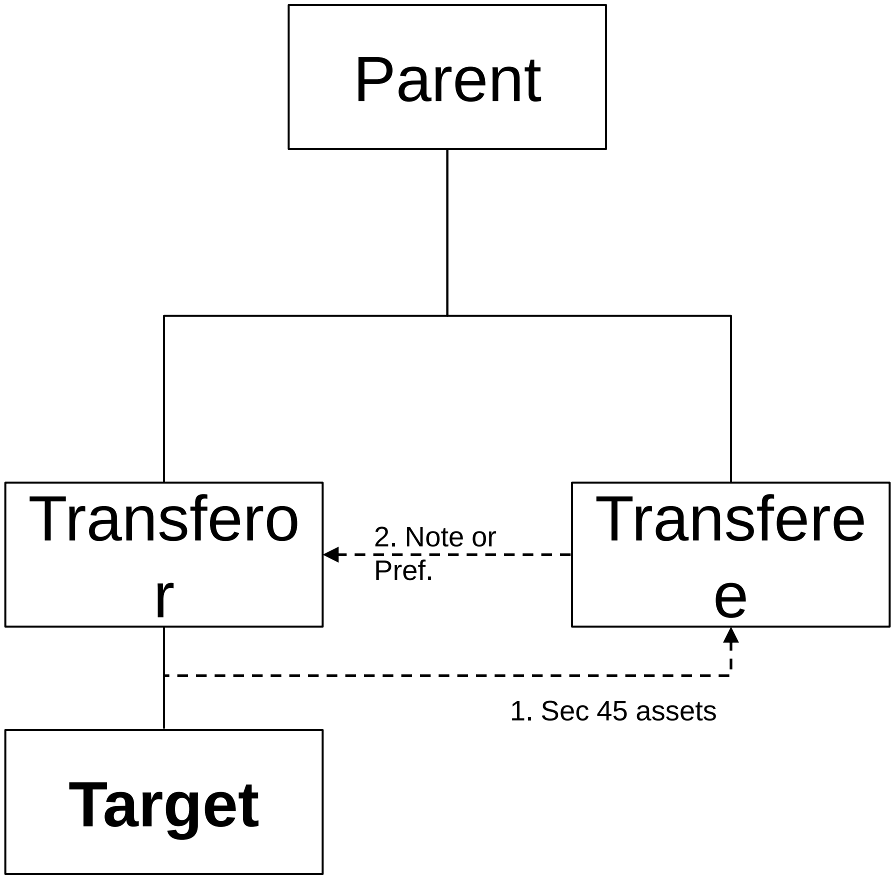
After test if H is a CFC:

- > 50% shares in H are held by Residents

Relief limited to gain or breakeven assets

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CFC INTRA GROUP TRANSACTION
Clause 83(1); section 45



Qualifying criteria [inbound and foreign]:

- Asset transferred must be equity shares held as capital assets
- Transferee must acquire assets in same character

Before and After test:

- Transferee and Transferor forms part of the same group of companies
- Transferee is a Resident or CFC in relation to a resident

Relief limited to gain or breakeven assets

CAPITAL GAINS PARTICIPATION EXEMPTION
Clause 133(1); paragraph 64B

- Past position:
  - No rollover relief for offshore reorganisation
  - CFC restructuring entitled to capital gains tax participation exemption (and other ancillary exemptions)
- New position:
  - Rollover rules extended to CFC restructurings
  - Capital gains tax participation exemption limited to cash disposals to independent third party and HQ disposals
- Qualifying criteria for non HQ disposals:
  - 10 per cent participation held for at least 18 months
  - Disposal to independent third party
  - Disposal for full value consideration [other than shares] to prevent disguised value shifts
- Qualifying criteria for HQ disposals:
  - 10 per cent participation [blanket exemption]

TAX UPON CEASING TO BE RESIDENT: Overturning Tradehold Decision (section 9H)

- **General principles:**
  - Ceasing to be a resident (migration) triggers CGT (exit charge) on deemed disposal of all assets at market value
  - The exit charge is triggered day before the cessation of residency
  - Exit charge cannot be neutralised by DTA
- **Reason for change:**
  - Tradehold case decision that the Luxembourg DTA applied to deemed disposal [no reference to timing of deemed disposal]
  - Align exit charge to international precedent
- **Proposed legislation:**
  - Year of assessment of migrant deemed to end day before migration. A new year of assessment commences on day of migration
  - Natural person emigrant deemed to dispose all assets at market value day before migration and reacquired at market value on day of migration
  - Corporate emigrant deemed to have distributed all its assets as distribution in specie for market value on day before migration. Shareholder deemed to have disposed shareholding on same day

RATIONALISATION OF WITHHOLDING TAXES
clause 72(1) and 75(1) in respect of sections 35 and 37J through 37N

- **Current procedures and timing for withholding taxes:**
  - Non-residents are subject to withholding tax when receiving royalties, interest and dividends
  - Dividends tax was introduced on 1 April 2012;
  - Interest withholding tax will come into effect on 1 January 2013
  - Procedures and timing rules for royalties and interest not aligned to well settled rules applicable to dividends
- **Proposed alignment of royalty and interest WHT to dividends tax:**
  - Withholding tax rates (15%)
  - Liability to withhold
  - Timing of tax payments to SARS
  - Refund mechanisms and declarations
  - Currency translation rules
  - Clarification of exemption of Government paid interest

REMOVAL OF CFC EXEMPTION FROM INTEREST AND ROYALTY WITHHOLDING TAX
Clause 22(1)(c) and 22(1)(k), and clause 75(1) in respect of sections 37J(1) and 37L(1)

- Current system:
  - Payment of royalty and interest by a resident to a CFC are exempt
  - CFC passive income (potentially including interest and royalties from resident) attributable to and taxed in hands of resident

- Revised rules:
  - Payment of interest and royalties to CFC will be subject to WHT
  - Subsequent attributable CFC net income will exempt such previously taxed interest and royalty
  - Application of previously taxed income exemption will take into account SA tax as reduced by applicable DTAs

RELIEF FROM EFFECTIVE MANAGEMENT TEST clause 2(1)(u); section 1

- Background:
  - SA multinationals may sometime prefer to manage their foreign active operations from SA
  - Disadvantage: SA based management potentially triggers dual residency and double taxation [subject to rebates]
  - This dual residency status has no fiscal benefit to SA where foreign operations are located in high tax jurisdictions

- Proposed reform – POEM test switched off in the following instances:
  - Foreign company qualifies as a CFC
  - Foreign company is “normally” taxed (not a tax haven) [at least 21% effective tax rate]
  - Foreign company has a foreign business establishment

RELIEF FROM TRANSFER PRICING
clause 71(1)(e); section 31

- Background:
  - SA multinationals often provide interest free loans and yield free IP to foreign subsidiaries [because of foreign law and exchange controls]
  - Loans and IP are subject to SA transfer pricing adjustment and tax on notional income without corresponding deduction in other country [double taxation]

- Proposed reform – No TP adjustment in following instances:
  - The holder of loan or IP is SA resident
  - The obligor is a CFC in relation to that resident
  - Holder has at least 10 per cent participation interest in obligor
  - The CFC has a foreign business establishment
  - The CFC is “normally” taxed (not a tax haven) [at least 21 per cent effective tax]

FURTHER REFINEMENTS TO HQ REGIME
Section 9I

- Current tax qualifying criteria:
  - For all prior years, each shareholder satisfy minimum participation of 10%
  - For all prior years satisfy the 80/10 asset test (without taking into account money market deposits)
  - In current year, 50% passive receipts and accrual test (excluding R5 million de minimis receipts and currency gains and losses)

- Further refinements:
  - Exempt dormant companies (no trade + ≤R50 000 assets) from the "always qualification"
  - Relax transfer pricing rules in respect of back-to-back licenses of IP [losses ring-fenced]

SOUTH AFRICAN FUND MANAGERS OF FOREIGN INVESTMENT FUNDS
clause 2(1)(w); section 1

- Background:
  - The use of SA based fund manager of a foreign fund potentially triggers SA world wide taxation of the fund [because of POEM test]
- Reason for change:
  - The triggering of the effective management test makes SA local managers potentially unattractive [as Gateway to Africa]
- Proposed legislation creates a carve-out from POEM test if:
  - Fund is incorporated, formed or established in a foreign country
  - Fund operates comparably similar to a local CIS
  - Sole assets of fund consist of cash or listed financial instruments
  - Fund has no full-time employees and directors, and
  - SA residents cannot participate more than 10% in fund
- Note: SA fund managers fees remain fully taxable in SA

REVISED CURRENCY RULES FOR INTRA-GROUP EXCHANGE ITEMS clauses 59(1)(j),(k),(l) and 59(1)(m),(n) and (o)

- Current two sets of rules for intra group currency gains and losses
  - Pre-8 November 2005: Recognition of gains and losses spread over a 10 year period
  - Post-8 November 2005: Gains and losses deferred until exchange item realised
- Reason for change:
  - Align the recognition of intra group currency gains and losses to accounting principles (IFRS)
- Revised rules for intra group exchange items:
  - Abandon the spreading rule in respect of pre 8 November 2005 exchange items
  - Defer gains and losses on exchange items that constitute a net investment in foreign subsidiary until the investment is realised

Administration

Administration: One stop border posts (Clause 1)

Background

- Bilateral agreement with Mozambique concluded in September 2007
- Bilateral agreement on annexures relating to officials' level in June 2011
- Agreement in principle on annexures after briefing to SCoF in June 2012

Proposal

- Enactment of a provision to give effect to agreement and its annexures in domestic law, once all requirements of section 231 of the Constitution have been complied with and the agreement binds South Africa

Administration: Dividends withholding tax notifications (Clauses 5 – 7)

Background

- Exemptions available to approved public benefit organisations, pension funds, etc. and reduced rates to non-residents in terms of DTAs
- Beneficial owner must provide an undertaking to notify company or regulated intermediary if beneficial ownership changes
- Other factors, such as loss of approved status or jurisdiction of residence, may also impact on eligibility for exemptions or reduced rates

Proposal

- Extend requirement to notify company or regulated intermediary of changes in circumstances affecting exemptions or reduced rates

Administration: Dividends withholding tax refunds (Clauses 9 – 11)

Background

- Refund is available to beneficial owner if withholding tax is over-deducted due to late filing of required notification
- Refund may also arise from foreign tax credit in respect of dividends paid by a non-resident company on listed shares

Proposal

- Extend refund to foreign tax credit cases, within three year period of payment of dividend
- Adequate proof of payment of foreign tax must be obtained

Administration: Provisional tax estimates (Clause 14)

Background

- Special tax table inserted for retirement fund lump sum benefits with effect from 1 October 2007, retirement fund lump sum withdrawal benefits with effect from 1 March 2009 and severance benefits with effect from 1 March 2011
- Provisional taxpayers' estimates of taxable income must include retirement and severance lump sum benefits, although taxed using a separate tax table and tax is withheld at source

Proposal

- Exclude retirement and severance lump sum benefits from provisional tax estimates to simplify process

Administration: Provisional tax penalties (Clause 15)

Background

- Imposition of understatement penalty discretionary for taxpayers with a taxable income of more than R1 million but compulsory, with a potential waiver based on circumstances, for those up to R1 million
- Taxpayers who underestimate their provisional tax at the end of a tax year (but have paid enough employees' tax and provisional tax) may be subject to an understatement penalty and have to seek a waiver

Proposal

- Bring imposition of penalty for higher income taxpayers in line with other taxpayers
- Make it clear that no penalty is due on an underestimate if enough employees' tax and provisional tax has been paid by the end of the tax year

Administration: Regulation of tax practitioners

Background

- Regulation of tax practitioners is a long standing issue, first raised in 2002
- Registration required from June 2005, first round of draft legislation proposing a statutory regulator released in February 2007, followed by a second round in July 2008
- Minister raised question of impact of personal non-compliance by registered tax practitioners in 2012 Budget Speech
- Meetings between Minister, Commissioner and tax practitioner associations thereafter to address question

Proposal

- Phase 1: Recognised controlling body in Bill
- Phase 2: Evaluate phase 1 and introduce statutory regulator

Administration: Recognised controlling body (Clauses 23 and 55 – 59)

Proposal

- Tax practitioners must be registered with a directly relevant statutory regulator or recognised tax practitioner's association
- SARS recognises tax practitioner associations based on:
  - Relevant and effective qualification and experience requirements, CPE, codes of ethics and conduct and disciplinary code and procedures
  - Tax exempt status as an association to promote the common interests of members carrying on a profession
  - Minimum membership (or likely membership in a year) of 1,000
- A recognised association must be given notice and opportunity to take corrective action if it no longer meets requirements
- Minister *may* appoint a panel of retired judges or similar persons to handle disciplinary matters for a recognised association
- Reportable misconduct expanded to cover additional tax specific misconduct

Closing and Going Forward

- August 1 - 21
  - More taxpayer workshops
  - Bill redrafting
- 22 August taxpayer hearings before the Standing Committee on Finance
- Further changes to the Bill
  - State Law Advisors
  - Parliamentary Law Officers
- 4 September response document before the Standing Committee on Finance
- 11 September formal Ministerial introduction before the National Assembly