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## INCOME TAX

## ASSET MANAGERS BEWARE

There has always been a very fine line between what constitutes trading and what constitutes a careful management of an asset or share portfolio and/or the rebalancing thereof from time to time. Our courts have indicated that prudence and foresight cannot be equated with an intention to speculate. Neither in law nor in logic can dogged adherence to a counter or carelessness in the management of a share portfolio be posited as pre-requisites for qualification as a capital investor.

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On the other hand, proceeds from the operation of business in carrying out a profit making scheme were held to be on revenue account. On this basis specific rules have been introduced to the effect that, if shares have been held for a period of three years, the proceeds associated therewith would be on capital account.

In the current volatile economy it is very difficult to hold on to a specific share portfolio for a period of three years. These shares are either rebalanced relatively frequently, for instance quarterly, alternatively derivative instruments are entered into in order to hedge or lock-in the inherent value in a specific share price.

On this basis asset managers have been successfully arguing that proceeds from the entering into of these type of transactions would always be on capital account. In the context of the portfolio of a collective investment scheme in securities this is quite critical given the fact that such portfolio (CIS) is exempt from the payment of capital gains tax.

However, a CIS is in itself subject to tax to the extent that it does not distribute income within a period of twelve months after its accrual to its unit holders (or in the case of interest, the receipt thereof).

The anomaly has been created that the active management of asset portfolios could be seen to be equivalent to trading on the basis that these proceeds are then subject to income tax and not capital gains tax.

It has always been argued that the tax consequences of a derivative should follow the tax consequences of the asset that is sought to be hedged. For instance, if an option is realised and it hedges an underlying share that is held on capital account, the option proceeds should then also be on capital account. SARS has indicated that this rule does not apply automatically and that one should consider the specific circumstances of the case. For instance, if an entire range of options is entered into, it may well be that proceeds are on revenue account and not on capital account. Also, if there is no specific correlation between the derivative and the underlying share counter, it may well be that there is an argument that the asset manager is seeking a minimum return as opposed to hedging a specific portfolio.

It has thus been proposed that rules be clarified to provide certainty on the treatment of trading profits by especially CISs. This proposal will most probably create significant concerns within the asset management industry as it may also extend to the management of other assets as opposed to being confined to CISs. If this is the case, it will most probably result in an entire re-think in the way in which assets are managed, specifically with reference to targeting minimum returns and/or hedging strategies.

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*Emil Brincker*

## INCOME TAX

# EXTENDING THE APPLICATION OF CONTROLLED FOREIGN COMPANY RULES TO FOREIGN TRUSTS AND FOREIGN FOUNDATIONS

Section 9D of the provides for the rules applicable to controlled foreign company (CFC). Section 9D of the Act provides for the imputation of the net income of a CFC to its resident shareholder in proportion to that resident's participation rights or voting rights in the CFC. A CFC is defined as a foreign company where more than 50% of the participation rights in that foreign company are directly or indirectly held or more than 50% of the voting rights in that foreign company are directly or indirectly exercisable by one or more South African residents.

The Government was concerned that the CFC Rules did not capture foreign companies held by interposed foreign trusts or foreign foundations. In the 2015 Budget it was announced that the Government would consider allowing CFCs held by interposed trusts or foundations to be subject to tax in South Africa. The Government was particularly concerned about the use of foreign discretionary trusts or foreign foundations used to escape the application of the CFC rules even if the participation or voting rights requirements were met. This was achieved by interposing a foreign trust or foreign foundation between South African tax residents and a foreign company, despite the fact that the foreign trust and foreign company formed part of the same group and consolidated by the South African tax resident group for financial reporting purposes under International Financial Reporting Standards 10 (IFRS 10).

The proposal was to capture foreign companies to whom the CFC Rules would have applied had no foreign trust or foreign foundation been interposed. The following proposals were made:

- the definition of a CFC in s9D would be adjusted so that a foreign company held through a foreign trust or foreign foundation whose financial results formed part of the consolidated financial statements (contemplated in IFRS 10) of a group of which the parent company is resident in south Africa, is regarded as a CFC for purposes of the Act; and

- a new proviso regarding the inclusion of net income of a CFC in terms of s9D(2) of the Act be inserted to clarify that the percentage of participation rights in respect of the CFC will be equal to the net percentage of the proportion of profits of a foreign company that are included in the consolidated financial statements (contemplated in IFRS 10) for the year of assessment of any resident company, and that it is a holding company as defined in the Companies Act, 2008.

The Taxation Laws Amendment Act, 2017 accordingly extended the application of CFC Rules to foreign companies held through foreign trusts and foreign foundations. The aforementioned amendments became effective on 1 January 2018.

In the Budget it was announced that the draft Taxation Laws Amendment Bill, 2017 developed related rules to classify distributions of discretionary foreign trusts or foreign foundations that holds shares in a foreign company to South African resident beneficiaries to be income in the hands of the South African resident beneficiaries and subject to normal tax in South Africa, based on applicable rates. This was done to discourage the use of trusts to defer tax or recharacterise the nature of income. These provisions would apply to any person other than a company, in other words to a natural person, trust, estate or a deceased person and insolvent estate.

Due to the complexity and broadness of the last-mentioned proposal, the specific rules were withdrawn and postponed to 2018. According to the Budget, these rules will now be considered.

*Mareli Treurnicht*

## INCOME TAX

## ADJUSTMENTS TO TAX RATES

Whereas an increase of 1% in the value-added tax (VAT) rate to 15% (effective 1 April 2018) was announced in the Budget, no adjustments were made to the top four income tax brackets. Rather, below-inflation adjustments to the bottom three income tax brackets were announced. It was further announced that the primary, secondary and tertiary rebates would be partially adjusted for inflation.

The Budget acknowledged the recent increase in effective capital gains tax rates, the dividends tax rate and the establishment of the 45% top bracket for individuals. This has led to an increase in the tax burden on individuals. According to the Budget, an additional personal income tax rate increase would have had greater negative consequences for growth and investment than an increase in VAT. Significant shortfalls from

personal income tax in 2017/18 also suggested that a further increase may not yield the revenue required to stabilise the public finances. It was also mentioned that, in recent years, corruption and wasteful expenditure in the public sector has eroded taxpayer morality and that the lack of an effective government response to allegations of corruption and poor governance has undermined the social contract between taxpayers and the state.

There is further a global trend to reduce corporate income tax rates. An increase in corporate income tax rates would therefore have affected South Africa's global competitiveness. Countries mentioned as having reduced their corporate income tax rates in recent years are the United States of America, the Netherlands and the United Kingdom.

*Mareli Treurnicht*

## WELCOME RELIEF?

The recently introduced anti-dividend stripping rules applicable to shares held as trading stock or as capital assets are seen by many as overly broad and having unintended consequences.

The amendments now result in exempt dividends being treated as additional proceeds, in the case that the shares are held as capital assets, or additional income in the event that the shares are held on revenue account, if certain conditions are met. This is especially the case in the context of simplifying or restructuring groups using corporate roll-over concessions. Should these simplifications or restructures results in the declaration of a dividend and combined with the termination of the company's corporate existence, such dividends could be subject to additional capital gains tax or income tax.

In addition to applying to legitimate restructurings, the anti-dividend stripping rules also find application in relation to the redemption of certain preference share structures. It is not uncommon for preference shares to contain gross-up clauses which may now be triggered pursuant to the redemption of these instruments.

It appears that the unintended consequences have been recognised by the Minister, and that the application of these rules will be clarified.

*Dries Hoek*



## INCOME TAX

ONGOING REVIEW OF THE VENTURE CAPITAL  
COMPANY REGIME

By way of background, the Venture Capital Company (VCC) tax regime was introduced into the Act in 2009. Section 12J of the Act encompasses the relevant legislation governing VCCs and provides for the formation of an investment holding company, described as a VCC, through which investors can provide equity funding to a portfolio of small and medium-sized enterprises (SMEs). More specifically, investors subscribe for shares in the VCC and claim an income tax deduction for the subscription price incurred. The VCC, in turn, invests in "qualifying companies".

Various legislative amendments to s12J have given rise to an increased participation in the asset class, evidenced by the increasing number of approved VCCs. To date, the South African Revenue Service's (SARS) website indicates that 90 companies have been approved as VCCs, while 2 have had their VCC status withdrawn.

However, there are certain administrative and technical concerns that have plagued s12J, which has resulted in a slow up-take in the VCC regime. Some of these issues are discussed in more detail below.

**Investment income threshold**

Section 12J(5)(b) requires that the sole object of a VCC must be the management of investments in "qualifying companies". Paragraph (f) of the definition of "qualifying company" in s12J(1) includes a company where the sum of the investment income derived by that company during any year of assessment does not exceed an amount equal to 20% of the gross income of that company for that year.

Small enterprises are often organised as groups of companies, where an operating company holds controlling interests in other operating companies. VCCs are often unable to

subscribe for shares in these small operating companies due to paragraph (f) of the definition of "qualifying company". More specifically, where the operating company receives dividends from a subsidiary operating company in excess of 20%, the first mentioned operating company will not be a "qualifying company".

**Controlled company test**

As set out above, s12J(5)(b) requires that the sole object of a VCC is the management of investments in "qualifying companies". A "qualifying company" is defined as, inter alia, a company that is not a "controlled group company" in relation to a group of companies.

Briefly, a "controlled group company" is a company that has a corporate shareholder that holds, directly or indirectly, at least 70% of the shares in that company.

Section 12J does not expressly state at which point the "controlled group company" test needs to be applied, which has resulted in numerous practical difficulties for VCCs.

**Connected person test**

With effect from 1 January 2017, s12J(3A) was amended so that the "connected person" test is deferred until the end of the third year of the first share issue, and each year thereafter.

Basically, the "connected person" test provides that if, at the end of any year of assessment, after the expiry of a period of 36 months commencing on the first date of the issue of the venture capital shares, an investor is a "connected person" in relation to that VCC:

- no deduction will be allowed in respect of such expenditure;
- the Commissioner for SARS must, after due notice to the VCC, withdraw the approval of the company as a VCC retrospectively; and

INCOME TAX

## ONGOING REVIEW OF THE VENTURE CAPITAL COMPANY REGIME...*continued*

- an amount equal to 125% of the expenditure incurred in the acquisition of the company's shares by any person must be included in the income of the company, in the year of assessment in which the approval is withdrawn,

if corrective steps, acceptable to the Commissioner for SARS, are not taken by the company within a period stated in the notice given by the Commissioner.

Before this amendment, the errant investor (ie the taxpayer who was a "connected person" in relation to the VCC) was penalised by not being entitled to claim the s12J(2) deduction. After this amendment, however, where a taxpayer is a "connected person" in relation to a VCC, the Commissioner must, inter alia, withdraw the approval of the company as a VCC with effect from the date of the approval.

### Proposal

In an attempt to encourage investment of equity into SMEs and junior mining companies, the Budget proposes that s12J be amended:

- to address rules relating to the investment income thresholds in the "qualifying company" test;
- to address at which point the "controlled group company" test needs to be applied; and
- to review the retrospective withdrawal of VCC status with reference to the "connected person" test.

These proposals illustrate National Treasury's ongoing commitment of ensuring that VCCs enable much-needed capital for SMEs.

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*Gigi Nyanin*

INCOME TAX

# REVIEW OF PROVISIONS OF ACT THAT REFER TO THE JSE

There are a number of provisions in the Act that refer to the Johannesburg Stock Exchange (JSE) or JSE Limited Listing Requirements (Listings Requirements).

For example:

- the definition of "company" in s1 of the Act includes, inter alia, a portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1 (x) of the Listings Requirements;
- a dividend is defined to exclude the acquisition by the company of its own shares by way of general repurchase as contemplated in paragraph 5.67B of s5 of the Listings Requirements;
- an "identical share" includes any other share that is substituted for that listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the Listings Requirements; and

- most importantly, a "REIT" as defined in the Act refers to a company which is a South African tax resident and whose shares are listed on an exchange as shares in a REIT, as defined in terms of the Listings Requirements.

Over the last couple of years, additional stock exchanges (such as ZAR X, 4Africa Exchange and A2X Markets) have been introduced into South Africa. As a result, there have been numerous lobbying efforts to National Treasury to make the requisite amendments to the Act in order to incorporate these new stock exchanges.

It seems that National Treasury has finally heeded this call as the Budget proposes the review of the relevant provisions of the Act to include the newly introduced stock exchanges, subject to certain regulatory and transparency criteria.

*Gigi Nyanin*



## INCOME TAX

TAX TREATMENT OF DOUBTFUL DEBTS TO BE  
CLARIFIED BY WAY OF STATUTORY AMENDMENTS

In 2015, various discretionary powers afforded to the Commissioner of SARS in the context of assessment provisions contained in the Income Tax Act, No 58 of 1962 (Act) were removed in order to formalise the move towards income tax self-assessment in South Africa. This re-alignment was done against the backdrop of international research performed as part of the study on the transition to income tax self-assessment, which confirmed that the international trend was to move away from administrative income tax assessment towards self-assessment and voluntary compliance.

One of the provisions impacted by this was the doubtful debts allowance contained in s11(j) of the Act. Section 11(j) of the Act provides for a deduction of such amount that represents debts which are doubtful. The allowance is only made in respect of debts which would have been allowed as a deduction had they become bad. Importantly, s11(j) of the Act afforded the Commissioner of SARS a discretion to decide whether the debt was doubtful. In line with the removal of the remnants of the administrative assessment system, the Commissioner of SARS's discretion in respect of the doubtful debt allowance under s11(j) of the Act was to be deleted with effect from a date to be determined by the Minister. The intention behind the deletion and substitution of an amended s11(j) was that, in future, the allowance would be claimed according to certain criteria set out in a public notice issued by the Commissioner of SARS.

The one issue with such a proposal was that there was a risk that the public notice may have been limited to the extent that it failed to take into account certain taxpayers' circumstances and was thus too broad in its defining criteria. Nevertheless, while there has been engagement between SARS and the banking industry on this specific matter given the significant impact it has on that industry, no general criteria have been formulated and published up to this point as was originally intended. In any event the new proposed s11(j) of the Act has not come into effect such that the Commissioner's discretion is still applicable. SARS has in the past usually allowed the taxpayer a deduction of 25% of its list of doubtful debts or alternatively a deduction based on a formula.

The Minister announced in the Budget that instead of publishing the criteria by way of a public notice, it is now proposed that the criteria for determining the allowance should instead be included in the Act. The intended certainty and a move towards more objective criteria will be welcomed by taxpayers. However, it will be interesting to analyse and consider the draft legislation once it has been published, bearing in mind that different industries will be impacted by different criteria.

*Jerome Brink*



CHAMBERS GLOBAL 2018 ranked our Tax & Exchange Control practice in Band 1: Tax.

Gerhard Badenhorst ranked by CHAMBERS GLOBAL 2014 - 2018 in Band 1: Tax: Indirect Tax.

Emil Brincker ranked by CHAMBERS GLOBAL 2003 - 2018 in Band 1: Tax.

Mark Linington ranked by CHAMBERS GLOBAL 2017- 2018 in Band 1: Tax: Consultants.

Ludwig Smith ranked by CHAMBERS GLOBAL 2017 - 2018 in Band 3: Tax.

INCOME TAX

## FRUITLESS AND WASTEFUL EXPENDITURE: TAX DEDUCTIBLE NO MORE?

In the lead up to the Budget, the opinion was widely expressed that if the extent of fruitless and wasteful expenditure in the public sector were addressed, it could go a long way in correcting our country's budget shortfall.

.....  
An interesting issue raised in the Budget is that Treasury will consider the tax implications arising from fruitless and wasteful expenditure. To ensure proper governance of public entities

and encourage accountability, government proposes that losses or expenditure classified as fruitless and wasteful will not qualify for a tax deduction. What remains to be seen is exactly how fruitless and wasteful expenditure will be defined for tax purposes, as no such definition currently exists in the Income Tax Act, No 58 of 1962.

.....  
*Louis Botha*

## MEDICAL TAX CREDITS – ONLY YOUR FAIR SHARE

.....  
A measure of tax relief is granted by the Income Tax Act, No 58 of 1962 (Act) to those individuals who incur certain medical related expenses. This relief takes the form of tax rebates (medical tax credits) which reduce the individual's tax liability. Section 6A provides for a medical scheme fees tax credit where contributions are made to a registered medical scheme or fund and s6B provides for a medical tax credit where additional, qualifying medical expenses, as defined, are incurred.

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At present, a taxpayer responsible for contributing to the medical scheme of another person is allowed as a rebate a fixed, monthly amount determined by the Minister. The Budget states that in the 2019 year of assessment, this fixed amount will increase from R303 to R310 per month for the first two beneficiaries of

the medical scheme, and from R204 to R209 per month for each of the remaining beneficiaries. Where additional expenses are incurred on another's behalf, an amount calculated in terms of the provisions of s6B will be allowed as a medical tax credit.

In the Budget, the concern is raised that taxpayers are excessively benefitting from these rebates where multiple taxpayers contribute to the medical scheme fees or other medical expenses of a third party (for example, adult children jointly contributing to their elderly mother's medical scheme). To prevent this excessive benefit, it has been proposed that where taxpayers carry a share of the medical scheme contribution or medical cost, the medical tax credit be apportioned between the various contributors.

.....  
*Louise Kotze and Louis Botha*



## INCOME TAX

## THE INCREASE OF THE "OFFICIAL RATE OF INTEREST"

It has been proposed in the Budget that the "official rate of interest" is increased to a level closer to the prime rate of interest, which is currently 10.25%.

The "official rate of interest" is the present repurchase rate plus 100 basis points (7.75%) and is used to quantify the fringe benefit of low interest rate loans provided by employers, as well as the amount of a donation for low interest loans to trusts by connected persons.

#### The effect of low interest loans made by employers

In terms of the s1 of the Act, any amount received or accrued to an employee who is a resident, in cash or otherwise, must be included in the income of the employee. Paragraph (i) of the definition of "gross income" in the Act specifically includes as an amount subject to income tax "the cash equivalent, as determined under the provisions of the Seventh Schedule, of the value during the year of assessment of any benefit ... granted in respect of employment or to the holder of any office..."

In terms of paragraph 2(f) of the Seventh Schedule, a taxable benefit is said to exist where a debt which has been incurred by the employee, which includes a director as per the definition of "employee" in paragraph 1 of the Seventh Schedule, whether in favour of the employer, or any other person by an arrangement with the employer or any associated institution in relation to the employer, and either of the two requirements are met:

- no interest is payable by the employee in respect of the debt; or
- interest is payable by the employee in respect of the debt at a lower rate than the official rate of interest.

Paragraph 11 in turn seeks to quantify the amount of the taxable fringe benefit to be included in the gross income of the employee. Essentially, the taxable fringe benefit would be equal to the amount of interest that would have been payable on the

amount owing in respect of the debt in the year of assessment if the employee had been obliged to pay interest on the debt amount at the official rate of interest, less the amount of interest actually incurred by the employee.

It must further be kept in mind that although the definition of the "official rate of interest" was deleted by s67 of the Taxation Laws Amendment Act, 2017, in the event that a new repurchase rate or equivalent rate is determined, the new rate of interest applies from the first day of the month following the date on which that new repurchase rate or equivalent came into operation.

Therefore, should the proposed official rate of interest be increased to a level closer to the prime rate of interest, which is currently 10.2%, a significantly larger taxable benefit will be included in the income of the employee from the first day following the date on which the new rate comes into operation.

#### The effect on loans made to trust by connected persons

In the event that a connected person makes a donation to a trust, and the trust incurs no interest in respect of the loan, alternatively interest at a rate lower than the "official rate of interest", a donation arise in this regard, in terms of s7C(3) of the Act.

In this regard, an amount equal to the difference between the amount incurred by that trust during a year of assessment as interest in respect of that loan that would have been incurred by that trust at the "official rate of interest", must be treated as a donation made to that trust on the last day of that year of assessment of that trust.

Therefore, the proposal that the "official rate of interest" is increased to a level closer to the prime rate of interest could have far reaching tax consequences wherein loans made by connected persons to trusts will be seen as a donation and taxed at rate of 20%.

*Candice Gibson*

## INCOME TAX

## ADDRESSING THE ABUSE OF COLLATERAL LENDING ARRANGEMENT PROVISIONS

A large proportion of debt agreements involve the use of collateral, more specifically the use of equity (ie listed shares) as well as listed government bonds, as security for the repayment of the debt. The provision of collateral usually takes one of two forms, namely a pledge (no transfer of beneficial ownership with no tax implications) or an outright transfer (out and out cession of beneficial ownership with tax implications).

Importantly the event of granting collateral by way of a pledge for securities lending is currently not subject to income tax and securities transfer tax because it does not involve the actual transfer of beneficial ownership. Similarly, the alignment of this tax treatment of collateral lending arrangements was extended in 2015 in respect of the outright transfer of collateral such that no income tax and securities transfer tax implications arise for collateral arrangements for a duration of up to 24 months.

Notwithstanding the recognition of this common business practice in South Africa's relevant fiscal legislation, the Minister has announced the introduction of further measures to combat certain arrangements which amount to abuse. In particular, it has been identified that foreign shareholders reduce their dividends tax rate to zero by taking out a loan with a South African resident company and using the listed shares as collateral. In this manner, any dividends declared on the listed shares to the resident South African company is tax free on the basis of the dividends tax exemption of dividends declared between two resident companies. Thereafter, in accordance with the collateral agreement, the South African resident company pays an amount (called a manufactured dividend) based on the dividend received by that resident company to that foreign company, free of dividends tax.

While certain anti-avoidance rules already exist in respect of similar arrangements, the Minister has proposed further amendments to the legislation in order to close any loopholes.

*Jerome Brink*

THE TRANSFER OF RETIREMENT FUNDS:  
ANOMALIES NO MORE

In terms of paragraph 2(l) of the Seventh Schedule to the Income Tax Act No 58 of 1962, where an employer has made any contribution for the benefit of any employee to any pension fund, provident or retirement annuity fund, such contribution constitutes a fringe benefit in the hands of an employee. Such fringe benefit is included in the gross income of an employee. The amounts contributed by the employer forms of a so-called employer reserve account and constitutes a post-tax amount as the fringe benefit has already been taxed.

However, the Budget notes that currently, the transfer of fund amounts between, or within, retirement funds at the same employer has inadvertently led to a tax liability for members, due to the current wording of the legislation. In principle, there should be no additional tax consequence for members if the transfers refer to amounts that have already been contributed to the retirement fund. The Budget therefore proposes that legislative amendments will be retrospectively introduced to correct these unintended tax liabilities. This proposed amendment is likely to be welcomed by all persons who have contributed to a retirement fund, especially as it will likely apply retrospectively.

*Louis Botha*

## VAT

## INCREASE IN VAT RATE TO 15%

The Minister announced that the standard rate of VAT will increase from the current 14% to 15% with effect from 1 April 2018. In terms of s7(4) of the Value-Added Tax Act, No 89 of 1991 (the VAT Act), the increased rate will apply from the effective date as announced by the Minister and the rate in s7(1) of the VAT Act must be amended by Parliament to 15% before 31 March 2019 to give effect to the rate in the Minister's announcement.

The VAT rate increase is expected to raise an additional R22,9 billion, which is nearly two thirds of the total additional tax revenues expected from all the tax proposals announced in the budget. The VAT rate increase will have a significant impact on poor households, although the blow is somewhat softened through a higher than inflation increase in social grants and the zero rating of basic food items, which remain intact. However, it is also proposed that from 1 April 2018, only brown bread and whole wheat brown bread will be zero rated, whereas rye or low GI bread will become subject to the new standard rate from that date.

The VAT rate increase was motivated as being necessary to meet spending commitments and to prevent further erosion of public finances. The VAT rate increase was preferred over an increase in personal income tax (PIT) and an increase in the corporate tax rate. A concern was raised that an increase in PIT would constrain growth and investment, and that companies may respond to a corporate tax rate increase by raising prices, lowering wages or retrenching workers.

An introduction of a higher VAT rate on luxury goods was considered but is not proposed mainly on the back of the Davis Tax Committee's (DTC) findings that there is no global evidence that a luxury goods VAT rate would meaningfully improve equity in the VAT system. The DTC found that multiple VAT rates add

significantly to the complexity of the VAT system, and pointed out that a number of so-called luxury goods, including motor vehicles, cell phones, perfume and photographic equipment already bear an ad valorem excise charge, upon which VAT is again levied. These ad valorem duties are also increased with effect from 1 April 2018.

The proposed effective date of 1 April 2018 does not leave much time for vendors to amend their systems and procedures to properly implement the VAT rate increase from that date. Some of the industries that will be most affected by the change are the financial services sector and the insurance industry, which face a number of practical challenges with regard to supplies made before, during and after the effective date of the increase.

Businesses who sell their goods and services on a cash basis and who have extended credit terms with their suppliers, may experience a positive cash flow impact on their business as a result of the VAT rate increase. However, businesses who supply their goods or services on extended credit terms and which are generally required to pay their creditors before they collect payments from their customers, will experience a negative cash flow impact resulting from the VAT rate increase. These businesses may even require additional working capital. Exporters who are in a constant refund situation will also look to SARS to process their refunds timeously in order to alleviate the cash flow impact on their businesses.

There are a number of provisions in the VAT legislation that deal with supplies over the transitional period from the current rate to the new rate, as well as certain anti-avoidance provisions to prevent vendors from structuring transactions to avoid paying VAT at the new rate.

*Gerhard Badenhorst*

## Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

VAT

## VAT DEDUCTIONS ON THE SALE OF BOOK DEBTS

Where a vendor has made taxable supplies of goods or services on credit, and has accounted for VAT at the standard rate on such supplies, the vendor is entitled to a deduction of the VAT previously accounted for to the extent that the debt is written off as irrecoverable.

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If the written down book debts are subsequently sold to another vendor, such as a bank or debt collector on a non-recourse basis, the sale is exempt from VAT and the seller is not required to make any adjustment in respect of the debts previously written off.

The purchaser is in turn also entitled to a deduction of VAT to the extent that the purchaser writes such debt off as irrecoverable. The deduction by the purchaser is equal to the tax fraction of the face value of the debt transferred, but limited to the amount which the purchaser paid for the debt.

It is not clear from the VAT Act as to what is meant by the 'face value of the debt transferred', ie whether it is the total amount of the debt owing or the amount owing less the debts previously written off by the seller. This uncertainty may have given rise to a double deduction, ie a deduction by both the seller and the purchaser.

In order to prevent such a double deduction, a definition of the term "face value of a debt transferred" will be introduced to make it clear that such face value is the amount less any amounts previously written off by the seller as irrecoverable.

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*Gerhard Badenhorst*



## VAT ON ELECTRONIC SERVICES

It was indicated in the 2017 Budget Review that the regulations listing the electronic services which are supplied by foreign suppliers to South African consumers and which are subject to VAT from 2014, will be broadened to include cloud computing and other on-line services such as computer software and on-line storage of data.

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Updated draft regulations will be published for public comment to prescribe and clarify the electronic services which are supplied by foreign suppliers to South African consumers which are subject to VAT.

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*Gerhard Badenhorst*

VAT

## ZERO RATING OF SUPPLIES IN TERMS OF THE NATIONAL HOUSING PROGRAMME

The supply of goods or services in terms of the government's national housing programme qualifies for VAT at the zero rate in terms of s8(23) read with s11(2)(s) of the VAT Act. The zero rating was repealed by the Taxation Laws Amendment Act, 2015 with effect from 1 April 2017.

However, it was announced in the 2017 Budget Review that the repeal of the zero rating of these supplies will be postponed for two years to 1 April 2019 because neither National Treasury nor the municipalities are ready to implement change. Sections 8(23) and 11(2)(s) were therefore reinstated.

It has now been proposed that the effective date of the repeal of the zero rating of supplies in terms of the national housing programme be postponed indefinitely, until the effective date of the change is published by the Minister in the Government Gazette.

*Gerhard Badenhorst*



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Recognised Chris Charter as Lawyer of the Year for Competition Law (Johannesburg).

Recognised Faan Coetzee as Lawyer of the Year for Employment Law (Johannesburg).

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CUSTOMS  
& EXCISE

## CUSTOMS &amp; EXCISE

Government expects a R48,2 billion shortfall for 2017/18. Personal income tax, VAT and customs duties account for 80% of the total shortfall.

Overall, VAT and customs duties shortfalls are attributable to a weaker consumer outlook and substantially lower import growth.

#### Increase in VAT also applies to Importation

VAT, which includes VAT upon importation, is proposed to increase by 1% to 15%, effective 1 April 2018.

#### Excisable Products

As is the case each year, government proposes an increase in duties and levies for excisable products.

- *Ad Valorem* Excise duties on luxury products (effective 1 April 2018):
  - Motor vehicles: increased from 25% to 30%;
  - Cellular phones: The flat rate of 7% may be replaced with a progressive rate duty structure based on the item's value. Classification of cellular phones may be amended to include "smart phones"; and
  - General: 5% rates to be increased to 7% and 7% rates to be increased to 9%.
- Tobacco and alcohol (effective 21 February 2018):
  - Tobacco: Increase of 8,5%;
  - Alcohol: Increase of between 6-10%;
  - Government to explore methods to reduce consumption, which may include minimum price and stronger enforcement; and
  - Traditional African beer is not affected.

#### Environmental & Health Taxes (Effective 1 April 2018):

- Plastic bag levy: 50% increase to 12 cents/bag;
- Incandescent light bulbs: Increased from R6 to R8;

- Vehicle emissions tax increased to:
  - R110 per gram above 120g CO<sub>2</sub>/km for passenger vehicles;
  - R150 per gram above 175g CO<sub>2</sub>/km for double cab vehicles; and
- Sugary beverages: To be implemented on 1 April 2018. A policy on the use of the taxes collected to encourage healthy choices is to be published soon.

#### Fuel Taxes (Effective 4 April 2018):

- General fuel levy: Increased by 22 cents/litre; and
- Road Accident Fund levy: Increased by 30 cents/litre.

#### Special Economic Zones

Six special economic zones are to be approved to encourage investment in manufacturing and tradable services sectors to support exports and economic growth to promote jobs. Coega, Dube Trade Port, East London, Maluti-a-Phofung, Richards Bay and Saldanha Bay are proposed to offer attractive incentives.

#### General

Amendments to the Customs and Excise Act, No 91 of 1964 CEA is considered to prevent 'forestalling', which is a practise where abnormal volumes of products are moved from warehouses into the market in order to avoid increases in excise duties.

The extension of the use of fiscal markers is to be introduced by way of amendments to the CEA, which has as its goal to eliminate illicit trade in tobacco products. Additional products are intended to be marked.

Additional information is available upon request.

*Petr Erasmus*

OTHER

## ESTATE DUTY RATE RISES, FOR THE WEALTHY

With effect from 1 March 2018, the rate of estate duty has been increased from 20% to 25% for estates with a value exceeding R30 million.

On 24 August 2016, the Davis Tax Committee (DTC) released its report on estate duty following the report being submitted to the Minister for consideration during April of the same year. In the report, the DTC made the recommendation to increase the estate duty rate from 20% to 25% particularly for estates in excess of R30 million. The Minister’s proposal in the Budget is therefore in line with the DTC’s recommendations, keeping with the progressive structure of the tax system.

In addition, in order to limit the staggering of donations as an avoidance tactic in terms of the increased estate duty rate, in the event that donations exceed R30 million in one year, these donations will also be taxed at 25%, as opposed to the normal flat rate of donations tax at a rate of 20%.

*Candice Gibson*



OTHER

## EXCHANGE CONTROL - RELAXATION OF PROHIBITION TO LOOP STRUCTURES

Generally South African residents are prohibited in investing in a foreign company, which in turn invests back into South Africa. This is called a so-called loop structure.

Previously, the Financial Surveillance Department of the South African Reserve Bank allowed South African companies to apply from 10% to 20% equity and/or voting rights, whichever is the higher, in a foreign target company, which could in turn hold investments into the common monetary area. This dispensation did not apply to foreign direct investments where the South African company held interests in the foreign entity exceeding 20%.

It was also indicated that state owned enterprises may not use low tax jurisdictions as a conduit for outward foreign direct investments outside in the world. In other words, the state owned enterprises could not make use of so-called double tax treaty to reduce withholding taxes.

It has now been announced that a relaxation will be introduced pertaining to loop structures. The loop structure provision will be increased from 20% to a maximum of 40% for bona fide investment purposes. Currently, the South African company also had to hold at least a 10% interest in the foreign company. This requirement will equally be abolished. It should be appreciated that these requirements applied to all companies, including private equity funds.

It has also been indicated that loop structures that exceed the 40% threshold will require Reserve Bank approval with due consideration to transparency, tax, equivalent audit standards and governance.

At the same time, it was indicated that the limit that applied to South African companies investing offshore will be increased. Holding companies can now transfer R3 billion in the case of listed companies and R2 billion for unlisted companies, subject to Reserve Bank reporting requirements.

*Emil Brincker*



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Mark Linington ranked by CHAMBERS GLOBAL 2017- 2018 in Band 1: Tax: Consultants.

Ludwig Smith ranked by CHAMBERS GLOBAL 2017 - 2018 in Band 3: Tax.

## CARBON TAX, 12 YEARS IN THE MAKING

The Carbon Tax Bill is expected to be enacted before the end of 2018 and the proposal by Government is to implement carbon tax from 1 January 2019.

The 2006 Draft Environmental Fiscal Reform Policy Paper (DEFRRP) published by National Treasury provided a framework to ensure the consistent development and assessment of environmentally regulated tax proposals. The DEFRRP specified the environmental related taxes and charges available at the time, such as the levies placed on transport and aviation fuel, electricity, water supply and waste water.

Following the DEFRRP, National Treasury published the Carbon Tax Discussion Paper, Reducing Greenhouse Gas (GHG) emissions during December 2010 for public comment (2010 Discussion Paper), where it was indicated that 80% of South Africa's carbon dioxide (CO<sub>2</sub>) emissions were produced from the electricity sector, the metals industry and the transport sector. One of the main causes of South Africa's carbon intensive economy is due to the electricity sector's reliance on low-cost fossil fuel based electricity generation.

Carbon tax (which seeks to reduce emissions through the price mechanism directly) and emissions trading (which targets specific levels of emissions through trade-in allowances) were highlighted as the two main economic policy instruments for putting a price on carbon and curbing GHG emissions. Although carbon tax does not set a fixed quantitative limit to GHG emissions over the short term, at appropriate levels and phased in over a period, will provide a strong price signal to both producers and consumers to change their behaviour over the medium to long-term.

In May 2013, National Treasury published an updated Carbon Tax Policy Paper for public comment (2013 Policy Paper), which considered the comments received in respect of the 2010 Discussion Paper. The 2013 Policy Paper elaborated on and contextualised the specific carbon tax design features briefly discussed in the 2013 Budget Review, such as carbon tax, energy-efficiency savings and the electricity levy, the increase in vehicle CO<sub>2</sub> emissions tax and the certified emission reductions tax incentive.

The imposition of tax applied directly to actual GHG emissions or CO<sub>2</sub> equivalents was noted as the best option for carbon tax at a proposed tax rate of R120 per ton of CO<sub>2</sub> equivalents above the thresholds. In terms of the Draft Carbon Tax Bill 2015 and the Draft Carbon Tax Bill 2017, the proposed rate of tax of R120 per ton of CO<sub>2</sub> equivalents has remained unchanged.

### National Treasury's recent carbon tax briefing

On 13 February 2018, the Standing Committee on Finance (SCoF) held a meeting to clarify South Africa's GHG emissions reduction system, as well as provide details in respect of the Draft Carbon Tax Bill 2017.

In this meeting the need to fast track the finalisation of carbon tax legislation was emphasised by the SCoF, in order for binding legislation to facilitate the necessary transition in 2020 when the Paris Agreement on Climate Change (Paris Agreement) comes into operation. The Paris Agreement was ratified by South Africa on 2 November 2016 and aims to collectively address the threat of climate change within the context of sustainable development and includes efforts to eradicate poverty. The Paris Agreement further seeks to reduce carbon emissions globally by ensuring that the globe's temperature does not exceed a 2-degree Celsius increase.

The main issues discussed at the meeting are as follows:

#### 1. South Africa's GHG emissions reduction system

In terms of South Africa's National Determined Contribution (NDC) required by Article 4(9) of the Paris Agreement, three key elements have been identified to reduce GHG emissions:

- i. a long-term goal in the form of a national emissions trajectory range to 2050;
- ii. a medium-term goal in the range of 398 – 614 metric ton CO<sub>2</sub> equivalents in the year 2025 until 2030; and
- iii. provide flexibility in the form of a range which will require a periodic review in the medium/long term, taking into account science and natural circumstances.

To meet the 2-degree Celsius target, countries will have to submit more ambitious goals going forward, as the current NDCs are not sufficient to reach the proposed target.

## OTHER

## CARBON TAX, 12 YEARS IN THE MAKING...continued

**South Africa's Mitigation System and the carbon tax phased in approach**

In 2015, Cabinet approved the following key elements in respect of the climate change mitigation system framework (Mitigation System); a carbon tax, GHG inventory, national emissions trajectory, a carbon budget for each company, pollution prevention plans for companies with carbon budgets and a reporting system to gather information regarding the emissions of users, amongst others.

Regarding the introduction of a carbon tax, a phased approach has been suggested which allows for developmental challenges faced by South Africa, encourages investment in more energy efficient technology, and ensures that South Africa's competitiveness is not compromised. The Mitigation System is to be introduced in two phases:

- Phase one (2016 – 2020)

Phase one will be voluntary as there is no legal basis to set emission limits for sectors or companies, however during phase one, the chief director of climate change indicated that particular attention to the 2010 Integrated Resource Plan, setting of carbon budgets, calls for pollution plans and annual reporting must take place.

National Treasury noted in the Explanatory Memorandum published with the Draft Carbon Tax Bill 2017, that the impact of phase one has been designed to be revenue-neutral, and revenues will be recycled by way of reducing the current electricity generation levy, credit rebate for the renewable energy premium, as well as a tax incentive for energy efficiency savings.

Phase one is said to last for a period between 4 to 5 years from the implementation date of the tax. During phase one, there will be no impact on electricity prices. In addition, carbon credits should be developed under the Clean Development Mechanism (CDM), Verified Carbon Standard (VCS) and the Gold Standard (GS).

Companies that wish to reduce their carbon tax liability up to 5% or 10% can do so by subscribing to the carbon offset scheme as provided for in the Draft Carbon Offset Regulations.

- Phase two (post 2020)

Phase two will only become mandatory when climate change response legislation is in place, and will include:

- new regulatory instruments to be included in future climate change legislation, such as DEA (Department of Environmental Affairs) Indirect Emissions Mandatory Reporting Requirements, Sector Mitigation and Low Carbon Development Plans and Climate Change Response Implementation Plans;
- regulatory instruments based on existing regulations, such as the National GHG Reporting Regulations and Pollution Prevention Plans Regulations;
- DEA Monitoring and Evaluation (M&E), such as the National Climate Change Response M&E System; and
- DEA Inventory, such as the National GHG Emissions Inventory.

The DEA and National Treasury examined various options to align carbon tax and carbon budgets for phases one and two. Phase one provides companies who participate in the carbon budget system with an additional 5% allowance, providing for a maximum tax-free threshold of 95%. Phase two contains a "in-principle agreement" in respect of the alignment option where companies cannot be penalised twice by the alignment of carbon tax and the carbon budget. The Draft Carbon Tax Bill would require additional amendment in order to allow for the aforesaid two-phase interface.

## 2. Draft Carbon Tax Bill 2017

The Carbon Tax Bill will give effect to the Polluter-Pays-Principle and assist in ensuring that firms and consumers take these costs into account in their future consumption and investment decisions, and assist with the reduction of GHG emissions.

The carbon tax policy framework in South Africa

- Emissions above a certain level will be taxed.
- Who will be taxed?

OTHER

## CARBON TAX, 12 YEARS IN THE MAKING...continued

- electricity generation and fuel combustion;
- industrial processes;
- fugitive emissions;
- scope 1 (direct GHG emissions): stationary emissions. In terms of stationary emissions, reporting thresholds will be determined by source category as stipulated in the National Environmental Management: Air Quality Act, No 39 of 2004;
- scope 2 (energy indirect GHG emissions): non-stationary emissions (as an add on to fuel tax).
- Marginal rate of R120 per ton of CO2 equivalents taking into account allowance ranges from R6 to R48 per ton CO2 equivalents.
- Recycling measures and tax incentives, which are said to be included with the announcement of the implementation of carbon tax.  
  
Revenue recycling takes place where most of the revenue collected from the imposition of carbon tax is recycled to fund measures to assist with transition to a lower carbon economy, with the aim of mitigating short term negative impacts on the economy and employment. The recycling measures and tax incentives will include:
  - energy efficiency savings tax incentive (s12L of the Act);
  - credit against Eskom's carbon tax liability for the renewable energy premium built into the electricity tariffs;
  - credit for the electricity levy;
  - support for the installation of solar water geysers;
  - enhanced free basic electricity/energy for low income households; and
  - improved public passenger transport and support for shift of freight from road to rail.
- A phased-in approach starting with a relatively modest carbon tax rate, coupled with generous tax-free allowances of 60 to 95% adjusted over time. The phased in approach will minimise potential adverse impacts on low-income households and industry competitiveness;

The implementation of a carbon tax is said to level the playing field between carbon intensive (fossil-fuel based firms) and low carbon emitting sectors (renewable energy and efficient energy technologies),

The topic of carbon tax implementation in South Africa has stirred up numerous emotions and financial fears for businesses and business owners alike who are conducting activities resulting in GHG emissions above the various thresholds. Following the proposal made in the Budget that carbon tax will be implemented from 1 January 2019, the carbon tax reality is fast approaching and businesses must be adequately prepared.

.....  
*Candice Gibson*

### Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

## OTHER

## INTEREST PAID TO THE NON-RESIDENT BENEFICIARY OF A TRUST

Section 50B of the Act provides for the levying of a withholding tax on interest, calculated at the rate of 15% of the amount of any interest paid by any person to or for the benefit of any foreign person, to the extent that the amount is regarded as having been received or accrued from a source within South Africa.

Section 50C of the Act states that the foreign person to whom the interest is paid is liable for the tax to the extent that the interest is regarded as having been received by or accrued to that foreign person from a source within South Africa. In terms of s50E of the Act, any person who makes payment of any amount of interest to or for the benefit of the foreign person must withhold the interest withholding tax from that payment.

In the proposals published as part of the Budget, it is stated that the current tax rules are unclear as to who bears the withholding tax obligation pertaining to interest paid to a non-resident beneficiary of a trust. It is further stated that the rules dealing with trust income and beneficiaries do not deem the trust to have paid the interest to beneficiaries if they are non-residents.

For example, a resident trust makes a loan to another resident. In terms of the loan agreement, the resident is required to pay interest on the loan to the resident trust. The resident trust vests the interest received from the resident in its non-resident beneficiary. The questions that arise are the following:

- does interest withholding tax apply to the aforementioned facts, ie has any interest been paid by any person to or for the benefit of any foreign person; and
- if so, who bears the obligation to withhold tax from the interest paid to the trust and vested in the non-resident beneficiary.

The Government proposes to introduce provisions to address these issues.

*Mareli Treurnicht*



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### BBBEE STATUS: LEVEL THREE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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