23 August 2019

The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
PRETORIA
0181

VIA EMAIL: National Treasury (2019AnnexCProp@treasury.gov.za)
Adele Collins (acollins@sars.gov.za)

RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2019 (draft TLAB)

We have attached the comments from SAIT Business Incentives Tax Work Group on the draft Taxation Laws Amendment Bill (draft TLAB) pertaining to business incentives. 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

The SAIT Business Incentives Tax Work Group

All references are to the Income Tax Act, No. 58 of 1962 (the ITA), unless otherwise indicated.

1. Special Economic Zones– Aligning SEZ with Overall Objectives (i.e. Rules to Prevent Deadweight Government Revenue Losses

[Applicable provision: Section 12R]

Proposed amendment

The SEZ incentive was designed to facilitate the creation of additional domestic businesses beyond business activities that are pre-existing. Stated in economic terms, the incentive was never intended to provide a tax incentive for a deadweight loss. Treasury therefore proposes to limit the incentive to: (i) newly established businesses, and (ii) expansions of businesses already within South Africa as set by certain objective criteria. These objective criteria include a gross income requirement that would mandate a 100 per cent increase in income for the new SEZ expansion beyond the pre-existing South African business.

Problem identified and suggested solution

We agree with the sentiment that the incentive should not cover SEZ operations that effectively amount to a deadweight loss. Our concern is with the details:

- Problem #1: The term "trade" is fairly broad and is only loosely defined via common law. New operations may entail wholly new activities. For instance, a car manufacturer may be involved in overall car assembly but newly choose to manufacture a particular part (e.g. a catalytic converter) within the SEZ not manufactured elsewhere. In this scenario, the manufacture of the new part would most likely still be considered part of the same trade even though something new has been added. A narrower activities-based approach is preferred.

- Problem #2: The 100% gross income test as the minimum standard for qualifying expansions is unrealistic. Firstly, the generation of gross income is largely outside the taxpayer's control. Business expansions may not generate the profits desired due to poor economic conditions or lack of customer interest.

  The test is also harder for larger pre-existing businesses to meet. If a pre-existing trade generates R100 million gross, that same trade must generate R100 million; whereas, a smaller business of R15 million gross must only generate R15 million gross on the expansion (yet both expansions may be equally real).

- Problem #3: We understand the sentiment that pre-existing businesses should not be reduced but one should not that a business reduction in one location may not be so easily driven by tax. Any major reduction of employees in one location will most likely result in union criticism because a move will represent hardship for employees. We also note that the rule does not seemingly allow for a minor shift (e.g. one or two managers) when any normal expansion would entail some minor shifts of pre-existing personnel.

Possible Alternative: We believe that concerns about displacement are ultimately subjective. We accordingly believe that the incentive should require pre-approval like the section 12I incentive with specific SEZ criteria such as additional jobs rather than a monetary amount. One key factor would cover the displacement issue without being overly burdensome in terms of mechanics.

Although discretionary approvals have challenges of their own, pre-approvals do provide taxpayers with a higher level of certainty going forward as opposed to the current wholly self-assessment process. Precedent already exists for such a discretionary process in terms of SEZ given that SEZ operators already manage acceptance of investors to be located in the SEZ. With a S12R pre-approval process it could form part of the SEZ operators process.

2. Special Economic Zones–Anti-Profit Shifting and Anti-Avoidance

[Applicable provision: Section 12R]

Proposed amendment

The SEZ regime creates the possibility of artificial profit shifting from 28% down to 15%, much like cross-border transfer pricing. To prevent this concern, SEZ businesses lose the lower 15% rate if the SEZ business has income or expenditure that exceeds 20 per cent in terms of connected person transactions. Government now views the wholesale denial of the lower 15% rate is too harsh. The Government only seeks to deny SEZ benefits for amounts in excess of 20 per cent (not the current full amount).

Problem identified and suggested solution

Problem #1: We again fail to see why the profit shifting concern is being treated far more harshly than cross-border transfer pricing (which only seeks to impose an arm's length standard). We also note that domestic pricing rules are not unique in a domestic setting. Capacity for this concern exists in a domestic setting as evidenced by the existence of other pre-existing domestic arm's length rules (see section 24BA, 22(8) and paragraph 38 of the 8th Schedule). The SEZ market value rules should be seen in the same light.

Problem #2: The connected person test is simply too broad for a harsh prohibition against connected person transactions. The real abuse would entail group control (perhaps at the more than 50% control level); whereas, arm's length (joint venture) consortium players genuinely exist that would technically fall under the "connected person" test. Many black industrialists are seeking to operate as independent joint operators that are ancillary (and independent) of larger company groups (who could hold as much as 49% of the black industrials venture) While a connected person test can be overcome by genuine independent businesses under an arm's length standard, the test creates unfair outcomes in terms of an outright prohibition (in terms of both the pre-existing and newly proposed the 20 per cent prohibitions).

Possible alternative: The 20% connected party rule should be removed in its entirety and reliance should be placed on the arm's length standard.

3. Section 12J Venture Capital Company Incentive

Proposed amendment

Government is seeking to impose a R2.5 million per taxpayer ceiling on the section 12J deduction. The limit is seeking to mainly curtail the possibility of tax avoidance but also to limit the overall potential of foregone revenue.

Problem identified and suggested solution

We believe that targeting the investor for the wrongdoing of the underlying venture capital company is misplaced. The real problem are particular schemes, whereby the investment indirectly returns to the investor or the investor is engaged in suspect trades. Whatever abuse is outstanding (possibly vacation homes) should be addressed directly.

Possible alternative: The list of qualifying projects should be reviewed and narrowed in line with the S12J intention i.e. a list of disqualified projects should be developed.

4. Overdue Technical Corrections

- The section 12P (11th Schedule) list has become outdated and needs to be updated for all incentives such as Black Industrialist. This is creating tax uncertainty for grant recipients. We fail to see why these items cannot be adjusted as part of the Annexure C miscellaneous / correction list.
- Once again, section 12P should be elective. Certain taxpayers would prefer to have upfront income with a corresponding deduction in order to simply their tax accounting records, especially if the grants received and payouts made are closely connected in time. The election should be available simply by explicitly including grant income on the return.
- The section 12L incentive should be extended to 2030 to be in line with phase 1 and 2 of the Carbon Tax.

End.