

8 August 2016

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**RE: DRAFT TAXATION LAWS AMENDMENT BILL (TLAB), 2016: COMMENTS PERTAINING TO KEY
BUSINESS TAX INCENTIVES ISSUES**

We have attached the comments from the SAIT Business Tax Incentives Work Group on the draft Taxation Laws Amendment Bill pertaining to key business tax incentives issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Yours sincerely



Duane Newman

Chair of the Business Tax Incentives Work Group

BUSINESS TAX INCENTIVE ISSUES

1. URBAN DEVELOPMENT ZONES (UDZ) – ALLOWING ADDITIONAL MUNICIPALITIES TO APPLY FOR THE UDZ TAX INCENTIVE

Treasury Proposal

It is proposed that section 13quat be amended to provide a framework for the Minister to consider applications from municipalities currently not allowed to designate a UDZ area by applying assessment criteria.

Issues

We generally support the controlled broadening of the scope of the UDZ incentive to cover additional municipalities who meet appropriate criteria. However, we are of the view that the inclusion of the assessment framework and process in section 13quat is too complicated an approach.

Recommendations

We recommend that a list of municipalities should be directly identified and that the section 13quat(6) list should be expanded accordingly rather than including an assessment framework and process in section 13quat. The smaller municipalities do not have the capacity for such a process, and the exact locations should rather be identified by National Treasury.

We also recommend that the transfer of property in a UDZ should be exempted from transfer duty under the Transfer Duty Act, 40 of 1949. The profit margins for residential businesses are extremely low and the upfront cash costs are hindering low-income rental housing. The depreciation incentive does little for these businesses given that profit margins take several years to realise in the best of circumstances.

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2. ACCELERATED CAPITAL ALLOWANCE IN RESPECT OF SUPPORTING INFRASTRUCTURE USED IN PRODUCING RENEWABLE ENERGY

Treasury Proposal

It is proposed that the provisions of the Act be broadened to include the supporting capital infrastructure in the form of capital expenditure incurred on roads and security fences for large scale renewable energy projects. The expenditure will be deductible in the year incurred, subject to specific ring-fencing and roll over provisions. Amounts actually incurred during years of assessment commencing on or after 1 April 2016 will qualify for deduction.

Issues

General rule: We generally welcome the granting of additional tax relief for renewable energy projects in terms of supporting infrastructure. However, we are of the view that the ring-fencing and roll over provisions will cause unnecessary complexity in the tax compliance of these taxpayers. The relative values of this supporting structure do not mandate unique taxing provisions

Effective date: Another concern is the effective date of the proposed amendment as there should be parity between the various renewable energy projects. It should be noted that the Renewable Energy Independent Power Procurement Programme (REIPPP) bid rounds (up to 4.5) for renewable energy projects, and many are currently closed [they have been adjudicated based on financial models which could not have taken this incentive into account]. Projects with completed bids should not receive the incentive because this use of the incentive represents a simple deadweight-loss.

Recommendations

Revised general rule: We recommend that section 12B of the Act rather be amended to include the relevant roads and security fences, so that these assets can qualify for the 50:30:20 capital allowances already provided for in section 12B. This would eliminate the need to insert section 12U into the Act and keep all the related incentives on par with one another.

Effective date: We recommend, as far as the effective date is concerned that, in the interest of parity, either:

- All the relevant capital expenditure incurred since the REIPPP first came in should qualify for capital allowances under section 12B (possibly by way of claiming the capital allowances in tax returns going forward but based on all costs incurred to date); or
- Only projects approved in terms of future bid rounds (after promulgation of the TLAB) should qualify for these capital allowances under section 12B.

3. CLARIFYING THE TAX RATE APPLICABLE TO SMALL BUSINESS CORPORATIONS LOCATED IN SPECIAL ECONOMIC ZONES (SEZ's)

Treasury Proposal

It is proposed that the legislation should be amended in order to clarify that small business corporations located within an SEZ should be able to benefit from the lower tax rate that they would otherwise qualify for outside SEZ's and should also benefit from the flat rate for SEZ's of 15%. Hence, they should be taxed on whichever is the lower rate.

Issues

We are supportive of the clarification regarding the rate. SEZs are one of the critical tools that have been identified by the South African government for the purpose of giving effect to the industrialisation agenda in the country.

Recommendations

Given that many start-up companies make losses for a number of years, during which period they would not benefit from a reduced tax rate, we recommend that the SEZ tax rate should continue to apply for 10 years once the qualifying company becomes taxable.

Problem left unaddressed: We continue to object to the connected person anti-avoidance rule in respect of SEZs. Large companies will not simply locate all of their operations within an SEZ. Allocations to an SEZ typically will occur only in terms of certain specified operations. This separation will occur via a separate subsidiary in terms of SEZ operations. This anti-connected person limitation effectively knocks out most potential investors. We again suggest a section 31 transfer pricing rule be applied to prevent perceived avoidance. The avoidance potential here is far less than cross-border connected person activity with a low-tax / no tax jurisdiction.

4. TAX EXEMPTION OF NATIONAL HOUSING FINANCE CORPORATION

No comment

5. TAX TREATMENT OF LAND DONATED UNDER LAND-REFORM INITIATIVES

No comment

6. CLARIFYING THE TAX TREATMENT OF GOVERNMENT GRANTS

Treasury Proposal

All government grants received or accrued on or after 1 January 2017 will be specifically included in gross income and may qualify for a special exemption granted in terms of section 12P read with the Eleventh Schedule.

Issues

As we mentioned last year, although the receipt and accrual of grants is technically stated to be tax exempt, the relief is more akin to deferral due to the tax attribute reduction rules contained in section 12P. We note that mere deferral is a far cry from exemption because the loss of tax attributes might, in certain circumstances, be too high a price to be paid for the exemption (particularly in cases where certain SARS auditors take positions that could result in a double loss of tax attributes). Some taxpayers find the complexity (and resultant uncertainty) of tracing the exemption to tax attribute reduction as similarly problematic.

Recommendations

We request that the application of section 12P by taxpayers should be optional. This would mean that taxpayers would have the option of being taxed on receipt or accrual of the government grant and then not to be subject to section 12P to the extent that the grant was taxed upfront.

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7. PROVISION FOR EXCEPTION TO THE RESEARCH AND DEVELOPMENT (R&D) INCENTIVE PRESCRIPTION RULES

Treasury Proposal

It is proposed that an amendment should be made to section 11D to allow for a reopening of assessments in circumstances where delays in the processing of the approval cause assessments to prescribe before an application is adjudicated upon by the pre-approval committee.

Issues

Specific amendment: The proposed amendment is generally welcomed. However, section 93 of the Tax Administration Act which deals with reduced assessment has not been amended accordingly. Taxpayers should have the comfort that these R&D deductions can be claimed by way of reduced assessments without impacting the otherwise prescribed status of their tax returns.

Timing of the deduction: Taxpayers are also concerned that they may incur interest and penalties if they claim the deduction when the expenditure is incurred, as required by section 11D(2), but before receiving the approval from the Department of Science and Technology.

Ongoing operational concerns: The proposed change does not fix the real problems associated with the Department of Science and Technology (DST) in terms of improved administration of the incentive. The process is overly adversarial and obstructive. Most advisors now recommend that the incentive not be pursued. Little has improved since the last Parliamentary hearings were held on the matter.

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Recommendations

Specific amendment: Section 93 of the Tax Administration Act should be amended to make it clear that reduced assessments should be made where section 11D(20) is applicable. The amendment should allow for reduced assessments to be made for the years directly affected by section 11D(20) as well as any subsequent years where the assessed loss brought forward should be increased as a consequence of the application of section 11D(20) in an earlier year.

Timing of the deduction: We recommend that taxpayers should be given the discretion to claim the deduction that has been expenditure is incurred, as required by section 11D(2), in any year of assessment up to and including the year in which they receive the approval from the Department of Science and Technology.

Ongoing operational concerns: Although the proposed amendment should mitigate problems experienced to some extent, it is not a comprehensive solution, taking into account the nature of R&D. Given that R&D mostly takes place as an ongoing process, we would recommend that taxpayers should be able to apply for approval of R&D after the R&D has been performed but before the deadline for the submission of the relevant tax return, in which case delayed approval should be deemed approval.

The recommendations as contained in the Task Team report set up by the DST Minister should be accelerated.

8. ADDRESSING POSSIBLE ADMINISTRATIVE AND TECHNICAL CHANGES IN RESPECT OF INDUSTRY POLICY FOR SECTION 12I

Treasury Proposal

It is proposed that section 12I be amended to enable SARS to recoup the difference in allowance claimed in respect of an industrial policy project (IPP) which was approved as a preferred status project but changes to a qualifying status project by the end of the compliance period. Such recoupment may be rolled-back into previous years. Currently taxpayers must claim the section 12I deduction when the assets are brought into use and not when they have complied with all the requirements.

Issues

SARS discretion: Giving the Commissioner a discretion regarding the making of an appropriate adjustment as envisaged in the proposed section 12I(13)(d) leads to unnecessary tax uncertainty. The Commissioner would likely use a formula based on the difference between the deductions previously claimed by the taxpayer under preferred status versus the deductions that the taxpayer would have been entitled to under qualifying status. Therefore, we do not see the need for an open-ended discretion to be exercised by the Commissioner.

Additional assessment rectification: It is proposed in section 12I(14) that the Commissioner may raise additional assessments to adjust for these differences in years of assessment prior to the year in which the change in the approval status of a project. We are of the view that raising additional assessments for past years would be administratively burdensome for SARS and taxpayers. In addition, taxpayers are concerned that they may incur SARS interest and penalties even though they claimed the deductions in good faith (as and when the costs were incurred in terms of section 12I) in order not to forfeit the deductions.

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Recommendations

We recommend that the onus should be on the taxpayer to use a the formula prescribed in the Act (based on the difference between the deductions previously claimed by the taxpayer under preferred status and the deductions that the taxpayer is actually entitled to under qualifying status). This difference should be the recoupment in its taxable income for the year during which the approval status is substituted by the Minister of Trade and Industry.

A recoupment approach would be far simpler and less risky than a re-opening of assessments. The change in status is often due to factors beyond the taxpayer's control. The difference should not create interest and penalty charges. This risk would mean that many business would choose to fall outside the incentive. Alternatively taxpayers should be given a discretion to defer the section 12I deductions until they are comfortable that they will meet the relevant approval status. This deferral mechanism would eliminate the risk for both the taxpayer and government.

Additional comments

We note that funds have been fully committed to pre-existing projects so new projects can no longer be approved by the Minister of Trade and Industry at this stage. In light of these concerns, we are aware that all incentives are being reviewed but this could take 6 months to a year. We believe that section 12I has an important role to play in the interim. The sunset clauses in section 12I effectively determines that the incentive scheme will close for applications at the earlier of:

- When the potential allowances in respect of all approved projects will in aggregate exceed R20 billion;
- Applications received by the Minister of Trade and Industry after 31 December 2017

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We are aware that some of the approved projects will not go ahead as planned and that amounts will consequently revert back to the R20 billion budget allocation in due course. However, in the meantime projects cannot be approved and if projects assets are ordered without upfront approval they are disqualified.

We recommend that, to enable this incentive to carry on playing its role in the interim, either:

- An additional allowance budget should be allocated, in addition to the R20 billion; or
- The legislation should be amended to allow the Minister to approve IPPs (with relevant point scoring and associated normal or preferred status) at zero additional allowance pending the potential allocation of funds to those IPPs out of funds that revert back upon the formal withdrawal of an IPP.

This will allow projects to order assets as the project has been approved by the Minister. Once budget is released, the approval can be updated.

It is also a concern that the regulations supporting section 12I have not been updated. This is creating uncertainty during the compliance period once a project is implemented. We will take this matter to National Treasury so the regulations are brought back into line with the legislation.

9. TAX EXEMPTION OF PUBLIC BENEFIT ORGANISATIONS PROVIDING INDUSTRY BASED EDUCATION AND TRAINING ACTIVITIES

No comment.

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10. ENERGY EFFICIENCY SAVINGS

The draft interpretation note for section 12L is creating a major problem. Under the draft note, SARS is seeking to place the same pre-approval limitation as currently exists for R&D. Pre-approval for section 12L energy efficiency savings is wholly impractical given that energy efficiency improvements are ongoing. These improvements are not set as new separate projects.

We further point out that the Draft Note has no basis in law. Section 12L imposes no explicit pre-approval obligation. However, in light of the SARS draft note, we suggest that section 12L be amended to clarify that no such pre-approval be required. The imposition of this form of pre-approval would simply kill the incentive altogether.