Hills to climb
Budget 2011

pwc

Budget 2011 23 February 2011

The Minister of Finance, Mr Pravin Gordhan, in his second Budget announced that he had provided tax relief of R8.1 billion in personal income tax relief to individuals, mostly to taxpayers in the lower income brackets.

Government expenditure is to be allocated as follows:

Education	R189.5 bn
Public order and safety	R90.9 bn
Economic affairs	R130.5 bn
Social protection	R146.9 bn
Housing and community amenities	R121.9 bn
Health	R112.6 bn
Defence	R38.4 bn
Other	R144.3 bn

There were several more interesting announcements, including the following:

- A third rebate for individuals 75 years and
- Conversion of medical tax deductions to tax credits;
- Increase in the Transfer Duty exemption threshold;
- Increases in the General fuel levy and Road Accident Fund levy;
- Taxation and limitation of deductions on contributions to retirement funds; and
- Taxation of gambling winnings above R25,000.

Income tax - individuals

Both the minimum marginal rate of 18% and the maximum marginal rate of 40% have remained unchanged. The upper level of the band to which the 18% rate applies has been increased from

R140 000 to R150 000 and the level at which the maximum rate is applicable has been increased from R552 000 to R580 000. The intervening brackets have all been adjusted upwards.

The proposed scale of rates for individuals and trusts is set out in the appendices. The new scale of rates for individuals will be applicable for years of assessment beginning on 1 March 2011.

The primary rebate is increased from R10 260 to R10 755, whilst the secondary rebate for individuals aged 65 years or older increased from R5 675 to R6 012. A third rebate for individuals 75 years and older has been introduced, and which amounts to R2 000.

As a result of the amendments to the scale of rates and the rebates increase, the tax threshold for individuals below the age of 65 is increased from R57 000 to R59 750, and for individuals aged 65 and over from R88 528 to R93 150. As a result of the introduction of a third rebate for individuals 75 years and older, the tax threshold for these individuals is R104 261.

The resultant decrease in the tax liability for individuals younger than 65 is illustrated below:

Taxable income	2010/2011	2011/2012	Decrease
R	R	R	R
60 000	540	45	495
150 000	17 440	16 245	1 195
500 000	130 710	127 095	3 615
1 000 000	329 670	325 495	4 175

The interest exemption for individuals increases from R22 300 to R22 800 for individuals under the age of 65 and from R32 000 to R33 000 for individuals over the age of 65. The exemption in respect of foreign interest and taxable foreign dividends remains unchanged at R3 700 of the total exemption limit.

Medical deductions and conversion to medical tax credits

The monthly monetary cap for monthly medical scheme contributions is to be increased from R670 to R720 for the first two beneficiaries and from R410 to R440 for each additional beneficiary.

There is a further proposal to convert the monthly deductions for contributions to medical schemes and qualifying medical expenses into tax credits, effective 1 March 2012. It is believed that a tax credit provides for more equitable tax relief. A discussion document on the tax credits will be published by the end of March 2011.

National Health Insurance

It is expected that the national health insurance (NHI) will be phased in over 14 years. The NHI system will require additional funding and it is anticipated that the phasing in of a payroll tax (payable by employers) will be introduced. Further announcements about specific funding instruments will be made in the 2012 Budget.

Travel allowances

The deemed cost tables for travel allowances has increased as well as the deemed tax free reimbursive rate for business travel (R3,05 per kilometre) for business kilometres not exceeding 8 000 kilometres per annum.

Subsistence allowances

Tax-free subsistence allowances paid by an employer to an employee will be increased as follows:

- Meals and incidental costs - from R276 to R286 per day;
- Incidental costs only – from R85 to R88 per day; and
- Overseas travel – as set out on the SARS website per overseas country.

Tax treatment of contributions to retirement funds

Employer contributions to retirement funds are currently not taxed in the hands of employees. The following changes are proposed to improve tax administration and promote greater equity in the tax system:

- Employer contributions on behalf of employees will be deemed to be a taxable fringe benefit in the hands of the employee. Individuals will be allowed to deduct up to 22.5% of their taxable income for contributions to pension, provident and retirement annuity funds.
- Two thresholds will be established, a minimum annual deduction of R12 000 and an annual maximum of R200 000.
- The base upon which contributions to retirement funds and other social security taxes are determined will be streamlined.

The above proposals are effective from 1 March 2012.

Government proposes to subject lump sum withdrawals from provident funds to the one third limit which applies to pensions and retirement annuities. Implementation dates have not been announced and will be subject to consultation with trade unions and other interested parties.

Taxation of lump sum benefits upon retirement

With effect from 1 March 2011, the tax-free lump sum benefit upon retirement increases from R300 000 to R315 000.

Gambling

Effective from 1 April 2012 all gambling winnings above R25 000 will be subject to a final 15% withholding tax.

Risk benefits

It is proposed that any compensation from the Road Accident Fund be exempted from income tax. Alignment of the tax treatment of risk benefits paid by private sector funds will be investigated.

Employer-provided long-term insurance plans

Certain ambiguities and peripheral issues remain after introduction of amendments in this regard in 2010. These, amongst other, pertain to the potential capital gain and the use of employer plans to fund the buy-out of key deceased shareholders/partners. It is proposed that these concerns be rationalised.

Living annuities

To encourage competition, government proposes to broaden the list of service providers allowed to provide these annuities to include collective investment schemes and the National Treasury's retail savings bond scheme.

Savings

Government will explore two incentivised savings schemes, one for housing and another for education, as alternatives to tax-free interest income thresholds. A more consistent tax treatment of all forms of income from capital, such as interest, dividends and capital gains will also be considered.

Learnerships and youth employment subsidy

Government proposes to extend the incentive for 5 years, subject to an analysis of its effectiveness by businesses, sector and training authorities, and the Department of Higher Education and Training. The review will take place during 2011.

A youth employment subsidy will be introduced, it will be administered by SARS and implemented through the PAYE system to limit abuse, ensure maximum liquidity and ease business compliance.

Anti-avoidance rules regarding share incentive schemes

The following issues pertaining to the taxation of share scheme incentives will be investigated:

- Whether deferred taxation of share incentives should give rise to Skills Development Levy contributions or Unemployment Insurance Fund contributions once employees have left the employment that gave rise to the shares.

- Employer-provided employment trusts appear to result in unintended double taxation and allow for the conversion of disguised salary into tax-free dividends.

Capital gains on foreign currency assets

Taxing individuals on their foreign currency gains is considered to be impractical. It is proposed that the capital gain charge for foreign currency is completely removed.

Corporate tax

Corporate tax rate

The corporate tax rate remains unchanged at 28%, and the secondary tax on companies (STC) rate remains unchanged at 10%.

Taxation of debt

Taxation rules relating to interest have given rise to technical difficulties, especially with regard to debt with indefinite or indeterminable maturities, as the interest calculation requires a set term period.

A special calculation is proposed, which should be used in such circumstances, to reach an appropriate yield without reliance on a set a term date. It is also proposed that the disposal of debt instruments prior to their maturity, generate ordinary revenue, as the gain or loss reflected implies interest differentials to overall market rates.

Government grants to private stakeholders

The income tax exemption for certain government grants is dependent on a list of factors. One of the main issues in this regard, is the distinction between (1) grants representing an indirect form of compensation for goods and/or services that should be taxed, and (2) other grants designed as a subsidy mainly for the benefit of the grantee. Changes are proposed for the establishment of a new set of clear and transparent principles to determine this distinction.

Securities Transfer Tax ('STT')

It is proposed that the STT exemption for members of a stock exchange (brokers) be revised to clarify that it applies solely to players engaged as market makers, and not to facilitate the role of banking institutions.

Venture capital company

Government previously introduced the concept of a venture capital company into the Income Tax Act to aid small and medium-sized businesses to access equity finance. Due to the poor response to this vehicle, it is proposed that the provisions should be reviewed.

Turnover tax for micro businesses

Tax rates for micro businesses will be adjusted from 1 March 2011 so that it only becomes liable to pay turnover tax if its turnover exceeds R150 000 (currently R100 000) a year.

From 1 March 2012, micro businesses that register for VAT will no longer be barred from registering for turnover tax. The three-year bar on voluntary deregistration from the turnover tax will also be lifted.

Where SARS detects micro businesses that are not registered for turnover tax, SARS will now be able to register such businesses for turnover tax.

Film incentive

The film incentive will be transformed to a tax incentive that encourages profits and will no longer be based upon upfront production and post-production expenditure. This reform has been necessitated due to the wide abuse of this incentive in the past where taxpayers artificially inflated expenditure.

Dividends tax ('DT') reform process

DT, which will replace STC, will take effect on 1 April 2012. DT will be levied at 10%, unless tax treaty relief applies.

When DT is introduced, it is proposed that the tax rate applicable to foreign-owned South African branches (currently 33%) be replaced by the standard rate for companies (currently 28%) where tax treaties concluded by South Africa prevents the rate of 33% from being levied.

Related to the implementation of DT, it is proposed that the taxation of inbound foreign dividends be reviewed to ensure that the dividend exemptions and tax rates are adjusted in line with the new DT.

Corporate restructuring

If a business is acquired as a going concern, the purchaser often assumes contingent liabilities (such as warranty obligations). These acquisitions may be taxable or tax-free. In the case of taxable asset acquisitions, it is proposed that a set of explicit rules will be established to ensure these transfers do not give rise to double deductions or double inclusions. In the case of tax-deferred reorganisations, it is proposed that contingent liabilities be completely transferred from seller to buyer.

As part of internal company restructurings, special rules currently apply to debt cancellation and similar adjustments. Where debt is cancelled or reduced, it is proposed that taxable capital or revenue gains realised by the debtor be exempted from tax in certain circumstances.

Internal company restructuring

The Income Tax Act provides special rules that give rise to taxable gains or ordinary revenue imposed on a debtor where debt is cancelled or reduced. Government will consider exempting such gains or revenue for insolvent debtors.

Tax Administration Bill

The long awaited Tax Administration Bill will be will be introduced in the National Assembly during 2011. This Bill will incorporate various administrative provisions currently enclosed in various different tax acts.

Environmental taxation

Government is considering a carbon tax. A discussion paper has been published for public comment. The design features of a proposed tax and a schedule for its introduction will be announced in the 2012 budget.

An increase in the electricity levy has been proposed on electricity generated from non-renewable and nuclear resources. This increase will be effective from 1 April 2011 and will increase the levy from 0.5c/kWh to 2.5c/kWh.

Islamic finance

In the 2010 Budget it was announced that the taxation of Islamic financial products would be aligned with conventional financial instruments. Rules are proposed that will address ijara products (which act like commercial finance leases), and amendments to legislation are proposed which will facilitate the issue of Islamic-compliant government bonds.

Research and development ('R&D') tax incentive

It is proposed that the current R&D tax incentives are streamlined by introducing an approval process by the Department of Science and Technology before a taxpayer can claim this incentive for income tax purposes. This will limit opportunities for retrospective reclassification of R&D expenditure.

Voluntary disclosure programme ('VDP')

The VDP that began in November 2010 will remain open until 31 October 2011.

Closure of dividend schemes

It is proposed that dividends arising from certain transactions, e.g. dividend cessions, derivative positions and preference shares, will be treated as ordinary revenue rather than exempt dividends in certain circumstances.

Learnership allowances

Learnership allowances will expire in September 2011. It is however proposed that this incentive be extended for a further five years, subject to an analysis of its effectiveness by businesses, sector and training authorities, and the Department of Higher Education and Training. It is proposed that this review will take place during 2011.

Capital distributions and pre-2001 capital gains assets

The capital gains tax impact of capital distributions has had a controversial history. In essence the most appropriate (internationally acceptable) result is for capital distributions to reduce the distributing share base cost, with gains only taking effect once base cost is exceeded. Pre-2001 capital gains tax rules however prevent taxpayers from determining the base cost of pre-2001 assets until disposal. A revised and simplified system for determining the base cost of pre-2001 assets will therefore be considered that does not require the base cost determination of these assets to be deferred until disposal. If this is achieved, the rules for capital distributions can be realigned with international practice.

International tax

Income tax relief for international shipping

Ongoing efforts will be made to provide tax relief for the shipping industry (such as a proposed tonnage tax). This is an ongoing process, which commenced in 2005.

Offshore cell companies

It is proposed that offshore cells will be taxed according to their substance, as multiple-investment entities. This will trigger imputed income for each party controlling each offshore cell. Consideration will also be given to enhancing the recoupment system when funds are directly or indirectly returned to the insured parties paying the premiums.

Completion of the cross-border withholding tax

It is proposed that the new interest withholding tax regime will become effective from January 2013. In the meantime, the withholding enforcement mechanisms will be adjusted to enhance future South African Revenue Service (SARS) enforcement and taxpayer compliance.

Tax treaty coordination of similar taxes

Tax treaties apply to income tax and similar taxes. The scope of the term "similar taxes" is an issue, especially when the different treaties have differing lists of similar taxes. It is proposed that the income tax be amended to list all similar taxes (including the impending dividends tax and interest withholding tax) as explicitly eligible for tax treaty relief.

Currency transactions indirectly connected to certain foreign hedges

Foreign currency held for business use is largely taxed on an annual mark-to-market basis. There are however certain exemptions and deferrals of currency gains and losses until actual disposition. It is proposed that the exemption is extended to currency gains and losses on all instruments which are linked to assets which are currently subject to the exemption.

Gateway into Africa – Headquarter regime

Due to potential double taxation and the manner of imposition of residence-based tax in terms of the current 'headquarter company' rules, these rules will be reviewed.

Refinement of controlled foreign company legislation

As the controlled foreign company legislation is overly complex it can interfere with normal business conduct, while others could create unintended loopholes. It is therefore proposed that the legislation be refined in order to focus on the main purpose of preventing South African residents from shifting passive income offshore.

Investment funds

Mutual and private equity funds are showing an increased interest in Africa, including the use of South African management to channel these funds.

While tax changes in 2010 have sought to alleviate potential negative tax consequences associated with South African management for certain intermediary partnership and conduit entities, the vast majority of funds use offshore intermediary companies that currently fall outside this new relief. It is proposed that these intermediary companies receive tax relief from the effective management test to ensure that the available tax reliefs for trust and partnerships similarly apply.

Offshore restructurings

Many South African multinationals seek to restructure their offshore operations. Because many of these offshore restructurings give rise to immediate tax, even if the restructured offshore entities remain wholly under the control of the South African group, it is proposed that tax relief be provided in these circumstances.

Indirect Tax

VAT

National Treasury is considering two tax policy research projects specific to VAT. National Treasury will consider the VAT treatment of public passenger transport, rail, bus and taxi with a view to facilitating higher levels of investments in passenger transport infrastructure. Furthermore, National Treasury will consider the VAT treatment and apportionment rules concerning educational institutions that provide contract research and student accommodation.

The current notional VAT input credit for the purchase of fixed property from a non-VAT registered vendor will no longer be limited to the transfer duty paid by the VAT registered purchaser. It is proposed that a notional VAT input credit equal to the tax fraction may be claimed on the lower of the consideration payable for the property, open market value of the property, the current municipal value of the property or the VAT-inclusive purchase price excluding improvements by vendor.

Due to operational difficulties, technical amendments have been proposed to the applicable customs item numbers to ensure that VAT exemption is afforded for the temporary importation of duty-free goods.

VAT is payable on the import of goods and services into South Africa. Currently there is a de-minimus threshold for imported goods of R100, but no threshold for imported services. To ease taxpayer compliance and to reduce the cost of enforcement the minimum threshold will be increased to R500 and will apply to both imported goods and imported services.

Currently VAT becomes payable on goods located in a storage warehouse which are subsequently sold and then entered by the purchaser for home consumption. The VAT Act currently does not mention the value upon which the VAT must be calculated and paid by the purchaser and many

taxpayers calculate the VAT based on the value of the goods upon initial entry to the warehouse. It will be proposed that the VAT payable by the purchaser on entry for home consumption be calculated by reference to the actual sale value.

Relief for the repayment of input VAT claimed on outstanding debts between group members is being considered. Where a VAT vendor does not settle an invoice within 12 months it must repay the input VAT claimed to SARS. In the case of purchases between VAT vendors within a group of companies, the 12 month period is often unrealistic with group loans often clearing after a number of years. Relief from the 12 month claw-back of input VAT is proposed.

It is proposed that the zero-rating for mineral-right conversions or renewals be removed on the basis that such conversions or renewals are non-supplies for VAT purposes, and can cause distortion in VAT turnover calculations. Zero-rating was introduced to allow relief to holders of old-order mineral rights to convert their rights to new-order rights after approval from the Department of Mineral Resources.

It is proposed that a purchaser may only be entitled to VAT input credits for the consideration actually paid in the case where the purchaser presents to the vendor a rebate coupon issued by a third party. This measure is aimed at the retail sector where manufacturers issue coupons to customers which are subsequently redeemed by retailers to offset the purchase price of the manufacturer's goods.

Where a vendor uses goods and services for both taxable and non-taxable purposes only a portion of the VAT incurred may be claimed as input credits. SARS has prescribed the turnover method as the default method, however SARS has the discretion to retrospectively approve an alternative method. It is proposed that retroactive changes of apportionment be limited to periods within current open years of income tax assessment to ensure that any retroactive input credits allowed by the use of an alternative method is accompanied by a reduction in income tax offsets for the same prior periods.

Vendors generally account for VAT according to tax periods ending on the last day of a calendar month, however the VAT Act allows for a vendor to alter the month-end cut off date to another fixed date within 10 days of the month end. To avoid vendors regularly changing their end dates to reduce VAT payable in a particular tax period, it is proposed that end dates should not be changed more than once per 12-month period.

Excise Duties

It has been proposed that the Excise duty will increase on the following products with effect from 23 February 2011 by the following percentages:

Cigarettes:	8.95% from R8,94 to R9,74 per 20 cigarettes
Cigarette tobacco:	8.18% from R9,73 to R10,53 per 50g cigarette tobacco
Cigars:	6.00% from R47,66 to R50,52 per 23g of cigars
Pipe tobacco:	10.25% from R2,70 to R2,98 per 25g pipe tobacco
Unfortified wine:	8.41% from R2,14 to R2,32 per litre
Sparkling wine:	4.50% from R6,67 to R6,97 per litre
Fortified wine:	7.44% from R4.032 to R4,33 per litre
Spirits:	10.00% from R84,57 to R93,03 per litre absolute alcohol
Malt beer:	7.51% from R50,20 to R53,97 per litre absolute alcohol
Ciders & alcoholic fruit beverages:	7.54% from R2,52 per litre to R2,71 per litre

A review of the excise duty structure for alcoholic beverages was announced in the 2010 Budget. A discussion document will be published for public comment in July 2011.

Fuel Levy and Road Accident Fund ('RAF')

It is proposed that the general fuel levy on petrol and diesel be increased by 10 c/l.

It is proposed to increase the RAF levy on petrol and diesel by 8 c/l from 72 c/l to 80 c/l.

These increases will come into effect on 6 April 2011.

International air passenger departure tax

It is proposed that the air passenger departure tax on flights to Southern African Customs Union member states and other international destinations be increased from R80 and R150 per passenger respectively to R100 and R190 per passenger.

The increase will come into effect on 1 October 2011.

Electricity Levy

An increase in the generation of electricity from non-renewable and nuclear energy sources by 0.5 c/kWh to 2.5 c/kWh. The increase should have no impact on the electricity tariffs, because it has already been taken into account in the National Energy Regulator tariff structure. The increase will come into effect from 1 April 2011.

Ad Valorem Excise Duties

Excise tax rate on motor vehicles increase from 20% to 25%. The increase in the excise tax will affect the price of the vehicles.

Ad valorem excise duties on monitors will be reinstated at a flat rate of 7 per cent.

The above will come into effect on 1 April 2011.

Customs

Customs codes aligned with procedures prescribed in the Kyoto Convention have been introduced during the launch of SARS customs modernisation programme in 2010. Automated inspection services and electronic acquittals will be implemented during 2011. Two bills (Customs Control Bill and the Customs Bill) will be introduced later in 2011 to provide an internationally aligned legal framework that will support the customs modernisation.

Transfer Duty

The transfer duty threshold is increased from R500 000 to R600 000. A rate of 3% will be applicable to the value from R600 001 to R1 000 000, an amount of R12 000 plus 5% to the value between R1 and R1.5 million, and an amount of R37 000 plus 8% to amounts above R1.5 million.

This revised rate structure will apply to properties acquired under purchase agreements concluded on or after 23 February 2011. It will also apply to legal persons (close corporations, companies and trusts).

RATES

INDIVIDUALS RATES, REBATES AND TAX THRESHOLD 2011/12	
Persons (including deceased estates) other than companies and trusts, but including special trusts and trusts established for the benefit of minor children	
Taxable income (R)	**Rates of tax**
0 – 150 000	18% of each R1
150 001 – 235 000	R27 000 + 25% of the amount above R150 000
235 001 – 325 000	R48 250 + 30% of the amount above R235 000
325 001 – 455 000	R75 250 + 35% of the amount above R325 000
455 001 – 580 000	R120 750 + 38% of the amount above R455 000
580 001 and above	R168 250 + 40% of the amount above R580 000
Rebates (applicable to individuals only)	
Primary	R10 755
Secondary	R6 012
Third	R2 000
Tax threshold	
Below age 65	R59 750
Age 65 and older	R93 150
Age 75 and older	R104 261
Capital gains exclusions	
Individuals and special trusts	R20 000
Exclusion on death	R200 000
Person over 55 disposing of business	R900 000

TRUSTS (OTHER THAN SPECIAL TRUSTS)	
Flat rate	40%

TURNOVER TAX FOR MICRO BUSINESSES	
Turnover (R)	**Rates of tax**
0 – R150 000	0%
R150 001 – R300 000	1% of each R1 above R150 000
R300 001 – R500 000	R1 500 + 3% of the amount above R300 000
R500 001 – R750 000	R7 500 + 5% of the amount above R500 000
R750 001 and above	R20 000 + 7% of the amount above R750 000

INCOME TAX: SMALL BUSINESS CORPORATIONS	
Taxable Income (R)	**Rates of tax**
0 – R59 750	0%
R59 751 – R300 000	10% of taxable income above R59 750
R300 001 and above	R24 025 + 28% of taxable income above R300 000

COMPANY RATES		
	2011/2012 %	2010/2011 %
Normal company income tax rate (excluding taxable income from mining operations and long-term insurance	28	28
Branch income tax	33	33
Tax on ‘employment companies’	33	33
Secondary tax on companies	10	10

CAPITAL GAINS TAX RATES			
Taxpayer	Inclusion rate %	Statutory rate %	Effective tax rate %
Individuals	25	0 – 40	0 – 10
Retirement funds	N/a	N/a	N/a
Life assurers			
•Individual policyholder fund	25	30	7.50
•Company policyholder fund	50	28	14

•Corporate policyholder fund	50	28	14
•Untaxed policyholder fund	0	N/a	0
Companies (standard)	50	28	14
Branches of foreign companies	50	33	16.5
Trusts (normal)	50	40	20
Trusts (special)	25	0 – 40	0 – 10

OTHER RATES		
	2011/2012 %	2010/2011 %
Value-added tax	14	14
Donations tax	20	20
Estate duty	20	20
Skills development levy	1	1

The information contained in this summary is based on our interpretation of the existing legislation and Budget proposals. These proposals are subject to amendment during the forthcoming debate in the National Assembly before they become law. Whilst we have taken every care in preparing the summary, we cannot accept responsibility for any inaccuracies that may arise.

We suggest that you use this summary as a guide, but that you consult us before taking any decisions based in the information contained herein.