

Revenue Laws Amendment Bills 2006

Select Committee on Finance
13 November 2006

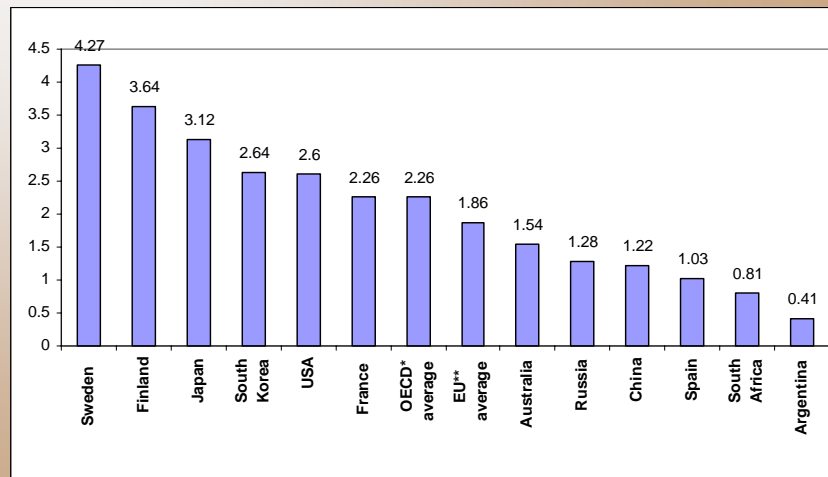


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R&D

(R&D Expenditure as a % of GDP): International comparisons



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Objective of the R&D Incentive

- **Encourage R&D spending in line with broader government objectives:**
 - National R&D strategy adopted by SA - 2002: target of R&D spending as % GDP of 1% ; increasing it over time to 2%
 - R&D in engineering, medical and health sciences, agriculture, mathematical & chemical sciences
 - To make local businesses more competitive
 - R&D should fit within a broader framework of macro economic policy (science councils, grants)

R&D - Basic Regime

- **Operational/ Current expenses**
 - Expenditure deductible by taxpayer - increase from 100% to 150% R&D activities to be undertaken in South Africa - must be of scientific or technological nature for purpose of new discoveries and inventions
 - Depreciation allowance R&D related capital expenditure increase from the current 4 year write-off period (40:20:20:20) to a 3 year write-off period (50:30:20)
- **Patents and Designs**
 - Full deduction for expenses incurred in obtaining/renewing a patent/ the registration/extension of registration of any design

R&D - Limits

- R&D to be incentivised:
 - The incentive is only for novel scientific and technical R&D
- Deductions not allowed:
 - To promote spending on genuine R&D expenditure on these activities will not be allowed as a deduction
 - Exploration or prospecting; management or internal business processes; trade marks; social sciences or humanities; market research or marketing promotion.



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R&D - Reporting

- Taxpayer reporting
 - For monitoring purposes, taxpayers will be required to report additional information to the Department of Science and Technology (the type of information, form and location of this reporting to be determined by the DST)
- DST reporting
 - The DST will be required to report annually to Parliament stating the tax benefits that accrued to qualifying R&D activities and such activities contribution to innovation, competitiveness and economic growth



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Employee Bursaries

- Background
 - A key challenge facing South Africa is the mismatch between employer needs and employee skills
 - Employees can also receive tax-free training bursaries under certain conditions
- Proposal
 - All employee bursaries will be tax-free even if those bursaries are part of a salary sacrifice
 - Employers can fully deduct bursaries, even if viewed as a salary sacrifice
 - This proposal eliminates potential uncertainty
 - Subject to an agreement that the employee will repay the money if unsuccessful except due to ill health or death



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SME Relief - Background

- A special withholding tax regime was introduced in 2000 to discourage employees from artificially providing services through corporate entities (Personal Service Entities (PSE)) in order to reduce their tax liabilities (i.e. to prevent "incorporated" salaried employees benefit from a lower (corporate) tax rate)
- This special tax regime penalises these PSEs by accelerated tax payments and increasing effective tax rates
- After consultation with various stakeholders, it was established that this regime negatively affects legitimate small businesses (e.g. by impairing their cash flow)



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SME Relief - PSE Definition

- Companies/trusts are subject to employee monthly withholding if they qualify as a PSE
- PSE status no longer exists merely because :
 - The client controls and supervises the manner of the SME's work (unless the work must be mainly performed at the client's premises)
 - The PSE is receiving regular payments from the client
- Safe harbour from PSE status now exists if that SME has a minimum of 3 employees (as opposed to the previous 4 employee minimum) [the employee minimum for SME business relief for services is similarly reduced]



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SME Relief - Personal Service Entities (PSEs) (Continued)

- Easing the Onus of Proof :
 - Clients of SMEs can be relieved of any withholding tax responsibility by good faith reliance on an SME affidavit that the SME is not a PSE
- Added Deductions :
 - PSEs can now deduct more than salary; items such as business premise expenses, pensions and medical scheme contributions
- SARS Directive for Reduced Withholding :
 - The standard 34% flat withholding for PSE can be reduced to more realistic final tax liability levels upon receipt of a SARS directive



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Co-operatives

- Background
 - Co-ops allow various parties (i.e. members) to pool financial resources
 - Co-ops come in many forms: consumer co-ops (buy-aids, burial societies), agricultural, banking, worker, etc...
 - In 2005, the DTI enacted the new Co-ops Act to facilitate the operation of co-ops
- Issues
 - The Income Tax Act needs to be updated in line with the new Co-ops Act
 - There is a need to incentivise co-ops in line with international practice
- Current changes to legislation
 - As an initial step, the Income Tax Act is being amended so that co-ops can qualify for small business relief (e.g. the graduated tax regime (0%, 10% and 29%) and 100% depreciation
 - Due to the diversity of co-ops, further amendments contemplated (new Co-ops Act (DTI) is not yet fully effective)

Oil & Gas supplies

- South Africa currently obtains its transport energy needs from the following sources:
 - Imported crude
 - Coal-to-liquids
 - Gas-to-liquids
 - Mossel Bay offshore gas fields
 - Local offshore crude: Mossel Bay offshore

Local offshore oil and gas deposits that are currently being exploited nearing the end of life

Oil & Gas - Current Expiry of OP26

- South Africa has maintained a special fiscal incentive/stability regime for oil and gas exploration and production (known as OP 26 agreements) for over 30 years
- The purpose of OP 26 was to create incentives and certainty for potential investors - to encourage exploration given the limited known oil and gas deposits onshore and offshore
- OP 26 is set to expire in June 2007. This pending expiry is delaying key exploration activities off South Africa's (south and west) coasts
- Government intends to formalise key aspects of OP26 into explicit law (within the 10th Schedule to the Income Tax Act as opposed to agreements outside the tax code), thereby creating transparency and certainty for oil and gas exploration/production



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Upstream Oil & Gas Incentives - Coverage

- The incentive applies to any company that either:
 - Holds or leases oil and gas "new order" rights; or
 - Engages in oil & gas exploration/production or gas refiningBUT, the company may not engage in any other trade
- The incentive applies to both domestic and foreign companies



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Upstream Oil & Gas Incentives - Rate Ceilings

- Maximum Corporate Tax Rate:
 - Rates for domestic oil & gas companies cannot exceed 29%
 - Rates for foreign oil & gas companies cannot exceed 32%
- Maximum Dividend Tax Rate:
 - Dividend taxes (e.g. the current Tax on Secondary Companies) cannot generally exceed 5%
 - Pre-existing OP26 rights holders generally receive the benefit of a 0% limitation



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Upstream Oil & Gas Incentives - Enhanced CAPEX/OPEX

- CAPEX:
 - Exploration CAPEX receives an immediate 200% write off
 - Production (i.e. extraction) CAPEX receives an immediate 150% write off
- CAPEX and OPEX:
 - CAPEX and OPEX can be freely deducted during the start-up phase
 - Other associated finance charges can similarly be deducted
- Ring-Fencing:
 - CAPEX and OPEX losses generally can only be used against oil and gas production income or gas refining income
 - However, 10% of any unused excess above the ring-fencing can be freely deducted against any other income
 - All unused losses can be carried forward indefinitely



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Mining Rehabilitation Environmental Funds - Background

- Mining companies must make long-term financial provision for environmental rehabilitation on closure in terms of the Mineral and Petroleum Resources Development Act (2002).
- Methods of financial provision include reserves set aside in a rehabilitation fund (e.g. trust, company, society or association)
- Contributions to these funds are currently tax deductible and the growth accumulates tax free.
- These incentives for reserves set aside operate as an incentive for environmental rehabilitation



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Mining Rehabilitation Environmental Funds - Proposal

- The list of parties who can make deductible contributions to rehabilitation funds has been expanded to include:
 - Holders of mineral rights (current law)
 - Parties engaged in mining/prospecting without mineral rights
 - Other parties subject to Commissioner approval (e.g. parties required to pay for rehabilitation as part of a long-term mineral purchase contract)
- All contributions to valid funds will be deductible (i.e. no longer limited to the formula)
- As a quid-pro-quo for the above relief, the rules preventing impermissible withdrawals (i.e. withdrawals for other purposes) have been tightened



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Retirement Funds

- (Individual) Retirement Annuity Funds (§1 "retirement annuity fund" definition):
 - Individual funds cannot be withdrawn before age 55 to ensure retirement savings
 - However, administrative fees may eliminate any growth (or the funds themselves) if the funds are small
 - The Minister is given the power for de minimis withdrawals with the level set by way of Gazette Notice
- Post-Retirement Employer Benefits (2nd Schedule Para's 5&6):
 - In 2001, Government guaranteed minimum benefits (out of employer contributions); among other impacts, this guarantee requires the surplus to be apportioned to ex-fund members (i.e. retired employees)
 - Ex-fund members will now have a choice when receiving these post-retirement benefits; they can:
 - withdraw the benefits and be subject to tax, or
 - Rollover those benefits into another retirement fund free of tax



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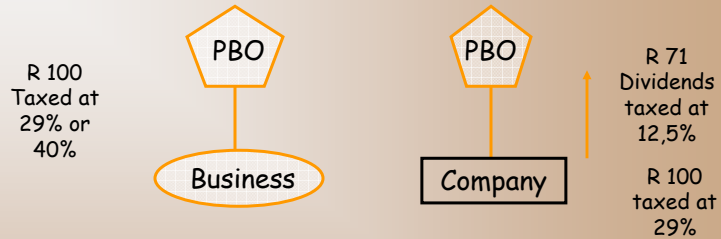
Public Benefit Organisations (PBOs) - Background

- Since 2001, Government has amended the provisions relating to the income tax status of PBOs
- The current proposed amendments address some ongoing anomalies:
 - Creating financial sustainability for PBOs
 - Encouragement of foreign charitable donor support into South Africa
 - Easing undue administrative burden for PBOs



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PBO Proposal #1 - Uniform Rate



- The PBO company/trust rate for excess trading activities will be subject to a flat 29%, regardless of PBO form (Schedule 1, Para. 1 of the June Tax Laws Amendment Bill)
- The system should be neutral as to whether the PBO conducts the activity directly versus through a separate controlled company or trust
- Administratively easier to track trading activities in a separate vehicle

PBO Proposal #2 - Foreign PBOs

- Foreign PBOs can receive Income Tax exemption (as well as possible VAT zero rating) like domestic PBOs:
 - Foreign PBOs must prove PBO status exists in the foreign home country
 - Only SA located assets must be transferred to SA PBOs if the foreign PBO liquidates (not the foreign PBO's worldwide assets)
- Donations to foreign PBOs, however, will not be deductible (consistent with international practice)

Recreational Clubs - Background

Reason for Change

- Clubs currently receive complete exemption from Income Tax with few restrictions (as opposed to PBOs whose exemptions are subject to a high degree of conditions)
- The complete exemption for clubs is questionable in an environment with a high degree of disparity between rich and poor

Essence of Proposal

- Recreational clubs will become subject to a system of partial taxation
- Clubs will only qualify for exemption to the extent that their activities merely represent a sharing of expenses by members through membership fees (e.g. covering sport and capital facilities)
- Operating and investment revenues generated from outside sources will now be generally taxable (at a 29% rate)

Recreational Clubs - Partial Taxation

- Recreational clubs will now benefit from partial income tax-exemption (as opposed to a complete exemption)
- The exemption generally applies only to the extent the members are sharing costs, as follows :
 - Membership fees/subscriptions
 - Trading activities integral to the provision of facilities, directed towards the recovery of cost and do not result in unfair competition;
 - Fundraising activities;
 - Other sources as do not exceed 5% of fees and subscriptions or R50 000;
- To the extent clubs engage in taxable activities, they are not subject to provisional tax (6 monthly)

Regional Electricity Distributors (REDs)

- Restructuring of electricity distribution sector will involve the transfer of assets from Municipalities and Eskom to REDs
- REDS will be exempt from Income Tax up to 2014 - to be reviewed at the time
- REDS will be allowed to account for VAT on a payment basis - similar to municipalities. To be reviewed in 2014?

Traditional Communities

- Exemption:
 - Traditional communities will be “explicitly” exempt until a date determined by the Minister

Grants - Scrapping Payments

- Current Law: Government payments for assets are generally taxable
- Proposal:
 - Government payment for assets solely for destruction, scrapping, etc... (e.g. diseased animals) will be exempt by Ministerial notice (in lieu of providing full replacement value)



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General Anti-Avoidance Rule The Process So Far

- Discussion Paper - 3 November 2005
- Public Comment
 - Original deadline - 31 January 2006
 - Extended - 28 February 2006
- Interim Response - 16 March 2006
- Hearings - March 2006
- A professional and constructive debate
- Consultation with international experts
- Revised proposals - 15 September 2006
- Additional interactions with practitioners



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General Anti-Avoidance Rule Proposals

- Four factors
 - Arrangement
 - Tax benefit
 - Tax Avoidance sole or main purpose
 - Containing a tainted element
 - Abnormality
 - Lack of commercial substance (4 indicators)
 - Misuse or abuse of the Act
- May apply in the alternative
- Applies to whole arrangement or steps
- Notice requirement before application

Reportable Arrangements

- Disappointing results
 - Only 55 arrangements reported
 - 53 “plain vanilla”

2010 FIFA World Cup - Background

- All countries who bid for the 2010 World Cup were required to sign a number of guarantees ranging from visa requirements to safety and security, etc. Also included were two guarantees relating to taxation
- Guarantees Nos. 3 & 4 covers taxation on imports and other taxes respectively
- Following South Africa's successful bid to host the 2010 FIFA World Cup the National Treasury and SARS engaged FIFA over an extensive period to unpack, clarify and refine the tax related guarantees
- These engagements culminated in the drafting of a Memorandum of Understanding that contains the provisions of the tax related guarantees - effectively replacing guarantees Nos. 3 & 4.



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2010 FIFA World Cup - Imports

- The following organizations / individuals may import goods related to the 2010 FIFA World Cup free of import taxes
 - FIFA & FIFA subsidiaries
 - FIFA National Associations
 - FIFA - Commercial affiliates
 - FIFA - Merchandising partners
 - FIFA - Licensees
 - The FIFA flagship store operator
 - FIFA designated service providers
 - The Host broadcaster, others broadcasters & broadcasting agencies
 - Media representatives
 - A non-resident (for income tax purposes) employee of any of the above entities temporarily seconded in relation to the championship - in respect of households goods and goods normally associated with relocation)



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2010 FIFA World Cup - Imports

Customs Aspects (Imports free from import taxes)

- Trading stock for resale sold at a Site or re-exported.
- Samples of trading stock not for resale distributed at a Site or re-exported.
- Capital goods, consumable goods and promotional materials, not for resale, individually of little value used in connection with the Championship or re-exported.
- Household effects of a person temporarily seconded to the Republic for the Championship.



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2010 FIFA World Cup - Overview of Categories

Other Tax Aspects (Guarantee No. 4)

Essentially 3 categories of persons-

- Exempt Entities
- Partially Exempt Entities
- Partially Exempt Natural Persons



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Wholly Exempt Versus Partially Exempt Entities

Wholly Exempt

- FIFA
- FIFA Subsidiaries
- Participating National Associations (except SAFA)

Partially Exempt

- Commercial Affiliates
- Licensees
- Host Broadcaster, Other Broadcasters & Broadcasting Agencies
- Merchandising Partners
- FIFA Designated Providers
- Concession Operators
- Hospitality Service Providers
- FIFA Flagship Store Operator



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2010 FIFA World Cup - Wholly Exempt Entities

These entities are exempt from all taxes in the Republic barring those specified

- Specific exclusions -
 - Where match tickets, accommodation or off-site hospitality is sold by any of the wholly exempt entities, VAT must be levied at the standard rate.
 - FIFA is to withhold UIF and SDL from its employees
 - Embedded taxes, e.g. fuel levy, excise duties etc.
- These entities will be treated in a similar manner to diplomatic missions for VAT refunds in respect of goods directly connected to the Championship



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2010 FIFA World Cup - Partially Exempt Entities

- Introduction of a “Tax-free Bubble” concept (see next slide)
- Entities are essentially FIFA sponsors
- These entities are only exempt from income tax and VAT on the sale of goods or services in designated Sites
- Regardless of whether the entity is a resident or a non-resident for tax purposes (leveling the playing-field)
- Limited areas and periods of time



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2010 FIFA World Cup - “Tax Free Bubble”

- The most practical way to accommodate the provisions of the tax guarantees was the subsequent agreement on the idea of a “tax free bubble”
- Goods (consumables and semi-durables with a maximum value of R2 000 per unit) and services sold within designated Sites (the tax free bubbles) will be free of income tax and VAT. However, expenses related to such sales will not be allowed as deductions of income tax purposes
- The “tax free bubble” concept is a mechanism to restrict most of the tax concession to prescribed areas for a limited period:
 - The Stadia, one week before the Championships until the closing ceremonies for both the Confederation Cup and the World Cup).
 - Training sites on official FIFA sanctioned training days
 - Official host city public viewing venues, on Championship days only
 - The FIFA Flagship Store - six months before the 2006 Confederations Cup until one month after the closing ceremony of the 2010 FIFA World Cup



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2010 FIFA World Cup - Exempt Non-Resident Natural Persons

- Income derived by non-residents in connection with staging the championship will not be subject to income tax.
 - FIFA delegation
 - Championship referees
 - Participating National Association Officials
 - FIFA Confederation Officials
 - Media representatives
 - All commercial affiliate staff
 - All merchandising partner staff
 - All FIFA designated service providers' staff and
 - Host broadcaster, broadcast rights agency and broadcast staff



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2010 FIFA World Cup - Taxable Natural Persons

- However, the following natural persons (resident and non-resident) will be subject the Income Tax on income derived in connection with staging the championship.
 - Team members (withholding tax on foreign sports persons)
 - Directors and personnel of SAFA; and
 - Directors and personnel of the Local Organising Committee



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2010 FIFA World Cup - VAT

- Tickets and hospitality services (including hotel accommodation) will be subject to VAT at the standard rate (14%)
- Some of the VAT revenue collected from the sale of tickets will be made available via the budget of the Department of Sports to subsidize the ticket prices for some of the local supporters



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Employee Issues - Business Travel

- The exemption for business travel allowances is currently set by the Minister:
 - One system of allowances for domestic travel; and
 - One system of allowances for all foreign travel
- The uniform system of rates for all foreign travel is unrealistic because different countries have different travel costs
- The Bill accordingly allows foreign rates to be set on a per country or per region basis
- The responsibility for setting the travel allowance rate will shift to the discretion of the Commissioner (as opposed to the Minister) to facilitate administration



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