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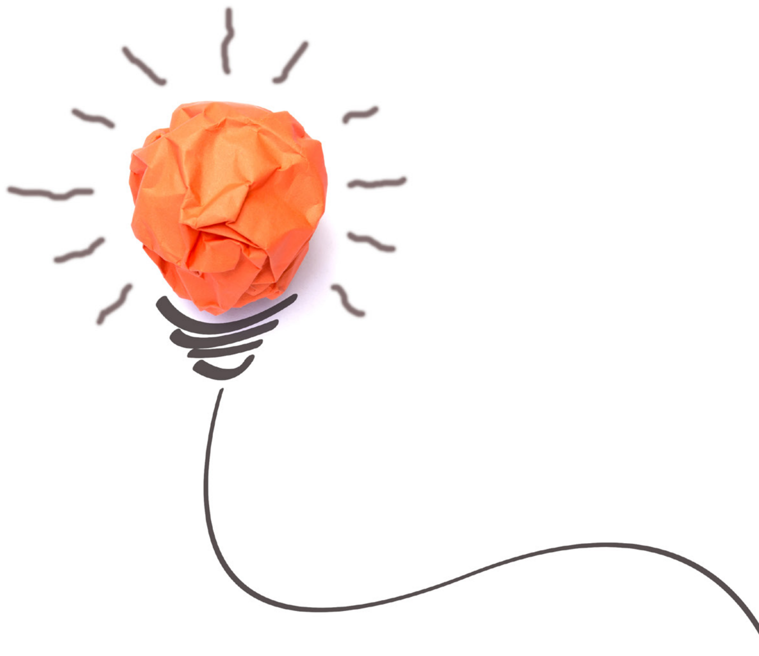

2018 Draft Taxation Bills

The Draft 2018 Taxation Laws Amendment Bill (Draft 2018 TLAB) and Draft Tax Administration Laws Amendment Bill (Draft 2018 TALAB) were released for comment by National Treasury on 16 July 2018 (the 2018 Draft Bills).

The 2018 Draft Bills contain tools designed to assist National Treasury in achieving the targets set in the Budget Review 2018, where it was stated that the fiscus aims to raise additional revenue of ZAR 36 billion in 2018/19.

Some of the significant proposed amendments, which appeared in Annexure C of the Budget have been given positive content in the 2018 Draft Bills, including further amendments to address the impact of the new debt relief provisions introduced in 2017, clarifications on the interaction between the new share buyback and corporate rules, and amendments to cater for cryptocurrencies. The 2018 Draft Bills also propose significant refinements to the venture capital company incentive structure.

National Treasury stated in 2017 that the extension of controlled foreign company (CFC) rules to foreign companies held through foreign trusts and foundations would once again be revisited in the 2018 legislative cycle. As part of National Treasury's broader CFC project, amendments regulating the use of trusts to defer tax or recharacterise the nature of income have been included in the Draft 2018 TLAB.

In this newsletter, we discuss some of the key proposed amendments in the 2018 Draft Bills. We will continue to contribute towards the public participation process of the 2018 Draft Bills and will continue to share our insights with you on the proposed amendments as they develop during the year.

Kind Regards

Brian Dennehy
Director, Head of Tax

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Income Tax: Business

Proposed amendments under the headings *Income Tax: Business (General) and Income Tax: Business (Financial Institutions and Products)* extend to both policy changes and corrections of anomalies. We set out some of the key proposals below.

Refinement of dividend stripping rules

The introduction of more targeted dividend stripping rules in 2017 was aimed primarily at curbing the perceived abuse of share buy-back schemes where "extraordinary dividends" received by a shareholder company holding a "qualifying interest" were deemed to be proceeds for capital gains tax (CGT) purposes, or income on the disposal of the shares. These provisions included an override of the corporate roll-over provisions set out in Part III of the Income Tax Act, 1962 (Income Tax Act) even in circumstances where no avoidance transaction was present. This override of the corporate roll-over provisions by the dividend stripping rules has been reversed and amendments have been proposed in an attempt to limit the application of the dividend stripping rules to transactions which fall outside the corporate roll-over provisions.

In addition, the application of the dividend stripping rules to preference dividends and what constitutes "extraordinary dividends" has been clarified, and instead of recharacterising pre-sale dividends received within 18 months as extraordinary dividends the definition of extraordinary dividends for preference share instead now refers to:

> "...so much of the amount of any dividend received or accrued in respect of that share as exceeds the amount that would have accrued in respect of that share had it been determined with reference to the consideration for which that share was issued by applying an interest rate of 15 per cent per annum for the period in respect of which that dividend was received or accrued".

The effective date for the amendment to the override of the corporate roll-over provisions is 1 January 2019, and applies in respect of any disposal on or after that date, whilst the clarification to the preference share criteria applies in respect of disposals on or after that date is 19 July 2017.

Conversion and artificial repayment of debt

The 2017 amendments to the provisions in section 19 of the Income Tax Act and paragraph 12A of the Eighth Schedule to the Income Tax Act resulted in unintended consequences for legitimate transactions by, *inter alia*, negatively impacting on transactions where there is no loss to the fiscus. Certain of the market value determinations currently required are also onerous and cumbersome. In an attempt to address some of these concerns, the 2018 amendments propose that:

- no regard is to be had to changes in the terms and conditions of a taxpayers' debt arrangements unless such changes result in a realisation event;
- only interest-bearing debt that is converted into equity will be subject to the debt relief rules;
- the definition of "debt benefit" sets out the tax consequences in relation to the cancelation, waiver, remittance, redemption and conversion of debt to equity; and
- a definition of "market value" will be introduced.

In addition, amendments have also been proposed which (i) limit the donations tax exclusion under the waiver rules to donations arising from a debt relief arrangement and (ii) provide for a capital gain, capital loss or recoupment where a debt benefit would have resulted in such capital gain, capital loss or recoupment had an asset not already been disposed of.

The proposed refinements apply in respect of years of assessment commencing on or after 1 January 2018, whilst the effective date for the amendments to the donations tax exclusion and disposal rules is 1 January 2019 and will only apply in respect of years of assessment commencing on or after that date.

Refinement to 80% "income test" for operating companies

Section 24O of the Income Tax Act allows companies using debt funding to acquire a qualifying controlling interest in an operating company a special interest deduction on the debt. An operating company is currently defined as being a company where at least 80% of its receipts and accruals are income for tax purposes.

An amendment, effective from 1 January 2019, and applicable in respect years of assessment commencing or after that date, has been proposed: that the end of the year of assessment of the shareholder company be the point in time that the determination for applying the 80% "income test" be made.

Mitigating against the abuse of collateral arrangement provisions

Measures have been proposed to counteract the perceived abuse where foreign shareholders use listed shares as collateral for loans with resident companies. The perceived abuse arises in circumstances where the resident companies would be exempt from dividends withholding tax on the dividends distributed by the listed company and the full amount distributed would then be paid to the foreign shareholders as manufactured dividends, as opposed to an amount net of dividends withholding tax had it not entered into the arrangement. The proposed effective date of these measures is 1 January 2019, and applicable in respect years of assessment commencing on or after that date.

Broadening the list of exchanges on which a REIT may be listed

The Draft 2018 TLAB proposes to expand the number of permissible South African exchanges on which a REIT may list to include exchanges other than the JSE, provided that such exchange has been approved in consultation with the Minister of Finance and published by the Prudential Authority.

This practical proposal will be effective from 1 January 2019, and apply in respect of listing requirements approved in terms of section 11 of the Financial Markets Act, 2012 on or after that date.

Collective investment schemes (CIS)

Measures have been proposed to regulate the capital/revenue nature of financial instruments disposed of and distributed by a CIS. The measures include:

- a one-year holding period rule;
- the introduction of a first-in-first-out method for determination of holding periods; and
- a limitation of deductions and allowances for unit holders to amounts of gross income.

The proposed effective date of these measures is 1 March 2019, and applies to financial instruments disposed of on or after that date.

Limiting perceived abuse of the venture capital company (VCC) regime

The VCC incentive in section 12J has been amended both to streamline its administrative provisions, as well to curb perceived abuse on the deductions afforded in terms of this provision. In this regard, a number of significant provisions have been introduced, including that a VCC may not issue more than one class of share, nor will a company qualify as a "qualifying company" if it has more than one class of share in issue on the date of acquisition or on any date thereafter. In addition, limitations on the ability of a "qualifying company" to trade with investors in the VCC have been imposed.

The amendments come into operation on 1 January 2019, and apply in respect of years of assessment commencing on or after that date.

Income Tax: Individuals, Savings and Employment

Proposed amendments under the heading *Income Tax: Individuals, Savings and Employment* include policy changes and corrections of anomalies.

With regard to the policy changes, it is proposed that the fringe benefit rules relating to loans granted in relation to low-cost housing be amended to not apply to a loan granted solely for the acquisition of residential accommodation where the loan is less than ZAR 450,000 and the employee earns remuneration of less than ZAR 250,000.

Separately, provisions have also been proposed to recognise employer contributions to funds administered by bargaining councils for the benefit of employees as fringe benefits and to facilitate the withholding of employees tax (PAYE) on such employer contributions.

The above proposed policy changes will apply in respect of years of assessment commencing on or after 1 March 2019.

A sample of the corrections to anomalies relating to individuals, savings and employment as proposed in the 2018 Draft TLAB are set out below.

Medical tax credits

An amendment to section 6A of the Income Tax Act has been proposed to ensure that taxpayers who proportionately share in medical aid costs of a single individual are not entitled to each claim the medical tax credit for such shared dependant. This amendment will be effective from 1 March 2018, and apply in respect of years of assessment commencing on or after that date.

Transfers between retirement funds of the same employer

Amendments to the Seventh Schedule of the Income Tax Act, which ensure that transfers between or within retirement funds of the same employer do not create a taxable fringe benefit in the employee's hands, have also been proposed. These amendments will apply, with retrospective effect, to years of assessment commencing on or after 1 March 2017.

Harmonising the tax treatment of retirement funds

Amendments have been proposed to the definitions of pension preservation or provident preservation funds to ensure that, as with retirement annuity funds, an expatriate may upon emigration withdraw the full post-tax value thereof. The Income Tax Act currently only allows for the transfer of funds from a pension or provident fund to a retirement annuity fund after reaching normal retirement age where a taxpayer has not yet retired. Transfers under such circumstances are to be expanded to similarly allow for transfers to pension preservation or provident preservation funds. These amendments are proposed to apply to assessment commencing on or after 1 March 2019.

Extension of employment tax incentive (ETI) scheme

The ETI regime was originally introduced in January 2014, in order to promote employment of young workers. After an initial three-year period, the ETI regime was extended for a further two years. This extended period lapses on 28 February 2019. Consequently, a further extension of the ETI regime for five years is proposed, which means the ETI will lapse on 28 February 2024. The proposed amendments will be effective from the date of promulgation of the Draft 2018 TLAB.

Income Tax: International

Tax treatment of secondary adjustments

Amendments have been proposed to exclude a dividend in *specie* arising as a result of a transfer pricing secondary adjustment, in terms of section 31 of the Income Tax Act, from the definition of "dividend" as defined in section 1 of the Income Tax Act, and for such secondary adjustments to be subject to tax in terms of section 64D of the Income Tax Act.

Effective date is 1 January 2019, and applies in respect of years of assessment commencing on or after that date.

The use of trusts to defer tax or recharacterise the nature of income

In relation to the use of trusts to defer tax or recharacterise the nature of income, the Draft 2018 TLAB proposes, that:

- the section 7(8) of the Income Tax Act attribution rule be amended to exclude the foreign dividend exemption found in section 10B of the Income Tax Act; and
- the paragraph 72 of the Eighth Schedule to the Income Tax Act attribution rule be amended to exclude the participation exemption in respect of capital gains derived from the sale of foreign shares as provided for in paragraph 64B.

The rationale for the above proposal is that if there is a donation, settlement or other disposition to a trust to acquire shares in a foreign company, any foreign dividend received by or capital gain arising from a disposal of the shares should always be attributed back to the resident donor and taxed in that donor's hands.

The following further amendments are proposed:

- in relation to section 25B(2A) of the Income Tax Act, it is proposed to exclude the section 10B(2)(a) foreign dividend exemption. The implication thereof is that foreign dividends received by the offshore trust, whenever distributed to the resident beneficiary, will be subject to South African tax in the hands of the resident beneficiary; and
- when determining an amount of capital gain that should be attributed in terms of paragraph 80(3) of the Eighth Schedule to the Income Tax Act, it is proposed to exclude the paragraph 64B participation exemption in respect of capital gains derived from the sale of shares held by a foreign trust (where a beneficiary is a resident). Capital gain from the disposal of shares of foreign companies, whenever distributed to a resident beneficiary, will be subject to South African tax in the hands of the beneficiary.

Proposed VAT amendments in the Draft 2018 TLAB

Face value

The Draft 2018 TLAB proposes that the definition of "face value" be inserted under the provisions dealing with irrecoverable debts in section 22 of the Value-added Tax Act, 1991 (VAT Act). The purpose of the insertion is to prevent a double VAT deduction when a written-off debt is sold by a vendor on a non-recourse basis to another vendor for an amount that is less than the amount owing and the purchaser then attempts to claim a further VAT deduction where it is unable to recover the debt.

For purposes of the proposed amendments "face value" means the net value of the account receivable at time of transfer, after adjustments have been made for debit and credit notes and taking into account the input tax claimed on the bad debt already written off by the supplying vendor. The proposed amendments will be effective from 1 April 2019.

Cryptocurrency

In terms of the Draft 2018 TLAB, provisions relating to the issue, acquisition, collection, buying or selling or transfer of ownership of any cryptocurrency under section 2 of the VAT Act dealing with financial services, have been proposed. The purpose of the insertion is to clarify the existing provisions dealing with cryptocurrency in South African tax law.

Telecommunication exemption

An exemption from VAT is proposed in respect of the supply of any goods and services by the International Telecommunication Union in connection with the "Telecom World 2018" exhibition of telecommunication equipment scheduled to take place in South Africa. The proposed exemption is in accordance with international best practice.

Electronic services

The Draft 2018 TLAB contains no clarification regarding National Treasury's proposal to significantly expand the ambit of the "electronic services" (cross border e-commerce) regime. Specifically, it has not been clarified whether the proposed new regime will draw a distinction between supplies made between businesses, so-called business-to-business (B2B) and business-to-consumer supplies (B2C).

Proposed amendments in the Draft 2018 TALAB

The Draft 2018 TALAB proposes clarifications to, *inter alia*, the VAT Act and the Customs and Excise Act, 1964 (Customs and Excise Act).

The proposed amendments to the VAT Act include the following.

Cancelling an incorrect tax invoice

A VAT vendor cancelling an incorrect invoice and issuing a new invoice containing the correct information on it is not committing an offence by issuing more than one invoice for a single supply, which was not always clear. A vendor issuing a revised tax invoice will, however, be required to maintain proper supporting documents as part of the audit trail.

The amendment requires that a "material error" must have been made, which means that the error is of a nature where the original (incorrect) invoice would have been precluded from being used by a vendor to claim an input tax deduction.

Goods returned to purchaser of a going concern

Where an enterprise is sold as a going concern, the purchaser of the enterprise may issue a credit note in respect of goods that were supplied by the seller of the enterprise, but are returned to the purchaser. The proposed amendment seeks to ease the compliance for purchasing vendors to alleviate VAT being a cost to the business.

Prescription rules

The prescription rules prior to the introduction of the Tax Administration Act, 2011 (TAA) will apply where a vendor does not claim an overpayment within a period of five years from the date payment was made to SARS. The proposed amendment to section 44 of the VAT Act clarifies that claims will not be considered valid if the enterprise's banking details for the payment of the refund have not been provided.

Changes promoting operational efficiency

An amendment has been proposed by SARS which will only require relevant material to be retained by the vendor for purposes of submitting special returns. In this regard, the relevant material is to be submitted to SARS only when requested.

Members of a joint venture (JV)

All members of a JV may be jointly and severally liable for the VAT debts of the JV. Unfortunately, the VAT implications of the supply of a going concern by a JV have not been clarified.

Enterprises carried in branches or divisions

The proposed amendment seeks to simplify SARS' set-off and recovery provisions and provides legal certainty that the set-off and recovery provisions will apply across separately registered branches and divisions of an enterprise. In this regard, the main business and branch operate as the same legal entity and any legal action can only be taken against the legal entity.

The proposed amendments to the Customs and Excise Act include the following significant amendment.

Writing off or compromise of debt

A new provision which provides for the writing off or compromise of debt in terms of the Customs and Excise Act has been proposed. The new provision, section 114A, makes Chapter 14 of the TAA applicable to such debt to be written off or compromised. This proposal is to be welcomed.

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