Revenue Laws Amendment Bill, October 2004

Presentation to the Portfolio Committee on Finance

15 October 2004

National Treasury

Contents

Income Tax Amendments

Broad-based employee share initiative (Annex 1: s 8B)

- Many countries that have incentives for employee share ownership base these incentives on the theory of enhanced productivity.
- In the South African context, this initiative can also promote a broader empowerment.
- It adds to the broadening of asset ownership in the hands of previously disadvantaged South Africans.
- Current law: employee receiving such reward for consideration<market value is taxed as fringe benefit in his/her hands (7th Schedule) at ordinary marginal rates – Employer issuing such shares cannot get tax deduction for shares issued as a share issues is not being regarded as a "cost incurred".
- Proposal: draft legislation allows an employer-company to issue R3 000 worth of its own shares annually (during 12-month period) per employee free of fringe benefit tax.
- These shares are fully deductible for the employer.

Broad-based employee share initiative (Annex 1: s 8B)

- Tax-free treatment for 'qualifying shares' to ensure 'broad-based' real participation if following conditions are met:
  - Employer must offer equities to employees for no consideration (free) so all low-income employees can fully and equally participate
  - Widespread participation - shares must be issued to at least 90 per cent of that company's permanent employees (75% in the case of Australia).
  - No dividend or voting restriction for shares offered under a 'scheme'
  - No other restrictions may be imposed so that employee gets a 'real' ongoing equity interest but some flexibility is provided to employer:
    - Employer may directly administer share scheme or indirectly through agent (collective employer schemes to benefit from economies of scale)
    - Employer may retain right to acquire shares back from employees at fair market value with a view to protecting the company against share dilution (hostile takeover risk)
    - Employer may issue restriction on employee's right to dispose of equity share but restriction may not extend beyond the earlier of:-
      - 5 years from date of acquisition
      - Employee's date of death
      - Date employee leaves employ of company
- Only shares qualify for the incentive (not options or derivatives).
- Employees will be taxed at:
  - ordinary PIT rates if shares are sold within 5-years.
  - capital gains rates apply if shares are sold after 5-years (25% inclusion and annual R10 000 capital gains exemption).

Broad-based employee share initiative (Annex 1: s 8B)

- The tax on sale encourages employees to retain their share interests in their employer.
- Note most important restriction that may be imposed by employers: the option to impose an outright restriction that prevents employees from selling these shares for a 5-year period.
- Creates some stability in the share ownership requirements for the various BEE charters.

Full taxation of executive equity schemes (Annex 2: s 8A)

- Certain consultants have developed a series of tax schemes comprising options, restricted or deferred shares and convertible debentures.
- The aim is to provide equity benefits to executive employees with little or no tax.
- These schemes effectively convert ordinary income into capital gains.
- All of these schemes depend on employers issuing share rights to employees when these rights have little tax value.
- State thus suffers from erosion of PIT base as these schemes are clearly compensation for employment services delivered.
- It is being argued that executive share option scheme come at no cost as it requires no cash outlay for company as long as exercise price is set equal to co's share price on day option was issued – co's in US could give away as many options as they wanted with no adverse earnings impact ...
- BUT: "the exercise of options transfers value from a company's investors [opportunity cost] to the [executive] employees who exercise them; like inflation, options are a hidden tax."

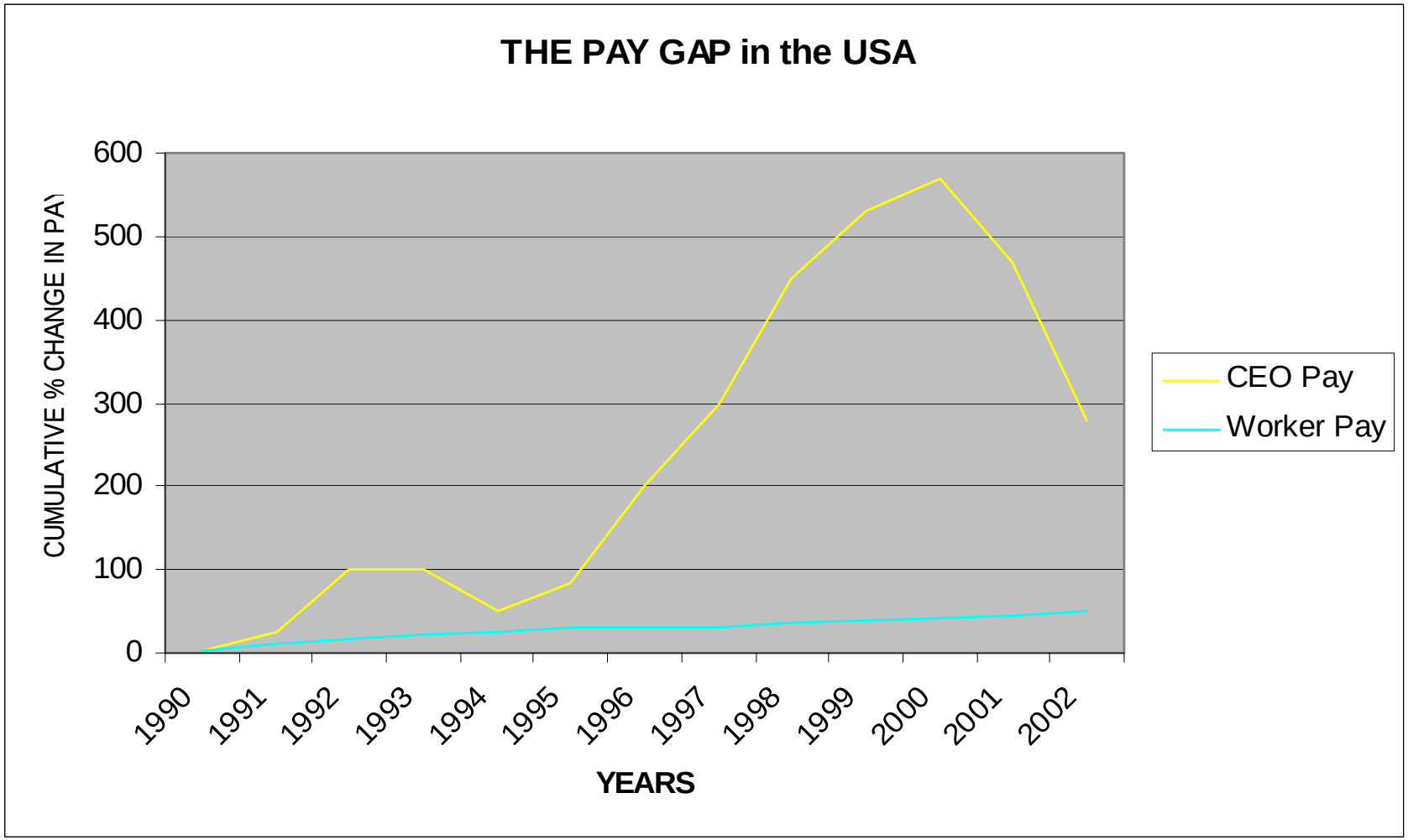
– Alex Berenson (2003:101) – *The Number – Why Companies lied and the Stock Market Crashed*

Why is Government applying harsh anti-avoidance rules in respect of executive equity schemes?

- Worldwide shareholder activists are forcing companies to establish maximum ratios between what executives earn & what average- or lowest-paid workers earn.
- Pay ratios are getting more attention, prompted by recent corporate scandals & popular perceptions that executives' pay is too high.
- Average CEO in US earned 282 times the salary of average worker in 2002, according to annual survey by Washington-based Institute for Policy Studies – in 1982, ratio was 42:1.
- Similarly, in SA there is rising wage gap as reported in FM of 3 September '04 (p 21): *"in 2004 the salary of a CEO of an intermediate to large-sized company was 48 times that of a worker paid the minimum wage."*
- Furthermore, comparing only cash remuneration is masking the fact that share option / deferred delivery schemes dwarf the cash pay package.
- SA anecdotal evidence suggests that some top executive share option schemes are valued at R100 million.
- Proposal is to tax all these rights under executive equity schemes as 'share appreciation rights' – such rights effectively now become taxed at full ordinary income rates (not the more beneficial CGT rate) & are treated as deferred salary where subsequent growth in value of shares is fully taxed at marginal ordinary income tax rates – vertical equity

USA – cumulative change in average CEO pay & average earnings of production workers since 1990

Source: "Executive Excess 2003" – United for a Fair Economy & Institute for Policy Studies



Full taxation of executive equity schemes (Annex 2: s 8A)

- These rights then increase in value (free from income tax) to the benefit of employees after the issue date.
- The proposal enhances current anti-avoidance rules by treating all these rights as “share appreciation rights.”

Full taxation of executive equity schemes (Annex 2: s 8A)

- The taxing event is shifted to a later date, such as when these rights are sold (at a time when these rights have substantially greater value).
- These rights effectively become taxed as deferred salary with all subsequent growth in the value of the share fully captured as ordinary income.

Hybrid financial instruments (Annex 3: s 8E)

- Over the years a number of financial arrangements were developed that blur the distinction between debt and equity.
- While current anti-avoidance rules limit certain debt/equity manipulations, these rules are limited.
- The proposed section 8E tightens the existing rules against debt disguised as redeemable shares (by preventing avoidance of the existing 3-year rule against redeemable features that are added after the instrument's initial issue).

Hybrid financial instruments (Annex 3: ss 8F, 24J)

- The proposed section 8F targets convertible / exchangeable debt that operates like shares by denying the interest deduction for payment of interest (while the interest income remains fully includible).
- Payments are also subject to Secondary Tax on Companies as if these were dividends.
- The proposed section 24J also eliminates artificial enhancement of interest through circular cash-flows.

Hybrid financial instruments (Annex 3: ss 24J and 64B)

- The proposal effectively eliminates circular-cash flows, thereby limiting the interest deductions solely to the real economic amount loaned.
- The proposal also eliminates costly transactions that swap dividends and interest. The net effect of these schemes is to convert taxable interest into tax-free dividends.

Sales based on contingent income (Annex 4: s 24M)

- Taxpayers sometimes sell assets in exchange for a series of payments over time (i.e., deferred instalments).
- As a general matter, this sale triggers tax for the seller (either as capital gains or ordinary income, if trading stock is involved) as if all the deferred payments are immediately received.
- Confusion arises if the instalment payments are contingent (i.e., are payable based on certain events or have amounts that vary based on certain events).

Sales based on contingent income (Annex 4: s 24M)

- For instance, a taxpayer may sell real estate for an amount equal to 10 per cent of the gross rental earned over five years.
- The net result is that the total amount due is uncertain.
- The proposal clarifies and streamlines the taxation of contingent instalment sales by adopting an “open transaction” method.
- Under this method, gains will be triggered only once all contingent sale proceeds received exceed the cost of the property transferred.

Sales based on contingent income (Annex 4 s 24M)

- Losses are similarly deferred until all payments are complete to the amount of the total purchase price.
- The proposal eliminates the need to predict future cash-flows in advance.
- The purchaser of the property transferred similarly obtains a cost in that property only to the extent payments are made.

Contingent Share Sales (Annex 4: s 24N)

- The holders of a business often sell their businesses for a fixed sum that is payable over time.
- The timing of these fixed sums may be contingent on future profitability (sometimes called an income “earn-out” clause).
- In many of these transactions, failure to reach certain targets effectively results in the reversion of the business back to the seller.
- One subset of empowerment transactions is modeled after this payment flow.

Contingent Share Sales (Annex 4: s 24N)

- The proposal treats the sale of company shares pursuant to an “income earn-out” clause as a deferred capital gain event.
- To qualify for relief, the sale must involve company shares and the seller must transfer more than 25 per cent of the shares within the same fiscal year (modeled after the company reorganisation rules).

Investments Held by CMA Investors (Annex 5: s 10(1)(h))

- Foreign residents can generally receive tax-free interest income from South African investments.
- This exemption encourages portfolio investment into South Africa.
- However, this interest exemption currently does not apply to local interest-bearing investments held by CMA residents (Namibia, Swaziland and Lesotho).

Investments Held by CMA Investors (Annex 5: s 10(1)(h))

- When this elimination was enacted, tax avoidance through capital outflows were limited solely by Exchange Controls.
- Movements within these CMA countries are free of these controls and anti avoidance rules were accordingly required.
- With the enactment of South Africa's worldwide tax system in 2001, no reason exists to exclude the above countries because the tax system itself now has built-in protection measures.

Investments Held by CMA Investors (Annex 5: s 10(1)(h))

- The proposal eliminates the CMA exclusion so CMA residents can fully participate in South African interest-bearing investments.
- This change will be especially welcomed by Namibia, which actively sought the legislation.

Public-Private-Partnerships (Annex 6: s 11(g))

- The current taxation of public-private-partnerships contains a number of anomalies stemming from Roman-Dutch law.
- Private contributions to these partnerships typically involve buildings and other fixed improvements located on Government land.
- Under Roman-Dutch law, ownership of these buildings and fixed improvements immediately shifts to the landowner (i.e., Government) as the structures are built.

Public-Private-Partnerships (Annex 6: s 11(g))

- The law will be clarified so that these-partnerships can generally claim depreciation on the cost of buildings and fixed improvements on Government land despite the loss of immediate ownership to the State.

Public-Private-Partnerships (Annex 6: s 11(g))

- The tax write-off is allowed over the expected duration of the partnership arrangement.
- Cannot benefit from shorter tax write-off periods for asset classes if these assets are not owned by PPP.
- Should the PPP terminate early, any remaining undepreciated cost becomes immediately deductible.

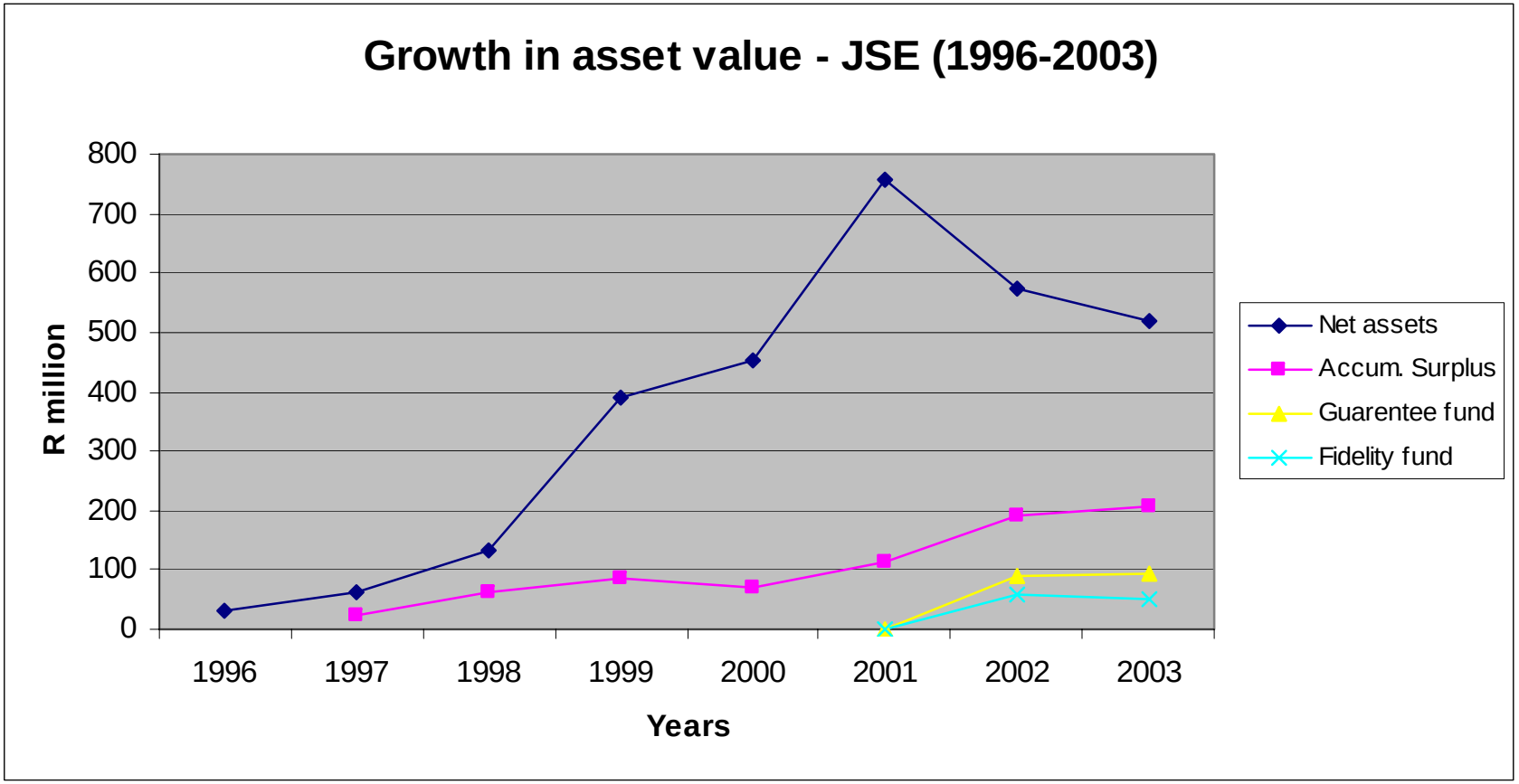
Non-proprietary Exchanges (Annex 7: s 10(1)(d))

- Currently, non-proprietary exchanges (i.e., the Johannesburg Stock and Bond Exchanges) are tax-exempt but will become taxable with effect from the date of promulgation by the President.
- The main reason for the decision to remove the tax-exempt status relates to the profit motive and subsequent distribution of these profits to members.

Non-proprietary Exchanges (Annex 7: s 10(1)(d))

- The National Treasury is of the opinion that the abovementioned exchanges do have a profit motive (refer attached graphs).
- Other taxpaying companies can either invest profits to grow the company or distribute these profits to shareholders as dividend.
- Although the exchanges may not currently distribute profits to members through dividends, accumulated surpluses may be distributed to members on liquidation (See Section 17(3) of the Security Services Act).

JSE approximate asset values



Non-proprietary Exchanges (Annex 7: s 10(1)(d))

- The decision to remove the tax exemption for the exchanges are also in line with international trends.
- The following stock exchanges are subject to income tax: Australia, Canada, Mauritius, New Zealand, United Kingdom and the United States of America.
- The withdrawal of tax exempt status has been accepted by JSE/Bond officials during further discussions with NT and SARS on 4 October.

Enhanced Tax Administration (Tax practitioners registration (Annex 11: s 67A)

- In order to promote better compliance and ensure that taxpayers receive advice consistent with the tax legislation, the regulation of tax consultants and advisors, is under consideration.
- As it will only be practical to introduce legislation during the course of 2005, the following interim measures are proposed:
- Individuals who–
  - Provide tax advice on legislation administered by SARS; or
  - Complete, or assist in the completion of, any tax returns, for reward must register with the Commissioner as a tax practitioner no later than 30 June 2005 or 30 days after the date on which they begin providing tax advice.

Enhanced Tax Administration – Tax practitioners registration (Annex 11: s 67A)

- Exclusions are proposed for:
  - Legal professionals advising/assisting clients during or in anticipation of litigation;
  - Any person advising as an incidental part of the provision of goods or other services;
  - Employees advising/completing the returns of their employer;
  - Employees advising/completing returns while under the supervision of a tax practitioner; or
  - Any person advising/completing any Customs and Excise document.

Enhanced Tax Administration - Advance Rulings (Annex 11: ss 76B to 76S)

- At present, South Africa lacks a formal system for providing taxpayers with advanced guidance from SARS in respect of the application of the tax laws.
- The proposed South African model envisions a unit within SARS that will have responsibility for issuing various types of binding rulings.
- The proposed model is based on advance ruling systems currently in place a number of jurisdictions, such as:
  - Australia, Canada, New Zealand and USA.
- The proposed amendment will permit the Commissioner to issue three types of rulings:

Enhanced Tax Administration – Advance Rulings (Annex 11: s 76B to 76S)

- (1) binding general rulings, issued by the Commissioner in respect of topics of general interest;
- (2) binding private rulings, issued in response to applications by individual taxpayers regarding the tax consequences of proposed transactions; and,
- (3) binding class rulings, issued in response to applications by certain entities regarding the tax consequences of proposed transactions.

Share-for-property transfers
General rule (Annex 12: s 24B(1))

- Companies frequently issue their own shares in exchange for property (e.g., land, machinery) especially on company formation.
- Under current law, a company receiving property in exchange for its own shares would receive a zero tax cost in the property acquired (unless part of a tax-free formation.
- This zero tax cost means that the company cannot depreciate the property acquired and will have capital gain on full gross proceeds when subsequently selling that same property.

Share-for-property transfers
General rule (Annex 12: s 24B(1))

- This practice is contrary to international tax norms in an overwhelming number of tax jurisdiction.
- This practice may render the South African tax system uncompetitive.
- The proposed legislation accordingly allows a market value cost in the property acquired for the shares of an issuing company.

Share-for-property transfers – Cross issuance (Annex 12: s 24B(2))

- Certain transactions are premised on the cross-issue of shares.
- In this circumstance, two companies simultaneously issue their own shares to one another generally adding little overall value.
- These parties are now seeking a fair market value tax cost for both sets of shares (currently the tax cost is nil).
- The proposal strengthens the current zero tax cost treatment for the cross-issue of shares.

Share-for-property transfers- Cross issuance (Annex 12: s 24B(2))

- This measure is essential for the protection of the income tax base.
- Cross-issues are frowned upon by many tax administrations because these transactions are typically utilised for tax avoidance.

Annexure 13:
Technical corrections in terms of Annex C of the 2004 Budget Review

STC
(Annex 13: s 64B(3A)(d))

- Secondary Tax on Company problems can stem from certain loop structures. In a loop structure, a South African Holding company owns foreign subsidiaries that have part ownership in a lower-tier South African subsidiary.
- The lower-tier South African subsidiary frequently distributes dividends that eventually flow-through to South African Holding company.
- South African Holding company then distributes those dividends onward to its shareholders.

STC
(Annex 13: s 64B(3A)(d))

- Under current law, the dividends of the lower-tier South African subsidiary are subject to STC.
- However, profits distributions by South African Holding company will not be subject to additional STC if South African Holding company can “directly trace” its subsequent distributions to the prior distributions made by the lower-tier South African subsidiary.

STC
(Annex 13: s 64B(3A)(d))

- The problem is that South African Holding companies cannot “directly trace” the source of dividends as a practical matter because money is fungible.
- Therefore, current relief is often of no value.
- The proposal accordingly eliminates this direct tracing requirement.

General STC anomalies – Tax Treaty (Annex 13: s 64B(5)(f))

- The proposed legislation eliminates a potential treaty conflict that could allow for the tax-free outflow of profit distributions as highlighted in the August media release.
- Tax practitioners advised that in terms of the non-discrimination art. (24) in the model OECD tax convention on income and capital that informs bilateral treaties which are designed to eliminate double taxation, STC distributions to foreign parent companies should not attract STC (= permanent exemption) in line with the domestic STC provision which only defers the STC charge …
- The proposal merely seeks to preserve the intent of current law without raising any potential treaty issues.
- Proposed law (like current law) merely seeks to ensure that dividends flowing offshore are subject to one level of STC and will not benefit from a permanent tax exemption.

Foreign discretionary trusts (Annex 13: sec 7(8))

- South African taxpayers continue to shift assets offshore via foreign discretionary trusts.
- In 2001 and 2002 (as part of the shift to worldwide taxation), rules were enacted to ensure that assets shifted offshore in this manner remained within the tax net.
- Unfortunately, these rules contained a technical defect that only kept South African sourced assets within the tax net.

Foreign discretionary trusts (Annex 13: s 7(8))

- This defect will be remedied so that all assets transferred to a foreign trust (whether they generate foreign or domestic source income) will remain within the tax net.
- The proposal properly extends the scope of Government's power to prevent the avoidance of tax through offshore trusts.

Urban development zones (Annex 13: s 13*quat(6)*)

- Last year a tax incentive for 16 urban development zones was introduced.
- These tax-preferential zones are being geographically demarcated in co-operation with the municipalities but are intended to focus primarily on inner city environment
- At issue are certain requirements for the zones that are overly restrictive:
  - designated zones must currently have a residential, commercial and industrial component when, in fact, most urban development zones realistically have only one or two of these components
  - municipalities can now show the sustained decline in property rates (income source) in both nominal or real terms
  - municipalities have to indicate only estimated costs incurred & estimated jobs created in the reports to Parliament which are intended to evidence the take-up rate of this significant incentive.
- The proposal accordingly liberalises these and other requirements.

CGT Real Property Withholding: Rationale Annex 16:

- As is well accepted internationally, non-residents selling South African real estate are subject to South African Capital Gains Tax.
- However, the tax is difficult to enforce because the non-resident selling the property may no longer have any practical connection to South Africa after the sale.
- In order to prevent any enforcement problems, many countries impose a withholding obligation on the buyer when making the purchase payments to a foreign seller.

CGT Real Property Withholding: General Rule (Annex 16)

- The buyer must withhold cash payments made to a foreign seller in exchange of real property.
- This withholding equals 5% if paid to non-resident individual, 7,5% if paid to non-resident company and 10% if paid to a non-resident trust.
- Amounts withheld must be paid over to SARS 10 business days after the amount was withheld.
- Amounts withheld act as an offset against the non-residents income tax ultimately due.

CGT Real Property Withholding: Exemption & Directives (Annex 16)

- No withholding applies if the real property has a value that does not exceed R1 million. Thereby limiting withholding to high-value properties.
- Withholding will apply the deposits only after closing when the deposit is applied to the contract purchase price.
- The non-resident seller may alternatively obtain a directive from SARS for partial or total relief if:
  - The non-resident provides adequate security (e.g., a guarantee)
  - The non-resident can demonstrate that other assets exist in South Africa that can be used to pay the tax
  - The non-resident's ultimate CGT is less than the withholding amount.

CGT Real Property Withholding: Tax liability (Annex 16)

- Purchaser Liability:
  - The purchase is fully liable for the withhold.
  - The purchase is also liable for interest and a possible 10% penalty.
  - This purchase liability applies only if the purchase "knows or should have known" the seller is a non-resident.
- Estate agent/conveyor liability: Estate agents and conveyors must notify the purchaser of the obligation to withhold and this notification must be in writing. Failure to inform will result in joint and several liability.
  - This liability will apply only if the estate agent/conveyor "knows or should have known" the seller is a non-resident.

VAT Amendments

Transfer Payments (Annex 15)

- The VAT treatment of grants / transfer payments/ subsidies by Government to Public Entities, PPPs, municipalities and private businesses has not be consistent and has resulted in some considerable uncertainties.
- The proposed amendments intend to provide clarity in this regard.

Transfer Payments: Public Entities (Schedule 1, 3A & 3B) (Annex 15)

- As a general rule the activities of the following entities are either of a regulatory nature or not in competition with the private sector:
  - Constitutional entities (e.g. IEC);
  - Non-business entities (e.g. SARS and the SETAs);
  - Regulatory entities (e.g. Gambling Boards); and
  - Certain research institutions or grant making bodies (e.g National Research Foundation)
- Grants to these entities will not be subject to VAT. These entities will not be able to register as VAT vendors. Such entities will also not be able to claim input VAT credits.

Transfer Payments: Government Business Enterprises (Schedule 2, 3C & 3D) (Annex 15)

- Major Public Entities (Schedule 2, e.g. State owned enterprises like the SABC and Spoornet) and other Government Business Enterprises (Schedule 3C and 3D entities like Mintek & the Water Boards) generally provide goods and / or services that are potentially or actually in competition with the private sector.
- Annual transfers / grants to these entities will be subject to VAT. Such transfers are viewed as payments for goods and services and therefore subject to VAT.

Transfer Payments: Public Private Partnerships (PPP) (Annex 15)

- As a rule grants / transfer payments to PPP will be subject to VAT.
- PPPs are business entities and payments by government departments to PPPs are viewed as payment of goods and / or services.
- Is this regard PPPs will be treated similar to government business enterprises.
- Where the ultimate supply by a PPP is an exempt supply (e.g. public transport or education) the PPP will not be allowed to register as a VAT vendor and the grant / transfer payment to the PPP will be outside the scope of VAT, i.e. exempt.

Transfer Payments: Municipalities (1)

- Unlike national and provincial government departments municipalities provide goods and / or services that are subject to VAT and are therefore required to register as VAT vendors.
- Currently certain grants by national and provincial governments to municipalities are either subject to VAT (at 14 % or 0%) or are being viewed as outside the scope of VAT / exempted. It is proposed that all grants to municipalities be zero-rated.

Transfer Payments: Municipalities (2)

- This proposal will significantly simply the financial (VAT) administration of municipalities and at the same time provide additional cash flows to municipalities.
- The additional cash flows will be due to the fact that municipalities will now be able to claim more input VAT credits.
- Currently they are denied input VAT credits when using the grants to acquire goods and services that are viewed as non-taxable supplies, e.g. provision of municipal roads and clinics.
- Examples of taxable (Vatable) supplies by municipalities include electricity and water.

Transfer Payments: Subsidies to private businesses

- The government provides various forms of selective subsidies to private businesses to encourage certain activities or to provide emergency assistance on an ad hoc basis.
- Such forms of assistance normally comprises a small proportion of a business's income and cannot be viewed as part of its regular income.
- In order to simply the compliance burden of businesses such ad hoc subsides will be viewed as taxable supplies and subject to VAT at a zero rate.
- Examples of such subsidies are: export marketing assistance and drought relief.

Transfer Payments: Transitional Provisions

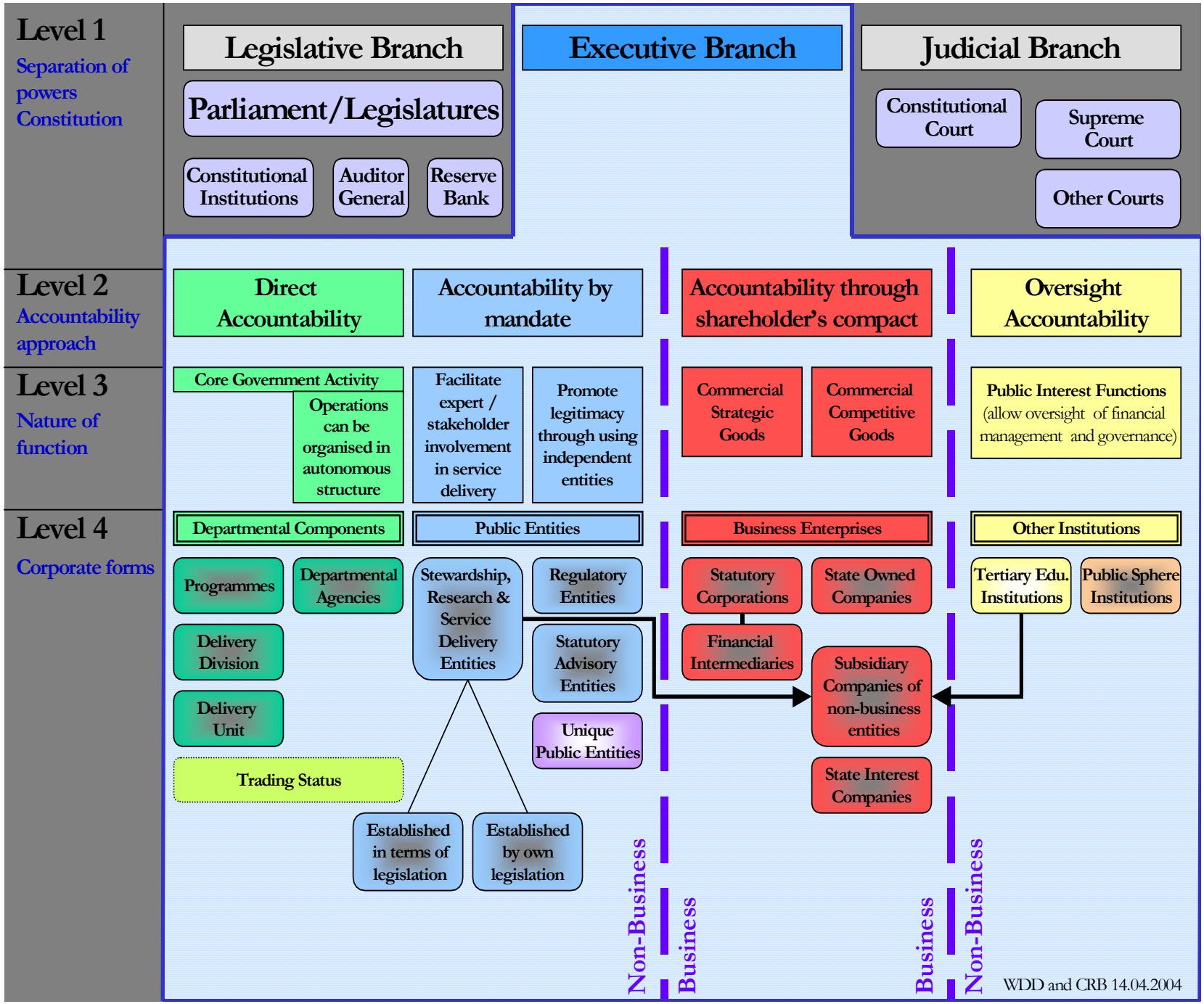
- To ensure the smooth implementation of the above proposals a number of transitional and anti-avoidance measures will simultaneously be enacted.

Transfer Payments:
New classification of Public Entities

- The National Treasury and the Department of Public Service and Administration have completed a major review of the role and classification of Public Entities.
- This review is expected to result in certain amendments to the PFMA Act and the schedules to the PMFA Act.
- The proposed amendment to the VAT Act has taken cognisance of the daft policy directions in this regard and is consistent with proposed classification of Public Entities.
- Where necessary minor amendments to the VAT act might be required in future.

Transfer Payments: Number of Entities				
Schedule	Not Registered	Registered	TOTAL	TOTAL %
1	7	2	9	2.7%
3A	61	105	166	50.2%
3C	51	30	81	24.5%
sub total	119	137	256	77.3%
2	1	16	17	5.1%
3B	1	31	32	9.7%
3D	0	9	9	2.7%
Unscheduled	8	9	17	5.1%
sub total	10	65	75	22.7%
TOTAL	129	202	331	100.0%

Public Entities - Grants - Rand : R'000 - 2003/04				
Schedule	Not Registered	Registered	TOTAL	TOTAL %
1	151,198	779,310	930,508	3.7%
3A	10,170,988	7,607,266	17,778,254	71.4%
3C	484,665	554,915	1,039,580	4.2%
sub total	10,806,851	8,941,491	19,748,342	79.4%
2	0	1,733,931	1,733,931	7.0%
3B	0	2,985,393	2,985,393	12.0%
3D	0	190,181	190,181	0.8%
Unscheduled	166,032	60,540	226,572	0.9%
sub total	166,032	4,970,045	5,136,077	20.6%
TOTAL	10,972,883	13,911,536	24,884,419	100.0%
TOTAL: %	44.1%	55.9%	100.0%	


Level 1
Separation of powers Constitution
Legislative Branch
Parliament/Legislatures
Constitutional Institutions
Auditor General
Reserve Bank
Executive Branch
Judicial Branch
Constitutional Court
Supreme Court
Other Courts
Level 2
Accountability approach
Direct Accountability
Accountability by mandate
Accountability through shareholder's compact
Oversight Accountability
Level 3
Nature of function
Core Government Activity
Operations can be organised in autonomous structure
Facilitate expert / stakeholder involvement in service delivery
Promote legitimacy through using independent entities
Commercial Strategic Goods
Commercial Competitive Goods
Public Interest Functions (allow oversight of financial management and governance)
Level 4
Corporate forms
Departmental Components
Public Entities
Business Enterprises
Other Institutions
Programmes
Departmental Agencies
Delivery Division
Delivery Unit
Trading Status
Stewardship, Research & Service Delivery Entities
Regulatory Entities
Statutory Advisory Entities
Unique Public Entities
Established in terms of legislation
Established by own legislation
Statutory Corporations
State Owned Companies
Financial Intermediaries
Subsidiary Companies of non-business entities
State Interest Companies
Tertiary Edu. Institutions
Public Sphere Institutions
Non-Business
Business
Business
Non-Business
WDD and CRB 14.04.2004

Customs warehouses and Value-added Tax (Annex 10: s 21 Customs Act)

- Under current law, the importation of goods by a VAT vendor triggers VAT payments.
- VAT input credits may be claimed at a later stage after filing.
- The delay in claiming input VAT credits causes undue cash-flow problems if goods are imported simply for re-export.
- In the case of dutiable goods, the payment of VAT on importation may be avoided if goods are held in customs warehouses solely for re-export.

Customs warehouses and Value-added Tax (Annex 10: s 21 Customs Act)

- However, duty-free goods cannot be placed in a customs warehouse and are required to pay VAT immediately on importation.
- The proposal allows for duty-free goods to be placed in a customs warehouse free of VAT as long as those goods are intended for re-export.
- The goods must be exported within six months (this may be extended to nine months in special circumstances).
- This amendment facilitates South Africa's growth as a distributional hub for the rest of Africa.

Industrial Development Zones ("IDZs") (Annex 10: s 21A Customs Act)

- An IDZ is a specific geographical area meant to attract foreign and local investment where economic development is required.
- Within each IDZ are other designated areas known as Customs Controlled Areas ("CCA").
- Last year, VAT legislation was enacted ensuring that CCA-specific provisions are aligned with those in the Customs and Excise Act.
- The economic benefit of these CCAs is of huge importance as operators can import goods without VAT (positive cash flow implications) & re-export again (exports are zero-rated). Only on importation for domestic consumption within SA will VAT be imposed.
- For example, these interventions create a conducive environment for the jewellery manufacturing industry.
- Currently, IDZs are in operation in Coega, Richards Bay & East London.

Industrial Development Zones ("IDZs") (Annex 10: s 21A Customs Act)

- Changes to Customs law (as an administrative control measuer) now treat the entry of goods into a CCA from a foreign country as an importation for Customs .
- Because VAT follows the Customs rules for imports, Vat must now be levied on importation.
- A further problem is a "double imporation" if those goods enter into South Africa from the CCA.
- The proposal aligns the VAT Act to the Customs and Excise Act, thereby eliminating the import and "double import" anomalies.

Other Noteworthy VAT Amendments

Noteworthy VAT Amendments (Annex 14:)

- Old age homes
  - Old age homes that provide domestic goods and services (section 1 VAT Act) (i.e., electricity, telephone, television and meals) are subject to VAT under a preferential formula (approx. 60% of the VAT base – s10 of VAT Act, 1991)).
  - The proposal extends the list to laundry services offered by housing schemes for retired persons, thereby qualifying for similar tax preferential treatment.
- Motor vehicles
  - VAT vendors generally do not receive VAT input credits for motor vehicles (section 1 VAT Act) despite the existence of substantial business use.

Noteworthy VAT Amendments (Annex 14:)

- Some exceptions exist for special purpose vehicles (e.g. ambulances, tractors).
- The proposal adds hearses and game viewing vehicles as additional exceptions.

- Commercial accommodations
  - It has always been intended that commercial accommodations (section 1 VAT Act) (e.g., hotels, holiday accommodations,bed and breakfasts and holiday homes) should not be eligible for registration as a VAT vendor if annual taxable supplies do not exceed R60 000.

Noteworthy VAT Amendments (Annex 14:)

- This higher threshold ensures that taxpayers cannot readily convert their personal homes to partial business use in order to artificially generate excess input credits.
- The actual literal language within the VAT Act, however, appears to run contrary to the above intent.
- The proposal eliminates this technical anomaly.

Stamp Duties on leases (Annex 8: ss 1 to 5)

- Government has imposed Stamp Duty since the 1940's.
- The current system is antiquated in terms of penalties and other issues, resulting in large levels of non-compliance.
- The proposal will shift the proof of payment from the physical affixation of stamps to electronic filing.

Stamp Duties on leases (Annex 8: ss 9, 9A and 9B)

- Private use of franking machines will also be phased-out in favour of direct Stamp Duty receipts from the South African Revenue Service.
- The regime will be enhanced and made consistent with the penalty regimes as contained in other tax acts. Under the new regime, these penalties will be as follows:
  - A non-discretionary interest charge;
  - A 10 per cent late penalty; and
  - A penalty of up to 200 per cent for failure to pay with an intent to evade.

Stamp Duties on leases (Annex 8: s 22)

- Proposed section 22 will modify the rate on Stamp Duty on leases. The current system of multiple rates will be streamlined into a single 0.5 per cent rate.
- A R100 *de minimis* exclusion for Stamp Duty will also apply, saving on administrative costs where the Stamp Duty yield is relatively low.
- This exclusion also provides relief for low-income simlar to government's recent efforts to provide relief for low cost housing.

Stamp Duties on leases (Annex 8: turnover leases)

- Lastly, the Stamp Duty on turnover leases is currently unworkable. This form of lease typically arises in the case of retail leases with the retail tenant making payment based on a percentage of gross sales (i.e., turnover).
- The proposed legislation will instead require Stamp Duty to be paid on an annual basis as turnover is generated.

Transfer Duty - estate agent reporting (Annex 9: s 14(b))

- In 2003, legislation was enacted to prevent the avoidance of Transfer Duty on residential property using companies and trusts (Entities).
- Changing beneficial ownership in these entities that mainly hold residential property is subject to Transfer Duty as if the residential property were transferred directly.
- Concerns exist that additional enforcement measures may be necessary. In particular, for foreign-owned entities, whose offshore status creates added enforcement problems.

Transfer Duty - estate agent reporting (Annex 9: s 14(b))

- For example, joint liability for a foreign seller and a foreign purchaser has little meaning since both parties often reside offshore.
- The proposal seeks to increase enforcement by imposing reporting obligations on estate agents involved in the sale of residential property companies and trusts.