Dear Sir,

TECHNICAL TAX PROPOSALS FOR ANNEXURE C OF THE BUDGET REVIEW

We refer to the invitation to submit technical proposals to improve or correct current tax legislation. Set out below please find the SAICA National Tax Committee’s proposals in this regard.

Income tax - individuals, employment and savings

Allowance in respect of transport expenses and employer provided vehicles used for private purposes

Legal nature of the problem
Where an en employer has granted an employee the right to use a motor vehicle for private purposes the value of the private use of such vehicle (as determined in terms of paragraph 7 of the Seventh Schedule) is included in remuneration for purposes of deducting employees’ tax. Similarly, if the employee receives an allowance or advance in respect of transport expenses (referred to in section 8(1)(b)) the amount thereof is also included in remuneration. The
amount included is 80% of the amount of the taxable benefit or 80% of the amount of any allowance or advance unless the employer is satisfied that at least 80% of the use of the motor vehicle for a year of assessment will be for business purposes. If the employer is so satisfied then only 20% of the amount (in both instances) is included in remuneration.

**Detailed factual description of the relevant transaction**

Many employees travel extensively for business with their own vehicle or are provided with an employer owned vehicle, which is used extensively for business. The problem faced by some of these employees is that the business usage or the actual business travel, whilst significant, may be less than 80%.

They consequently are in the position that 80% of the allowance or taxable benefit respectively must be included in their remuneration. The result is that they are out of pocket on a monthly basis and will only recover the tax overpaid (deducted) once assessed by SARS.

The legislation should provide the employers of such employees with an opportunity to rely on the actual kilometres travelled for business purposes.

**The nature of the taxpayers impacted by the problem**

All individuals and their employers that either receive a travel allowance or an employer provided vehicles for business purposes.

**Extension of definition of “disability” to include diabetes, especially type 1 diabetes and to a lesser extent type 2 diabetes**

**Legal nature of the problem**

The proposed list contained in Annexure 1 of the discussion document do not include all medical conditions which cause sufferers to be physically impaired as defined, i.e. the conditions restrict the person’s ability to function or perform daily activities, such as Diabetes Type 1, amongst other. The reason for the exclusion of conditions such as Diabetes Type 1 is not clear.
Detailed factual description of the relevant transaction

Diabetes is recognised as a disability for tax purposes by many jurisdictions.

The current definition of "disability" contained in section 18 of the Income Tax Act, No 58 of 1962 ("the Act") does not include dread diseases, such as diabetes. The management of these conditions are expensive, if done properly and consequently patients with insufficient financial means or who do not have adequate medical aid cover do not management their conditions properly. It is noted that the majority of the tax jurisdictions include dread diseases where special dispensation is given to disability related expenditure. The exclusion in the South African context is therefore unclear and even possibly unfounded.

Failure to management these conditions properly may eventually result in the patients becoming disabled or suffering from conditions which qualify as "disabilities" as defined in section 18 of the Act. The costs of treating these conditions exceed the costs of the products needed to manage and treat the dread diseases are less than the costs of treating the "disabilities".

Nature of business impacted by the problem

Various individuals suffering from diabetes.

Proposal

The definition of "disability" contained in section 18 of the Act should be extended to include dread diseases.

In addition, annexure 1 the discussion paper on proposed list of qualifying physical impairment and disability expenses under section 18(1)(d) of the Income Tax Act, No 58 of 1962 and proposed criteria for diagnosis of a disability need to be expanded to include the following items:

2.1. Insulin;
2.2. Needles and syringes required for the administration of insulin;
Vouchers entitling an employee to any meal or refreshment

Legal nature of the problem
A taxable benefit generally arises where an employee has been provided with any meal, or refreshment or voucher entitling the employee to any meal or refreshment, either for free of charge or for a consideration less than the value of such meal, refreshment or voucher, as the case may be. This is in terms of paragraph 2(c) read with paragraph 8 of the Seventh Schedule to the Income Tax Act.

Detailed factual description of the relevant transaction
Employers often grant employees with meal vouchers which must be redeemed only at a canteen, cafeteria or a dining room operated by the employer. Employers prefer to use vouchers for various reasons, for instance to monitor costs.

Paragraph 8(3) of the Seventh Schedule to the Income Tax Act provides circumstances under which the taxable benefit in relation to any meal or refreshment will have no value for tax purposes. It does not specifically include a voucher where such voucher can only be redeemed at the employers’ canteen.

We propose that paragraph 8(3) of the Seventh Schedule be amended that the meal vouchers granted to an employee and which can only be redeemed at the employers’ canteen also receive a nil value.
The nature of the taxpayers impacted by the problem
All employers and their employees who receive meal vouchers that may only be redeemed at the employer’s canteen.

Definition of “determined value” under paragraph 7 of the Seventh Schedule

Legal nature of the problem
Where an employer has been granted an employee the right to use a motor vehicle for his or her private or domestic purposes the value of such use is determined by using “determined value”. This is in terms of paragraph 7(1)(a) of the Seventh Schedule to the Income Tax Act. The determined value, in cases where the motor vehicle was acquired by the employer under a bona fide agreement of sale or exchange concluded by parties acting at arm’s length, is the original cost thereof to the employer (excluding any finance charges).

Detailed factual description of the relevant transaction
The determined value once calculated is the used for the duration of the period that the employee utilises the motor vehicle for private purposes. The benefit is therefore not based on the cost to the employer. The problem is that where an employee uses the vehicle for period exceeding the period over which the employer depreciates the vehicle the determined value will still be the same. The Act recognises that the determined value must be reduced, but only where the vehicle was acquired by the employer not less than 12 months before the date on which the employee was granted such right of use.

The nature of the taxpayers impacted by the problem
All employees who have been granted the right of use of a company car.

Residential accommodation

Legal nature of the problem
Paragraph 2(d) of the Seventh Schedule provides for the taxation of residential accommodation provided by an employer to an employee. Paragraph 9 of the Seventh Schedule provides the method used to determine the value of the fringe benefit. The value to
be included as a fringe benefit is the greater of the formula or the actual rental paid. The formula will apply where the accommodation is owned by the employer. The formula used to determine the value of the benefit is based on the previous year’s remuneration of the employee and the size of the accommodation and the services included.

Paragraphs 9(7A) and (7B) provide an exception in respect of accommodation provided to an employee away from his or her usual place of residence outside the RSA provided the cash equivalent of the taxable benefit does not exceed R25,000. Paragraph 9(2) then provides that the cash equivalent of the benefit will be determined in accordance with subparagraph 3 (which is the greater of the formula or the rental payable), subparagraph 3A (which is the circumstances under which only the formula will apply), subparagraph 4 (holiday accommodation) and subparagraph 5 (other cases, where a directive should be requested).

**Factual description**

The current structure of the fringe benefit when using the formula is linked to the remuneration of the employee.

“Remuneration factor” as defined in paragraph 9(1), or the proposed “remuneration proxy” is the remuneration derived by the employee in the preceding year of assessment. This therefore includes lump sum payments such as bonuses and share gains which can significantly distort the earning of the employee in a particular year and thereby create an inflated benefit that is higher than the market related value.

The value of a housing benefit should not be linked to remuneration but to value of monthly rental or the value of the property.

The value of the benefit therefore differs depending on the remuneration level of the employee. The calculations for two employees receiving the same type of accommodation will render different taxable values. The higher earner will therefore pay a higher marginal rate on a higher value therefore essentially being punished twice for receiving the same benefit.
Paragraph 9(7A) and (7B) require the cash equivalent to be determined. Under sub-paragraph 2, the employer in these circumstances can only use subparagraph 3 to determine the cash equivalent, which is the greater of the formula or the rental paid. In a number of cases the formula provides a higher value than the actual market related rental paid. The employer is then required to apply to SARS for a directive to confirm that the rental value may be used instead of the formula created value.

For example:
Employee A is a foreign resident on a 1 year assignment in SA. His remuneration factor is R1,800,000 due to the assignment allowances provided and he is provided with a 1 bedroom fully furnished and serviced apartment for which the employer pays R10,000 per month.

Calculation:
\[(R1,800,000 – R63,556 \times 19/100 \times 12/12) = R1329,924 \text{ for the 12 month period}\]
\[= R27,493.66 \text{ taxable benefit per month}\]

Under paragraph 9(3) he will be taxed on R27,493.66 per month being the greater of the formula result (i.e. R27,493.66) or the rental paid (i.e. R10,000 per month).

This exceeds the R25,000 limit provided for in paragraph 9(7B) and the excess will therefore become taxable but the formula result bears no relation to the actual cost of the accommodation provided i.e. R10,000.

The rental value where two employees share the same residential accommodation:
A further difficulty arises where employees share the same employer provided residential accommodation. No provision exists in the current legislation to deal with this situation. It is inequitable for both employees to be taxed on the full benefit as they do not enjoy the full benefit of the accommodation.
For example:

Employees A, B and C are provided with a 3 bedroom fully furnished rented house for the duration of their 1 year assignment in SA. The market related rental for the property is R20,000 per month which is paid for by the employer. Their remuneration level is R250,000 for the prior year.

Based on current legislation:
(R250,000 – R63,556) x 19/100 x 12/12
= R35,424.36 for the 12 month period
= R2,952.03 taxable fringe benefits per month

For the 3 employees the taxable benefit is therefore R8,856.09 with each of them being taxed as if they were the sole occupant of the premises.

As can be seen, the taxable benefit bears no relation to the market-related cost of the accommodation.

Proposals/suggested solutions
1. The current structure of the fringe benefit when using the formula is linked to the remuneration of the employee.

   a) We suggest that the definition of remuneration for the purposes of paragraph 9 be narrowed by excluding lump sums, share gains and every discretionary amount; alternatively

   b) We suggest that the entire taxable benefit calculation be revised and remuneration be removed as the determining factor in the calculation of the taxable fringe benefit and an alternative amount be used such as either the market related rental or the municipal rate value of the property.

   c) Expatriate accommodation should not be subject to the formula as the only factor that triggers the taxable benefit is the remuneration factor. The market related cost of rental
subject to the R25, 000 limitation should determine the taxable benefit. This would significantly reduce the administrative burden on both the employer and SARS on the directive process. SARS would still collect revenue on those expatriates that are provided high value accommodation.

Where a market related/arm’s length rental value is determinable for employer–owned accommodation, the employer should have the option to use this value to determine the fringe benefit without the administrative burden of applying to the Commissioner for rulings under paragraph 9(5). A provision that requires the employer to be satisfied that the value being used in the determination of the fringe benefit is market related/arm’s length is suggested and that the employer is therefore required to maintain some documentary proof of research or information obtained in order to satisfy himself as to this fact.

For those types of employer-provided accommodation where no market value can be determined such as in the farming, mining or forestry industries, a formula based approach with a narrow definition of remuneration could then be used to determine the value of the benefit.

2. How to value this benefit where two employees share a house
   We suggest that the legislation allow for the apportionment of the taxable benefit where the accommodation is occupied by more than one employee at the same time.

   We would suggest the insertion of paragraph 9(6A) to provide for the equal apportionment of accommodation under these circumstances.

**Nature of business impacted**
Employers and employees provided with residential accommodation.
Inclusion of cash for purpose of long service award

Legal nature of the problem
Under paragraph 5(2)(a) and (b) of the Seventh Schedule, no taxable benefit arises where an employee is given an asset for long service or an award for bravery.

Factual description
Under the newly issued Interpretation Note 71 the awarding of gift vouchers to employees in recognition of long service has been included in the definition of “assets” for purposes of paragraph 2(a).

We propose that the principle of including gift vouchers in the definition of assets be extending to all type of gifts provided by an employer to an employee. This will ensure alignment and standardization.

Nature of business impacted
Employers

Capital Gains

The legal nature of the problem
Paragraph 67 allows for the roll-over of any capital gain that arises where assets are transferred to a spouse. It only applies if ownership is acquired intestate or by testamentary succession or as a result of a redistribution agreement. It also applies where the assets are transferred in consequence of a divorce order or an agreement for the division of assets.

Detailed factual description of the relevant transaction
In terms of section 3 of the Matrimonial Property Act, at the dissolution of a marriage subject to the accrual system, by divorce or by the death of one or both of the spouses, the spouse whose estate shows no accrual or a smaller accrual than the estate of the other spouse, or his/her estate if he/she is deceased, acquires a claim against the other spouse.
In terms of the Maintenance of Surviving Spouses Act, if a marriage is dissolved by death the survivor shall have a claim against the estate of the deceased spouse for the provision of his reasonable maintenance needs until his/her death or remarriage in so far as he/she is not able to provide therefore from his own means and earnings.

Both these claims do not amount to the spouse obtaining ownership as required by paragraph 67. These claims are required in terms of the relevant other Acts.

Description of what the transaction seeks to achieve

The transaction seeks to prevent the spouse from having to realise assets to pay for the resulting capital gains, but as the above two scenarios are not included in the law, the spouse will be forced to realise the assets and award the cash after tax to the spouse entitled to either the accrual claim or the maintenance claim.

We propose that the forced sale of the assets in the two situations described above also be excluded in terms of paragraph 67.

Nature of the businesses impacted by the problem

This provision impacts on all taxpayers that have to dispose of property to meet an accrual claim or a claim for the maintenance of the surviving spouse.

Acquisition of property below market value

Legal nature of the problem

Paragraph 5(3A) of the Seventh Schedule provides that immovable property acquired by an employee from an employer at below market value will not have a value. The Explanatory Memorandum states that “The market value of the immovable property that is acquired by the employee, may not exceed R450 000.”

Detailed factual description of the relevant transaction

According to the Explanatory Memorandum the nil value will apply where the remuneration proxy does not exceed R250 000 and the value of the immovable property does not exceed R450 000. The wording in the legislation does not achieve this.
The legislation introduces a connected person requirement. From the wording it is clear that the R450 000 limit will only apply if the immovable property is acquired from a connected person.

The nature of the businesses impacted by the problem
This impacts all acquisitions of immovable property with a market value in excess of R450 000 if acquired at less than the market value from an employer.

Income tax - domestic business,

Exclusion from exemption from income tax of dividends paid to employees in terms of proviso to section 10(1)(k)(i)(ii) of the Income Tax Act, No 58 of 1962

Legal nature of the problem
Section 10(1)(k)(i)(ii) of the Income Tax Act, No 58 of 1962 provides that the exemption from income tax provided for in terms of this section does not apply
“to any dividend received by or accrued to a person in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office, other than a dividend received or accrued in respect of a restricted equity instrument as defined in section 8C held by that person or in respect of a share held by that person;”

Various major corporates operate share trust schemes aimed at lower income employees as well as part of the BBBEE initiatives. The employees participating in the schemes have voting rights and received benefits however the shares are held in a trust and not by the employees. The exclusion of “restricted equity instrument as defined in section 8C held by that person or in respect of a share held by that person” from the proviso in section 10(1)(k)(i)(ii) therefore do not apply to the share trust schemes.

Factual description of the relevant transaction
South African corporations holds true to their objectives for an improved economic situation for all South Africans and in many cases extend those objectives to the broader SADC region. The corporations achieve this through the operation of several share and share option schemes
which are available to employees either immediately or once they have completed a certain length of service. A large number of these schemes are targeted at employees and associates who earn below a certain threshold, say below R7 000 per month. These schemes are therefore open to a significant portion of the employees and in many cases the majority of the participants are classified as Black in terms of BBBEE legislation. For example, in one instance there are 6 343 employees and associates participating in such a scheme, of which 96% are considered Black in terms of BBBEE legislation.

Shares are often offered to the employees no consideration and are held by the Trust (not by the employees or associates) until the death or retirement of the employee or associate. The employees or associates are however are entitled to vote on the shares and receive the dividends even though the shares are held in the Trust. There are instances where dividends in excess of R70 million have been paid to employees or associates.

Section 10(1)(k)(i)(ii) now results in an additional income tax liability in the hands of low income earning employees and associates who participate in share schemes of the nature set out above. The dividends are not paid to them as compensation for services rendered or to be rendered. Consequently, some corporations are considering terminating share schemes of this nature as a result of the significant impact the additional income tax charge have on the affected associates and employees.

**Nature of the businesses impacted by the problem**

Corporate employers wishing to contribute to the upliftment of previously disadvantaged employees or associates and improve the economic conditions of their lower income earning employees or associates.

**Recommendation**

The exclusion from the exemption from income tax of dividends paid to employee in terms of this proviso to section 10(1)(k)(i)(ii) should be limited so as not to include dividends paid by share schemes which aims to encourage participation by Black and lower income employees and associates.
Fair value taxation in respect of financial instruments: section 24JB of the Income Tax Act

Legal nature of the Problem
The draft Taxation Laws Amendment Bill, 2013 (‘the Bill’) proposes a new section 24JB to deal with the taxation of financial assets and financial liabilities for bank groups. This section will come into operation on 1 January 2014.

The new section 24JB applies to covered persons and provides that all amounts in respect of financial assets and financial liabilities of that covered person that are recognized at fair value in profit and loss in terms of IFRS must be included income in or deducted from the income for a particular year of assessment.

The concept of ‘covered person’ includes, amongst others, any company or trust that forms part of a banking group as defined in section 1 of the Banks Act, excluding a company that is a long-term insurer as defined in section 1 of the Long-term Insurance Act.

Factual nature of the Problem
In the definition of a covered person the conceptual exclusion has already been made with reference to a company that is a long-term insurer as defined in section 1 of the Long-term Insurance Act. Unfortunately this exclusion does not go far enough, as it does not extend to subsidiaries of an insurance company. An insurance group is not predominantly engaged in banking or any associated activities per se.

Insurance groups are by virtue of the definition of covered persons included within the ambit of section 24JB notwithstanding the fact that they hold investments on capital account and are not engaged in banking activities.

Furthermore, insurance groups have separately undertaken organisational restructures in anticipation of the implementation of Solvency II in South Africa to avoid any negative
impact the Regulations may have on the amount of capital that they must hold. In this regard the insurance group and other related group subsidiaries would be held directly by a controlling company. The insurance group would typically not hold any other subsidiaries which are engaged in banking activities.

A “controlling company” is defined in the Long-term Insurance Act Amendment Bill and means a holding company that is a public company whose only business is the acquiring, holding and managing of another company or other companies, including an insurance group.

The controlling company and the insurance group will also be subject to the supervision of the Registrar of Long-term Insurance.

**Businesses impacted and Proposal**

Notwithstanding the exclusion in section 24JB(2), it is proposed that the current exclusion of a long-term insurer be extended so as to refer to a controlling company, as defined in the Long-term Insurance Act Amendment Bill, and any company that is held directly or indirectly by the controlling company. A covered person should therefore not extend to the insurance group that is governed separately in terms of the Long-term insurance Act and should consequently be specifically excluded from the definition of covered person as contemplated by section 24JB(1) of the Taxation Laws Amendment Bill.

**Section 29A of the Income Tax Act: proposal to allocate the business of foreign retirement funds to the Untaxed Policyholder Fund (‘UPF’) of a long-term insurer**

**Legal nature of the problem**

In terms of section 29A of the Income Tax Act, 58 of 1962 (‘the Act’), every long-term insurer (‘insurer’) is required to establish four funds, namely the individual policyholder fund (“the IPF”), the company policyholder fund (“the CPF”), the untaxed policyholder fund (“the UPF”) (“collectively the policyholder funds”) and the corporate fund (“the CF”).

The business allocated to the UPF consists of the following:
• Business carried on by the insurer with any pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund or benefit fund (‘Retirement Fund’s);
• Any policy of which the owner is a person where any amount consisting gross income of whatever nature would be exempt from tax in terms of section 10 were it to be received or accrued to that person; and
• Any annuity contract entered into in respect of which annuities are being paid.

**Factual description of relevant transaction**

Long-term Insurers often issue Fund policies to Retirement Funds (“Fund business”) registered and regulated in Lesotho, Swaziland or other neighbouring countries. While these non-resident Retirement Funds are exempt from normal income tax in the relevant country of residence, they are not exempt from income tax in accordance with the provisions of section 10 of the Act.

As section 29A(4)(a) only refers to Retirement Funds, as contemplated in section 1 of the Act i.e. South African registered and approved funds, long-term insurers are obliged to allocate the Fund business of these non-resident Retirement Funds to the CPF. Any investment growth allocated to the Fund business of these Retirement Funds will consequently be subject to income tax or capital gains tax, notwithstanding the fact that the non-resident Retirement Fund is actually exempt from normal income tax in its country of residence. This unfavourable tax treatment is detrimental to the members of the non-resident Retirement Funds and acts as a barrier to non-resident Retirement Fund business into South Africa.

**Nature of business and associated transactions that are impacted**

Fund business conducted/and policies issued by South African registered Long-term Insurers to non-resident Retirement Funds, which are exempt from normal income tax in their country of residence.

**Proposal**
It is proposed that section 29A of the Act be amended to direct that any Fund business conducted with/and any policy issued by a long-term Insurer to any Retirement Fund, which is exempt in terms of the laws of the neighbouring country, be allocated to the UPF.

Section 30B entities and its funding

Legal nature of the problem
Section 30B(2)(ix) provides that substantially the whole of a section 30B entities’ “funding” must come from its long term members or from an appropriation from government.

Detailed factual description of the relevant transaction
The word “funding” is however not defined and the word’s normal meaning could thus include:

- Amounts of a capital nature (e.g. donations)
- Exempt income (e.g. dividends from SA companies)
- Non-business income (e.g. passive investment income, interest)
- Amounts received from related members organisations, the public or sponsors of a public benefit activity (as listed in the Ninth Schedule), conducted by the organisation.

Where such an entity earns interest or passive investment returns on its surplus funds (non-business income), such amounts may also constitute “funding from non-members”, notwithstanding the fact that the funds were originally contributed by the member. Dividends received from a South African resident company, which will be exempt from normal tax, will also be seen as funding.

Funding received from other exempt entities (e.g. Universities, similar local or international associations, chambers of industries / commerce etc.) for the benefit of their profession, the industry and the public will equally put the entities tax status at risk.

The word funding should be replaced.
The nature of the businesses impacted by the problem
All entities approved by SARS under section 30B.

Transfer pricing

Legal nature
Section 31 requires that international transactions to be based on arm’s length principle. In the Explanatory Memorandum to the Bill (2010) that introduced the section in its current format the following was stated, on page 79:
“SARS will amplify its interpretation of the rules in this context by way of Interpretation Note or other published guidance”.

Factual description
The effective date of the section was made 1 October 2012 and therefore already applies now. The guidance has not been provided.

Nature of taxpayers impacted
The lack of guidance impacts on all taxpayers engaged in international transactions with connected persons.

Proposal
It is suggested that the guidance be made available as a general binding ruling or that section 31 is amended to clarify issues requiring interpretation.

Practical difficulties associated with application of section 64FA(1)(a) of the Income Tax Act, No 58 of 1962 in respect of listed companies

Legal nature of the problem
Section 64FA of the Income Tax Act No. 58 of 1962 deals with the exemption from and reduction of tax in respect of dividends in specie. Section 64FA(1)(a) provides that “(W)here a company declares and pays a dividend that consists of a distribution of an asset in specie,
that dividend is exempt from the dividends tax to the extent that it constitutes a distribution of
an asset in specie if –

(a) the person to whom the payment is made has, by the date of payment of the
dividend, submitted to the company—

(i) a declaration by the beneficial owner in such form as may be prescribed by the
Commissioner that the portion of the dividend that constitutes a distribution of
an asset in specie would, if that portion had not constituted a distribution of an
asset in specie, have been exempt from the dividends tax in terms of section
64F; and

(ii) a written undertaking in such form as may be prescribed by the Commissioner
to forthwith inform the company in writing should the circumstances affecting
the exemption applicable to the beneficial owner referred to in subparagraph
(i) change or the beneficial owner cease to be a beneficial owner;”.

Listed companies do not have extensive details of their shareholders nor do they have the
contact details of these shareholders as the information is kept and maintained by regulated
intermediaries contracted to the listed companies to maintain these records. In many
instances, there are multiple layers of regulated intermediaries between the actual listed
company and the ultimate shareholder. The listed companies are often not in possession of
the details of the regulated intermediaries which interact which its primary contracted
regulated intermediary. It is therefore practically impossible and expensive to obtain the
declarations required, especially where the shareholders are not resident in South Africa.
Listed companies are also not able to verify or obtain the declarations required as provided for
in section 64FA(1)(a). The listed companies can also not rely on the declarations held by the
regulated intermediaries as these are issued and submitted to the regulated intermediaries and
not to the company concerned as is required in terms of section 64FA(1)(a).

In addition, section 64L, read with section 64G(1) only makes provision for refunds of tax in
respect of dividends declared and paid by companies to the extent that the dividend does not
consist of a distribution of an asset in specie.
**Factual description of the relevant transaction**

A listed South African corporation undertakes an unbundling exercise in terms of which the unbundled shares are distributed as assets in specie to its shareholders. The company is liable to for the dividends tax unless the shareholder has, by the date to of the distribution of the asset in specie submitted to the company a declaration that the dividends is exempt or that a reduced dividends tax rate can be applied.

The transaction is effected within a short period of time and the listed corporation is not able to obtain the relevant declarations as it does not have the detailed shareholder information at hand; it was restricted by law to disclose any information about the transaction to any other parties – and hence could not obtain the information by the time the transaction took place etc.

As such, the listed corporation is liable for dividends tax on the asset in specie and as a result of the limited application of section 64L, are not able to claim a refunds of any dividends tax which would not have been payable had the it been in possession of the declarations.

**Nature of the businesses impacted by the problem**
Listed South African corporations undergoing unbundling transactions.

**Recommendation**
The companies should be able to claim a refund and/or be able to rely on the declarations in possession of the regulated intermediaries applicable to cash dividends.

**Concept of “economic employer” in the Fourth Schedule**

**Background**
In 2010 SARS issued Binding Private Ruling No. 85 in which the concept of an “economic employer” was endorsed. The concept was applied to determine that foreign employees were taxable in South Africa because the local entity was ultimately charged for these services and that the individuals could therefore not benefit from protection under their respective Double Taxation Agreements (“DTA”) with South Africa.
The ruling went further to say that the South African company would be obliged to comply with paragraph 2 of the Fourth Schedule to the Act on the remuneration paid by the foreign employer in their respective countries during their assignments to South Africa.

**Legal nature of the problem**
Paragraph 2(1) of the Fourth Schedule provides that every employer (defined below) who is a resident or a representative employer in the case of a non-resident employer, who “pays or becomes liable to pay any amount by way of remuneration to any employee”, shall deduct or withhold employees’ tax.

Employer is defined as “any person who pays or becomes liable to pay to any person any amount by way of remuneration.”

Representative employer is defined as inter alia “in the case of any employer who is not resident in the Republic, any agent of such employer having authority to pay remuneration.”

**Factual description**
Under the existing legislation there is no provision for an economic employer to be obliged to withhold employees’ tax under the Fourth Schedule. While the economic employer may bear the costs of employment via a chargeback structure this does not amount to the economic employer being obliged to pay remuneration nor does it make the economic employer liable to pay remuneration. The economic employer therefore does not meet the definition of an “employer” under the Fourth Schedule.

Further the economic employer does not become a representative employer by virtue of the chargeback as this is not an agency agreement and the economic employer is not authorised to pay the remuneration of the foreign employees as the foreign employer retains this obligation. The economic employer therefore does not meet the definition of a representative employer under the Fourth Schedule either.
There is therefore no provision in the Fourth Schedule under which the economic employer is obliged to withhold employees’ tax and we submit that the BPR is technically incorrect in this regard.

If the intention is to create an obligation for the economic/local employer to withhold PAYE, an amendment to the Fourth Schedule paragraph 2 and the definitions of employer and/or representative employer would be necessary to include the economic employer in the realm of employees’ tax withholding obligations.

**Nature of business impacted**

Employers

**Provisional Tax - Underestimation penalty**

**The legal nature of the problem**

Paragraphs 20(1)(a)(ii) and 20(1)(b) of the Fourth Schedule to the Income Tax Act provides that employees’ tax paid during the year of assessment is taken into consideration in determining when a penalty applies.

**Detailed factual description of the relevant transaction**

This can best be explained by an example:

If a taxpayer underestimated by 1% (i.e. 79% of taxable income) for the second provisional (i.e. paid 40% thereof) and paid 1 day late then under the old law a penalty for underestimation of 10% will be levied on the 1% and a late payment penalty of 20% will be levied on the 40%. Under the current wording a penalty of 20% will be levied on the 40% for underestimation notwithstanding that the underestimation is only 1% as it refers to “provisional tax paid during the year of assessment”. The amendment has effectively imposed two late payment penalties instead of merely providing relief by taking cognisance of the employees’ tax paid during the year as well.
Paragraph 20(1)(a)(ii) should be amended to read. “the aggregate of the employees’ tax paid during the year of assessment and the estimate of provisional tax submitted in terms of paragraph 19(1)(a) or 19(1)(b)” for the final or last estimate.

Paragraph 20(1)(b) should be amended by ,“…….and the aggregate of the amount of employees’ tax paid during the year of assessment and the estimate of taxable income submitted in terms of paragraph 19(1)(a) or 19(1)(b) for the final or last estimate”.

The nature of the businesses impacted by the problem
All provisional taxpayers.

Income tax – international

Treasury companies: section 9D

The legal nature of the problem
It is clear that National Treasury recognises the importance of treasury companies in the efficient operation of groups of companies. This is evident from the Minister of Finance’s announcement of the establishment of a treasury management holding company regime as part of the Budget proposals on 27 February 2013 and the provision in the 2013 Taxation Laws Amendment Bill providing for a special currency tax dispensation for South African based treasury management holding companies sanctioned by the South African Reserve Bank.

Despite this, the current CFC regime as applied to group treasury operations established outside South Africa are excessively punitive and do not recognise the importance of such companies to the efficient and effective operation of active trading companies.

A detailed factual description of the relevant transaction
Say for example a South Africa Group operates throughout the world. They have established a treasury company in South Africa for funding to the South and Southern African trading operations as well a treasury company in the UK to fund UK and European trading
operations. The UK treasury company is also the intermediate holding company for the UK and European subsidiaries. The UK treasury company was established for valid commercial reasons in the UK, close to London, which is widely regarded as a financial services centre of excellence.

Treasury companies, in conducting their trade will inevitably receive and pay interest to banks and other financial institutions.

While it is true that the net income of treasury companies incorporated in high tax jurisdictions may be deemed to be R nil if the aggregate amount of tax payable by the CFC to all spheres of government of any country other than the Republic is at least 75% of the amount of normal tax that would have been payable in respect of any taxable income of that CFC had that CFC been a resident (“the 75% rule”), it is submitted that reliance on this in practice is very difficult.

There are key differences between SA tax legislation and the tax legislation in other countries that often results in the high tax rule not being met despite relatively high tax rates in these countries.

In addition, the tax rates of the most of the top financial centres in the world are well below the SA tax rate, e.g. London, Zurich, Hong Kong and Singapore.

The implications of all this is that external interest and similar income received by offshore treasury companies are imputed, often with no foreign tax credits being available.

**The nature of the businesses impacted by the problem**

Multinational groups headquartered in South Africa making use of offshore treasury companies for commercial reasons. Recommendations:

At the very least, the 50% tax rule applied in the diversionary rule applicable to income derived from the sale of goods (s9D(9A)((a)(i)aa) should also apply to income arising from financial instruments derived by Treasury companies.
However, it is submitted that the foreign business establishment requirement is sufficient to ensure that mala fide treasury companies are kept within the SA tax net.

Alternatively, if the treasury company is “subject to tax” in the foreign jurisdiction at a rate of at least 70% of the SA rate then it should qualify for the exemption in paragraph (9A)(iii)(aa)(A).

**Intra-group sales in terms of international restructuring**

**The legal nature of the problem**
The section 45 roll over relief involving foreign companies only applies in relation to the sale of equity share in a foreign entity and only if the sale is done for the issue of debt or shares other than equity shares.

It often happens that the foreign entities involved want to do the sale for cash. To ensure that the transactions falls within the scope of section 45, the transaction then takes place on loan account followed by the almost immediate repayment of the loan.

This unnecessarily complicates the transaction as a loan agreement must be drafted and transfer pricing and thin capitalisation rules needs to be considered. It is extremely difficult to justify this additional requirement to the foreign entities involved.

**A detailed factual description of the relevant transaction**
Company A, a non-resident is owned 100% by a SA resident company. Company A in turn owns 100% of the shares in Company B, also a non-resident. Company A wishes to dispose of the shares for cash to Company C, also a non-resident. Company C is indirectly owned 100% by the same SA resident company that owns Company A.

**The nature of the businesses impacted by the problem**
Multinational groups headquartered in South Africa wishing to restructure their offshore operations.
It is recommended that section 45 be amended to also allow for cash disposals of foreign equity shares in terms of intra-group transactions.

**Other taxes - value-added tax**

**Accounting for the tax on the payment basis**

**Legal nature of the problem**
Section 15(2)(b) of the VAT Act allows a vendor that is a natural person with an annual turnover not exceeding R2.5 million to account for VAT on the payments basis. The qualifying turnover level of R2.5 million was last reviewed in 1998 – inflation has largely made the limit irrelevant. There is also no logical reason for the distinction between vendors that are natural persons and corporate members.

**Detailed factual description of the relevant transaction**
The nature of the problem is not strictly speaking legal. Due to inflation the historic thresholds are now largely irrelevant. The VAT Act should be aligned with Government’s policy of stimulating and supporting small business. In actively pursuing this objective thresholds in the VAT Act aimed at benefitting small enterprises should be reviewed on an ongoing basis.

The distinction between natural persons and corporate entities creates discrimination between various business options; this goes against the basic principal that tax should be neutral; i.e. it should not drive a business decision.

**The nature of the businesses impacted by the problem**
For income tax purposes small businesses with a turnover of R20 million qualify for beneficial income tax treatment. For VAT purposes relief is only provided in the form of the turnover tax applicable to small businesses where turnover does not exceed R1 million or where natural persons have annual
turnover levels below R2.5 million (in which case VAT may be accounted for on the payments basis). For all practical purposes, the above is of very limited benefit for small businesses.

We propose that the income tax and VAT legislation be aligned; the payments basis should be available to organisations with an annual turnover of R20 million or less. We also recommend that the application of the payments basis be extended to all classes of vendors with annual turnover below the above threshold.

**Input tax on importation of goods**

**Legal nature of the problem**
In terms of the revised section 16(3)(a)(iii) importers may with effect from 1 April 2014 only claim input tax on the importation of goods in the tax period that the VAT has been paid. The current proposed wording of the section leaves doubt whether it is the VAT of the foreign supplier that should be paid.

“(iii) charged in terms of section 7(1)(b) in respect of goods imported into the Republic by the vendor and paid, during that tax period;”

**Detailed factual description of the relevant transaction**
The relevant section can be interpreted in two ways. It could be read that the VAT must be paid; it could also be read that the foreign supplier must be paid. This potential anomaly needs to be clarified.

**The nature of the businesses impacted by the problem**
If goods are imported into South Africa by a vendor and the vendor pays the importation VAT to SARS, an input tax credit may be claimed in the tax period that the VAT is paid to SARS (the intended outcome of the amendment). If the paid requirement is however linked to “goods imported into the Republic by the vendor and paid” input tax can only be claimed once the foreign supplier has been settled. This was never the intended outcome by the legislator.
We propose that it be made clear that the payment requirement is linked to the importation VAT, not the payment of the goods.
This may be achieved by rewording the section as follows:
“(iii) charged in terms of section 7(1)(b)[,] in respect of goods imported into the Republic by the vendor[,] and paid during that tax period;”

**Bio diesel**

**Legal nature of the problem**
The Value-Added Tax Act provides that the supply of goods consist of fuel levy goods referred to in Fuel Item Levy numbers 195.10.03, 195.10.17, 195.20.01 and 195.20.03 in Part 5A of Schedule No. 1 to the Customs and Excise Act qualify for the rate of zero percent.

**Detailed factual description of the relevant transaction**
Fuel used in burners, furnaces and boilers increasingly consists of bio fuels. These products do not qualify for the rate of zero percent.

**The nature of the businesses impacted by the problem**
Businesses that manufactures fuel in an environmentally friendly way.

**Restriction of remuneration for purposes of UIF and SDL**

**Legal nature of the problem**
The definitions of remuneration for purposes of unemployment insurance contributions and skills development levies are linked to the definition in the Fourth Schedule to the Act. Furthermore, the definition of remuneration in the Unemployment Insurance Contribution Act¹ and Skills Development Levies Act² excludes certain amounts, such as once lump sum from retirement funds and amounts paid by the employer upon termination of employment by

---

¹ No 4 of 2002
² No 9 of 1999
the employee for purpose of determining the liability for skills development levy and unemployment insurance contributions.

**Factual description**
Certain payments such as share gains are paid to employees during the year of assessment which creates an inflated liability for the employer. These amounts do not occur yearly, such as lump sum from retirement funds and amounts paid by the employer upon termination of the employment by the employee.

We propose that amounts such as share gains payments must be excluded in calculation of the monthly liability for the employer as they inflate the monthly liability for the employer. This amendment will be aligned with the current treatment which does not include similar lump sum payments.

**Nature of business impacted**
Employers and employees

**Expatriate exclusions from UIF and SDL**

**Legal nature of the problem**
Inbound expatriates are currently excluded from UIF contributions under section 4(1)(d) of the Unemployment Insurance Contributions Act, No 4 of 2002 provided they are to leave the Republic on the termination of the contract/ learnership. No similar provision exists in the Skills development legislation.

**Factual nature**
Outbound expatriates are still required to contribute towards UIF and their employers are still required to contribute to SDL.

In most cases the employees remain on the payroll purely for pension contributions etc and should they become unemployed, their last remuneration levels would be determined based on a significantly reduced remuneration figure.
We would suggest that for consistency, the UIF and SDL treatment for employees out of the country on temporary assignment, similarly structured to section 4(1)(d) of the Unemployment Insurance Contributions Act be enacted to allow employees and employers to temporarily cease UIF and SDL contributions for those employees on assignment for the period of assignment on the condition that the contract requires them to return to South Africa on termination.

**Nature of business impacted**
Employers

**Grouping: Tax Administration Act (TAA)**

**Legal nature of the problem and factual description of the relevant transaction**

Generally, for income tax, SARS is precluded from reopening an assessment if more than three years has passed since the date of such assessment. This limitation does not apply in specified circumstances (such as fraud, misrepresentation or material non-disclosure).³ However, upon reading section 99(1)(a) of the TAA, the three year rule appears to only apply to the reopening of *original* assessments. Currently, the only limitation placed on SARS (i.e. when SARS may not issue an assessment) in the case of an additional assessment is if either of the following applies:

- the amount of tax which should have been assessed under the preceding assessment was not so assessed due to the practice prevailing at the time such assessment was issued; or
- if the full amount of tax which should have been assessed under the preceding assessment was, in accordance with practice, not so assessed.⁴

Therefore, the current TAA appears to grant SARS far greater powers to reopen *additional* assessments (when compared to original assessments) in that the three year limitation rule does not appear to extend to additional assessments. Thus, provided that the above two requirements do not apply,⁵ SARS’s ability to reopen an additional assessment will never prescribe (e.g. SARS may reopen

---

³ Section 99(1)(a) and 99(2)(a) of the TAA
⁴ Section 99(1)(d)(i) of the TAA
⁵ as well as the requirements relating to fraud, misrepresentation or material non-disclosure
an additional assessment even if ten years has passed since the date such additional assessment was
issued). This is contrary to the corresponding legislation which was contained in the Income Tax Act
(ITA)\textsuperscript{6} (i.e. prior to the introduction of the TAA) which imposed the three year limitation to \textit{either}
type of assessments.\textsuperscript{7}

\textbf{Nature of the businesses impacted by the problem}

From the above factual description, in terms of current law, it is submitted that all taxpayers may be
prejudiced due to SARS being able to reopen \textit{any} additional assessments, regardless of the time
elapsed since the date of such assessment.

\textbf{Proposal}

Based on the above, it is submitted that section 99(1)(d)(i) of the TAA be amended to impose the same
three year limitation in the case of additional assessments as what currently applies to original
assessments (as contained in section 99(1)(a) of the TAA). This would also correct the TAA to reflect
the legislation which was in force prior to the implementation of the TAA.

\textbf{Extension of legal professional privilege to non-legal tax practitioners}

\textbf{Legal nature of the problem}

Currently legal professional privilege is only afforded to tax practitioners in legal practice.
Unlike other legal advisory services and legal litigation services, tax advisory services are
provided by a number of qualified practitioners who are not lawyers. Clients of these
practitioners currently do not enjoy legal professional privilege regarding any tax advisory
services which are the subject to privilege where the services were provided by non-lawyers.
As all South African residents are entitled to equal treatment and rights, the clients of the non-
legal advisors are in effect the victims of discrimination.

\textbf{Detailed factual description of the relevant transaction}

Section 64 of the Tax Administration Act, No 28 of 2011 (“the TAA”) deals with situations
where documents which are subject to legal professional privilege may be obtained during a
search and seizure operation performed by the South African Revenue Service.

\textsuperscript{6} No. 58 of 1962, as amended
\textsuperscript{7} See proviso (i) of section 79(1) of the ITA (since repealed with the introduction of the TAA)
The TAA does not contain a definition of "legal professional privilege" nor does it contain any provisions in terms of which the term can be said to apply to material produced or prepared by other non-legal professional. The discriminatory aspect of the exclusion of legal professional privilege in the case of tax law has been recognised by various other countries such as Canada, Australia, New Zealand, the United Kingdom of Great Britain, and Hong Kong to mention a few.

As South Africa prides itself as a nation with one of the most advanced Constitutions, the exclusion of clients of non-legal professionals from the right to legal professional privilege is unwarranted.

**Nature of business impacted by the problem**

All taxpayers who make use of the services of non-legal professional tax services.

**Proposal**

A definition of "legal professional privilege" which states that the privilege will also apply to non-legal professional tax advisors must be inserted into the TAA.

Alternatively, the provisions of section 64 of the TAA must be expanded to include material produced by non-legal professional tax advisors.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

Piet Nel CA(SA)

**PROJECT DIRECTOR: TAX**

*The South African Institute of Chartered Accountants*

cc:  Mmule.Majola@treasury.gov.za  
klouw@sars.gov.za  
ftomasek@sars.gov.za