

# Tax Alert

8 June 2011

## Proposed 2011 Tax Amendments – Call for Comment

*On 2 June 2011, National Treasury published the two DRAFT 2011 Taxation Laws Amendment Bills. In this Alert, we set out:*

- *a summary of some of the main amendments proposed in the draft Bills; and*
- *a brief explanation of the legislative process going forward.*

### Summary of proposals

#### 1 Corporate Transactions

##### “Hiatus” of s45 intra-group roll-over relief

To curtail perceived abusive tax avoidance schemes, a 19-month suspension of the s45 relief is proposed. For any intra-group transfers undertaken between 3 June 2011 and 31 December 2012, s45 will simply not be available. The position thereafter (i.e. from 1 January 2013) is subject to review.

##### Asset-for-share transactions – secured loans

Where, in the context of s42, the transferor of an asset also transfers (i.e. is relieved from) certain liabilities –whether actual or contingent– the amount of the debt transferred will reduce the base cost of the shares received from the purchaser company. This would be a change from the current position, and is in line with the new changes in respect of capital distributions / returns of capital.

#### 2 Company Distributions

##### Dividends and contributed tax capital (CTC)

For dividends received by companies (and, in some cases, by trusts), the dividend exemption will be



denied in respect of certain borrowed shares, ceded dividend-streams, and other similar positions. The exemption is also effectively denied for dividends on “*third-party backed*” shares, e.g. shares subject to call or put options or certain other arrangements.

The “*dividend*” definition will be confirmed to refer only to distributions from SA-resident companies (in contradistinction to “foreign” dividends).

“Private” share buy-backs by listed companies will be considered to be dividends (i.e. general on-market buy-backs will continue to be excluded from the dividend definition).

CTC will be automatically reduced (deemed to be returned by the company) in the case of share buy-backs and upon liquidations.

### **Capital distributions / Returns of capital**

The existing concept of “*capital distribution*” will be replaced by a new “*return of capital*” concept, which will be more narrowly linked to a company’s repayment of CTC (subject to exceptions). A definition of “*foreign return of capital*” is also inserted, which will be based on the tax law of the foreign company’s country of incorporation.

The receipt (by a shareholder) of a return-of-capital will in future simply reduce the shareholder’s base cost in the affected shares, and only trigger a capital gain to the extent that the distribution produces a negative base cost. It is thus proposed that the current regime, in which a capital distribution triggers a deemed part-disposal, will only continue until 31 December 2011.

There also appears to be a proposal that the automatic deemed part-disposal that would have been triggered on 1 July 2011 (in respect of certain capital distributions received before October-2007) could be removed.

### **Dividends Tax (DT)**

In respect of in-specie dividends, the distributing company (not the shareholder) will bear the liability, although it will be subject to similar exemptions and treaty relief as cash dividends. The major implication is likely to be an administrative issue for companies whose dividends normally flow through “regulated intermediaries” —that is, in the case of *in-specie* dividends, the administration burden will be upon the company itself.

The proposed Value Extraction Tax —which would have been a 10% charge on deemed dividends (or “value extractions”), in lieu of Dividends Tax— is proposed to be withdrawn. Instead, the “dividend” definition will be broadened, which essentially means that value-transfers currently understood as “deemed dividends” may still be caught. The big difference will be that the value-transfer will be subject to the normal withholding rules (as opposed to creating a tax cost for the company).

### **Foreign dividends**

It is proposed that all foreign dividends will be taxed at a maximum rate of 10%.

The exemptions for foreign dividends are re-written substantially. The new proposals are two specific exemptions and one general exemption. The two specific exemptions are the existing “participation exemption” —although the participation threshold is to be reduced to 10%— and the existing CFC exemption.

A general blanket exemption of 75% for natural persons, and 18/28 (around 64%) for companies and trusts, is proposed, for all otherwise taxable foreign dividends. (The result will be that the maximum effective tax rate is essentially limited to 10%.)

However, substantial restrictions and prohibitions will apply to corporate shareholders in respect of shares not actually owned, or certain categories of trading stock, borrowed shares, etc.

## 3 Debt, Financing & Interest

### Interest-bearing instruments

The treatment of interest-bearing instruments is proposed to be amended by:

- deeming interest to be dividends—in respect of open-ended (or “perpetual”) instruments, i.e. no specified repayment date;
- dealing with “demand” instruments on a year-by-year basis; and
- deeming the redemption date to be the “likely” date, in cases where the settlement date is uncertain (conditional, etc.).

### Waiver of debts

The treatment of debt-cancellation in the hands of the debtor/borrower will reflect more closely the *quid pro quo* given by the debtor/borrower, as opposed to necessarily being linked to whether the liability was created from a previous deduction (etc.)—as is the case in the current recoupment and assessed loss (etc.) rules. The Donations Tax provisions will also specifically focus on the face value (as opposed to market value) of the liability forgiven.

### Hybrid instruments

Hybrid equity and debt instruments are proposed to be retrospectively broadened to catch instruments with redemption/conversion terms of up to 10 years (instead of only three years).

### Transfer of contingent liabilities

The transfer of (i.e. relief from) contingent liabilities will explicitly be confirmed as consideration. Therefore the contingent liabilities assumed will form part of the proceeds for the seller (revenue or capital depending on nature of assets sold) and cost for purchaser (revenue or base cost depending on nature of assets).

The deemed consideration amount will be the *market values* of the contingent liabilities.

The new rules also confirm that, in the context of the transfer of a going concern business, the *seller* will be entitled to claim a deduction for the contingent liabilities. The purchaser will effectively be prevented from benefitting from the deduction for actual expenditure to the extent that it represents the settlement of the contingent liabilities assumed. A series of inclusions in income and allowances is proposed to ensure that the future deductions are limited to only the excess over the original market value of the contingent liabilities taken over.

### Islamic finance

Shari’ah-compliant government bonds (“sukuks”) will be introduced. Also, the “murabaha” rules will be extended to scenarios where the bank is the borrower (or deposit-taker), as opposed to only being applicable where the bank is the lender—but the proposals do not extend to transactions entirely between non-banks.

## 4 Incentives

### Industrial projects

Substantial enhancements to the s12I “industrial policy project” allowances are proposed, where those projects are undertaken within an IDZ (industrial development zone).

### Venture capital companies (VCCs)

Further relaxations to the VCC requirements are proposed, making this regime slightly more attractive to VC investors.

### Research and Development allowances

S11D for R&D has been rewritten with the major change being the requirement that R&D projects be pre-approved in order to qualify for the additional allowances.

## Learnership allowances

The s12H learnership allowance will be extended for a further five years, i.e. to include learnership agreements concluded up to 30 September 2016.

## 5 International operations

### Foreign source income

A comprehensive set of source rules is proposed to be codified into the Income Tax Act. Specifically, the main objective is to harmonise the SA tax treatment with OECD principles. Specific categories to be covered will include dividends, interest, royalties, service fees, annuities, pensions and capital gains. The general “originating cause” concept is confirmed as governing all other categories of income.

The foreign tax rebate rules are extended to cover foreign taxes on certain service fees (e.g. management fees), notwithstanding that those services may have been rendered inside SA.

### Controlled foreign companies (CFCs) – Restructuring

The corporate reorganisation rules (e.g. asset-for-share transactions) that are currently available essentially to SA-resident entities only, are extended to groups of CFCs.

### CFCs – Other changes

The ambit of targeted foreign entities is broadened substantially by including the concept of “protected cell companies” and also by extending the concept of control to include also certain corporate governance matters (e.g. appointment of directors) as opposed to only participation and voting rights.

The exemption in respect of “*foreign business establishments*” (FBEs) is substantially re-written. Most of the over-arching principles are retained, but a greater emphasis is placed on attribution of income and pricing.

## Headquarter companies

The qualification criteria are relaxed by condoning the holding of cash and certain financial instruments. However, advance pre-approval will now be an additional requirement. (Approval considerations will include questions around skill-creation, tax-base erosion, and others.)

## 6 Personal Income

### Retirement – Living annuities

From 1 March 2012, the regulation of living annuities will be revised and relaxed slightly. The main impact will be to allow these products to be offered by providers other than only insurers and retirement funds. Also, the rules will effectively recognise that these products are not truly “annuities” and they will also be renamed “retirement income draw down accounts” (RIDDAAs).

### Medical scheme credits

From 1 March 2012, additional rebates (to be called “medical tax credits”) will be introduced for natural persons who contribute to medical schemes. The introduction of these rebates is expected to coincide with the discontinuation of the current deduction regime. A discussion document is to be issued on the conversion of other medical deductions into a credit regime.

### Employee share schemes

The 2010 rules to tax the dividends on certain employee scheme shares are relaxed slightly to exclude certain trust structures.

## 7 VAT

### Property developers

Property developers who temporarily rent out residential developments (in anticipation of disposal) will not immediately be subject to the VAT rules

applicable to lessors of residential property. However this interim proposal is subject to review.

## **8 Rates, thresholds, etc.**

The usual annual adjustments to matters like the personal income tax tables, exemption thresholds and other monetary amounts, etc., are also set out in the Bills.

## ***The legislative process***

As always, PwC will be lobbying National Treasury and making submissions to Parliament's Standing Committee on Finance in respect of the proposed amendments. Interested parties are requested to contact any of the contacts listed below should you wish for PwC to act on your behalf in this consultation process with National Treasury and the SA Parliament.

The next steps are likely to be as follows:

1. Written submissions must be made to National Treasury, SARS and Parliament's Standing Committee on Finance (SCF). The deadline for our Parliamentary submissions is likely to be around 17 June 2011 (to be confirmed). The deadline for submissions to National Treasury is 4 July 2011.
2. Oral presentations will be made before the SCF (currently scheduled for 21/22 June). Although we may have many submission points, the presentation to the SCF usually has to be limited (because of time constraints) to only the top few issues.
3. National Treasury typically holds a two-day workshop to discuss and debate the submissions

received. These are likely to happen in mid-July (and PwC will participate).

4. Thereafter, the matter becomes an internal National Treasury matter during which they consider the submissions received and amend (as they consider appropriate) their original proposals, and produce the final Bills in consultation with the State Law Advisor for eventual introduction into Parliament's National Assembly. At the same time National Treasury would typically prepare a response document in which it addresses the major submissions made on the draft Bills.

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