

# Tax Alert

22 September 2010

## 2010 Tax Amendments

We present below a summary of some of the main amendments contained in the two Bills that were tabled in Parliament on 24 August 2010, namely:

- The Taxation Laws Amendment Bill; and
- The Voluntary Disclosure Programme and Taxation Laws Second Amendment Bill.



### ADMINISTRATION

#### Voluntary Disclosure Programme (“VDP”)

A fixed-period VDP is established (dates to be Gazetted). The main relief is the waiver of potential penalties and interest—but the full amount of tax remains payable—in respect of defaults that occurred before 17-Feb-10. The VDP will usually not be available for taxpayers who are (or about to be) the subject of audit/investigation.

#### Binding Rulings

In addition to existing pre-requisites, applicants for Binding Rulings must confirm that they have registered for all

taxes for which they are required to register and have rendered all required returns.

#### Interest waivers

SARS’ discretion to waive interest under s89*quat* ITA is now limited to only circumstances beyond the control of the taxpayer, similar to the provisions of the VATA.

### EMPLOYMENT

#### Motor vehicle benefit and travel allowances

The monthly taxable value of employer-provided motor vehicles is changed to 3.5% (currently 2.5%) of the “determined value” (including additional vehicles – currently 4.0%), reduced to 3.25% if the vehicle is subject

to a “maintenance plan”. The “determined value” now includes VAT.

Deductions for fuel, maintenance, insurance and licence fees paid by employees may be allowed on assessment.

80% of the monthly car benefit or travel allowance is subject to PAYE. This may be reduced to 20% if at least 80% of the use of the vehicle/subsidised travel during the year of assessment will be for business purposes.

#### Tax-free fringe benefit for indemnity insurance

No benefit arises where an employer pays for a policy indemnifying the employee against negligent acts or omissions in rendering services to the employer.

#### Executive share schemes

Dividends received on “restricted equity instruments” (“REIs”) will be denied the dividend exemption, unless the REI in question is an “equity share” or the dividend in question is another “equity instrument”. Capital distributions on REIs in the form of equity instruments will not be taxable.

The taxing rules (S8C) will also apply where the equity instrument was acquired from any employee or director of the employer. Swaps of REIs need not be directly with the employer.

Where an unregistered (e.g. foreign) associated institution provides the equity instrument and does not withhold PAYE, the SA employer must deduct the PAYE for the aggregate remuneration received from both the SA employer and the associated institution.

#### Key employee insurance schemes

Where the employee is the insured person, the deduction of premiums may now only be considered under if either:

- the employee is taxed on the premiums paid as a taxable benefit, or
- the policy complies with other specified requirements, such as: it is a pure risk policy owned by the employer, and there are no back-to-back agreements to use the proceeds for a pay-out to the employee, etc.

Ceded policies will generally be taxed in the hands of the employee. Tax-free cession of existing (pre 1-Jan-11) policies is permitted.

#### Employment Severance Payments

A definition for “severance benefit” is inserted, similar to the termination lump sum descriptions used in s10(1)(x) — e.g. termination payments resulting from reaching 55, infirmity, retrenchment, etc. The R30,000 exemption and averaging will be withdrawn and the benefits will be taxed on a separate scale (yet to be enacted). Retrenchment benefits are extended to directors.

#### Post retirement commutation of annuities into lump sums

The scope of “lump sum benefits” increased to include commutation of annuities payable by retirement funds.

#### Winding up Umbrella Funds

Amendments have been made to remove technical impediments that prevented tax-neutral transfers on partial winding up of umbrella funds.

#### Official rate of interest

The “official rate of interest” for ZAR-denominated loans will be set at 100 basis points above the SA repurchase rate (i.e. “repo” rate + 1%) —and will apply automatically from the start of the month after the repurchase rate is changed.

For loans denominated in a foreign currency, the official rate will be 100 points above the rate that is —for that foreign currency— the equivalent of the SA repurchase rate.

#### Recovery of employees’ tax upon adjustment of fringe benefit value

Upon determining or re-determining taxable benefit values, SARS may now assess the employer (for PAYE), while retaining the right to collect the tax from the employee (on assessment).

#### Discontinuation of Standard Income Tax on Employees (SITE)

SITE is to be phased out over 3 years.

## COMPANIES, SHARES & DIVIDENDS

#### Co-ordination with Company Law reform

Numerous amendments to a plethora of provisions of the ITA are proposed to be introduced in anticipation of the new Companies Act becoming effective.

For example, several new provisions that were expected to only take effect when Dividends Tax comes into

operation will now take effect from 1-Jan-11, e.g. the definitions of “dividend” and “contributed tax capital”, and the new s40C covering the issue of shares for no consideration.

The concept of “equity share capital” is replaced by a definition of “equity shares”, and the provisions that previously used concepts like “share capital”, “share premium”, “profits” and “reserves” are re-written (or, in some cases, deleted) in line with the new reliance on “contributed share capital” and “equity shares”.

### STC: Deletion of Liquidation exemption

The liquidation exemption in s64B(5)(c) is deleted.

### Deemed Dividends (STC)

Consequential upon the re-writing of the thin capitalisation and transfer pricing rules (in s31 ITA), the text governing the resultant deemed dividends is also re-written.

Two provisions that are currently dependent on a company’s “profits” (i.e. the so-called exit charge in s64C(2)(f) and the overall limitation on the total amount of the deemed dividend in s64C(4)(c)) are re-written to be based instead on formulae that use the company’s assets (market value), liabilities and “contributed tax capital”.

The cross-holding disqualification contained in the current exemption for downward loans (s64C(4)(l)) is clarified and relaxed.

### Listed share-for-share reorganisations

Where a listed company acquires shares in another listed company in exchange for an issue of shares, the requirement to determine the capital/trading stock nature of the target shares is removed. If the purchaser acquires a substantial interest, the capital/trading stock distinction may be ignored, and base cost is recognised equal to market value. If the threshold is not met base cost rollover will still apply.

The transferors will continue to enjoy rollover relief in both cases.

The existing step-up to market value for acquisitions by listed companies where the transferor acquires < 20% in the acquiring company will also be deleted.

### Corporate rollover rules

The option to “elect” out is now converted into a straightforward agreement between the parties, which must be “in writing”.

## BUSINESS INCOME & EXPENDITURE

### Devalued financial instruments held as trading stock

All “mark-to-market” write-downs in respect of financial instruments held as trading stock (currently shares held by companies) must be disregarded and these items must be reflected at cost for income tax purposes by all taxpayers.

### Islamic Finance

The tax treatment of three of the more common Islamic Finance products is addressed in the new s24JA ITA. As regards the two financing products —i.e. the “murabaha” (similar to an instalment sale), and “diminishing musharaka” (similar to a finance lease)— the new rules treat the repayment premiums as financing arrangements and also deem the double asset-transfers to be a single transfer direct from the seller to the purchaser. Supportive amendments are reflected in the VAT and Transfer Duty rules.

For the deposit investment product (“mudaraba”) there is a confirmation that the general interest-exemption will apply to natural-person depositors,

### Improvements on Government Land

S12N ITA is inserted to allow access to accelerated depreciation allowances. The lessee (who incurs the cost) is entitled to claim the allowances in the same way that a property-owner would have. However, the improvement must be in pursuance of a public-private partnership or a lease obligation with the Government or certain statutory entities.

## INTERNATIONAL

### CFC high-tax exemption

The requirement for the foreign tax to be determined with reference to the CFC’s “net income” is deleted, which confirms that the theoretical SA “taxable income” is the basis for the comparison with the actual foreign tax amount.

### Definition of “foreign dividend”

The new definition of “foreign dividend” is now reliant on whether the amount distributed by a foreign company is treated as a dividend in terms of the income tax law (alternatively company law) of the country where that foreign company is “incorporated, formed or established”.

## Foreign Dividend exemption

A proviso is added to the participation exemption disallowing exemption where the dividend is paid out of amounts that have been allowed as a deduction to a connected SA resident of the shareholder. This proviso will also prohibit the exemption where the dividend is received from a foreign collective investments schemes or financial instrument holding companies.

## Transfer Pricing and Thin Capitalisation

From 1-Oct-11, the existing s31 transfer pricing rules will be substantially broadened and brought more into line with the OECD Guidelines. The previous s31 requirements identifying the parties to a transaction are retained, and the provisions will now apply if any party derives a “tax benefit” under a “transaction, operation, scheme, agreement or understanding” directly or indirectly entered into other than at “arm’s length”. Thin capitalisation will no longer be separately addressed, but is to be treated as simply a breach of the general arm’s length standard.

Importantly, the taxpayer is obliged in terms of the ITA to determine income in transactions with non-resident connected persons on the arm’s length standard.

## Headquarter Companies

A “headquarter company” (HQ-Co) regime is introduced from 1-Jan-11, offering exemption from CFC imputation, dividends exempt from normal tax and STC (not STC creditable), exemption from thin capitalisation and transfer pricing on back-to-back financing (subject to ring-fencing of losses) and participation exemption for shareholder disposals of shares in HQ-Cos.

The HQ-Co must be SA-resident and there are strict requirements as regards the shareholding in the HQ-Co, as well as the composition of the HQ-Co’s assets and receipts.

## Foreign fiscally transparent entities (LLCs & LLPs)

A new definition of “foreign partnership” is inserted, and these entities are afforded the same treatment as partnerships recognised as such under SA law.

## Regional Investment Funds

Where a partnership or trust undertakes transactions in financial instruments, qualifying foreign investors into that entity may be protected from exposure to SA tax. Essentially, the activities of the entity will not be automatically ascribed to the investor in determining

whether that qualifying investor has a “permanent establishment” in SA.

## Currency translation

References in the ITA to “... the currency used ... for the purposes of financial reporting” are replaced with the concept of “functional currency” (similar to the accounting concept).

## Withholding Tax on Interest (“WTI”)

A withholding tax on interest is to be introduced from 1-Jan-13 in respect of interest received by or accrued to any foreign person (excluding CFCs or persons liable to normal tax on the interest).

Several exemptions will apply, like for Government, listed or bank instruments, import financing, and HQ-Co debts excluded from thin capitalisation restriction.

The exemption in respect of bank interest is denied for interest in a back-to-back arrangement designed to effect an indirect advance of funds by a non-resident to a resident.

## VAT

The current zero-rating of supplies of goods to “foreign-going” ships and aircraft is extended to also apply to foreign naval ships or military aircraft.

The double VAT charge that arises as a result of the combination of:

- the deregistration of a VAT vendor, which triggers a VAT charge on the value of any asset held on the cessation of business; and
- the claw-back of input VAT on long-outstanding debts;

is eliminated by excluding from the deregistration charge any asset that has already been subject to the input clawback.

## MINING ROYALTIES

Where minerals are exported without actually being sold, the tax will only become chargeable upon the actual sale.

Where minerals are sold below specified conditions and the charging formula adds a notional increase to the gross sales value, the attendant expenditure may now also be notionally increased.

Transfers between SA “extractors” may now be exempt from the royalty by agreement between the transferor and transferee.

The transfer of unrefined minerals below minimum condition will be treated as having achieved the minimum condition.

Secondary by-products may in some cases be disregarded when they comprise a secondary part of a concentrate.

## OTHER IMPORTANT CHANGES

### Termination of residential entities

The initial (2009) rules will be deleted and be replaced on 1-Oct-10.

The new rules are broader and more inclusive. The deadline for transfers under the new para 51A is 31 December 2012.

The occupants must (as at the date of the disposal) be “connected persons” in relation to the company/trust. However, the transferor company/trust must be liquidated / deregistered.

The trust/company is deemed to have disposed of the residence at an amount equal to its base cost, i.e. no-gain-no-loss. This same value would usually also be the acquisition base cost in the hands of the natural-person transferee(s). In some cases, the base cost of a property transferred by a company to its shareholder(s) could be the shareholders’ base cost of the shares held in that company.

The new rules also cater for multi-tier structures, but each entity must also be terminated and the residence must ultimately be transferred to one or more of the natural-person occupants.

### STT: Corporate Rules Exemptions

A technical amendment is intended to confirm the STT exemption for share-transfer transactions that fall within the definitions of the specified transactions but which are for other reasons denied income tax relief.

### Estate Duty: Transfer of Abatement (Simultaneous Deaths)

On simultaneous death of spouses the person with the smallest estate must be deemed for purposes of s4A to have died immediately prior to his or her spouse.

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