Tax Alert

27 October 2008

Revenue Laws Amendment Bills

Following on from our Tax Alert of 8 August (summarising the ***draft*** Bills released on 1 August), we now present a summary of the final Bills presented to Parliament.

PRICEWATERHOUSECOOPERS

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Note that the proposed effective date for the amendments is usually (unless otherwise indicated) the commencement of tax years ending on/after 1 January 2009.

(A) Provisional Tax

The option to use the 'basic amount' for the second provisional tax payment has been scrapped, and the 90%-of-Taxable-Income requirement is reduced to 80%. So whereas taxpayers could previously avoid the penalty by ensuring that their estimate was not lower than the basic amount nor lower than 90% of their actual taxable income, the new rule simply requires that the estimate is not lower than 80% of actual taxable income.

(B) Dividends, STC & the new DT (Dividends Tax)

Effective dates & Transition

No effective dates have been fixed at this stage –rather the date is to be determined by the Finance Minister. But the effective date must be at least 3 months after Minister's notice. The same effective date will apply for (I) commencement of DT ("Dividends Tax"); (ii) the end of STC; and (iii) the new "dividend" definition.

STC credits will survive for five (5) years after effective date. STC-credited dividends will be deemed to be on-declared first in an attempt to ensure that such dividends are cleared out of the system as quickly as possible. Declaring companies must notify recipient shareholders of the STC-content of dividends declared.

The old "dividend" definition will remain applicable for "foreign dividends".

Dividends declared before, but only paid out after, the effective date, will be subject to STC only, i.e. exempt from DT.

Dividends Tax (DT) withholding regime

The DT rate will be 10%, and:

it will apply to all dividends declared by SA-resident companies

unless the dividend is paid to any of the specified exempt "beneficial owners", e.g. SA-resident companies, Public Benefit Organisations, SA government, etc. The best examples of non-exempt shareholders are natural persons, trusts, and any non-residents.

The trigger event is *payment* of the dividend (not *declaration*).

A company with certificated shares (i.e. actual physical share certificates) must –as the default– withhold the DT, except in cases where the shareholder (beneficial owner) has formally confirmed its exempt status. However, no formal confirmation from the shareholder is necessary if it is in the same ‘group’ as the declaring company.

For un-certificated shares, it appears that the default is that the paying company must not withhold any DT, so the DT obligation will fall primarily upon intermediaries (like depository recipients or collective investment schemes) . In this case, the intermediary may presume the exempt or taxable status of the recipient on the basis of the details in the intermediary’s register (unless the recipient specifically informs the intermediary to withhold). There is no DT obligation if recipient is another intermediary.

The DT must be paid over to SARS by the end of the month following the month of the dividend payment (similar to current STC rule). The ultimate DT liability remains upon the beneficial owner of the share that receives the dividend, unless the DT has been withheld at some point earlier in the process. For unlisted companies that have paid dividends, there is the threat of personal liability of management if the DT is not paid to SARS.

New dividend definition

The definition of “dividend” (previously one of the longest single sentences in the ITA, spanning some 4 pages), is replaced in its entirety by a single 8-line paragraph. The main concept is that any share-linked amount transferred from a company to a shareholder is a dividend, unless it’s a return of CTC (“contributed tax capital” –see definition below). The issue of additional shares (e.g. capitalisation issues) are also excluded.

A new definition of “contributed tax capital” (CTC) is introduced, the main concept being the amount received by the company as consideration for shares issued. The definition permits the carrying forward of existing pure Share Capital and Premium to be the opening CTC balance under the new regime. However, in the case of assets received in terms of an “asset-for-share transaction” (s42 ITA), the company is deemed to have received only an amount equal to the base cost that the asset had in the hands of the contributing shareholder. The re-allocation of CTC when groups are restructured under the amalgamation or unbundling relief rules (s44 & s46) is also addressed.

Passive holding companies (PHCs)

The intention seems to be that PHCs should pay tax (probably at 10% –but the rate is not yet fixed) on dividend income and should be exempt from having to withhold DT on dividends paid out. It appears that a flat rate of 40% will apply to a PHC's other income.

A PHC is essentially a company of which more than 50% is owned (directly or indirectly) by 5 or fewer natural persons, if more than 80% of the company’s gross income is derived from financial instruments (typically dividends and interest). Note that the 80% calculation is subject to some inclusions and exclusions.

There are several excluded companies, including listed groups, non-resident companies, banks, insurers,

(C) Other Corporate and Commercial

Company reorganisations

Roll-over for replacement assets: Where replacement assets are subject to the roll-over regime in terms of paras 65 or 66, 8th Sch. (and s8(4)(e) ITA), the roll-over is preserved (i.e. the transferee is effectively substituted for the transferor) upon asset-transfers in terms of s42, s44, s45 or s47 transactions.

Exit & De-grouping charges: The exit charge in the amalgamation rules (s44) –i.e. where the shareholding drops below the "qualifying interest" within 18 months– will no longer apply in situations where the 'resultant' company is listed or is a CIS.

The de-grouping charge in the intra-group rules (s45) is amended to address the fact that there might have been several successive s45 transfers of the same asset in the 6 years before the de-grouping. The potential taxable inclusions determined as at the de-grouping must be compared to the calculated inclusions that might have arisen upon previous s45 transfers.

Application & Elections: Asset-for-share, intra-group and liquidation relief will apply automatically to qualifying asset-transfers, with the option for the parties to jointly elect out. (Previously s42, s45 & s47 required a joint election.) However, whilst the s42 and s45 opt-out can be elected on an individual asset basis, the s47 opt-out will exclude the entire liquidation transfer. This brings s42, s45 & s47 in line with what is already the position in s44 & s46.

Liquidation of excluded subsidiaries: The s47 liquidation roll-over can now also apply to the liquidation of non-"group" subsidiaries, e.g. where the subsidiary is non-resident –as long as the SA-resident holding company holds at least 95% of the subsidiary. In this case, the assets (of the liquidating subsidiary) are taken over by the holding company at market value.

Anti-avoidance – s45 transfer of own shares to transferee: There is a prohibition on the application of s45 to the transfer of a company's own shares to itself. For example, if a transferor owns shares in the transferee and then sells those shares to the transferee, the transferor's taxable gain might previously have been shielded by s45. (Effective 21-Feb—08)

Unbundling CFCs: Whereas the current rules only cover the unbundling of CFCs if both the unbundling and unbundled companies are CFC's, the relief can now can apply even if only the unbundled company is a CFC –as long as the shareholder holds at least 95% of the unbundling company. (Effective 21-Feb-08)

Share issue anomalies

When a company issues shares in consideration for an asset acquired, the deemed asset acquisition-expenditure will be limited to the lesser of the market value of the asset and the shares issued. (Currently the rules just look at the market value of the asset.) The two market values must be compared immediately after the asset-acquisition.

Intellectual property arbitrage – Denial of royalty deduction

The not-yet-in-operation s23I –which seeks to deny deductions for royalties paid to non-residents (etc.)– is amended in certain respects (although the proposed effective date of 1 January 2009 is retained). If royalty receipts are not taxed as 'income' in the hands of the recipient, the deduction in the hands of the payer (the "end user") will be denied if the underlying intellectual property was previously owned or developed by the end user, or is currently owned by any SA taxable person, or was previously a material part of a business that was acquired by the end user from a SA taxable person.

CFCs held as trading stock

Where shares in a CFC are held as trading stock, the s9D 'net income' inclusion can be added to the cost of CFC shares.

(D) Retirement issues

Taxation of withdrawals from retirement funds

It is proposed that lump sum benefits on withdrawal with effect from 1 March 2009 should, instead of the current annual amount of R1 800, enjoy a rebate equal to R22 500. This will be a lifetime aggregate deduction. Contributions not previously allowed as a deduction from income will continue to be deductible from the lump sum. In addition, the net amount of the withdrawal benefits will be ring-fenced and taxed at the normal rates of tax, without entitlement to any further rebate.

Exclusions from lump sum accruals

Lump sums that are by election by the dependents or nominees converted to annuities or which are used to create a beneficiary fund shall be deemed not to have accrued. The same applies to unclaimed benefits that have been transferred to a pension / provident preservation fund. This deeming provision supersedes the normal accrual at payment rule.

Allocations to spouses on divorce

From 1 March 2009, any benefits paid out of the retirement fund entitlement of a member to or for the benefit of a former spouse will be deemed to be a withdrawal benefit and will be taxed in the member's hands in the manner noted above.

The former spouse may elect that a lump sum benefit award be transferred to his or her retirement fund without triggering a liability to tax.

Default withdrawals / Unclaimed benefits

The present law that deems a lump sum to accrue six months after the member ceases to be a member of a former employer's retirement fund is to change to provide that the benefit will only be deemed to accrue when the member elects payment in cash.

Transfers from pension to provident funds

The Pension Funds Act does not recognise an accrual on the transfer of a member's interest from a pension fund to a provident fund. In effect, this represents a tax-free withdrawal and a tax-deductible contribution to a provident fund. As contributions to provident funds are not deductible (i.e. made from after-tax income), an amount equal to the sum transferred is deemed to accrue to the member on the date of transfer.

(E) Employers and Employees

Employee

Labour brokers who are corporates or trusts will be excluded from the definition of employee. The definition is now limited only to natural persons. This change applies to the limitation of deduction of expenses and allowances for a small business corporation.

Repayable employee benefits

Employees will be permitted to deduct remuneration that must be refunded to the employer including repayments of restraint of trade payments.

Exemption for personal use of business cell-phones and computers

For fringe benefit purposes, the incidental personal use of telephones and computers that are provided to employees to use for business purposes will be exempted.

Consolidation of deemed employee regimes

A new concept of "personal service provider" (PSP) is introduced to replace and consolidate personal service companies/trusts. Significantly, the PSP concept refers simply to a "person" suggesting that the rules are being further unified, i.e. no distinction between contractors operating through companies, trusts, or in their personal capacity.

The previous benchmarks and exemptions appear to have been largely retained, i.e. control or supervision, the 80%-of-income rule, the 3 full-time-employees rule, etc.

Deductions in respect of learnerships

Learnership allowances are enhanced by permitting repeating full annual allowances in each year for programmes that extend over several years.

Payroll giving

The Employees' Tax system is enabled to permit the deduction of donations from employees' remuneration, where donations are deducted and paid over by the employer (on behalf of the employee).

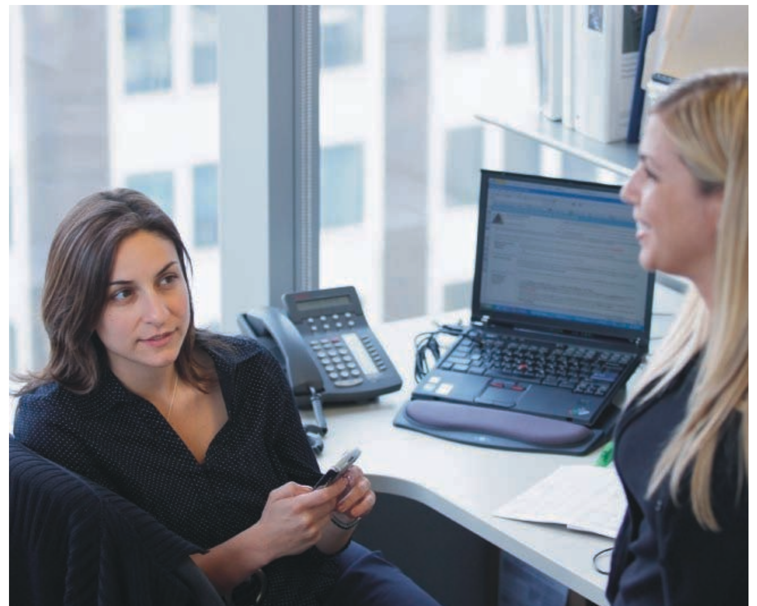
Share incentive schemes

For broad-based employee share plans (s8B), the threshold participation is reduced to 80% of total employees (down from 90%), the maximum share allocation increased to R50,000 over 5 years (up from R9,000 over 3 years), and the and maximum employer deduction increased to R10,000 p.a. (up from R3,000).

For other employee share schemes (s8C), so-called 'phantom' schemes are brought into s8C rules since the definition of "equity instruments" is extended to include contractual arrangements linked to equity. Furthermore, the threat of potential financial penalties may also rank as restriction, i.e. might prevent vesting.

Administration

Employers will no longer have to apply to SARS for directives on lump sum payments on the date of transfer.



(F) Investment incentives

Venture Capital Company (VCC) Regime – Deduction for investors

It is proposed to allow natural persons and listed groups a deduction for equity capital invested into VCCs (not applicable for investors that are trusts or unlisted companies):

- Individuals: Maximum deduction of R750,000 per tax year and maximum aggregate deduction for all tax years of R2.25 million.
- Listed companies (incl. group companies): No limitation on deductions, but they may not hold more than 10% of the VCC.
- There are strict requirements for a company to qualify as a VCC, subject to formal SARS approval:
  - Must be SA-resident and can not be part of a group (50%-rule);
  - Gross income exclusively from financial instruments (dividends, CGT, share-dealing);
  - Minimum gross assets of R30m (or R150m if investee companies include junior mining/exploration);
  - At least 80% of gross assets must be investments into small & medium-small companies (maximum asset value of R5m or R10m);
  - Maximum of 15% of VCC's investment expenditure can be invested into one investee company.
  - The VCC together with any connected company may not control the qualifying company
  - There are also restrictions on which investee companies can be targeted by the VCC (e.g. must be SA-resident; not listed; certain trades disqualified like land-dealing, financial services, gambling, etc.; cannot be a controlled company in a group (50%-rule); tax affairs must be in order; etc.).
  - The allowance is limited to shares purchased before 30 June 2021.

Allowances for Industrial policy projects (Manufacturing assets & Employee-training.)

Additional allowances are offered in respect of qualifying industrial policy projects. These incentives are once-off initial allowances over and above allowances that are in any event claimable (s11(a), s11(e), s12C, etc.):

- 55% or 35% of the cost of manufacturing assets; and
- The cost of employee-training, limited to R36,000 per employee.

Depreciation allowances for residential units (rental)

A new s13*sex* is proposed to replace and enhance the existing s13*ter* regime where the owner of the property earns rental income from the properties or grants occupation to employees. The concept of minimum 5 residential units (in the same vicinity) is retained.

- Basic allowance of 5% p.a. (of cost) x 20 years;
- Additional allowance of 5% for "low-income" residential units (as defined) which accelerates the allowance to 10% x 10 years.
- Effective from 21 October 2008 (construction commencement).

Urban development zones

These incentives are broadened and extended:

- Expiry date extended to 31 March 2014 (instead of 2009);
- Allowances for new buildings enhanced to 11 years (20% + (10yrs x 8%)), as opposed to 17 years (20% + (16yrs x 5%));
- A special allowance is introduced for "low-income" residential units over 7 years (25% + (5yrs x 13%) + 10%) Purchased buildings that were acquired from a developer now qualify for a full deduction (previously

restricted to 55% or 30%), although the restrictions will continue to apply to the acquisition of "part" of a building.

Employer sales of low-cost housing to employees

A new s13*sept* is proposed to grant allowances to employers transferring "low-income" residential units to employees on interest-free loan account.

- Allowance of 10% p.a. of loan amount (i.e. selling price) x 10 years;
- Selling price cannot exceed cost;
- Loan must be interest-free;
- No conditions may be set other than buy back by employer in event of non-payment or termination of employment;
- Loan repayments treated as a recoupment.

Licence payments

The deduction of certain initial up-front licence fees paid to the State will be allowed in the telecommunication, petroleum and gambling industries. The fee may be written off over the lesser of the term of the licence or 30 years.

(G) Miscellaneous Income Tax Issues

Donations to multilateral humanitarian organisations

Donors will be permitted to deduct donations to foreign agencies (enjoying diplomatic immunity) even though such foreign agencies are not registered as public benefit organisations in SA.

Promotion of biodiversity

A new s37C is inserted to permit the deduction of non-capital expenditure incurred to conserve or maintain land in terms of a biodiversity management agreement. The land must be owned by the taxpayer and used (wholly or partially) in the production of income.

Small Business Presumptive Tax

A new presumptive "Turnover Tax" (TT) in respect of MBs ("micro businesses") will be enacted. A new 6th Schedule is inserted into the ITA to define MBs and to govern the application of the TT. The first requirement is that annual turnover should not exceed R1m.

MB income (if subject to the TT) is exempt from Normal Tax and dividends paid out are exempt from DT (Dividends Tax) up to a maximum of R200,000 p.a.

Effective date 1 March 2009.

(H) VAT

Industrial developments zones

The deemed supply rules dealing with the temporary removal of goods from customs controlled areas are amended to address potential double taxation that could arise where goods are sold before their return or immediately after their return.

Transfer of rental streams

Anti-avoidance measures are introduced to combat arrangements involving the transfer of rental streams. Whereas previously these transfers may have been taxable, thus permitting an input tax claim, they are now classified as exempt.

Land reform

Special rules are introduced to reduce the VAT and/or Transfer Duty cost of land transfers undertaken in terms of restitution and redistribution programmes.

(I) Estate Duty

Life insurance and pension benefits

Retirement lump sums will be exempted from the estate property.

Time limits for assessment

Assessments will be deemed to have been issued upon specified events, in order to establish clear dates for cut-offs, prescription, etc.

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