Presentation to the Parliamentary Standing Committee on Finance at Public Hearings

2018
Draft Taxation Laws Amendment Bill and Draft Tax Administration Laws Amendment Bill

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Tax Administration Act (TAA): Protection of taxpayers' rights?

- A year ago we said that ***"The legislation should provide accessible remedies to taxpayers to protect their rights"***
- We made Annexure C submissions in relation to the following **critical areas** of Tax Administration (several of which had been raised before):
  - Entitlement to **letters of findings before adjustments**
  - **Disparity** between Taxpayers' rights and SARS' rights to correct assessments
  - Problems with **Voluntary Disclosure Programme** tax provisions
  - Problems with the **"Pay now, Argue later"** rule
- National Treasury/SARS held **public workshops** (including small VDP workshop) where these submissions were clarified
- However they have largely **not been addressed** (except audit engagement letter - PTO)

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Tax Administration Act (TAA): Notice of commencement of an audit or verification needed

- It is proposed that a taxpayer must be provided with an **"audit engagement letter"** by SARS to ensure that the taxpayer is notified at the start of an audit as part of efforts to keep all parties informed
- We **welcome** this proposal as a step in the right direction
- However we reiterate that the notification requirements should apply to **all SARS actions that may result in an assessment**, including a "verification".
- The **Promotion of Administrative Justice Act** requires that any administrative body gives a person *"adequate notice of the nature and purpose of the proposed administrative action"* and *"a reasonable opportunity to make representations"*
- We **recommend that the requirement for notification of audit is extended** to apply equally to verification (or inspection) processes so that SARS officials and taxpayers both understand the correct position in law, with reference to the tax legislation only, without having to also be aware of administrative justice laws
- We highlight that a notification of verification/ inspection is as important as a notification of audit when it comes to a **taxpayer's entitlement to refunds** (as well as for VDP)
- SARS need not authorize a refund until a verification, inspection or audit of the refund has been finalised so a taxpayer needs not to be notified to know **why the refund is withheld**
- We recommend that the term **"notice of commencement of an audit"** is used to be consistent with the section dealing with voluntary disclosure
- We also recommend that the **legislation should stipulate the timeframe** for the notice

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Debt benefit rules refined: "Concession or compromise" limited to realisation events - welcomed

- We commented in 2017 that the amendment that any change in the terms or condition of a debt would be a **"concession or compromise"** may affect legitimate transactions and would be administratively burdensome
- We welcome that this definition is now proposed to only relate to **realisation events**
- We also welcome that the **substitution of a debt** will not per se trigger a debt benefit

Debt benefit rules refined: Problematic areas remain – dormant company exclusion too narrow

- **Dormant company exclusion** is limited to South African group companies only, all other forgiveness of debt due by a dormant company will still trigger tax
- This makes it **difficult to wind-up** dormant companies where they owe money to a person outside the South-African group or a third party
- Dormant companies would have forfeited their assessed losses and any recoupment will give rise to tax which they may **not have the money to pay**
- We suggest that the dormant company exclusion **should apply to all debt** to the dormant company from anyone

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Dividend-stripping: The real avoidance – overall policy

- We question the **method of remedying** the real avoidance
- The real avoidance is when (taxable) proceeds on disposal of an asset is **recharacterised** as (exempt) dividends
- The real avoidance takes place when the **purchaser** of the asset effectively funds the dividend
- The anti-avoidance rule has **delinked** the extraordinary dividend from the existence of the purchaser
- Now all extraordinary dividends are problematic with some **complex relief for reorganisation rules** requiring tracing
- CGT is wrongly triggered on all buybacks and redemptions where **no third-party acquirers** are involved
- Conceptually the solution is rather to distinguish between **dividends from earnings and capital distributions**

Dividend-stripping: Override of corporate reorganisation rules reversed

- **2017 amendments included an override by the dividend-stripping rules of the corporate reorganisation rules**
- **This affected legitimate reorganisation** transactions
- We welcome that the override will be reversed and replaced by **"deferral transaction"** rules
- Disposal of shares in a "deferral transaction" will not trigger dividend stripping rules but if they are again **disposed of within 18 months** of the "deferral transaction" the dividend stripping rules will be triggered
- The dividend stripping provisions focus on dividends within 18 months prior to the disposal of the asset but in this case the period is **36 months** (including dividends 18 months before "deferral transaction")
- The proposed effective date for this amendment is 1 January 2019 instead of the original effective date of 18 December 2017 – we query **why the amendment does not go back**

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Dividend-stripping: Preference shares: Arrear dividends

- Preference dividends are often calculated at regular, say monthly or annual intervals over the term of the preference shares but only declared and paid at the **end of the term**
- If these preference dividends coupon rate is higher than 15%, the **excess amount** will be extraordinary dividends
- This means that dividends that relate to the **period before** the effective date (19 July 2017) will also be caught simply because they had not been paid out
- We suggest that only the portion of the dividend that relates to the **period/days from 19 July 2017** should be taken into account in the extraordinary dividend calculation

Doubtful debt allowance: New rule needs further consultation

- So far the **SARS has a discretion** as to how much of a taxpayers debtors it regards as being doubtful
- Many taxpayers apply **25% of their book provision**
- Taxpayers often put forward their **support for a suitable methodology** for their doubtful debt allowance claim such as a specific list of doubtful debts
- Many taxpayers in the financial sector rely on the **BASA ruling**
- It is proposed that the SARS discretion be removed and replaced with a **formula** (25% of IFRS9 impairment or, if IFRS9 not used, debts older than 90 days)
- To minimise the cash tax impact of the change in methodology we recommend a **phasing in** of the change over 2 or 3 years

Doubtful debt allowance: Competitive disadvantage for non-bank lenders

- Significant concern that non-bank lenders, **who compete with banks**, may be at a competitive disadvantage
- Banks are entitled to claim **more favourable allowances** in terms of section 11(jA) – on certain parts of their impairment provision as much as 40% or 85%
- **Legitimate non-bank lenders** who are also subject to the National Credit Act and other regulations will be affected
- These include stores who provide store credit as well as other non-deposit taking lenders and who are currently applying the **favourable BASA ruling**
- Further **consultation** and consideration whether these non-bank lenders should not be treated similar to banks needed

Faster write-off for electronic communication cables: 10 year write-off period & scrapping

- We welcome that the period over which electronic communication cables can be written off has **been aligned and reduced to 10 years** (or longer if the lease is longer)
- These cables are subject to technological development and obsolescence as well as environmental factors that **impact their useful lives**
- Allowance assets with a useful life of 10 years or shorter useful life generally qualify for **scrapping allowances** when they are no longer used
- We recommend that a **consequential amendment** be made to the scrapping allowance provisions to include these electronic communication cables

Venture capital companies (VCC): How to defeat the avoidance structures while protecting the innocent?

- The VCC regime has an important role to play in the **financing of SMME’s** but is prone to abuse
- In certain instances it is being utilised for purposes other than the original policy intent – **query what all is out there**?
- The avoidance structures need to be **defeated without undermining** legitimate VCC structures
- For example, **different classes of shares** are used for avoidance structures but are also necessary for many legitimate structures involving innocent investors
- A **different trigger** to prevent the avoidance while protecting the innocent needs to be found
- **Policy certainty and existing VCC’s** should not be undermined
- Perhaps the regime should be **wholly revised for future VCC’s**
- We suggest **full consultation** with all VCC regime stakeholders

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Transfer pricing secondary adjustment /dividend in specie not subject to DTA relief: Punitive measure compounded

- When a TP primary adjustment is made, for example an excessive interest deduction is disallowed, it also results in a TP secondary adjustment, namely that the amount of the primary adjustment is treated as a **dividend *in specie***
- The proposed amendment will result in the dividend *in specie* not being treated as a "dividend" as defined in section 1 but **only as a deemed dividend *in specie* for purposes of the dividends tax**
- This amendment means that the TP secondary adjustment will be subject to **dividends tax at 20%** without any relief from double tax under a double tax agreement (DTA)
- The denial of DTA relief is another **punitive measure** (on top of withholding tax on interest as corresponding adjustment not made; interest and penalties on late / underpayment/ understatement of tax) and we disagree with the philosophy behind the amendment
- The purpose of transfer pricing (s31) is to **realign the stated transaction** with a transaction that would hypothetically have arisen had the pricing truly been arm's length
- The secondary adjustment simply flows as a further shift to put the parties back in the original arm's length position – **no reason exists to treat the secondary adjustment any worse** than the primary adjustment
- By deviating from the principles provided for in the OECD MTC and supported by international academic writers, **uncertainty is created for potential foreign investors**
- The absence of a **safe harbour test for thin capitalisation** purposes makes this worse

Mining royalty proposal: Reducing Gross Sales by Transport, Insurance and Handling (TIH) costs Why amend wording after court case?

- The mining royalty is **calculated** as:
  Gross Sales x EBIT (Earnings Before Interest and Tax)
- Therefore the higher the **Gross Sales** the higher the royalty
- When the mining royalty legislation was **drafted Treasury** commented that:
  - Based on extensive research and practical considerations it was decided that the tax base will be the value of the minerals mined, i.e. **gross sales less the transport costs between the seller and the buyer of the final product (mineral)**
  - This exclusion is necessary so as **not to penalize minerals that are located far** from markets or an export port
- Despite this Treasury comment, the interpretation of the law has lead to **disputes** between SARS and taxpayers
- SARS argued in the **UMK court case** that UMK was not entitled to reduce its Gross Sales by the TIH costs incurred – SARS lost the case
- The UMK court case has now confirmed the interpretation and **provided certainty**
- Such certainty should not be removed by an **amendment of the law**
- We are concerned that the proposed amendment may result in **SARS insisting** that mining companies must disclose detailed confidential information on their customer invoices or risk paying an inflated royalty – both these outcomes are not commercial

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Collective investment schemes (CISs): Deemed revenue treatment of short term trades – impact on savings?

- CISs (also known as unit trusts) **hold portfolios of financial instruments** (e.g. shares and bonds) on behalf of their investors (also known as unit holders)
- The CISs also **buy and sell financial instruments for a number of reasons** including to buy back units from unit holders, to invest funds from new unit holders and to rebalance portfolios
- CISs have a **specific tax regime**:
  - The investment returns of the CIS (e.g. dividends and interest) are not taxed in the hands of the CIS but in the hands of the investors as these **returns flow through to the investors**
  - The gains and losses on disposal of the financial instruments by the CISs are regarded as being of a capital nature and therefore **not subject to tax at all**
  - When the **unit holders disposes of their units** they effectively pay CGT on the capital growth
- It is proposed that the disposal of financial instruments **within 12 months be deemed to be income of a revenue nature and taxable**
- Such income would be subject to **normal tax at the marginal rates of the investors** if distributed to them (it is inconceivable to retain this in CIS with 45% tax rate)
- Proposal will result in **inequity** between investors in CIS versus other financial products and create severe distortion in the trade conduct of portfolio managers
- We view the proposal as significant and request **extensive consultation** and analysis of the impact on the broader economy, the CIS and related industries before implementation

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Value-Added Tax (VAT) on Cryptocurrency: What is it?

- "Cryptocurrency" should be **defined** to ensure that items such as digital vouchers are not inadvertently treated as cryptocurrencies
- It has been proposed that the issue, cancellation, collection, buying, selling or transfer of ownership of any cryptocurrency be included in the VAT Act as a **deemed financial service** and hence an exempt supply
- We query whether this will be the **most appropriate treatment** from a VAT perspective
- Although it makes sense from a cryptocurrency trader's perspective, it could give rise to **unintended consequences** for others
- For example, where a **retailer** accepts crypto's as payment the original supply of goods and services in exchange for crypto's should not give rise to a concern
- However, should the retailer **subsequently sell or barter** these crypto's it would be making an exempt supply
- Therefore a portion of the retailer's supplies will be exempt resulting in **input tax apportionment issues**
- Should cryptocurrency not be treated the same as **"money"** and excluded from "goods and "services"?
- We recommend that the treatment in **other jurisdictions** also be considered

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Removing taxable benefit on low or interest free loans granted to employees for low-cost housing

- We **welcome the proposal** to remove the taxable benefit on interest-free loans of <= R450,000 by an employer to a low-earning employee (with remuneration proxy <= R250,000) granted for the acquisition of residential housing with market value <= R450,000
- However, we **recommend** that the requirement that the market value <= R450,000 be removed as the other two monetary limits should suffice
- The R250,000 limit on the income of the employee will serve as a **practical barrier** for affordability
- The limit on the market value of the residence could result in **practical anomalies**, for example, the market value of houses in remote areas such as mining towns are often very high due to their scarcity compared to the demand of the mine
- This could mean that the employees of the same mining company/group might be able to buy housing for less than R450,000 if they work at one mine but might not be able to do so if they work at another mine – this could **complicate labour relations**
- Another concern is that the R450,000 market value is a **hard cut-off** so that even if the value is slightly more e.g. R460,000 the full benefit is taxable
- Employees should rather be encouraged to use their **own savings to augment** the R450,000 loan from the employer to afford a house with a higher market value

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Taxable capital gain triggering provisional tax registration: Additional compliance burden

- Taxpayers who only earn remuneration/ salary subject to **employees' tax (PAYE)** are not required to register as provisional taxpayers or make provisional payments
- It is proposed that any taxpayer who makes a taxable capital gain when they **sell an asset** will have to register as a provisional taxpayer
- The explanation is given that the **tax must be collected during the year** and not only on assessment to address problems with collecting any tax debt arising from that gain
- Registering and complying with the **provisional tax system is confusing and difficult for unsophisticated taxpayers**
- **Most high-earning taxpayers will already have to be registered** for provisional tax and therefore pay provisional tax on capital gains
- The potential loss to the fiscus **does not seem to justify the extra complexity** and administrative burden associated with the provisional tax system as well as having to deregister afterwards
- This proposal will not result in the effective, efficient and economic use of resources and we **recommend that it not be implemented**

THANK YOU

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