SA Budget 2019/20 – A further win for the youth

The historically high levels of unemployment among the youth in South Africa has led to the introduction of various tax incentives and benefits aimed at encouraging the employment and training of such persons. Among these is the employment tax incentive (ETI) scheme which was introduced by the Employment Tax Incentive Act, No 26 of 2013 (ETI Act).

The ETI is a temporary tax incentive aimed at encouraging employers to employ young employees between the ages of 18 and 29, as well as employees of any age in special economic zones and industries indicated by the Minister of Finance. The benefit for employers is that the ETI enables eligible employers to reduce the amount of employees tax due by them by the ETI amount claimed.

The ETI scheme originally came into operation on 1 January 2014 and was legislated to end on 28 February 2019, after which date no further ETI credits would be claimable by any employer. A review of the ETI scheme presented the following positive outcomes:

- The employment growth rate and number of employees increased significantly in firms that claimed the ETI;
- The ETI improved employment growth rates even in firms with deteriorating employment rates, thereby demonstrating the role played by the ETI in halting job losses; and
- The retention rate of the ETI employees after the two-year eligible period has lapsed is substantial as employers are inclined to retain those employees who have gained experience and training.

Given the success of the ETI scheme, it has been proposed that the period for which the scheme applies be extended by 10 years. Employers will therefore be able to claim the ETI for qualifying employees until 28 February 2029.

A further amendment has also been proposed to cater for the effects of inflation. In this regard, it is noteworthy that the ETI is claimable in respect of employees earning income within specified income bands. From 1 March 2019, employers will be entitled to claim the maximum value of R1,000 per month for each employee earning up to R4,500, where previously this amount was R4000. The maximum monthly income earned by employees to qualify for the ETI has also increased from R6,000 to R6,500 per month.

Author: Louise Kotze – Special Edition Budget Speech Alert 2019

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Finality to Debt Benefit Rules

Author: Siyanda Gaetsew.
The Taxation Laws Amendment Act, 2018 (**TLAA**), which was promulgated on 17 January 2018, amended South African tax legislation by overhauling two provisions relating to the reduction of debt, (the **Debt Benefit Rules**), namely section 19 of the Income Tax Act, 1962 (the **ITA**) and paragraph 12A of the Eighth Schedule to the ITA (the **Eighth Schedule**). This article will examine the notable areas where the legislation per the TLAA differs and the importance of the timing of the

application of such amendments.

Some amendments to the Debt Benefit Rules are effective retrospectively, as from years of assessment commencing on or after 1 January 2018. These proposed amendments were first introduced in the Draft Taxation Laws Amendment Bill, 2018 which was published for comment on 16 July 2018. This caused a great deal of uncertainty as the proposed amendments were only in draft and were subject to possible change, which made it difficult for taxpayers to manage their tax affairs during 2018.

In this regard, the most significant amendments relate to paragraph (*a*) of the definition of concession or compromise. Previously, the definition of concession or compromise included any arrangement in terms of which

(*a*) **any**

(i) **term or condition applying in respect of a debt is changed or waived; or**

(ii) obligation is substituted, whether by means of novation or otherwise, for the obligation in terms of which that debt is owed ” (our emphasis added)

Therefore, under the previous section 19 and paragraph 12A of the Eighth Schedule to the ITA, changes to any terms or conditions applying to existing arrangements would give rise to a debt benefit where the face value of the debt exceeded the market value thereof as a result of the change. The change to the term or condition need not have resulted in a new debt or novation of the existing debt. Thus, any change that could result in a change in the market value of the debt would (in the absence of an exclusion applying) have had far-reaching consequences for debt arrangements that were normal in the course of business, for example, changing the interest rate or extending the repayment date of a debt.

As per the TLAA, paragraph (*a*) of the definition of concession or compromise has been amended to include any arrangement in terms of which

(*a*) a debt is

(i) cancelled or waived; or
(ii) extinguished by
(aa) redemption of the claim in respect of that debt by the person owing that debt or by any person that is a connected person in relation to that person; or
(bb) merger by reason of the acquisition, by the person owing that debt, of the claim in respect of that debt, otherwise than as the result or by reason of the implementation of an arrangement described in paragraph (*b*)

Therefore, the approach taken in defining concession or compromise under the current section 19 and paragraph 12A of the Eighth Schedule to the ITA, is much narrower and is welcomed, in that not all changes to terms or conditions applying to existing arrangements would constitute a concession or compromise, which could have given rise to a debt benefit where the face value of the debt exceeded the market value thereof.

The reason for the amendment provided in the Explanatory Memorandum to the Draft Taxation Laws Amendment Bill, 2018 is that although there is an understanding that voluntary intra-group debt subordinations may be used for tax structuring, however, the inclusion of any changes in the terms or conditions of a debt as a concession or compromise may have the unintended consequence of affecting legitimate transactions.

As the taxpayer has been placed in a better position as a result of the amendments, the retrospective nature of the amendments does not dilute the presumption that an amendment to legislation should be prospective as it was previously held in *S v Mhlungu*, which held that the presumption was not intended to exclude the benefits of rights but rather to prevent the limitation of rights.

On the other end of the spectrum are amendments to section 19 and paragraph 12A of the Eighth Schedule to the ITA, which are potentially onerous to the taxpayer, in that they are effective prospectively as from years of assessment commencing on or after 1 January 2019.

Such notable amendments include the insertion of section 19(6A) read with the substitution in paragraph 12A(4)(*b*) of the Eighth Schedule. In broad terms, these provisions have been inserted to address situations where a debt was applied to fund an asset which is disposed of in a year prior to the year in which the debt benefit arises.

The impact of these provisions is effectively that if the amount of capital gain or loss or recoupment that a taxpayer would have had, had a debt benefit arisen, differs from the amount of capital gain or loss or recoupment that arose by virtue of the disposal, then the difference must be taken into account for purposes of determining a capital gain or loss or recoupment in terms of sections 19 or paragraph 12A, in the year in which the debt benefit arises.

Although the current amendments tick all the boxes here, an important consideration is whether the future application of the legislation to events from the past (ie, retrospective application of legislation), is unconstitutional. In *Pienaar Brothers (Pty) Ltd v CSARS and the Minister of Finance*, the High Court dealt with the Taxation Laws Amendment Act, 2007 which inserted section 44(9A) into the ITA. The court, in that case, held that it is not necessarily unconstitutional for legislation which is not in favour of the taxpayer to be retrospective. The decision has not been challenged in a higher court, however this case should not be viewed as authority that any amendments made to the legislation that are made retrospectively would pass constitutional muster. The particular context and impact of the amendment for the taxpayer as well as the fiscus would need to be considered.

Therefore, in our view, the amending legislation relating to section 19(6A) and paragraph 12A(4)(*b*) of the Eighth Schedule has correctly been made prospective and not retrospective.

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Major new tax burden introduced

Author: David Warneke (Partner and head of Tax Technical at BDO South Africa).

The Taxation Laws Amendment Act of 2017 (Act 17 of 2017) which was promulgated on 18 December 2017 contains provisions, namely section 22B of the principal Income Tax Act and paragraph 43A of the Eighth Schedule to the Income Tax Act, that will result in a significant compliance burden for companies, even in cases in which they do not result in additional taxation. The provisions deal with disposals of shares in a company (say A) that are held by another company (say B) in circumstances in which B held a significant portion of the equity shares (which the Amendment Act defines as a qualifying interest) in A at any time within the 18 months preceding the disposal. Section 22B applies in situations in which the shares that are the subject of the provision are held as trading stock while paragraph 43A of the Eighth Schedule applies in situations in which the shares are held as capital assets.

Essentially, any untaxed dividends (dividends that were exempt from income tax and also not subject to dividends tax) that were received by or that accrued to B during the 18 month period prior to the disposal, or in respect, by reason, or in consequence of the disposal, that are considered extraordinary in amount (which the Amendment Act defines as an extraordinary dividend), must be added to the proceeds on disposal of the shares for capital gains tax purposes. So for example if B held 50% of the equity shares in A and sells any shares held in A, then in calculating Bs capital gain on the disposal it would take into account its actual proceeds plus any extraordinary dividend which it had received or to which it became entitled.

The provision has been backdated to 19 July 2017, which implies that dividends that were received or accrued up to 18 months prior to that date may be subject to taxation if shares are disposed of on or after that date. There is however a carve-out if all the terms to the share disposal agreement were finally agreed to before 19 July 2017 by all parties to that agreement.

A substantial compliance burden is implied in that, in determining whether a dividend is an extraordinary dividend, one has to value the shares that are disposed of in order to determine the market value of the shares on the date 18 months prior to the disposal and then value the shares again at the date of disposal. It is often a difficult, costly and time-consuming exercise to value shares, especially a retrospective valuation such as at a date 18 months prior to the date of disposal of the shares.

Where there is only a holding of equity shares, the methodology to determine whether a dividend is an extraordinary dividend is as follows: If the market value of the shares 18 months prior to the date of disposal is C and the market value of the shares on the date of disposal is D, then the higher of C and D is chosen. One takes 15% of this figure. An extraordinary dividend is so much of any dividend received or accrued within 18 months prior to the disposal of the shares, or in respect, by reason, or in consequences of the disposal, as exceeds the 15% figure determined above. The provision requires that any untaxed dividend that was received or that accrued within 18 months of the date of disposal, or in respect, by reason, or in consequences of the disposal, must, to the extent that the untaxed dividend is an extraordinary dividend (i.e. the excess of the dividend over the 15% figure determined above) be treated as additional proceeds on the disposal of the shares. The wording of the provision suggests that each individual dividend received or accrued has to be tested against the 15% figure on an individual basis in order to determine whether that dividend is an extraordinary dividend i.e. that one does not aggregate the dividends received or accrued within the 18 month period and test the aggregate of such dividends against the 15% figure. This is likely an oversight.

The initial proposal contained in the Draft Taxation Laws Amendment Bill released in July 2017 was substantially similar, although an important difference was that there was no extraordinary dividend test. The initial proposal was thus that any untaxed dividends that were received or that accrued within the 18 month period were to become additional proceeds. Both the initial proposal and enacted provision are aimed at share buy-backs and the common practice of dividend stripping whereby companies receive untaxed dividends instead of taxable proceeds upon the disposal of shares. However, the provision is not limited to share buy-backs and applies to any disposal of shares. It would therefore apply if the disposal was by way of an outright sale of shares and even if the extraordinary dividend was unrelated to the sale.

The insertion of the extraordinary dividend test represents a better outcome for taxpayers than the more draconian initial proposal. However, it implies a substantial compliance burden even in the case of normal business transactions such as third party sales of shares. In view of the fact that the Tax Administration Act places the burden of proving that an amount should not be subject to tax on the taxpayer rather than on SARS, taxpayers would be ill-advised not to conduct the valuations to which the provision refers.

The definition of qualifying interest is central to the application of the provision in that a qualifying interest must be held at any time within 18 months prior to the disposal of the shares for the provision to apply. In the case of a listed company, the definition of qualifying interest contemplates an equity or voting interest of at least 10 per cent. In the case of an unlisted company, an equity or voting interest of at least 50 per cent (or 20 per cent if no other person holds the majority equity shares or voting rights), whether alone or together with connected persons in relation to the holder, must be held.

It should be noted that the provision could still apply in sell-down situations where a qualifying interest was held at some point during the 18 month period but not on the date of disposal of the shares in question. So for example, even if only a 5 per cent interest is disposed of, the provision could apply if at any point in the 18 month period prior to the disposal a qualifying interest was held.

The provisions have the further undesirable consequence that they have been added to the list of provisions that override the corporate restructuring rules contained in Part III of the Income Tax Act. So for example in an intra-group liquidation transaction under section 47 of the Income Tax Act, one will need to assess whether proceeds will need to be taken into account upon liquidation of the transferring (subsidiary) company. However the override of the corporate rules is not limited to section 47 transactions but potentially may include any corporate rollover transaction in which there is a disposal of shares and the other requirements of the provisions are met. This will add considerable complexity in the application of the corporate restructuring rules and may discourage taxpayers from utilising these rules, the purpose of which was to bring South Africas tax regime into line with international practice. If a disposal of shares would otherwise be capable of occurring on a tax neutral basis in terms of the corporate restructuring rules, it is unclear why a taxpayer should be penalised by having to pay tax on extraordinary dividends declared. Had the extraordinary dividends not been declared, the value of the shares disposed of would presumably have been higher but such disposal is in any event permitted as a tax neutral disposal under the corporate restructuring rules. Put differently, if a disposal of shares will qualify for relief from capital gains tax under the corporate restructuring rules, there is no incentive for taxpayers to attempt to dividend strip a company prior to such disposal in order to reduce the capital gain.

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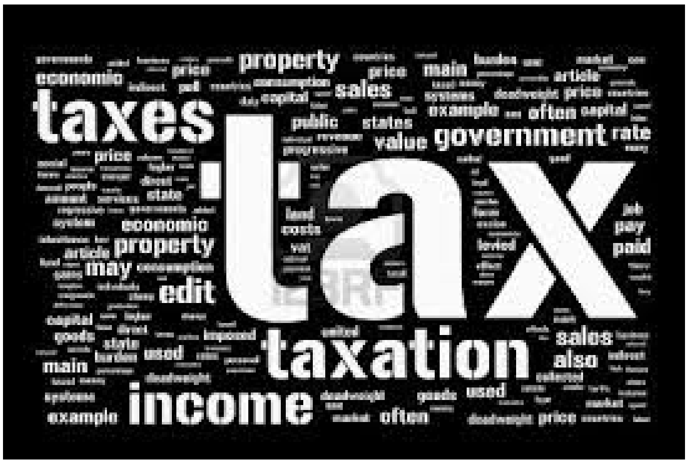
The lawfulness of retrospective amendments in tax law



Author: Beric Croome.

On 29 May 2017, Judge Fabricius delivered judgment in the Gauteng High Court in the case of *Pienaar Brothers (Pty) Ltd vs Commissioner for the South African Revenue Service and the Minister of Finance*, in a case dealing with the Taxation Laws Amendment Act, 2007 (the **Amending Act**) which inserted section 44(9A) into the Income Tax Act, 1962 (the **Act**).

The taxpayer sought an order declaring that section 34(2) of the Amending Act is inconsistent with the Constitution, and invalid to the extent that it provides that section 44 (9A) of the Act shall be deemed to have come into operation on 21 February 2007 and to be applicable to any reduction or redemption of the share capital or share premium of a resultant in company, including the acquisition by that company of its shares in terms of section 85 of the Companies Act, on or after that date.

Pienaar Brothers approached the court seeking a declaration that the amendment to section 44, the so-called amalgamation section in the Act, was unconstitutional and invalid on the basis that the amendment was retrospective. The company had concluded an amalgamation transaction in terms of section 44 of the Act, in which it acquired all of the assets of the company then known as Pienaar Brothers (Pty) Ltd on 16 March 2007 with effect from 1 March 2007 in terms of the sale of business agreement. Later, on 3 May 2007, the board of directors of the Company resolved, under the Companies Act, to make a distribution to its shareholders pro-rata to their shareholding of an amount of ZAR29.5-million out of the taxpayers share premium account. On the date of the resolution, the tax law excluded from the definition of dividendany amount distributed out of a companys share premium account. The company therefore argued that on 3 May 2007, when the distribution was made, it did not constitute a dividend as defined in the Act and thus, no secondary tax on companies (**STC**) was due and payable on the distribution on the basis that it was made out of the share premium account. The Commissioner, however, assessed the amount of ZAR29.5-million to STC on the basis that the amount fell within the amendments introduced to section 44 by way of the Amending Act, which was only promulgated on 8 August 2007.

The court examined the process whereby section 44 of the Act was amended. It was pointed out that in the 2007 Budget Speech presented on 20 February 2007, the then Minister of Finance indicated the intention to pass retrospective legislation to deal with anti-avoidance arrangements relating to STC. Subsequently, on 21 February 2007, the Commissioner issued a press release stating that the STC exemption for amalgamation transactions contained in section 44(9) of the Tax Act was to be withdrawn with immediate effect, that is, from 21 February 2007. On 27 February 2007, the South African Revenue Service (**SARS**) and National Treasury released for public comment the Draft Taxation Laws Amendment Bill, 2007. That Bill proposed the amendment of section 44 addressing the concerns raised by the Minister in his Budget Speech. As pointed out above, the amalgamation transaction, the distribution as well as the introduction of the B-BBEE partner in the company was completed in early May 2007. Thereafter, on 7 June 2007, the 2007 Taxation Laws Amendment Bill was published, but instead of proposing the deletion of sections 44(9) and (10) of the Act, it proposed the insertion of a new subsection (9A). The Bill also indicated that the amendment would be retrospective to 21 February 2007. The company contended that it concluded the amalgamation transaction in May and only later in June

2007 did it become aware that the transaction concluded by it could be covered by the amendment.

On 8 August 2007, the Taxation Laws Amendment Act, 2007 was promulgated, giving effect to the amendments announced in the February 2007 Budget Speech. The company argued that the amendment was invalid under the Constitution because it was retrospective and offended against the principle of legality of the rule of law. The company contended that when it completed the transaction in May, it was not possible to know that the amount would be subject to STC by virtue of the fact that there was no law in place and that it could not be held liable for interest for this reason and similarly could not be subject to penalties or criminal prosecution for not having submitted an STC return reflecting the reduction of share premium as a dividend liable to STC. The judgment deals with both the legal arguments of the company and the Commissioner at length, and refers to the position in South African law as well as a number of other countries.

The case is a very useful summary of the legal position regarding retroactive amendments, not only in the tax arena.

The Commissioners counsel contended that the taxpayer was given notice of a proposal to amend the law and that it was not correct to argue that there was no prior notification of the proposed amendment to plug the perceived loophole in the STC legislation. The Commissioners counsel referred to the process whereby the amendment was given effect to and the court made it clear that the history of the amendment made it clear that the Minster, SARS and Parliament were determined to close the STC loophole with effect from 21 February 2007. The court analysed the rule of law in the Constitution and various academic writings dealing with that topic. The court referred to the general principle that an amendment to a law should only apply prospectively, that is from a future date unless the amendment makes it clear that it applies from an earlier date. The court reviewed the position of retroactive amendments in the United States, United Kingdom, Canada and other countries and came to the view that those constitutional democracies do not specifically prohibit retroactive amendments to tax laws. The court indicated that it is also necessary to weigh up the public interest and the needs of the Treasury when considering retroactive amendments to legislation even though such amendments may adversely affect particular taxpayers. At paragraph 63, the judge stated as follows:

I am not aware of any authority or legislative provision that provides that a fairly precise warning needs to be given before the legislature can pass retrospective legislation, whether in general, or in the case of a tax statute. In the latter instance, economic demands must be considered in the context of the purpose and effect of an intended statute. If the tax statute is rationally connected to a legitimate purpose, no precise warning is required, if one at all.

The court pointed out that the Constitution itself does not contain a provision prohibiting retrospective legislation. The court accepted that Parliament may not legislate with retrospective effect as it pleases, but to do so must meet the standard required for the constitutional validity of retrospective amendments. It indicated that reference must be made to the rationality test and the second standard relating to reasonableness or proportionality.

The court referred to various judicial decisions and came to the conclusion that, in the particular instance, the standards set by the court had not been violated and therefore decided that the amendment to section 44 was lawful and the taxpayer was liable to the STC as assessed by the Commissioner.

The taxpayer also argued that its right to property had been violated as a result to the manner in which the amendment was enacted and the court dismissed this contention on the basis that the amendment did not constitute the unlawful deprivation of property.

The court came to the conclusion that it is not necessary that exceptional circumstances must exist for Parliament to pass retrospective legislation. The court decided that there was no overriding duty to give notice of intended legislation. It was decided, in the present case, that there was sufficient notice of general impact and that there is no overriding duty to give notice that indicates precisely what the intended legislation will encompass.

As a result, the court dismissed the companys application to find that the amendment was unlawful under the Constitution. By virtue of the fact that the case related to constitutional issues, it made no orders as to costs. It remains to be seen if the case will proceed on appeal to a higher court. The judgment is important in that it sets out clearly, for the first time, the consequences of retrospective amendments to legislation in the tax arena and taxpayers and advisors are well advised to study the comprehensive judgment which is a good summary of the law in South Africa and around the world.

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Ubi ius, ubi remedium: Proposed amendments to the Tax Administration Act

Author: Louis Botha (Associate at Cliffe Dekker Hofmeyr).

Currently, in terms of section 9 of the Tax Administration Act, No 28 of 2011 (TAA) a decision made by a South African Revenue Services (SARS) official and a notice to a specific person issued by SARS, excluding a decision given effect to in an assessment or notice of assessment is regarded as made by a SARS official, authorised to do so or duly issued by SARS, until proven to the contrary. Furthermore, s9 makes provision for such a decision to be withdrawn or amended by the SARS official, a SARS official to whom the SARS official reports or a senior SARS official, at the request of the relevant person.

Section 104 of the TAA

Section 104(2) of the TAA states that the following decisions may be objected and appealed against in the same manner as an assessment:

- A decision in terms of s104(4) of the TAA not to extend the period for lodging an objection;
- A decision under s107(2) of the TAA not to extend the period for lodging an appeal; and
- Any other appeal that may be objected or appealed against under a tax Act.

From the above, it appears that whereas s104 of the TAA defines the decisions against which a taxpayer may object and appeal, s9 deals with the scenario where a decision is made by a SARS official, but which is not subject to objection and appeal.

Proposed amendment

In the Memorandum on the Objects of the Draft Tax Administration Laws Amendment Bill, 2017 (Memorandum), it was noted with regard to decisions that are not subject to objection and appeal, that a taxpayer can potentially be prejudiced by not having access to other effective internal remedies that may provide relief. The Memorandum notes that under such circumstances, the taxpayers only remedy would then be to take the matter on review before the High Court in terms of the Promotion of Administrative Justice Act, No 2 of 2000 (PAJA). As we know, High Court litigation of this nature can be an expensive exercise.

The Memorandum states that decisions by SARS are generally subject to the internal remedy in s9 of the TAA, in terms of which specified SARS officials may reconsider the decisions. Decisions that are given effect to in an assessment or notice of assessment are however excluded since assessments generally have the separate remedy of objection and appeal. During the public comment process on the 2016 legislation, Government identified a situation where a decision given effect to in a notice of assessment is not subject to objection and appeal. Under such circumstances and based on the current wording of s9 and s104 of the TAA, it would mean that neither the internal remedy in s9, nor the right to objection and appeal in s104, will be available to a taxpayer under certain circumstances.

Although it is not entirely clear when a decision will be given effect to in an assessment or notice of assessment, as envisaged in s9, one such example might be where a taxpayer applies for the suspension of payment of tax in terms of s164 of the TAA. SARSs decision to reject an application brought in terms of s164 will most likely not be given effect to in an assessment or notice of assessment.

In light of the above, it is proposed in the Memorandum that such a decision, which is given effect to in a notice of assessment, but is not subject to objection and appeal, be subject to the remedy under s9 of the TAA. This will afford the taxpayer an internal remedy before exercising the external remedy of a review application to the High Court under PAJA.

Comment

While it always appears to be a positive development where legislation is amended to make it easier and cheaper for a taxpayer to exercise its rights, such an amendment will only have the desired effect if the SARS officials who are approached in terms of this section, exercise their powers in a reasonable manner.

Foreign employment income exemption is this the end?

Author: Nandipha Mzizi (Candidate Attorney at Cliffe Dekker Hofmeyr).

Currently, s10(1)(o)(ii) of the Income Tax Act, No 58 of 1962 (Act), states that if a South African resident works in a foreign country for more than 183 days a year, with more than 60 of those days being continuous, foreign employment income earned is exempt from tax, subject to certain conditions. This exemption is only available to employees from the private sector. Early this year in the 2017 Budget, it was proposed that the exemption be adjusted as it was excessively generous for those that still benefited from it, ie private sector employees. It was proposed that foreign employment income will only be exempt from tax if it was subject to tax in the foreign country.

A bit of history

In 2001, when South Africa changed from source to residence basis of taxation, s10(1)(o)(ii) was introduced to provide tax relief to South African tax residents who rendered services outside of South Africa. According to the Explanatory Memorandum on the Revenue Laws Bill, 2000 (2000 Memorandum), this move was to bring South Africa in line with internationally accepted practice. At the time, the s 10(1)(o)(ii) exemption did not apply to certain public sector employees. However, s10(1)(o)(ii) was again revisited in 2011 when the source rules were unified and s9 of the Act was significantly amended. In terms of the amendments to s9, the source of services provided to or on behalf of the various tiers of government were deemed to be from a South African source, irrespective of where those services were rendered. Consequently, s10(1)(o)(ii) was also amended by inserting a proviso excluding all public sector employees from the exemption.

Proposal

The proposal in the Draft Taxation Laws Amendment Bill, 2017 (Bill), goes further than the proposal stated in the 2017 Budget. In terms of the proposal in the Bill, the exemption is not merely being adjusted, but proposes that the entire exemption in terms of s10(1)(o)(ii) be repealed. Relief from double taxation will still be available in terms of s6quat of the Act.

Reasons

The reasons behind this move are twofold:

- The main purpose of the exemption was to prevent double taxation occurring, considering that a limited number of Double Taxation Agreements (DTAs) had been concluded by South Africa and other countries at the time. National Treasury has realised that this exemption creates opportunities for double non-taxation where foreign countries do not impose income tax.
- Secondly, unequal treatment has been created between public and private sector employees.

Role of the DTAs and practical considerations

Inasmuch as the DTAs eliminate double taxation by allocating taxing rights between source and resident states, the resident state is not precluded from taxing the same income that the source state is allocated a right to tax. In instances where the resident state (the state where the taxpayer is a tax resident) imposes tax in respect of the same income that the source state (the state where the services are rendered) has a right to tax, the resident state is required to provide relief by way of a foreign tax credit or exemption. The foreign tax credit is similar to the rebate available in terms of s6quat.

In practice, it could happen that where a person employed by a South African employer renders services abroad, such persons salary will be subject tax in the source state and in South Africa, before the employee can claim the relief available in terms of s6quat. The effect of this is that employees will likely be out of pocket until such time that they can claim a refund from SARS. It is important to note that the proposed amendment will come into effect on 1 March 2019 and will apply to years of assessment commencing on or after that date.

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Under the radar: Today one tax rate, tomorrow another?

Author: Louis Botha and Heinrich Louw.

Since the first version of the Draft Taxation Laws Amendment Bill, 2016 (First Draft TLAB) and the Explanatory Memorandum thereto (Memorandum) were released on 8 July 2016, the proposed amendments applicable to trusts and employee share schemes received most of the attention.

However, another proposed amendment with potentially far-reaching consequences that has received little attention since the release of the First Draft TLAB is one which could lead to a taxpayer paying tax at one rate today and another rate tomorrow, as and when the Minister of Finance (Minister) says so.

The proposed amendment

In terms of the First Draft TLAB, it was proposed that the Minister would have the power to amend the tax rates applicable in terms of various pieces of legislation, simply by announcing the amendment in the annual national budget speech. Furthermore, this amended rate would come into effect from the date announced by the Minister in the budget speech and will continue to apply for a period of 12 months from that date, unless Parliament passes legislation giving effect to that announcement within that 12-month period.

A similar amendment was already made to the Transfer Duty Act, No 40 of 1949, but was now proposed with respect to the following pieces of legislation:

- Income Tax Act, No 58 of 1962;
- Estate Duty Act, No 45 of 1955;
- Value-Added Tax Act, No 89 of 1991 (VAT Act);
- Skills Development Levies Act, No 9 of 1999 (SDL Act);
- Securities Transfer Tax Act, No 25 of 2007;
- Unemployment Insurance Contributions Act, No 4 of 2002 (UIC Act); and
- Mineral and Petroleum Resources Royalty Act, No 28 of 2008.

Issues raised and National Treasury's response

An obvious shortcoming of the proposal in the First Draft TLAB which was raised during public hearings, as highlighted in the Draft Response Document from National Treasury and SARS (Response Document), was that the provision constituted a delegation by Parliament of its legislative power to the Minister. In terms of s77 of the Constitution of the Republic of South Africa, 1996 (Constitution), a money bill is required to be passed by Parliament. In the Response Document, the problem was acknowledged and it was indicated that the proposed provisions would be amended to bring them in line with the Constitution. The wording of the charging provisions was amended and the provisions in the second version of the Draft Taxation Laws Amendment Bill, 2016 state that the rate changes announced by the Minister may be applied from the date announced subject to Parliament passing the relevant legislation giving effect to that rate change within 12 months of the announced effective date.

Comment

The implementation of the proposed amendments to the abovementioned legislation in its current form, could lead to a number of practical problems for taxpayers. An amendment in the rate of VAT in terms of s7 of the VAT Act, is one example that illustrates the problems that could arise.

In terms of s27 of the VAT Act, VAT vendors must submit VAT returns every month, every second month, every six months or every twelve months depending on the category in which they fall. In terms of s28, a VAT vendor must submit its VAT return within 25 days after the end of the relevant period. Currently, s7 of the VAT Act expressly states that VAT vendors must account for VAT at the rate of 14% on the value of the supply. If the Minister were to announce in the 2017 budget speech on 28 February 2017 (a hypothetical date) that the VAT rate will increase to 15% from 1 April 2017, Parliament will have to pass legislation to this effect within 12 months of 28 February 2017. If the legislation is not passed in time in accordance with s77 of the Constitution, VAT vendors will in theory be entitled to refunds on the basis that they should have levied VAT at the rate of 14% during this period instead of at the rate of 15%. The challenges that taxpayers have faced in obtaining their refunds from SARS, has been widely reported on recently. Similar problems could arise if the rates in terms of the SDL Act and UIC Act were amended and the necessary legislation is not passed in time, considering that payments in terms of this legislation must be paid by employers on a monthly basis.

Furthermore, the retrospective application of the legislation may also be open to constitutional challenge. In terms of s77(3) of the Constitution, all money bills must be considered in accordance with the procedure established by s75 of the Constitution and an act of Parliament must provide for a procedure to amend money bills before Parliament. The Money Bill Amendment Procedure and Related Matters Act, No 9 of 2009 (Money Bill Act) was passed by Parliament in this regard.

Section 11 of the Money Bill Act states that a revenue bill, being one which amends tax rates, among other things, must be referred to the National Council of Provinces, as stipulated in s75 of the Constitution. Neither s75 and s77 of the Constitution, nor the provisions of the Money Bill Act allow for implementation of legislation prior to the process in terms of these sections being followed. The consequences of not complying with the constitutional provisions regarding the enactment of legislation could be far-reaching and could even lead to the entire legislation being declared invalid as was the case in *Tongoane and Others v Minister for Agriculture and Land Affairs and Others* 2010 (8) BCLR 741 (CC), where the Communal Land Rights Act, No 11 of 2004 was declared invalid by the Constitutional Court as the incorrect procedure had been followed in enacting the legislation.

No "halfway-house" for Government Grants

Author: Esther van Schalkwyk, Senior Tax Consultant at BDO SA.

In terms of a proposed amendment contained in the Draft Taxation Laws Amendment Bill of 2016 ('Draft TLAB'), the taxation of government grants will likely change. National

Treasury proposed a special inclusion in taxpayers' "gross income" of "any amount received by or accrued to a person by way of a government grant as contemplated in section 12P".

Due to the proposed inclusion of government grants in gross income, the question of whether a government grant is of a capital or revenue nature will likely become irrelevant. If the proposed amendment is enacted, all government grants, whether of a capital or revenue nature, should be included in a taxpayer's gross income, except if they are specifically listed as exempt. Taxpayers who receive government grants are advised to take note of this significant change.

The Income Tax Act defines a "government grant" as "a grant-in-aid, subsidy or contribution by the government of the Republic in the national or provincial sphere". The definition of government grant is very wide although the possibilities for exemption are limited. Government grants may be exempt from normal tax in the hands of the recipient only if that government grant is specifically listed in the Income Tax Act or published by the Minister in the Government Gazette.

The proposed inclusion of government grants in a taxpayer's gross income is subject to some ambiguity. By referring to "a government grant as *contemplated* in section 12P", the 2016 Draft TLAB creates the impression that only government grants that qualify for exemption should specifically be included in gross income. This may contradict the apparent purpose of the proposed inclusion, which seeks to include all government grants as *defined* in section 12P. This would have the effect of including government grants, in a wide sense, in gross income, with the limited possibility of an exemption if the grant is specifically listed.

For the time being, government grants may generally be excluded from gross income if that grant constitutes a receipt of a capital nature in the taxpayer's hands. This was illustrated in a recent Eastern Cape Tax Court decision in ITC

13539/13673. In this case, the receipt of government grants in the motor industry were held to be of a revenue nature and therefore subject to income tax because the grant assisted the recipient taxpayer in carrying on its trading operations. The grants were made in the form of certificates that could only be used as a rebate against import duties on imported motor vehicles, therefore filling a so-called revenue hole in the taxpayer's trading operations. However, if the grant had been found to be of a capital nature the implication is that the grant would not have been taxable.

Ends

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Taxation Laws Amendment Bill released for comment

Authors: Bernard du Plessis and Peter Dachs (ENSafrica).

The Taxation Laws Amendment Bill 2016 has been released for public comment. It introduces various interesting amendments to South Africa's tax law, which include the following:

Use of trusts

In circumstances where an interest-free loan has been advanced to a trust by a connected person (which includes a beneficiary or a relative of a beneficiary), it is proposed that a market-related rate of interest (currently 8%) is deemed to be paid on that loan. This deemed interest will not be tax deductible in the hands of the trust but will be taxable in the hands of the lender and will not qualify for an interest exemption.

To the extent that the tax payable by the lender in respect of this inclusion is not recovered from the trust within three years, this will be treated as a donation to the trust and donations tax will be imposed thereon at the rate of 20%.

Hybrid debt instruments

The interest paid on various debt instruments with certain specified equity features is currently treated as a dividend for tax purposes. This means that no deduction is granted in respect of such interest for the borrower and, conversely, the lender receives a tax-exempt dividend.

These provisions are being amended. Firstly, where such debt instruments are issued by a non-resident entity, the hybrid debt rules will only apply if such non-resident entity issues the debt instrument from a South African permanent establishment or if the non-resident entity is a controlled foreign company of South African residents.

The rules are also being amended to state that where such hybrid debt instruments are subject to, for example, put and call arrangements in terms of which the holder has the right to transfer such debt instrument to another party, the hybrid debt provisions will not apply. This brings the hybrid debt rules in line with the rules relating to preference shares.

International tax amendments

The proposed withholding tax on service fees has been withdrawn. This means that the proposed 15% withholding tax that was to be imposed on technical, management and consulting services will no longer be introduced.

South Africa, therefore, imposes withholding taxes on royalties, interest and dividends at a rate of 15%.

Share incentive schemes

In respect of various share incentive arrangements, individuals are taxed on the difference between the market value of the shares on date of vesting and any amounts paid for such shares.

This meant that certain dividends paid on these shares prior to vesting were exempt from income tax in the hands of such individuals.

It is now proposed that such dividends declared prior to vesting of the shares will be subject to income tax in the hands of the holder.

Special Voluntary Disclosure Programme

The South African Reserve Bank has also issued a long-awaited media statement which sets out the detailed proposals regarding the joint tax and exchange control Special Voluntary Disclosure Programme (“**SVDP**”). This provides much needed certainty around the process to apply for the SVDP.

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The use of electronic or digital signatures in tax matters

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With tax litigation becoming more prevalent in recent years, taxpayers are now faced with new issues.

One such issue is: when and to what extent will documents bearing an electronic signature be acceptable under the relevant tax legislation?

In this regard, section 255(2) of the Tax Administration Act No. 28 of 2011 (“**TAA**”) provides that the South African Revenue Service (“**SARS**”) may, in the case of a return or other document submitted in electronic format, accept an electronic or digital signature of a person as a valid signature for purposes of a tax act if a signature is required. Section 255(3) of the TAA then continues to state that if, in any proceedings under a tax act, the question arises whether an electronic or digital signature of such person was used with the authority of such person, it must be assumed, in the absence of proof to the contrary, that the signature was so used.

The terms “electronic signature” and “digital signature” are not defined in the TAA. However, these terms are defined in the Rules for electronic communication (“**Rules**”) which were promulgated under section 255(1) of the TAA in terms of GG 37940, Notice 644, on 25 August 2014.

A “digital signature” is defined in Rule 1 to have the meaning assigned to an “electronic signature”. “Electronic signature”, is in turn, defined through ascribing a meaning thereto in relation to a “registered user” and an “electronic communicator”.

On page 36 of the SARS Electronic Communications Guide (“**SARS Guide**”), the TAA mentions both electronic and digital signatures, but because these terms are not necessarily interchangeable in terms of the Rules, when the TAA refers to a digital signature, it is specifically in the context of identification. In addition, the SARS Guide provides on page 13 that the concept of a digital signature is often used to denote encryption rather than a signature for identification purposes.

The meaning of electronic signature in relation to registered users

In this context “electronic signature” means the user ID and access code of the user and the date and time that the electronic filing transaction was received by the information system of SARS. A “user ID” is the unique identification created in compliance with the requirements of Rule 6 and used by a registered user in order to access the user’s electronic filing page. Further, an “access code” means a series of numeric characters, alphabetic characters, symbols or a combination thereof, associated with an individual user ID.

The meaning of electronic signature in relation to electronic communicators

In this context, “electronic signature” refers to data attached to, incorporated in, or logically associated with other data which is intended by the electronic communicator to serve as a signature. An “electronic communicator” is a person that is obliged to or has elected to communicate with SARS in electronic form or is a person who is a registered user, for example, a registered tax practitioner registered under Rule 5.

Rule 7 specifically deals with electronic signatures and states that, other than the use of a user ID and access code for the signing of electronic filing transactions, if a provision of a tax act requires a document to be signed by or on behalf of an electronic communicator, that signing may be effected by means of an electronic signature if the electronic signature is:

- uniquely linked to the signatory;
- capable of identifying the signatory and indicating the signatory's approval of the information communicated;
- capable of being accepted by the computers or equipment forming part of the information system of SARS; and
- reliable and appropriate for the purpose for which the information was communicated.

Rule 7 of the Rules further states that when considering the use of an electronic signature, an electronic communicator must specifically consider the level of confidentiality, authenticity, evidential weight and data integrity afforded by the signature.

According to the SARS Guide at page 36, "because an electronic signature can be an electronic image of a signature, a symbol or even a typed name at the bottom of an e-mail, the simple act of signing on the dotted line may be slightly more challenging within the electronic environment. The challenge, of course, is that of confidentiality and security, including authenticity, evidential weight and data integrity."

In light of the above, in our view, it may be argued that the information contained at the bottom of an email meets the requirements set out in Rule 7 of the Rules and if the sender of an email is someone who has elected to communicate with SARS in electronic form, an unsigned document attached to the email would constitute data attached to other data which is intended by the electronic communicator to serve as a signature.

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