Presentation to the Parliamentary Standing Committee on Finance at Public Hearings

2017/2018 National Budget

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Balancing the Budget in tough economic times

- The Minister had to make tough choices to find the additional R28bn needed in 2017/2018
- Choosing tax increases that will mostly affect upper income earners is understandable
- Individuals in all tax brackets have also only partially been compensated for inflation
- Increasing the effective individual tax rates is not sustainable
- Limit being reached and a tipping point being approached

Is the balance appropriate?

- Concerned with the balance between government and private sector
- Deeper cuts in government spending needed
- Government spending cuts should match tax increases
- Government and the private sector should share the pain
- Spending increases should not be at a rate greater than inflation
- Further spending on new programmes such as NHI should be delayed until affordable

Expanding the VAT base in future and interaction with the fuel levy

- Revenue needs to be increased by R15bn in 2018/2019
- It is foreshadowed that the VAT base may be increased
- The zero-rating on fuel may be removed together with a freeze or decrease in the fuel levy
- The diesel refund system for primary production activities will also be reviewed this year
- A shift from a fuel levy to VAT on fuel will have an interaction with the diesel refund
- Anticipated that any increase in VAT will be combined with targeted poverty relief measures
- Zero-ratings should be reviewed and those that are not properly targeted be removed

Dividends withholding tax rate increase from 15% to 20%

- Increased in line with increase of top individual tax rate to 45% to prevent tax arbitrage
- Small and medium business owners affected by the limited scope for arbitrage
- Not only high income earners but all individuals who receive dividends, including pensioners and B-BBEE shareholders will be affected
- Increased rate applies to all dividends <u>paid</u> from 22 February (Budget day) onwards
- Dividends that were declared before the Budget but paid after the Budget also caught
- Question whether dividends <u>declared</u> before the Budget should not be taxed at 15%
- Deemed dividends such as interest forgone on loans will also be caught for the whole year unless pro-rata relief is given

Foreign employment income tax exemption

- SA resident working in a foreign country for more than 183 days a year may be tax exempt
- Treasury of the view that the exemption appears excessively generous
- Proposal to adjust the exemption
- Wide consultation will take place with SARS and taxpayers
- An alternative solution would be a system of tax credits
- Many practical problems with claiming tax credits such as obtaining proof of taxes paid in foreign jurisdictions
- Treatment of independent contractors should also be reviewed and put on par with employees as the current distinction is a trap for the unwary

Remedial action for bargaining councils

- Some bargaining councils have not been deducting PAYE from holiday and year-end payments to members
- Consideration will be given to providing some relief to regularise their tax affairs
- Opportunity for regularisation and future compliance is welcomed

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Retirement reforms

- Proposed amendments to further facilitate retirement reforms are welcomed as preservation and reinvestment of funds is encouraged
- People should be encouraged to keep saving after retirement age given the increased life expectancies
- Suggestions made in the past to force withdrawal after a certain age should be resisted

Taxation of employee share-based schemes

- When a restricted equity instrument vests upon disposal, the gain should be subject to income tax in the hands of the employee and not also in the trust (double tax)
- The proposed amendment to clarify this interaction between section 8C and CGT is welcomed
- We commend Treasury for the extensive consultation on the 2016 proposals to treat dividends on restricted equity instruments as remuneration
- Any future changes to the taxation of employee share based schemes (including B-BBEE structures) requires further consultation
- Transition measures should be considered for pre-existing structures that are based on the current tax regime as B-BBEE structures are difficult to restructure if the tax regime changes

Tax implications of debt foregone

- The current tough economic climate results in lenders making compromises with borrowers
- The alignment of the income tax and capital gains tax treatment of debt foregone for group companies or companies under business rescue is welcomed
- The proposal to allow the conversion of debt to equity will provide certainty
- Consideration should however be given to a reciprocal adjustment for recouped interest
- In other words, the interest recouped by the borrower should be matched by a deduction by the lender

Tightening of anti-avoidance rules

- We welcome that the circumvention of certain anti-avoidance measures will be addressed
- Low-interest loans made to companies owned by trusts to avoid donations tax
- Abuse of disguised sale of shares using share buybacks
- Circumvention of dividend-stripping rules
- Changes to the definition of contributed tax capital
- Adequate consultation is needed to ensure that the mischief is targeted

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Real Estate Investment Trusts (REITs)

- Special tax dispensation for REITs has facilitated investment in property since 2013
- The rental profit received by the REIT flows through to the investor where it is taxed
- Proposal to amend corporate reorganisation rules for REITs welcomed
- Further measures to facilitate the simplification of REIT structures needed
- Explicit confirmation needed that interest on money borrowed to invest in REIT unit is deductible against rental profit

Refinement of the venture capital company (VCC) regime

- A regime to encourage investment in small and medium-sized enterprises and the need to make further changes is supported
- Main impediment to investment is that there is more than one level of tax on the same investment (double tax)
- The venture capital company is subject to CGT on the sale of the shares in the investment
- When the proceeds are then on-declared as a dividend, there is dividends withholding tax
- We recommend that there should either be no CGT or a flow-through tax regime

Base erosion and profit shifting (BEPS)

- South Africa’s position on the OECD action plan on BEPS is well advanced
- Controlled foreign company rules have been internationally acknowledged
- South Africa will be signing the multilateral instrument in June 2017
- Country-by-country reporting regulations were gazetted in December 2016
- SARS is updating the Transfer Pricing Practice Note in line with the OECD guidelines
- The efforts to limit interest deductions on debt financing should not go too far

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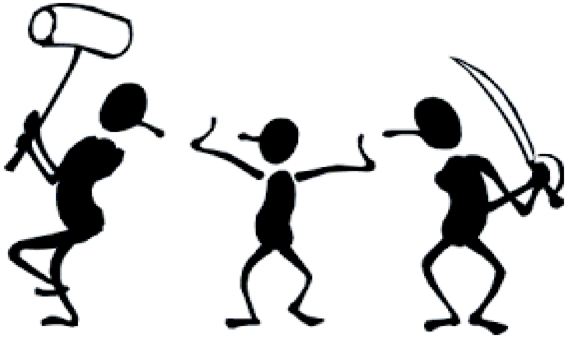
Small business compliance burden

- Many small businesses find their tax compliance burden very difficult and onerous
- Detailed accrual accounting and record-keeping is often only necessary for tax purposes
- Poor record-keeping makes otherwise compliant small businesses vulnerable to attack
- Burden of proof should be a reasonable civil burden - not be elevated to a criminal standard
- A cash basis of taxation (based on bank statements) could reduce the compliance burden
- It will also relieve the cash flow distress of paying tax and VAT before the cash is received from customers
- It should be made clear in law and applied in practice that SARS must pay interest on VAT refunds after 21 days

Rules for dispute resolution

- Draft revised rules for dispute resolution were expected to be published in 2016
- It has been indicated that the periods for taxpayers to object and appeal would be extended
- These draft revised rules have not yet been published
- Taxpayers given limited time periods within which to respond to SARS
- SARS are not subject to similar limited time periods
- Taxpayers are at a disadvantage
- Contributes to delays in receiving tax refunds



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Health promotion levy on sugary beverages (Sugar Tax)

- The enabling legislation is contained in the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill
- Will adequate consultation take place on the sugar tax introduced in this draft bill?
- Should it not be in the Draft Taxation Laws Amendment Bill which is subject to more comprehensive consultation?

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Estate duty – further DTC recommendations to be considered in 2018 budget

- The use of interest free loans to avoid estate duty was addressed in the 2016 budget
- The other DTC estate duty recommendations will be considered in the 2018 budget
- Concerns with these proposals have not yet been fully vented, e.g. the proposed abolition of the exempt transfer between spouses

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THANK YOU

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