31 March 2017

The National Treasury

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The South African Revenue Service

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RE: 2017 DRAFT RATES AND MONETARY AMOUNTS AND AMENDMENT OF REVENUE LAWS BILL

We have attached our comments on the 2017 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (the draft Rates Bill).

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

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Comments on the 2017 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill

1. Coming into effect of the increase in the dividends tax rate

The Minister of Finance announced in the National Budget Speech on 22 February 2017 that the dividends tax rate would increase from 15% to 20% with effect from that day.

Section 11 of the draft Rates Bill, which was published on the same day, proposes that:

> *(1) Section 64E of the Income Tax Act, 1962, is hereby amended by the substitution for subsection (1) of the following subsection:*
>
> > *"(1) Subject to paragraph 3 of the Tenth Schedule, there must be levied for the benefit of the National Revenue Fund a tax, to be known as the dividends tax, calculated at the rate of [15] 20 per cent of the amount of any dividend paid by any company other than a headquarter company.".*
>
> *(2) Subsection (1) is deemed to have come into operation on 22 February 2017 and applies in respect of any dividend paid on or after that date. (our underlining)*

This proposal means that dividends that had been declared before 22 February 2017 but paid after that date will be subject to the increased dividends tax rate of 20%. We are of the view that any amendment in the dividends tax rate should not affect dividends that had already been declared. When companies declare a dividend, they should have certainty regarding the tax consequences, particularly the dividends tax rate.

As a side note, you would be aware that the instant change of the dividends tax rate caused significant practical problems in relation to dividends paid on or soon after 22 February 2017, especially in the case of listed companies. The amounts required for a dividend, including tax set-asides, are determined at declaration. This upfront determination is especially true for listed companies. The excess tax distorts the outcome for either the company (being forced to pay an extra unintended amount) or for the shareholders (who will receive unexpectedly less).

We note that companies have to meet various corporate governance requirements, including those set out in the Companies Act, before declaring a dividend. We are of the view that the amendment contains an unfair element of retrospectivity since the key date for the commitment to pay dividends is the declaration date, especially in the case of listed companies.

We further note that when the dividends tax was introduced, it was made applicable in respect of any dividend <u>declared and paid</u> on or after 1 April 2012. Similarly, when the Secondary Tax on Companies (STC) rates were increased or decreased, the new rate applied to any dividend <u>declared</u> on or after a current or future date. In all these instances, any dividends declared prior to the date that the amendment of the rate was announced, remained subject to the old rate.

We are aware that government has tax avoidance concerns about artificial timing adjustments in terms of payment. However, an unlisted company could still back-date a resolution in such a way that a dividend was due and payable (and hence "paid" as envisaged for dividends tax) before 22 February 2017. The issue of illegal backdating is one of enforcement – not of legislation.

Our concern is that the impact of the proposed amendment goes against the principle of tax certainty. We caution that fundamental principles should not be undermined in an attempt to mitigate the risk of tax avoidance.

In addition to raising additional revenue, a reason given for the increase was:

> *Increasing the top marginal rate without concurrently raising the dividend withholding tax rate would increase the arbitrage opportunity for some individuals to pay themselves with dividends rather than salaries. Government therefore proposes to increase the dividend withholding tax rate from 15 per cent to 20 per cent.*

The above arbitrage opportunities are mostly likely to exist in the case of smaller owner-managed businesses, many of them with February year-ends. The extent of any tax arbitrage opportunity mainly depends on the difference between the individual tax rate (at which salaries are taxed) and the effect of the combined company tax rate and dividend tax rate (at which company profits are effectively taxed). The individual tax rates were only increased with effect from 1 March 2017. Therefore, increasing the dividend tax rate from 1 March 2017 would largely have addressed the risk of an increased arbitrage opportunity. Again, smaller companies seeking the reduced rate will most likely artificially backdate the distribution in any event. Listed companies should not be of concern because listed companies simply do not have the speed of decision-making to artificially accelerate dividends before 1 March given their heavier governance structures. Therefore, no need exists to impose the dividends tax rate change before the 1 March individual year of assessment change.

2. Health promotion levy on sugary beverages (sugar tax)

We question whether it is appropriate that a new substantive tax is introduced by way of the Rates Bill, rather than by way of the Taxation Laws Amendment Bill. The draft Rates Bill does not normally go through the same extensive process of consultation and public hearings in Parliament as the draft Taxation Laws Amendment Bill. The draft legislation to introduce the new sugar tax should go through extensive consultation and public hearings given the bills significance to certain industry sectors. This might be best achieved by moving the sugar tax to the draft Taxation Laws Amendment Bill. We also wonder whether the rates bill is indeed more efficient than the general taxation laws amendment bill because the rates bills are often delayed and eventually signed by the President at the same time as the taxation laws amendment bills.

Regardless of the merits of the sugar tax, we also question whether it is appropriate for National Treasury to be responsible for putting measures in place to address health concerns or that it has the capacity to do so. Should this responsibility not rest with the Department of Health who could address health concerns by way of regulation? In our view, care should be taken to ensure that each government department stays focused on its mandate. Therefore, health matters should be initiated from the Department of Health – not initiated from National Treasury. If a sugar tax is to be imposed, it should be part of the Health Department's overall strategy.