Dear Madam

CALL FOR COMMENT: DRAFT TAXATION LAWS AMENDMENT BILL 2009 FIRST BATCH (RE-RELEASE)

We refer to the call for comment on the above-mentioned document. Set out below please find the SAICA National Tax Committee’s submission.

1. CLAUSE X1 TO 3 OF DRAFT TAXATION LAWS AMENDMENT BILL

No amendment has been made to Section 5(10).

1.1 Section 5(10)(c) - “B represents the taxpayer’s taxable income (excluding any retirement lump sum benefit or retirement fund lump sum withdrawal benefit) for the said year”. This should be reworded to exclude any lump sum benefit. This will then tie in with the new definition inserted in section 1 by the same Act.

1.2 Section 5(10)(f)(ii) still includes “any amount contemplated in paragraph 2(b) of the Second Schedule which was included in the taxpayer’s income for the year;” represented as “L” in the rating formula. This should either be deleted or an end date must be inserted.

2. CLAUSE X4 CLARIFICATION REQUIRED REGARDING THE DETERMINATION OF "PERIOD DURING WHICH THE SERVICES RENDERED"

2.1 We refer to the determination of the tax-free portion of a lump sum in the circumstances provided for in section 9(1)(g) of the Act in circumstances for example where the taxpayer at some time during his/her career transferred his/her fund credit from a pension fund to a provident fund. There are currently two views regarding the determination of the period during which the services were rendered which should be applied. Supporters of one view argue that the tax-free portion of the lump sum should
be determined with reference to the period of *membership of the provident fund* and not with reference to the taxpayer's *years of service* in respect of which he/she is now receiving the lump sum payment whereas supporters of the other view argue that in these circumstances the period during which the services are rendered relates to the taxpayers total career and not merely the period related to his/her membership of the provident fund.

2.2 Whilst it is clear from the provisions of section 9(1)(g) of the Act, the calculation of the non-resident portion is totally dependent on the *years of service rendered in respect of which the pension or annuity is granted* and no reference is made at all to the period of *membership* of the particular retirement fund, it is unclear whether it can be said that the lump sum to which the taxpayer has become entitled has been granted "in respect of services" rendered by him, and if so, whether it is only in relation to the services rendered by the taxpayer whilst a member of the provident fund, or the total services rendered by him to his employer.

2.3 It is apparent that the present provisions of section 9(1)(g) of the Act, read with paragraph 2(a) of the Second Schedule to the Act, give rise to considerable uncertainty in application. Where previously the tax-free portion of a lump sum derived on retirement was determined by reference to formula A, and formula A was determined by reference to the number of *years of employment taken into account for purposes of determining the amount of benefits payable to the taxpayer under the rules of the retirement fund*, this is no longer the case. As a consequence of the benefit of taking years of employment (service) into account for purposes of formula A, that the revenue authorities allowed a provident fund in these circumstances to carry over the employee's service period under the pension fund on conversion. Having determined the tax-free portion of the lump sum, section 9(1)(g) of the Act would then have been applied to determine the portion of the taxable amount of the lump sum that was regarded as being derived from a South African source.

2.5 Had formula A not been replaced by the graduated tax rate regime (thereby rendering the years of service rendered by the taxpayer redundant for purposes of determining the tax payable in respect of a lump sum), there would have been no doubt that the period of service referred to in formula A and section 9(1)(g) of the Act were the same years of service, namely, in the stated situation, those relating to membership of the pension fund and *provident fund*. It is only now that years of service rendered under a pension and provident fund in the case of *conversion are no longer relevant for purposes of determining the tax-free portion of the lump sum*, an argument that only the period relating to the membership of the last retirement fund, in this instance the provident fund should be used, has arisen.

2.6 Unfortunately, in the absence of any authoritative pronouncements concerning this conundrum, whether by text book writers or the revenue authorities, we are of the opinion that this aspect be addressed in the proposed legislation.
3. **CLAUSE X6 (1) AMENDMENT TO SECTION 18 OF THE INCOME TAX ACT**

3.1 **Section 18(2)(c) and (5)**

It is not clear whether the intention is that the contributions paid by the employer and included in taxable income as a fringe benefit rank for deduction under 18(2)(c)(i) and 18(2)(c)(ii) or only under 18(2)(c)(ii). A strict reading of the amendment seems to indicate that 18(2)(c)(i) will apply first. This would be correct as the amount is included in gross income and if only (c)(ii) applies there may be no relief if the expenditure does not exceed 7.5% of taxable income. We request that this be clarified.

4. **CLAUSE X 7: AMENDMENT TO SECTION 30A OF THE INCOME TAX ACT, 1962**

4.1 There still appears to be uncertainty amongst taxpayers as to the obligation of existing Recreational Clubs, who were previously exempt in terms of other provisions of the “Income Tax Act, to re-apply for exemption in terms of section 30A before 30 September 2010. We propose that this uncertainty be addressed.

5. **CLAUSE X8 (1) AMENDMENT OF PARAGRAPH 1 OF THE SECOND SCHEDULE TO THE INCOME TAX ACT, 1962**

5.1 If paragraph (b) of “formula B” is deleted then the formula in the header of “formula B” Z = C + E – D should also be amended. As an example if someone had a previous lump sum of R300 000 and 120 000 was exempt and disallowed contributions made to a new retirement fund amount to R9 000. The formula then gives a negative result. Z = 0 + 9 000 – 120 000. We would presume this would be limited to nil. This is unfair as the contributions disallowed then are never allowed.

6. **CLAUSE X9 AMENDMENTS OF SECTION 9(1)(G) OF THE INCOME TAX ACT**

6.1 The expansion to specifically include a "lump sum benefit contemplated in the Second Schedule" is welcomed. Although we have argued that a lump sum is nothing more than the upfront payment of any pension or annuity granted to a person, the inclusion of the lump sum benefit now ensures that there is no doubt as regards the application of section 9(1)(g) of the Income Tax Act to these lump sum benefits.

7. **CLAUSE X15 AMENDMENT OF PARAGRAPH 12A OF THE SEVENTH SCHEDULE TO INCOME TAX ACT**

7.1 The amendments proposed in clause 15 of the DTLAB have the effect that the full contribution paid by an employer to a medical aid fund for the benefit of an employee is a taxable fringe benefit. Such amount is to be included in the employee’s
remuneration in full and subjected to employees’ tax. The amendments proposed in clause X6, however, enable the employee to claim a deduction in respect of so much of the employer contributions that does not exceed the capped amounts, listed in section 18(1)(c)(i) of the Income Tax Act. In our view, it is impractical to subject an amount to employees’ tax, merely to allow it as a deduction on assessment. These proposed amendments will also have cash flow implications for employees. We therefore recommend that the proposed amendments be reconsidered.

8. **CLAUSE X16 AMENDMENT TO PARAGRAPH 45 OF THE EIGHTH SCHEDULE TO THE INCOME TAX ACT**

8.1 The amendments proposed in clause X16(1)(a) provide that a natural person or special trust must, when determining an aggregate capital gain or loss, disregard a capital gain or capital loss determined in respect of the disposal of the primary residence of that person, if the proceeds from the disposal of that primary residence do not exceed R2 000 000.

However, clause X16(1)(b) states that this exclusion is not available to persons who have not been ordinarily resident in that residence for the entire period, as from valuation date, during which they held an interest, or who have used part of that primary residence for purposes of a trade. In our view, this is unnecessarily punitive. We recommend that the R2 000 000 exclusion also be made available to such persons, but on an apportionment basis.

**APPENDIX 1 – DRAFT TAXATION LAWS AMENDMENT BILL 2009**

1. **RATES OF NORMAL TAX AND REBATES**

1.1 **Paragraph 10(a)(i) (Withdrawal benefits)**

The deduction of the tax that would be leviable is not clear as it appears the hypothetical amount can be only calculated using the withdrawal table even if the previous lump sum was a retirement.

It is suggested that a reference be made to both tables under this part.

**EXPLANATORY MEMORANDUM – DRAFT TAXATION LAWS AMENDMENT BILL 2009**

1. **MEDICAL SCHEME CONTRIBUTIONS**

1.1 In the Explanatory Memorandum it is stated that this proposed change will be tax neutral for both employers and employees. However, recent press articles in certain financial publications suggested that the employee will only get the deduction for contributions made by employers on assessment (up to 18 months later) as appose to
the current deduction through the payroll system. This does not appear to be tax neutral and will have a significant impact on the cash flow of employees where the employer is making the contributions on their behalf. Although this might not be the intended treatment steps should be taken to clear the confusion.

2. MEDICAL SCHEME CONTRIBUTIONS

2.1 The revised DTLAB states (section 15 of DTLAB) that the amendment to the words preceding paragraph (a) of subsection 1 of section 18 come into effect on 1 March 2009. The words “as exceeds” at the end of this paragraph preceding paragraph (a) is therefore also deleted. The deletion of items (a), (b) and (c) of subparagraph (1) is however only effective 1 March 2010. It is not clear how paragraph 12A(1) of the 7th Schedule will read with part of the amendment only coming into effect on 1 March 2010. The words “as exceeds” before paragraph (1) is deleted while paragraphs (a), (b) and (c) remains unchanged until 1 March 2010.

3. LUMP SUM BENEFIT CALCULATIONS

3.1 In the SARS “Tax Pocket Guide” released after the Budget speech in February 2009, the tax table for “Retirement fund lump sum withdrawal benefits” is stated as R0 to R300 000 (18%), R301 000 to R600 000 (27% and R600 000 and above 36%). This is different to the current table suggested by the DTLAB. There appear to be confusion in the market as to what the correct table is, as SARS has distributed a lot of these “Tax Pocket Guide’s” and a lot of taxpayers are and will rely on them.

From the example on page 6 of the Explanatory Memorandum it is still not clear on the relationship between the withdrawal and retirement table on cumulative application. In the example when the R100 000 is received upon retirement, it is suggested that as a result of the cumulative application of the withdrawal benefits R600 000 previously received that R27 000 tax is to be paid. The total tax paid on the R700 000 therefore would have been R130 950 (R40 950 + R63 000 + R27 000). If the person would have retired with and received R700 000 the tax would only have been R81 000. This is mainly due to the first R300 000 not being taxable upon retirement. The difference between the R81 000 and R130 950 of R49 950 appears to be excessive and should reconsidered. The whole principle of the R300 000 retirement exemption being “lost” should be reconsidered.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully
M Hassan CA(SA)

**PROJECT DIRECTOR: TAX**

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