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Deloitte Africa Tax & Legal Highlights

Draft 2020 Taxation Laws Amendment Bill and the Draft 2020 Tax Administration Laws Amendment Bill

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Introduction

On 31 July 2020 National Treasury published the Draft 2020 Taxation Laws Amendment Bill and the Draft 2020 Tax Administration Laws Amendment Bill which give effect to the 2020 Budget proposals announced on 26 February 2020. The draft bills are open for public comment. Comments are to be made in the form of written submissions by close of business on 31 August 2020. A summary of the more pertinent tax proposals are included below.

References below to the ITA refer to the Income Tax Act No.58 of 1962, to the TAA refer to the Tax Administration Act No.28 of 2011, to the VAT Act refer to the Value-Added Tax Act No.89 of 1991 and to the Carbon Tax Act refer to the Carbon Tax Act No.15 of 2019.

Reimbursing employees for business travel

Where an employee is obliged to be away from the office on a day trip for business purposes, reimbursements paid by an employer in respect of meals and incidental costs are not taxable in the hands of the employee to the extent that they are expended for the purpose of the employer's trade, provided that the employee can prove that the costs were incurred on the instruction of the employer and that proof that the expenditure was wholly incurred for these purposes has been provided to the employer.

The draft proposal aims at clarifying the tax treatment of reimbursements where an employer does not explicitly provide an employee with instructions to incur these expenses. With effect from 1 March 2021, it is proposed that the requirements for the amounts to be treated as non-taxable be widened to instances where the company policy makes provision for and allows for the reimbursement of amounts to employees who have incurred such expenditure at their own discretion. A limit is also proposed to be gazetted, similar to the limits that are set in respect of expenditure that may be incurred when an employee is obliged to spend a night away from home for business purposes. The proposed change will go some way in easing the administrative burden of obtaining specific instructions to incur expenditure and employers should ensure that their policies are updated accordingly.

Employer provided bursaries

Bona fide scholarships or bursaries provided by employers to enable or assist any relatives of an employee to study at a recognised educational or research institution are exempt in the hands of the employee, provided that the employee's remuneration proxy (i.e. the remuneration earned by an employee in the previous tax year, excluding the residential accommodation fringe benefit) does not exceed R600 000 and the value of the bursary does not exceed certain monetary limits. In 2006, amendments were introduced to allow the exemption regardless of whether the scholarship or bursary scheme contained an element of salary sacrifice in order to promote skills development.

In order to curb the increasing number of schemes that have arisen that seek to take advantage of this exemption and the tax planning opportunities it provides, National Treasury proposes to reinstate the exclusion from the exemption provisions where the scheme includes an element of salary sacrifice. In these circumstances, the bursary will be taxable in the hands of the employees. In turn, the corporate tax deduction available to the employer will also only be afforded if the bursary to the employee's relative is not subject to an element of salary sacrifice.

In addition, the exemption in respect of scholarships or bursaries granted to relatives of employees will only apply where such scholarships or bursaries are offered to members of the general public.

Employers should take note of the changes effective from years of assessment commencing on or after 1 March 2021, particularly where salary sacrifices have been allowed or where scholarships and bursaries are not offered to the general public.

Deductions in respect of contributions to retirement funds

In determining the amount of lump sum benefits received from retirement funds to be included in a person's gross income, the Act currently makes allowance for a deduction equal to so much of a person's own contributions to retirement funds that did not rank for deduction against the person's income at the time of contribution. The wording "person's own contributions" inadvertently prevented an employer's contributions made on behalf of employees from qualifying for deduction.

National Treasury has proposed to widen the deduction that may be made against lump sum benefits to include all contributions i.e. both the employee and employer contributions made to retirement funds that did not rank for deduction. The change is proposed to take effect retrospectively from 1 March 2016 in order to eliminate the potential double taxation that could arise post this date.

Withdrawing retirement funds upon emigration

In the 2020 Budget Speech the Minister of Finance announced Government's intention to modernise the foreign exchange control system and, as a consequence, the concept of "emigration" for exchange control purposes will be phased out. This decision necessitates a revision of the Act insofar as the Act makes reference to "emigration" for exchange control purposes.

Currently the Act provides for retirement interests held in pension preservation, provident preservation and retirement annuity funds to be withdrawn when a member emigrates from South Africa and the South African Reserve Bank recognised such "emigration" for exchange control purposes. In line with the phasing out of the concept of emigration for exchange control purposes it has been proposed that, in relation to lump sum benefits referred to in the various fund definitions, a new test be inserted which makes provision for a member to make a withdrawal when the member has ceased to be a South African tax resident and has remained non-tax resident for a consecutive period of at least three years.

The proposed amendments come into effect from 1 March 2021.

Limitation to rollover of amounts claimable under the Employment Tax Incentive

Amounts that may be claimed against an employer's PAYE liability in terms of the Employment Tax Incentive (ETI) programme may be rolled over to the following month in instances where the amount that may be claimed exceeds the PAYE otherwise due that month, if a compliant taxpayer fails to reduce the PAYE payable despite being eligible to make the claim or where a non-compliant taxpayer was not allowed to claim the ETI due to outstanding tax returns or an outstanding tax debt with the South African Revenue Service (SARS).

Compliant taxpayers have until the last month of each reconciliation period (being August and February each year) to make their outstanding ETI claims, failing which the unutilised ETI amounts on either 1 September or 1 March will be deemed to be nil and the unclaimed amounts are forfeited.

However, the time limitation for compliant taxpayers does not extend to non-compliant taxpayers and non-compliant taxpayers are able to claim all outstanding ETI amounts in the first month that the employer is tax compliant without forfeiting any ETI amounts at the end of each reconciliation period.

National Treasury has proposed to amend the ETI provisions so that the time limit applicable to the claiming of outstanding ETI amounts will apply equally to compliant and non-compliant taxpayers. As a result, with effect from 31 July 2020, the rollover ETI amounts will be deemed to be nil on 1 September and 1 March each year for both compliant and non-compliant taxpayers.

This will affect non-compliant taxpayers who have unclaimed ETI amounts. These taxpayers now have until 31 August 2020 to become fully tax compliant in order to avoid forfeiting their unclaimed ETI amounts.

Anti-avoidance rules for trusts

Anti-avoidance measures were first introduced in 2016 to address instances of assets being transferred to trusts in exchange for interest free or low-interest loans that in many instances would remain outstanding or be waived thereby reducing Estate Duty in the hands of the individual. The anti-avoidance measures deem a donation to be made, calculated as the difference between the actual interest charged on the loan and interest had the SARS official rate of interest been applied, by the individual who advanced the loan or at whose instance a company advanced the loan, in every year of assessment that the loan remains outstanding. Further anti-avoidance measures were introduced in 2017 to address instances where the loan is not provided directly to a trust but rather to a company that is a connected person in relation to a trust.

The current proposals address further tax schemes that have been implemented by taxpayers in order to circumvent the anti-avoidance rules, namely the subscription of no or low value preference shares in a company whose shares are held by a trust that is connected to a natural person.

In terms of the proposal, the subscription price of preference shares will be deemed to be a loan advanced and any dividends in respect of those preference shares will be deemed to be interest for the purposes of the anti-avoidance provisions. These new provisions would apply where an individual (or at the instance of an individual, a company that is connected in relation to that natural person), subscribes for preference shares in a company if at least 20% of the equity shares in that company are directly or indirectly held or the voting rights can be exercised by a trust that is a connected person in relation to the subscribing individual, whether alone or together with any person who is a beneficiary.

The proposed amendments will come into operation from years of assessment commencing on or after 1 January 2021 and highlight National Treasury's continued focus on eliminating the use of trusts in complex tax planning schemes.

Long-term insurers

Long-term insurers are subject to income tax annually on, *inter alia*, surplus assets allocated to the respective policyholder funds and the risk policy fund. To the extent that the market value of assets allocated to and held by the fund exceeds the value of its policyholder liabilities, the insurer is required to transfer assets equal to the surplus from that fund to the corporate fund to be taxed at 28%.

While section 29A makes provision for the allocation to be determined with reference to the market value of assets in the policyholder funds and risk policy fund, it is not clear what should happen with assets that do not have a "market value" as defined (currently the term "market value" is defined with reference to the sale of an asset in an open market). For example, assets such as prepayments or intangible assets may in some instances not have a "market value" as defined, although they are treated as assets for financial reporting purposes.

National Treasury proposes amending the definition of "market value" in section 29A to make provision for the value of assets that can only be disposed of as part of a going concern to be the amount as disclosed in the audited financial statements at the end of the year of assessment. The proposed amendment will come into operation on the date of promulgation of the Taxation Laws Amendment Act of 2020.

We welcome this clarification as it provides certainty on the valuation of such assets for the purposes of determining taxable transfers. The move to align tax and accounting values also simplifies the application of these provisions.

Deductions claimed in respect of premiums paid in respect of short-term insurance policies

In terms of section 23L, a deduction may only be claimed for premiums paid in respect of short-term insurance policies if the premiums are recognised as an expense for IFRS reporting purposes. The section aims to prohibit the deduction of short-term insurance premiums where the premiums represent a contribution to a disguised investment, being the insurance policy. Where the premiums are deductible in terms of section 23L, the policy benefits are taxable in the hands of the taxpayer. However, where the deduction of the premiums has been limited by the application of section 23L, the policy benefits are only taxable to the extent that they exceed the premiums that were not deductible in terms of section 23L.

On the other hand, section 23(c) disallows the deduction of expenditure that is recoverable through a policy of insurance. Currently the interaction between section 23(c) and section 23L is unclear and it is possible that section 23(c) could operate to prohibit the deduction of premiums that were otherwise deductible under section 23L. While the premiums are not actually deducted, the policy benefits are still taxable without any relief being granted for premiums that were not deducted as they were deductible in terms of section 23L.

In order to clarify the interaction between these provisions it has been proposed that section 23(c) should be amended so that the provisions of section 23L override the application of section 23(c). As such, going forward section 23(c) should no longer prohibit the deduction of insurance premiums that are otherwise deductible in terms of section 23L. This amendment is effective from years of assessment commencing on or after 1 January 2021.

Curbing potential anti-avoidance caused by dividend deductions

Section 24JB requires brokers, banks and most companies and trusts that form part of a banking group as defined in the Banks Act to include in or deduct in the determination of taxable income all amounts recognised in profit and loss in the statement of comprehensive income in respect of financial assets and liabilities, subject to specific exceptions. One such exception are dividends received or accrued. However, dividends paid or declared are not excluded from the application of the provisions.

Schemes have been identified that interpose a special purpose vehicle within a banking group between the bank and the investor that successfully convert underlying taxable returns of the special purpose vehicle to dividends that are exempt in investors' hands by distributing the investment returns to the investors as a dividend. As the special purpose vehicle is subject to the provisions of section 24JB it generally remains neutral as dividends paid to investors are deducted against the returns earned by it.

In order to close this loophole, National Treasury has proposed to extend the exclusions from the provisions of section 24JB to dividends declared. This amendment is effective from years of assessment commencing on or after 1 January 2021.

Clarifying the meaning of a share in the definition of REIT

Specific tax rules apply to REITs and 'controlled companies'; most notably these entities may claim a tax deduction for distributions to shareholders in appropriate circumstances. Currently, a REIT is defined with reference to, inter alia, a company whose shares are listed on a recognised exchange.

It is proposed that the REIT definition be amended to clarify that it is the company's equity shares that must be listed on a recognised exchange. The reason stated for the change is that it has come to Government's attention that some REITs are considering issuing and listing preference shares on a recognised exchange and that granting REIT tax dispensation to distributions on such preference shares was never intended.

The proposed amendment will come into operation on 1 January 2021 and will apply in respect of years of assessment commencing on or after that date.

It is submitted that merely changing the definition of a REIT in the manner proposed will not have the desired impact because if the company has both equity shares as well as preference shares listed on a recognised exchange that entity will continue to qualify as a REIT and the tax dispensation available to the REIT will continue to apply and may extend to preference shares. For example, dividends paid on preference shares could qualify as "qualifying distributions" in respect of which a tax deduction may be claimed by the REIT. Similarly, dividends received by the preference shareholder from the REIT will not be exempt from normal tax.

Amending the taxation of foreign dividends and foreign gains received by REITs

As noted above, REITs and 'controlled companies' can in appropriate circumstances claim a tax deduction for distributions to shareholders. As the law currently stands, a REIT or controlled company can also avail itself of the participation exemption for foreign dividends (section 10B of the Act) and capital gains (paragraph 64B of the Eighth Schedule to the Act), that are generally available to all taxpayers.

It is proposed that REITs or controlled companies should no longer qualify for the participation exemptions referred to above that are generally available to all taxpayers. The reason stated for the change is to address a perceived mismatch, as it is claimed (wrongly in our view) that REITS or controlled companies may claim a full deduction when they distribute foreign dividends or capital gains that have previously qualified for participation exemption.

The proposed amendment will come into operation on 1 January 2021 and will apply in respect of years of assessment commencing on or after that date.

The reason stated for the proposed change appears to overlook the fact that, based on current legislation, the deduction that a REIT or controlled company may claim in respect of a 'qualifying distribution' is limited to the entity's taxable income for that year of assessment before taking into account, inter alia, any taxable capital gain. Therefore, to the extent that a participation exemption has been claimed in respect of a foreign dividend the deductible qualifying distribution that a REIT or controlled company can claim is already reduced. Furthermore, as the qualifying distribution that a REIT or controlled company can deduct is to be determined before taking into account any taxable capital gain, denying a REIT or controlled company a participation exemption on foreign capital gains will result in such gains being taxed in the hands of the REIT or controlled company (unless the foreign capital gain relates to the disposal of a REIT or 'property company', as defined). Finally, if the proposal is adopted and a REIT or controlled company finds itself in a position where it receives a foreign dividend but is unable to make a 'qualifying distribution' (because at least 75% of its gross income does not relate to 'rental income', as defined), the entity will not be able to claim a tax deduction for its distributions and will find itself worse off than other taxpayers.

Doubtful debts allowance for taxpayers not applying IFRS 9

Where a taxpayer does not apply IFRS 9 that taxpayer may claim a section 11(j) allowance in respect of doubtful debts, if those debts would qualify for a deduction should they become bad, in accordance with the aging of the debts.

Such allowances are determined without taking into account any security given in respect of such debt. This is inconsistent with the treatment applicable where taxpayers apply IFRS 9. As such, it has been proposed that the section 11(j) provisions applicable to taxpayers that do not apply IFRS 9 be amended so that any security given in respect of debt is taken into account when determining the section 11(j) allowance. This is intended to create parity between the provisions applicable to taxpayers that apply IFRS 9 and those that don't. The proposed amendment is effective from years of assessment commencing on or after 1 January 2021.

Alignment of doubtful debts allowances applicable to banking regulated taxpayers with other taxpayers

Section 11(jA) provides for a doubtful debts allowance to be claimed by banking regulated taxpayers. The allowance is based on the loss allowance relating to impairment recognised in terms of IFRS 9. Similar allowances are provided for non-banking regulated taxpayers under section 11(j) where such taxpayers apply IFRS 9 and for those taxpayers that do not apply IFRS 9.

Currently, section 11(jA) allows a banking regulated taxpayer to claim an allowance in respect of all impairments recognised in terms of IFRS 9 whereas section 11(j) only allows a doubtful debts allowance to be claimed where the doubtful debt would qualify for deduction, in terms of one of the provisions of the Act, should that debt become bad. In order to align the section 11(jA) provisions applicable to banking regulated taxpayers with the section 11(j) provisions that are applicable to taxpayers generally, it has been proposed that the section 11(jA) provisions be restricted. In terms of this proposal, from years of assessment commencing on or after 1 January 2021, banking regulated taxpayers will not be allowed to claim a deduction in respect of an impairment of a financial asset unless the ultimate write-off of the financial asset would qualify for deduction in terms of the general deduction formula (section 11(a)) or as a bad debt in terms of section 11(i).

Clarifying the tax treatment of doubtful debts for taxpayers carrying on leasing businesses

The doubtful debt provisions contained in sections 11(j) and 11(jA) currently prohibit the deduction of a doubtful debt allowance in respect of loss allowances recognised in terms of IFRS 9 in respect of the impairment of lease receivables. Taxpayers that conduct leasing operations may recognise lease receivables in respect of both amounts that have accrued to the taxpayers (i.e. arrear lease payments) and those that have not yet accrued to the taxpayer (i.e. future lease amounts). Therefore, the impairment of lease receivables recognised in respect of IFRS 9 apply to both arrear lease payments and future lease amounts.

The provisions as they are currently worded prejudice taxpayers that apply IFRS 9 and conduct leasing operations to the extent that impairments are recognised in respect of arrear lease payments. The arrear lease payments are no different from the amounts in respect of which other taxpayers claim a doubtful debts allowance. Thus, there should be no reason why these amounts do not qualify for a doubtful debts allowance. In addition, taxpayers that operate leasing operations that do not apply IFRS 9 can claim a doubtful debts allowance in respect of arrear lease receivables that have been outstanding for a sufficiently long period of time.

In order to address these anomalies, National Treasury has proposed to amend sections 11(j) and 11(jA) to allow all taxpayers to claim a doubtful debts allowance in respect of arrear lease receivables. While this clarification is welcomed the correction is made prospectively and taxpayers will have to wait for years of assessment commencing on or after 1 January 2021 before being able to apply the new provisions.

Addressing tax avoidance involving collateral and lending arrangements

Provisions exist in the ITA to prevent the avoidance of dividends tax through the use of collateral and lending arrangements. Collateral and lending arrangements contemplate the transfer of a listed share as collateral or the lending of shares by a lender to a borrower. These arrangements are generally not subject to income tax provided that identical shares are returned to the lender by the borrower within a limited period of time from the date on which the arrangement was entered into. However, in the absence of specific anti-avoidance provisions dividends tax can be avoided by structuring these arrangements so that dividends are beneficially received by a person not subject to dividends tax.

Despite the existing anti-avoidance provisions, Government has determined that dividend conversion schemes that consist of a series of transactions concluded between different parties in the period between the date the dividend is declared and the date the dividend is paid continue to avoid the payment of dividends tax. Key to the success of these schemes is that the person who pays the manufactured dividend to the person avoiding the dividends tax no longer holds a share in the company that declared the dividend.

In order to counter the avoidance of these schemes it is proposed that section 64EB(2) be amended to delete the requirement that the person who pays the manufactured dividend holds a share in the company that declared the dividend.

The proposed amendment is effective in respect of amounts paid in respect of shares that are borrowed or acquired in terms of a collateral arrangement.

Addressing anomalies on the acquisition of assets in exchange for debt issued

In terms of section 40CA, where a company acquires any asset in exchange for any amount of debt issued by that company, the company is deemed to have actually incurred an amount of expenditure in respect of the acquired asset equal to the amount of the debt. Section 40CA also contains rules that deal with the disposal of assets in exchange for the issue of shares by a company. Ordinarily, the provisions contained in paragraph 38 of the Eighth Schedule to the ITA deem a disposal which takes place between connected persons to take place for an amount received or accrued equal to the market value of the asset on the date of disposal. However, these provisions do not apply where the provisions of section 40CA apply. The interaction between these two provisions has created an opportunity for connected persons to avoid transacting at market value by selling an asset in exchange for the issue of debt for less than the market value of the asset and the parties are taxed in accordance with the value of the debt issued.

National Treasury has proposed that the provisions of section 40CA be amended so that the rules are deleted insofar as they relate to the issue of debt by a company. As such, it has been proposed that section 40CA(b) be deleted. Post the deletion of these provisions, connected parties will no longer be able to rely on the carve-out in paragraph 38(2)(e) of the Eighth Schedule to the ITA where an asset is sold in return for the issue of debt by a company. Thus, ordinary tax principles will apply in the determination of the amount deemed to be received by or accrued to the seller and the base cost of assets acquired by the purchaser where an asset is disposed of in exchange for the issue of debt. The proposed amendment comes into operation on 1 January 2021 and applies in respect of acquisitions made on or after that date.

Refining the interaction between the anti-avoidance provisions for intra-group transactions

Where debt and non-equity shares are issued in consideration for the disposal of an asset and the transaction constitutes an 'intra-group transaction' as defined in section 45, the debt and non-equity shares are deemed to have a zero base cost in the hands of the transferor (i.e. seller of the asset) in terms of section 45(3A) of the ITA. However, any gain or income that arises from the repayment of such debt or non-equity shares is tax neutral if the repayment thereof takes place between parties that form part of the same group of companies.

In terms of an anti-avoidance rule contained in the section 45 provisions, a de-grouping occurs when a transferor company ceases to form part of the same group of companies as the transferee company within six years of the date of the intra-group transaction. In the instance that the de-grouping rule is triggered, any deferred tax consequences from the intra-group transaction are triggered in the hands of the transferee company which in effect reverses the tax benefit of that original intra-group transaction.

An anomaly exists when the transferor and transferee cease to form part of the same group of companies and they were subject to an intra-group transaction where assets were disposed of by the transferor to the transferee on loan account. On the date of de-grouping, the transferee will trigger taxes as discussed above. If the loan between the transferor and transferee is still outstanding on the date of de-grouping, any subsequent settlement of that loan will result in a capital gain for the transferor as the loan has a nil base cost and the transferor and transferee no longer form part of the same group of companies. As such, it is possible for tax to be paid twice on the same transaction, firstly in the hands on the transferee and then in the hands of the transferor.

In order to address this anomaly it has been proposed that on the date that the transferor and transferee cease to form part of the same group of companies, the debt or non-equity shares in respect of which the zero base cost rules applied should be deemed to have a base cost equal to its market value on the date of the intra-group transaction *less* any repayments made in respect of debt or reductions in the base cost made in respect of non-equity shares prior to the de-grouping.

The proposed amendments will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date. We are in agreement with this amendment.

Limiting rollover relief in respect of unbundling transactions

The corporate reorganisation provisions applicable to 'unbundling transactions' contemplated in section 46 currently do not apply if immediately after the transaction 20% of the shares in the unbundled company are held by "disqualified persons" either alone or together with connected persons that are also 'disqualified persons'.

National Treasury has proposed that the 20% 'disqualified person' rule should be amended so that it applies without regard to whether the disqualified persons are connected or not. The reason for the change as outlined by National Treasury is that there has been an "increased use of the unbundling transaction provisions to erode the tax base in structures that use unbundling transactions to distribute shares of unbundled companies tax free to non-resident investors".

In our view, the amendment as currently drafted goes beyond the mischief which it aims to curb. The definition of disqualified persons in section 46(7) includes more than just non-resident persons, for example retirement funds and PBOs are also disqualified persons. The amended provisions will apply in situations where immediately after the distribution of shares in terms of an unbundling transaction 20% or more of the shares in the unbundled company are held in aggregate by "disqualified persons". As such, if 10% of the shares in a company are held by a non-resident and a further 10% is held by a retirement fund immediately after the company is unbundled in terms of an unbundling transaction, the transaction will not qualify for rollover relief in terms of the proposed amended provisions of section 46.

The proposed amendment applies to unbundling transactions entered into on or after 31 July 2020.

Transfer pricing rules applying to controlled foreign companies (CFCs)

A taxpayer is obliged to make a transfer pricing adjustment when an "affected transaction" (i.e., a transaction between connected persons that includes any non-arm's length term or condition) results in a "tax benefit" for a party to that transaction. A "tax benefit" is defined as "…any avoidance, postponement or reduction of any liability for tax". "Tax" is defined as meaning a "tax… imposed in terms of this Act", i.e. the South African Income Tax Act.

Any non-arm's length transaction between a CFC and its non-resident connected person also qualifies as an "affected transaction". The aim is to impute the understated "net income" of a CFC to its resident shareholder for the purpose of determining the latter's South African taxable income. However, where neither the CFC nor its non-resident connected person is subject to South African income tax, no party to the transaction would derive a "tax benefit". Therefore, arguably, the resident shareholder does not have to make a transfer pricing adjustment in respect of the CFCs understated net income.

In order to address this perceived deficiency in the legislation, National Treasury has proposed to expand section 31(2) to include within it scope "any tax benefit being derived…by any resident in relation to a controlled foreign company". The proposed amendment should address the "tax benefit" requirement effectively in this context. The amendment is proposed to come into operation on 1 January 2021 and will apply in respect of years of assessment commencing on or after that date.

Reference to "associated enterprises" in the transfer pricing rules

It was proposed in the 2019 tax amendments that the ambit of the transfer pricing rules be widened to include cross-border transactions between "associated enterprises" (in addition to those between connected persons) with effect from 1 January 2021. The proposed amendment has been postponed to come into operation on 1 January 2022 and will apply in respect of years of assessment commencing on or after that date.

New anti-avoidance provision regarding change in residence

While a South African tax resident company is deemed to dispose of all of its assets at market value for capital gains tax purposes when it ceases to be a South African tax resident, there are currently no tax implications for the shareholders of such companies. On the other hand, South African tax resident shareholders may dispose of shares held in a foreign company where those shares represent an interest of at least 10% of the equity shares and voting rights in the foreign company, have been held for at least 18 months, and are sold to a non-resident, without incurring any tax cost as the capital gain or loss on disposal is disregarded in terms of paragraph 64B of the Eighth Schedule to the ITA.

It has come to the attention of National Treasury that schemes are being employed where South African residents dispose of shares in a company following its change in residence from South Africa to another jurisdiction with no tax consequences as a result of the application of the participation exemption contained in paragraph 64B of the Eighth Schedule to the ITA.

In order to close this loophole, it has been proposed that section 9H be amended such that a shareholder that holds shares in a South African resident company that changes its place of residence to another country be deemed to have disposed of its shares in the South African resident company at market value on the day before the company ceases to be a South African resident and to have reacquired those assets at the same market value on the day of exit.

The proposed amendment comes into operation on 1 January 2021 and applies where a South African resident company ceases to be resident on or after that date.

Anti-avoidance provision regarding taxation of foreign dividends received by residents

Section 10(1)(k)(i) of the ITA makes provision for dividends received or accrued from South African resident companies to be exempt from normal tax, subject to certain exceptions. One of these exceptions is where a company incurs an obligation to pay deductible expenditure that is determined directly or indirectly with reference to dividends in respect of an identical share to the share from which the company received or accrued a dividend. In such cases, the dividend is taxable to the extent of the deductible expenditure. There is a further proviso to this exception in that the deductible expenditure should be reduced by any amount of income accrued to the company in respect of any distribution in respect of any other share that is an identical share.

Similarly, section 10B set outs the circumstances in which foreign dividends received or accrued are exempt. However, there is currently no anti-avoidance rule to be applied to the foreign dividends received as set out above for local dividends. The proposal inserts an anti-avoidance section to address this anomaly by applying the same proviso as for local dividends i.e. the foreign dividend is taxable to the extent of any deductible expenditure which has been determined directly or indirectly with reference to foreign dividends in respect of an identical share to the share from which the company received or accrued the foreign dividend. The deductible expenditure should also be reduced by any amount of income accrued to the company in respect of any distribution in respect of any other share that is an identical share in relation to that share.

The proposed amendments come into operation on 1 January 2021 and apply to foreign dividends received or accrued on or after that date.

Limiting the application of dividend and capital gain exemptions in loop structures

Currently, it is a contravention of the exchange control rules for a resident to set up an offshore structure that re-invests into the Common Monetary Area (CMA), consisting of South Africa, Namibia, Lesotho and Eswatini, by acquiring shares or other interests in a CMA company or CMA asset (known as a “loop structure”). However, in terms of an exception to this rule individuals and private South African companies are permitted to acquire up to 40% equity or voting rights in a foreign company which may in turn hold investments (including loans) in any CMA country. Where the 40% threshold is exceeded, approval is required of the Financial Surveillance Department of the South African Reserve Bank (SARB).

As part of government’s review of the current exchange control rules, it is proposing to relax the requirement for approval where the 40% shareholding is exceeded. While the ITA contains some rules that may reduce the risk of loop structures, increased tax planning opportunities may arise as a result of such relaxation.

Dividend exemption applicable to CFCs
Currently, dividends received by a controlled foreign company (CFC) from a South African resident company that qualifies for exemption under section 10(1)(k)(i) would not be included in the net income of a CFC.

To curb possible tax avoidance in the instance of loop structures, it is proposed that changes be made to the CFC legislation so as to require a portion of a dividend received or accrued from a resident company to be included in the net income of a CFC. The portion to be included will be determined by applying the fraction 20/28 to the amount of the dividend received or accrued from the resident company.

The proposed amendment applies to any dividends received by or accrued to a CFC during any foreign tax year commencing on or after 1 January 2021.

Disposal of shares in a CFC
Currently, gains on the disposal of shares in a foreign company to a non-resident are not taxed if the participation exemption applies in terms of paragraph 64B of the Eighth Schedule to the ITA.

In a further effort to limit the avoidance of tax through the use of loop structures, it is proposed that the participation exemption not apply to the disposal of shares in a CFC to the extent that the value of the assets of the CFC are derived from South African assets, i.e. assets that are directly or indirectly located, issued or registered in South Africa.

The proposed amendment will come into operation on 1 January 2021 and applies in respect of the disposal of shares in a CFC on or after that date.

Determination of taxable capital gains of a CFC
It is further proposed that taxable capital gains of a CFC will be determined by applying the inclusion rate applicable to companies, currently 80%, irrespective of the nature of the shareholder. In terms of the existing CFC rules, where the net income is determined in respect of a shareholder of a CFC that is an individual only 40% of the net capital gain of the CFC is included. This rule will not apply after the amendment of the provisions.

The proposed amendment applies in respect of any net capital gain received by or accrued to a CFC during any foreign tax year commencing on or after 1 January 2021.

Taxation of the transfer of listed securities to an offshore exchange
In preparation for the replacement of the existing exchange control rules with a new capital flow management framework that is aimed at making capital flows easier and to reduce the administrative burden of obtaining SARB approvals, tax rules are being introduced which deal with the tax consequences where a South African resident who holds shares in a company listed on the JSE transfers those shares from the JSE register to a register on an exchange outside of South Africa where the company is also registered on that other exchange.

The provisions will be contained in section 9K which will be inserted into the ITA with effect from 1 January 2021 and will apply to any security that is listed on an exchange outside of South Africa on or after that date.

In terms of these new provisions, a South African resident will be deemed to have disposed of the shares transferred to a register on an exchange outside of South Africa at market value on the day that the share is listed on the foreign exchange and will be deemed to have reacquired those shares on the same day with a cost equal to the market value at the time of the deemed disposal. This will establish a new base cost in respect of the shares in the hands of the resident taxpayer and future capital gains tax consequences will be determined with respect to this new base cost.

Narrowed application of mining capital expenditure deductions

In terms of the 2019 *Benhaus* judgment the Supreme Court of Appeal (SCA) ruled that contract miners, i.e. contractors who extract minerals from the soil on behalf of mineral rights holders for a fee, conduct "mining operations" as defined and therefore qualify to deduct capital expenditure on an accelerated basis in terms of the mining tax provisions contained in sections 15 and 36 of the Act.

Following this judgment, National Treasury now proposes to limit the application of these provisions to only those taxpayers that hold a mining right in respect of a mine where mining operations are conducted. The proposed amendments come into effect on 1 January 2021 and apply to expenditure incurred on or after that date.

This is significant for contract miners who have relied on the *Benhaus* judgment and have claimed capital expenditure on an accelerated basis in terms of the mining tax provisions. Not only will these taxpayers be precluded from claiming such deductions from 1 January 2021, but consideration will need to be given to the treatment of any unredeemed mining capital expenditure at that date.

Discretion granted to Commissioner to relax the ring-fencing of mining capital expenditure per mine

Section 36 which allows the deduction of mining capital expenditure on an accelerated basis applies to each mine of a taxpayer on a ring-fenced basis. As such, the mining capital expenditure of a loss-making mine cannot be set off against the taxable profits of another mine so that the overall tax liability of the taxpayer is reduced. In terms of the existing provisions only the Minister of Finance may relax the ring-fencing provisions in consultation with the Cabinet member responsible for mineral resources.

It has been proposed that that the Minister of Finance's discretion be removed and replaced with a directive process whereby taxpayers may apply to the Commissioner to deem two or more mines operated by that taxpayer to be treated as one for the purpose of applying the mining capital expenditure ring-fencing provisions. Factors that will be taken into account include the contiguity of the mines, whether they are operated as one mine and whether they are accounted for and treated as one mine by the taxpayer. Other factors not listed may also be taken into account if these are deemed necessary by the Commissioner.

The aim of the proposed amendment is to achieve administrative efficiency for taxpayers that wish to treat two or more mines as one for the purposes of the mining capital expenditure ring-fencing provisions. A prescribed process to make such an application and the listing of factors that may be considered in evaluating the application should also make the relaxation of the ring-fencing provisions more accessible to taxpayers. These proposals are effective from years of assessment commencing on or after 1 January 2021.

Sunset date in respect of SEZs

The Special Economic Zone (SEZ) tax regime provides for certain tax benefits in the form of a reduced corporate income tax rate of 15% and accelerated capital allowances in order to incentivise qualifying companies to invest in and operate from within demarcated zones, SEZs, within South Africa. The provisions were introduced in the ITA in 2013 and were intended to become effective in 2014. However, due to delays in publishing the required Gazette notices approving specific SEZs the provisions only became effective in 2018. The SEZ provisions contained in section 12R (defines a 'qualifying company') and section 12S (accelerated capital allowances in respect of buildings) currently cease to apply from years of assessment commencing on or after 1 January 2024. Where qualifying taxpayers commenced trading in the SEZ after 2014, section 12R will continue to apply until 10 years after the commencement of trade in a SEZ. The initial sunset date of 2024 was based on a 10 year period from the anticipated operation date of the SEZ Act being 2014.

National Treasury has proposed to extend the sunset date of the SEZ provisions to 2028 in order to provide for a minimum period of benefit of 10 years since the provisions became effective in 2018. However, the proposal is that this date will be a final date and that the SEZ tax incentive will cease to apply for all qualifying taxpayers in respect of years of assessment commencing on or after 1 January 2028. This will have an impact on those qualifying companies who have only recently invested in SEZs and that have either commenced training since 2018 or have not yet commenced trading, as they will only benefit from the lower corporate income tax rate of 15% until 2028. This may translate to a period of benefit of less than 10 years despite the period of 10 years being taken into account in their initial investment decisions.

The proposed change to the sunset date is deemed to come into operation on 9 February 2016 when the provisions originally came into operation.

Anti-avoidance provisions for Venture Capital Companies

Anti-avoidance measures were implemented in 2018 to disallow deductions claimed in terms of the Venture Capital Company (VCC) tax incentive regime where the taxpayer holds more than 20% of any class of shares in a VCC. This provision, implemented to prevent certain abusive schemes, causes inadvertent consequences, especially where the 20% shareholding is breached upon the legitimate unwinding of the underlying investment into a qualifying company related to that class of share.

In order to address this issue, it has been proposed that the 20% shareholding may be allowed to be exceeded if the VCC notifies SARS in writing of its intention to cancel a class of shares within the VCC and does so within six months of that notification. The proposed amendment is deemed to have come into operation on 31 July 2020.

Changes to the value-added tax (VAT) treatment of corporate rule transactions

Section 8(25) of the VAT Act provides for VAT relief in respect of corporate reorganisation transactions that take place between group companies by treating the supplier and the recipient as one and the same person, provided that the relevant rollover relief provisions contained in sections 42, 44, 45 or 47 of the ITA are complied with. However, in respect of section 42 (asset-for-share transactions) or section 45 (intra-group transactions) the relief is limited to a supply of an enterprise or part of an enterprise capable of separate operation, where the parties have agreed in writing that the enterprise or part thereof is disposed of as a going concern. As such where section 42 or section 45 rollover relief does not apply to certain assets supplied as part of a larger transaction, the transfer of such assets do not qualify for VAT relief despite being supplied as part of a going concern.

On the other hand, section 11(1)(e) of the VAT Act provides for the zero-rating of a supply of an enterprise or part of an enterprise capable of separate operation, where the parties have agreed in writing that the enterprise or part thereof is disposed of as a going concern, both parties are vendors and other requirements specified in SARS Interpretation Note 57 (dated 31 March 2010) are met.

Where the limitation in section 8(25) applies in respect of section 42 and section 45 transactions, the assets that fall outside of the corporate rollover provisions generally do not constitute a going concern. Therefore, the zero-rating in section 11(1)(e) of the VAT Act can arguably not be applied. Furthermore, as the transaction i.e. the supply of the going concern partly falls within the ambit of the rollover provisions section 11(1)(e) can arguably not be applied to zero-rate the entire transaction as the transaction is subject to the provisions of section 8(25).

In order to address this perceived limitation in the VAT relief provided in respect of section 42 and section 45 transactions where a going concern is supplied, National Treasury has proposed to include an election that may be made by the parties to the transaction to either apply the VAT relief specific to corporate reorganisations or to provide the zero-rating provisions applicable to the supply of a going concern provided that the necessary requirements for zero-rating are met.

These amendments are proposed to come into operation on 1 April 2021.

Aligning the carbon fuel levy adjustment with the Carbon Tax Act

Carbon Tax is currently levied and collected through the fuel levy mechanism. This portion of the fuel levy, the carbon fuel levy, is administered as part of the Customs and Excise Act.

While carbon tax rates are adjusted in January each year, this adjustment does not currently flow through to the fuel levy. To do so, a necessary link between the Carbon Tax Act and the Customs and Excise Act is required to ensure that increases enabled by the Carbon Tax Act automatically flow through to the fuel levy.

To address this issue, amendments have been proposed to amend the relevant Notes to the Customs and Excise Act in order to include formulas to calculate the carbon fuel levy rates, with reference to the Carbon Tax Act. These amendments are proposed to come into operation on 1 January 2021.

Carbon Tax "pass through" for the regulated liquid fuels sector

The 2013 Carbon Tax Policy Paper recommended a limited, transparent and equitable "pass-through" mechanism for carbon tax costs in order to recover a portion thereof against the carbon tax liability.

The current regulated nature of petrol and diesel fuel prices, however, does not allow refineries the ability to recover carbon tax costs for regulated fuels. This differs from the tax-free allowances for fuel combustion and fugitive emissions and as such, it is proposed that a limited deduction be allowed of carbon tax costs for regulated fuels offset against the carbon tax payable in terms of a new proposed formula.

The proposed amendment comes into operation on 1 January 2021 and affects refineries that produce regulated fuels.

Removal of requirement to prove intent in prosecuting tax offences

Currently the provisions in the ITA, the TAA and the VAT Act that deal with criminal offences relating to non-compliance with tax acts refer to acts that are carried out intentionally and with negligence.

Intent has a positive character and refers to actions that are carried out purposefully and knowingly. To prove intent is a subjective test and depends on the mind of the perpetrator at the time of carrying out his/her actions. On the other hand, negligence has a negative character. It refers to actions that are not designed and it requires a lesser degree of fault to be shown. Negligence is tested against the actions of a reasonable man. Thus, if a reasonable man could have contemplated the outcome of his actions and, specifically in these circumstances, that his/her action may constitute a tax offence, that person may be held criminally liable for his/her actions.

While it is technically not possible to act with intent and negligence at the same time and the current wording of the provisions needs to be corrected to address this, it is particularly difficult to prove intent. As a result the National Prosecuting Authority (NPA) currently experiences difficulty in criminally prosecuting non-compliant taxpayers. As such, it is proposed that paragraph 30 of the Fourth Schedule to the ITA, section 234 of the TAA and section 58 of the VAT Act be amended to delete the requirement of intent in committing tax offences in order for such actions to be criminally prosecuted. While this may make it easier for the NPA to criminally prosecute non-compliant taxpayers, the degree of fault of the taxpayer will still be relevant to determining the sanctions that are imposed in penalising such offence. As such, the question of whether an act of non-compliance is intentional or negligent will still be relevant for these purposes.

The proposed amendments come into operation upon promulgation of the 2020 Tax Administration Laws Amendment Act.

Estimated assessments

SARS may currently issue an assessment based on an estimate where a taxpayer fails to submit a return or where a taxpayer submits a return or information that is incorrect or inadequate.

National Treasury has proposed to extend these provisions so that SARS may also estimate an assessment where a taxpayer fails to submit relevant information requested by SARS after the taxpayer has received more than one request for such information. As such, taxpayers should take care to respond to requests for information received from SARS timeously and adequately.

The proposed amendments come into operation upon promulgation of the 2020 Tax Administration Laws Amendment Act.

Refund of withholding tax where royalties are irrecoverable

Withholding tax is payable in respect of royalties when royalties become due and payable. Where the royalties subsequently become irrecoverable, there is no mechanism to allow for the refund of the withholding tax paid.

It has now been proposed that the provisions of section 49G of the ITA are amended so that a refund is allowed where withholding tax has been paid in respect of royalties that have become irrecoverable. The proposed amendment aligns the royalty withholding tax provisions with the interest withholding tax provisions.

The proposed amendments come into operation upon promulgation of the 2020 Tax Administration Laws Amendment Act.

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