

Tax Alert

8 September 2011

Draft 2011 Taxation Laws Amendment Bill – National Treasury responds to our Submissions

On 7 September 2011 National Treasury briefed Parliament’s Standing Committee on Finance on their response to public submissions on the Draft Bill. In this Alert, we set out a summary of some of the responses on topical issues.

Important Note: *This summary is based on National Treasury’s draft Response Document and their presentation to the Committee, not on the actual text of the Amendment Bill. A final analysis can only be undertaken once the Bill is tabled in Parliament’s National Assembly –expected early October 2011.*

Summary of proposals

1 Corporate Transactions

Interest deductions related to s44, s45 & s47 intra-group roll-over relief

The restrictions on interest-deductions when using the roll-over relief rules in s45 (Intra-group transfers) and s47 (Liquidations) is confirmed. However, these restrictions will not apply to s44 (Amalgamations) – although certain lesser adjustments to s44 will be considered.

In short, a pre-approval system is being implemented for s45 (from 3 June 2011) and for s47 (from 3 August 2011). Where transactions involve no debt or interest-free debt, the corporate rules may be applied without approval. However, where an asset-transfer is funded by interest-bearing debt, the interest-deduction will be denied unless approval from SARS is obtained.

The factors to be considered by SARS will be published in separate Regulations, and factors would include issues like “tax leakage” (e.g. where the lender is non-resident), the borrower’s debt:equity ratio, the characteristics of the debt instrument, etc.

Consideration will also be given to withdrawing rulings if a taxable lender subsequently “offloads” debt to exempt funders.

Intra-group debt (which funds s45 asset-transfers) will have a nil base cost in the hands of the creditor – although gains will not be triggered by debt-repayments by the purchaser.

2 Financing & Interest

Hybrid instruments

The proposal to extend the targeted redemption period for hybrid instruments (from 3 years to 10-years) is withdrawn.

However, preference dividends may still be re-characterised as interest if the preferences shares are pledged or otherwise secured against debt instruments.

The effective date remains at 1 April 2012, even for pre-existing shares.

Third-party backed shares

As regards so-called third-party backed shares, the proposal to re-characterise dividends as income will be softened. For example :

- Back-to-back financing to acquire ordinary shares (including foreign shares) will not be targeted, and refinancing will be allowed.

- The proposed exclusion for “group” guarantors will be replaced by a broader exclusion for 3rd-party guarantors holding at least 20% of the purchaser or the target.
- Shares that are initially tainted but subsequently fall outside the rules may be excluded from the re-characterisation at that subsequent point.

The effective date will now be pushed back to 1 October 2012, but will apply to pre-existing instruments.

Waiver of debts

The proposals to reform the tax treatment of debt-waivers are deferred for further consideration.

Transfer of contingent liabilities

The proposals to clarify the deduction for contingent liabilities upon the transfer of a business, is to be withdrawn in its entirety. Rather, it is proposed that SARS will issue a Binding General Ruling (or Interpretation Note) to clarify the position.

Perpetual debt

The proposals regarding the treatment of “perpetual debt” as equity will be reconsidered. The main complication is the potential impact that the proposals would have on property loan stock companies (or “real estate investment trusts”).

Property Loan Stock Companies

A special regulatory or legislative framework will be enacted in 2012 or 2013 for property loan stock companies (which will include a new tax dispensation).

Islamic finance

The *targeted* effective date for the proposed Islamic Finance rules is January 2012.

The limitation on the delay between the first and second transfers in *murabaha* transactions will be extended from 30 days to 12 months.

The treatment of Government *sukuks* will be clarified as regards the trust’s holding of the transferred asset, as well as the aligning of the profit element to the s24J interest calculation.

3 Company Distributions

Dividends and CTC (contributed tax capital)

Share buy-backs and liquidations: The proposal to automatically deem share buy-backs and liquidations to be a return of CTC will be reconsidered.

Dividend cessions: The proposal to tax dividends (i.e. deny the exemption) in the case of cessions will apply to companies only (not to trusts). The rules around the targeted holding period are to be softened and simplified.

Dividends Tax (DT)

Effective Date: National Treasury re-affirmed their commitment to the proposed effective date of 1 April 2012 for the new DT.

Deemed dividends and VET: Only loans to shareholders will automatically be deemed to be dividends (subject to certain exclusions, e.g. market value interest rate). This is instead of the initial proposal that all potential “disguised” dividends would be subject to a “facts-and-circumstances” debate.

Dividends in specie: As regards the imposition of DT on *in specie* dividends, the proposal to levy this as a tax on the *company* is retained. Thus the DT represents a tax on the shareholder only for cash dividends, but a tax on the declaring company in the case of *in specie* dividends.

Insurers: The tax formula in the *individual* policy-holder fund will be adjusted to take account of the 10% DT charge.

Dual-listed shares: The position is to be clarified that the JSE-registered shares of dual-listed companies will

fall within the 10% DT regime, whereas the dividends from shares on foreign registers will fall within the normal Income Tax (10%) rules for foreign dividends.

Foreign dividends

Foreign Unit Trusts: The “foreign dividend” exemption will clarify the redemptions by foreign collective investment schemes are not dividends (and thus disposals instead). This “clarification” will be back-dated to 1 January 2011.

FFIHCs: Foreign dividends from FFIHCs (“foreign financial instrument holding companies”) will remain potentially exempt under the participation exemption (i.e. the automatic disqualification for FFIHCs will be removed).

4 Incentives

Film incentives

The proposal to exempt income is retained but a limited form of loss relief will also be retained—although only claimable two years after the film’s completion. Unsettled borrowings will also restrict the availability of losses.

The changeover date to the new regime (1 January 2012) will be more flexible to permit investors who “acquire exploitation rights” before January 2012 to remain under the old rules, as long as the film is completed by the end of 2012.

Research & Development allowances

The proposal to subject R&D claims to a pre-approval process (with the Department of Science and Technology) will be retained. The effective date for approvals will be back-dated to when the application is received. The prohibition around “internal business processes” will be removed if intended for sale or license to customers.

5 International operations

Foreign source income

It is clarified that interest and royalties attributable to a foreign PE (permanent establishment) of a SA resident will not be SA-sourced.

The source of exchange differences will be determined with reference to the underlying exchange item.

Foreign tax credits

The ability to deduct foreign taxes (as an alternative to a rebate-claim) will be retained, i.e. the proposal to delete the deduction is withdrawn.

Controlled foreign companies (CFCs) – General

The attempt to catch foreign companies that are *de facto* controlled by SA-residents is withdrawn for reconsideration (but remains a priority).

The proposals to catch “cell” CFCs will be restricted to the insurance industry.

The new anti-diversionary proposals for FBEs (“foreign business establishments”) are clarified as applying only if the CFC falls foul of both the 50% tax and PE requirements. The position for imports of services (into SA) from a CFC is withdrawn in favour of the existing rules. The 50% tax test is also clarified to be determined for the CFC as a whole (not just the “diverted” income streams).

Insurance FBEs will qualify for the exemption in respect of financial instrument income, as for banking FBEs. Finance lease income will be treated as financial instruments income (like interest).

An exemption for in-country dividends is introduced, i.e. where a CFC receives dividends from another company in the same foreign country (irrespective of whether the CFC holds 10% of the declaring company).

Headquarter companies

The pre-approval proposal is withdrawn. However a “simple and short” annual reporting requirement will be imposed.

Entry into the HQ regime will be elective.

The minimum “qualifying” income requirement of 80% will be reduced to 50% in recognition of the fact that the primary factor is the percentage of “qualifying” assets held by the HQ-Co. A R5m *de minimus* rule for start-ups will also be introduced. The nature of good income will also be extended to cover lease income and exchange gains.

The minimum qualifying participation in investment targets will be reduced to 10% (from 20%) in line with the similar proposal for the participation exemption.

CFCs – Re-organisation rules

The application of the s42 (asset-for-share) rules will be relaxed.

S45 (intra-group transfers) will also be made available for CFCs in the 2012 amendment bill.

The effective date for the application of this regime to CFCs will remain at 1 January 2012.

Transfer Pricing

Un-repatriated transfer pricing adjustments will (apart from the primary taxable income adjustment) be treated as an interest-free loan, thus triggering deemed interest treatment unless and until the original amount is actually repatriated.

6 Personal Income

Medical scheme credits

The treatment of medical expenses will be subject to a dual system in that medical scheme contributions will be converted into credits, whereas “out-of-pocket” expenses will remain subject to the deduction regime. The conversion of “out-of-pocket” expenses will be considered in 2012 and beyond.

7 VAT

Property developers

The proposed relief will not be automatically back-dated, but may be considered on a case-by-case basis by SARS, as an administrative matter.

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