Tax Law Review

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Briefing on the 2012 Taxation Laws Amendment Acts

pwc

Briefing on the Taxation Laws Amendment Act (No. 22—2012) and the Tax Administration Laws Amendment Act (No. 21—2012)

Contents

Important Note on EFFECTIVE DATES

The default effective dates are:

- for amendments in the TLAA, the *start* of tax years ending on/after 1-Jan-13 (e.g. in the case of a taxpayer with a February year-end, the default effective date would be 1-Mar-12);
- for amendments (in the TALAA) to the Tax Administration Act, 1-Oct-12; and
- for other amendments in the TALAA, date of promulgation which was 20 December 2012.

However, there are several exceptions to these default rules and the attached notes attempt to highlight only the exceptions, i.e. the default rule applies if the effective date is not specified.

1 Employment

1.1 Medical Expenditure

Effective date: Years of assessment on or after 1-Mar-14

Rules are introduced regarding the conversion of deductions to credits, and there are also some changes regarding the deduction rules.

PwC comment: The process of converting deduction-relief for medical expenditure into tax credits (rebates) is being phased in from 2013 (i.e. from 1-Mar-12) which will phase out s18. The first step was that only medical scheme contributions for under-65s are converted into rebates. The second phase which is now implemented is to implement the credit conversion for other medical expenditure and medical expenditure of persons aged 65 and over as well as persons with a disability.

Medical scheme contributions

Over65s are now included in the credit regime for medical aid contributions. (The exclusion of over65s, at the end of **s6A(1)**, is deleted.) Thus the same initial rebate applies across the board

Other medical expense (including excess medical scheme contributions)

S6B is added to the ITA (1-Mar-14), and deals with the conversion of medical scheme contribution deductions not allowed in s6A (as a medical credit) as well as other medical expenditure to an "*additional medical credit*".

The provisions of s18 regards the persons to whom it applies and the type of expenditure (etc) —i.e. definitions of child, dependant, disability, qualifying expenditure– are replicated into **s6B(1)**. The only change seems to be in **para (*c*)** of the **definition of "*dependent*"** (in **s6B(1)),** where s18 limited such person to "*immediate family*" but **s6B** only refers to "*family*" .

PwC comment: This is seemingly a wider meaning to "family" as the common law presumption includes all family up to the 3rd degree consanguinity, which seems to exceed "immediate family". The courts have also interpreted "family" as grammatically including any person living under same roof —including, for example, a servant.

The additional medical credit is calculated for persons aged 65 and over (**s6B(3)(*a*)**) and persons with disability (**(3)(*b*)**) as the aggregate of the "excess" medical contributions not yet converted under s6A and other medical expenditure converted at a rate of 33.33%. The "excess" medical contributions are calculated as the amount of actual contributions which exceeds <u>three times</u> the s6A medical credit allowed.

For persons under the age of 65 it is only the additional medical expenditure in excess of 7.5% of taxable income (thus excess contributions and other medical expenditure) which qualify to be converted to medical credits. Furthermore the excess medical contributions must exceed four times the s6A credit and the total credit conversion is only at a rate of 25%.

PwC comment: The low conversion rates for persons under 65 for additional medical expenditure may be seen by some as punitive as this group is already "penalised" by the 7.5% threshold and now even in years that high out-of-pocket expenses are incurred (e.g. sudden heart attack or illness) tax relief on such

expenses are capped at an effective rate of 25%. However, in essence only under 65s who have a taxable income of more than R515,500 a year will be worse off than they are currently (with under 65s who have taxable income of less than R515,500 a year being better off than they are currently).

PwC comment: There does not appear to be any provision to repeal s18. It is not clear whether there will be any reason to retain it after the new credit rules come into effect.

1.2 Dividends from employee share scheme shares

Effective date: 1-Jan-11

S10(1)(*k*)(i)(*dd*) is the anti-avoidance rule introduced in the TLAA 2010 relating s8C, which seeks to tax (i.e. deny the exemption for) dividends from certain REIs ("*restricted equity instruments*") —essentially where such dividends are considered to be disguised remuneration such as bonuses.

The amendment seeks to further limit the scope of the anti-avoidance rule by requiring, in addition to the existing requirement that the REI be as *defined* in s8C, that also be "*acquired as contemplated in*" s8C.

PwC comment: This extension of the limitation seems to ensure that only equity instruments given as remuneration should be caught by the anti-avoidance provision (which seeks to tax the dividends on unvested shares, i.e. untaxed shares, which were seen as form of avoiding income tax on disguised remuneration) and not restricted shares that are, for example, bona fide bought. For example, where management does a capital buy-out but is restricted from selling the shares for a stated period, this should not result in the anti-avoidance provision automatically applying.

1.3 Employer-owned Insurance Policies

Effective date: 1-Mar-12

Multiple changes have again been introduced to streamline the benefits and deduction in respect of employee associated insurance products.

Gross income – Eliminating "overlaps"

Para (*d*)(ii) of "*gross income*" (s1) —which catches insurance pay-outs to employees where the employer was the policyholder— is amended to now apply to amounts accrued or received "*directly or indirectly*" from the proceeds of a policy.

*PwC comment: The amendment was introduced as a concern existed that in back-to-back arrangements (i.e. where an amount accrues to employer who on-pays it in terms of employment contract) the amount would be indirectly in respect of the policy proceeds and thus would fall outside gross income, but more importantly also outside the exemption in **s10(1)(gG)** which requires the specific inclusion in gross income.*

Para (*a*) of "*gross income*" (s1) —annuities— is amended to now specifically exclude annuity payments from group life policies to employees (i.e. amounts covered by para (*d*)(ii)).

Furthermore, the need to specifically dis-apply para (*m*) from amounts that are caught by either paras (*a*) or (*d*), is considered superfluous, so **para (ii)** of the ***proviso* to para (*m*)** is deleted.

PwC comment: As regards the interaction between paras (d) and (m), National Treasury's stated position seems to be that the former is clearly aimed at employee-receipts whereas the latter is aimed at employer-receipts —hence there is no need to specifically include an exclusion in para (m) for items caught by para (d). However, the amendment to para (d), i.e. insertion of "indirectly", seems to specifically recognise that insurance pay-outs can be initially paid to the employer and then be on-paid to the employee. Perhaps the intention in these back-to-back cases is that the pay-out will in fact be caught by both paras (i.e. (m) for the employer and (d) for the employee), but that the on-payment would also be fully deductible for the employer? In this respect it is noted that in 2010 there was a proposal to deny the deduction of on-payments by employers but that proposal was subsequently withdrawn.

As regards annuities received by employees it is significant that para (a) is expressly dis-applied. The fact that only para (d) can apply ensures that the exemption in s10(1)(gG) can apply.

Policies ceded to retirement vehicles

Proviso (*cc*) of para (*d*)(iii) of gross income is deleted —so that "investment" policies that are ceded to a pension, provident or retirement annuity fund, will not be caught as gross income.

These amounts would have in many instances triggered a gross income inclusion for the employee, but without the exemption applying at cession (s10(1)(*g*G) requires all the premiums to have been taxed from inception of the policy), it would have discouraged employees to elect this option. The cession would be in furtherance of the SARS and NT policy to curtail the use by employers of deferred compensation schemes.

The EM suggests that (from the employee's perspective) the cession will be akin to a cash contribution by the employer. Thus, for cessions to a provident or pension fund, there would be no implications for the employee. For cessions to a RAF, the employer contribution (i.e. the cession) will however constitute a taxable fringe benefit, but will also (under s11(*n*)) result in a deemed employee contribution and a deduction for the whole or portion of the amount in terms of that provision.

PwC comment: S23(p)(ii) has however not been amended which results in the employer being denied a tax deduction notwithstanding that the employee is now in the same position as if the employer had made a cash employer contribution into a retirement vehicle for the benefit of the employee. This is because the employer would have already received a deduction for the initial contributions that created the policy value. The amendment also does not take cognisance of any previous contributions taxed as a taxable benefit to reduce the future tax for the employee, thus exposing the employee to double taxation. Therefore employers may still elect to rather cash in the policy and then make the contribution which voids the other amendments as to the relief envisaged and the NT policy object to encourage these persons to retain their retirement savings.

The eventual pay-out would then in any event, upon withdrawal/retirement from the fund, be subject to tax in terms of the Second Schedule.

"Employment only" related benefit policies

As regards the employer's deduction, s11(*w*) ITA still retains the basic ideas introduced in the 2010 TLAA, namely that the premiums would be deductible for the employer either if:

(i) the premiums are taxed (as fringe benefits) in the hands of the employee; or
(ii) the policy conforms with certain "key person policy" requirements

but some further retrospective refinements of these rules are made.

In the 2012 amendments a specific exclusion was introduced for insurance "*solely against an accident*" as defined in the Compensation for Occupational Injuries and Deceases Act (130 of 1993) ("COIDA") —which essentially envisages accidents that occur during the course of the employee's duties. The purpose of this exclusion was not to completely prohibit the deduction for these categories of insurance premiums, but rather to exclude it from s11(*w*) so that it would remain to be considered under s11(*a*). However this COIDA "*accident*" provision not did seem to cover all employment related insurance (i.e. seemed to exclude things like travel insurance and travel medical insurance).

To remedy this position, the exclusion from of s11(*w*) will not rely on the COIDA definition (deleted), but will instead be any policy of insurance " *that relates to death, disablement or severe illness of an employee or director of the taxpayer arising solely out of and in the course of employment of such employee or director*".

At same time, however, in order to ensure that only these "employment related" policy premiums are deductible under s11(*a*) —and that the door is not opened to all other kinds of policies (e.g. investment-type) that are excluded from s11(*w*)— the prohibition in **s23B(5)** is amended.

- On the one hand, the prohibition is extended to cover *all* insurance policies (not just s11(*w*) policies) on the life of or disablement of an employee—i.e. the reference to s11(*w*) is deleted.

- However, on the other hand, a specific exclusion for employment related incidents is now also inserted into s23B(5) which makes these policies premiums deductible under s11(*a*).

PwC comment: The retrospective amendment from 1 March 2012 may be problematic to some employers who may have accounted for these premiums as being deductible until now and may have reflected this deduction in years already ended or for provisional tax purposes.

Fringe benefit

Para 2(*k*) 7th Sch. ITA is amended to also exclude the taxable fringe benefit where an employer has provided employment related policy benefits "that *relates to death, disablement or severe illness of an employee or director of the taxpayer arising solely out of and in the course of employment of such employee or director*". This provision is only effective from **1-Mar-13**.

PwC comment: This results in only the proceeds from these policies becoming taxable on the happening of an event.

There is also a timing mismatch between s11(w) and para 2(k) 7th Sch where in both the "arising solely out of employment" exclusion applies but with a 12-month delay in the taxable benefit exclusion.

Taxation of Proceeds – Employer

S10(1)(*g*H) is re-written completely to retrospectively delink the provision from s11(*w*)(ii). Thus, it now applies more generally to any policy that relates to the death, disablement or severe illness of an employee or director of the taxpayer —as long as the premiums since 1-March-12 have <u>*not*</u> been <u>*deductible*</u>.

PwC comment: This results in a position that where the policy premium was deductible for the employer (but not taxed as a taxable benefit for the employee), then on the happening of an employment related

event the employer is taxed on the proceeds and will only tax the employee on any proceeds that it passes on and claim a deduction for such amount as an employment cost. Where the premium was not deductible from 1-Mar-12 for the employer, on a life policy, the proceeds will be tax exempt.

Taxation of Proceeds – Employee

Para (*a*) of gross income is amended to specifically exclude annuity amounts from a life policy which are taxable under para (*d*)(ii) of gross income. This ensures that the exemption in **s10(1)(*g*G)** applies to both lump sums and annuities payable under a life policy where the employee was an employee of the policyholder (i.e. assuming that the premiums were taxed as fringe benefits in the hands of the employee).

However for policy proceeds on policies "*arising solely out of employment*" **para (*d*)(ii)** of gross income will include the amount, with no exemption under **s10(1)(*g*G)** because the premiums would not have been caught as taxable fringe benefits under para 2(*k*), 7th Sch..

PwC comment: This exemption puts employer group life based policies in a better position than an employee's own policy as the latter only remains non-taxable if paid as a capital lump sum but not when paid as an annuity, even though the premiums are paid from after tax money.

1.4 Compulsory annuity exemption

Effective date: 1-Mar-14

A new **s10C** is inserted to exempt from income tax, contributions by a taxpayer to a "*pension, provident or retirement annuity fund*" that have not previously been allowed as a deduction either under the provisions of s11(*k*) or (*n*).

The exemption operates by providing an exemption against a compulsory annuity that applies to pension funds, pension preservation funds and retirement annuities. It seeks to bring forward this roll over and make it inter-deductible between retirement products by consolidating it into a single balance. For example where a retirement annuity matures and the person still contributes to a provident fund, then on assessment the non-deductible provident fund contributions, will as an exemption, reduce the annuity income and will not be deferred till retirement/withdrawal where the reduction against the taxable amount which would normally operate in terms of the **2nd Sch.** The exemptions applies in relation to the "*persons own contributions*" and thus does not roll over to any subsequent recipient of the annuity (i.e. spouse or dependants).

Paras 5(1) and **6(1) 2nd Sch** as well as **s11(*n*)** are also consequently amended to exclude from the pension withdrawal/retirement deduction, amounts or roll over deduction (retirement annuities) amounts that have already been exempted in terms of **s10C**.

PwC comment: This provision operates to some extent "retrospectively" because even though it applies only to income amounts paid or accrued after 1-Mar-14, it allows for the aggregation of the exemption amounts of all previously non-deductible contributions.

1.5 Learnership allowances

Effective date: 1-Jan-13

The amendments to s**12H** generally seek to administratively streamline the incentive to ensure taxpayers utilise it more readily.

Registration requirements

S12H(2)(c) is inserted to ensure that the allowance in practice remains claimable from the date that the learnership applies and not from the future date when registration is technically effected. S12H(2)(c) now gives the employer up to 12 months after the year of assessment in which the allowance will be claimed to register the learnership with the relevant SETA, however the allowance is still only claimable from the date that the learnership is entered into.

PwC comment: This was a concern for many employers who only applied for retrospective registration of the learnership (to date of employment) after the employee had completed a probation period, but may have a year-end during such period where it technically could not claim the allowance.

Excluded learners

S12H(6) provides for a general exclusion claiming an incentive allowance where such learner previously failed a similar learnership. This placed an enormous administrative burden on employer to try and determine the training history of each and every learner before claiming the allowance.

To lessen this burden **s12H(6)(*a*)** is amended to only exclude learners who have failed to complete similar learnerships at a specific employer or an "*associated institution*". "*Associated institution*" is inserted as a defined term in **s12H(1)** and replicates the same definition in the **7th Sch ITA**.

PwC comment: The provision does not limit the exclusion to only periods when the parties were associated institutions. Thus where a learner fails to complete a learnership and becomes employed by a company which only thereafter becomes associated institutions, technically it would disqualify the company from claiming the allowance. It also creates a practical problem in that it is unclear whether only the period for which they were associated institutions is excluded or for the full allowance. In all probability the former applies as income tax is assessed on an annual basis and on the legal facts applicable at such time.

Registered Learnership

The definition of "*registered learnership*" in **s12H(1)** deletes the references to apprenticeships under the repealed Manpower Training Act 1981 as being a "*registered learnership*" which has become redundant.

1.6 Variable cash remuneration

Effective date: 1-Mar-13

S7B is inserted to effectively tax certain types of variable remuneration (like bonuses) on a cash basis.

It seeks to prevent the situation where an amount that was subject to "determination" and payment in the current year from accruing in a prior tax period. In some instances the amounts may arguably even be contingent in that the current-year "determination" determines not only the amount but in fact whether the employee is even entitled to anything (i.e. profit sharing bonuses). SARS may have argued that these amounts accrued in the prior period. The accrual of the amount to the employee is now deferred to the date of payment by the employer, per **s7B(2)(*a*)**.

The relief only applies to payments between employer/employee (as defined in the 4th Sch, thus excluding independent contractors) and only to "variable remuneration". The latter is defined (in s7B(1)) to include overtime, bonuses, commission, travel allowances (s8(1)(*b*)(ii)), and encashed leave.

From the perspective of the paying employer, the date of incurral is also deferred to the date of actual payment (**s7B(2)(*b*)**).

PwC comment: Thus amounts deferred over year end will result in a tax "add-back" adjustment for the employer (and the risk that these amounts were not identified as non-deductible in the year of actual incurral).

Para 2(1B) 4th Sch is inserted to provide that the employees' tax on amounts paid in terms of s7B must be withheld on date of payment.

1.7 Government employees – Foreign service exemption

Effective date: 1-Jan-12

Background:

The exclusion from tax of certain amounts accrued to government officials, *stationed* and *rendering services* outside SA (s9(1)(*g*)), was introduced in 2002 by excluding certain allowances /advances (s8(1) *proviso* (iv)) and taxable benefits (para 1, 7th Sch.) from the applicable provisions. These persons were however excluded from the foreign service exemption in s10(1)(*o*).

The rationale for the initial exclusion is unclear (i.e. EM RLAA 74 of 2002) with the only conclusion being that the remuneration of such persons are SA sourced (s9(1)(*g*) ITA) by being payable by the SA government and taxable as these persons are by the nature of their duties outside of SA for long periods of time (i.e. consulate and embassy staff). It is also unclear what "*stationed*" means and whether this includes short periods of time i.e. less than 6 months, as its normal grammatical meaning is merely "place assigned to work".

These provisions are now however amended to extend these exemptions to a myriad of "government employees" (s9(2)(g)&(*h*) ITA) including holders of public office, employees of all 3 spheres of government, Sch 1 institutions (i.e. IEC, Public Protector etc), Sch 2&3 entities (i.e. ACSA, Telkom, ESKOM, Denel, IRBA etc) and municipal entities (municipal held private companies & service utility companies).

***Proviso* (iv) to s8(1)** is amended to exclude out of the *taxable income* inclusion provision, allowances or advances in respect of travel, accommodation and public office received.

***Proviso* (B) to s10(1)(*o*)(ii)** is amended to exclude from the exemption all remuneration received by these employees.

1.8 Company cars – rental value

Effective date: 1-Mar-13

The rental value for the purposes of determining the taxable benefit value of the use of a company car is amended to allow for "actual cost" as the *determined value* rather than the deemed cost of 3.5% of the value of the vehicle. This exclusion however only applies to "*operating leases*" as defined in s23A(1).

PwC comment: The use of an "operating lease" in s23A as the basis of the exclusion is less than ideal for taxing company cars which are usually used for a substantial part of the useful life of the vehicle (where provided as a company car) whereas s23A contemplates leases of periods less than 1 month (i.e Avis car hire). It also excludes certain trades from being lessors for the purpose of the provision, namely banks, financial service and insurance businesses and these businesses are commonly lessors in company car arrangements.

Para 7(1)(*b*), 7th Sch. is amended to exclude vehicles acquired by operating lease from the calculation of determined value.

Para 7(4)(*a*)(ii) is inserted which determines the taxable benefit value as:

(a) the "*actual cost*" to the employer of the operating lease; plus

(b) fuel costs in respect of the vehicle.

PwC comment: The cost of fuel is not specifically stated to be the cost to the employer, but within the scheme of the 7th Sch it can only have been intended that this applies only to employer provided fuel and not all fuel irrespective of who pays for it. This also seems confirmed in the exclusion in para 7(8) of operating leased vehicles, thus that the benefit value cannot be reduced by costs incurred by the employee.

***Proviso* (*a*) to para 7(1)** is amended to also exclude operating lease vehicles from the "second hand" value reduction.

The ability for the employee to reduce the taxable value in respect of business usage (7(7)) applies to operating lease vehicles, in the same way the standard rule. However, as regards the employee's contribution to the cost of licences, insurance, maintenance and fuel, an amendment to **para 7(8)** confirms that no reduction in the taxable value is available.

2 Dividends and Dividends Tax (DT)

2.1 Income Tax – Dividends via discretionary trusts

Effective date: 25-Oct-12

Dividends distributed by a discretionary trust to a company will be subject to income tax.

In **s10(1)(*k*)(i), item (B) of *proviso* (*ee*)** is amended to target dividends that are accrued to any company "*in consequence of … the exercise of a discretionary power*" of the trustee of a trust.

PwC comment: This means that the corresponding DT suffered by the trust (when the dividend was originally received by the trust) may be reclaimed by the beneficiary-company. Naturally, this creates the practical complication of the refund process.

2.2 DT General

Effective date: 1-Apr-12

Payment

The DT payment trigger in **s64E(2)** is reworked. There are now separate rules for cash and *in specie* dividends (in paras (*a*) and (*b*)), and for listed and unlisted companies (in **para (*a*)**).

(a) For *cash* dividends:
- the rule for unlisted companies is the earlier of when the dividend "*is paid*" or "*becomes due and payable*" (**(*a*)(ii)**). This is similar to the existing rule, except that "*due and*" is added.
- For listed companies, the DT trigger for cash dividends is now simply when the dividend "*is paid*"(**(*a*)(i)**).

(b) For dividends *in specie* the rule is identical for listed and unlisted companies, i.e. the earlier of when the dividend "*is paid*" or "*becomes due and payable*" (**para (*b*)**).

A new **s64E(6)** is inserted to confirm that the DT withheld (and paid to SARS) is in fact deemed to have been paid to the recipient (e.g. shareholder) for the purposes of Part VIII.

PwC comment: This new rule is presumably intended to clarify that the amount on which dividends tax is leviable is the gross amount of the dividend and not the net amount (i.e. the amount of the dividend that is paid after the deduction of any dividends tax leviable in respect of that dividend). It is not entirely clear why this rule is needed.

In specie distributions

The valuation rule for in specie dividends in **s64E(3)** is also amended, and is now split into separate rules for listed financial instruments (para (*a*)) and all other assets (para (*b*)).

(a) For listed financial instruments, the dividend value is deemed to be the "*ruling price*" on the day immediately before the deemed payment date.
(b) For all other assets, the original rule of MV-on-deemed-payment-date is retained.

Low-interest loans

The low-interest-benefit deemed dividend in s64E(4) is deemed (in **s64E(4)(*b*)(i)**) to be a *dividend in specie*.

PwC comment: This removes the previous uncertainty around who is liable for the DT on this deemed dividend. That is, it is now beyond doubt that the tax liability falls upon the lender company.

A new **s64E(4)(*e*)** is inserted to prevent double-taxation of shareholder loans. That is, if any amount of a shareholder loan was already previously subject to STC as a deemed dividend (s64C(2)), then the DT deemed dividend rule under s64E(4) cannot apply to that loan.

DT Rate

The actual withholding rate is clarified to be 15%. In **s64G(1)** and **s64H(1)**, the withholding rate is now linked to the actual charging section (s64E) instead of specifying an actual rate (which was still 10% in those sections).

In **s64E(1)**, the standard 15% DT rate has been made subject to **para 3** of the **10th Sch.**, which limits the DT rate on dividends paid by Oil & Gas companies (as defined in **para 1** of the **10th Sch.**) to 5%. Consequently, dividends paid by Oil & Gas companies are now subject to dividends tax at a maximum rate of 5%.

Effective date: 1-Jan-13

There are several textual and consequential changes involving the replacement of references to terms like "*loan or advance*" with the word "*debt*".

2.3 DT Exemptions

Effective date: 1-Apr-12

Three (3) additional categories of exempt BOs ("*beneficial owners*") are introduced into **s64F**, namely:

- **para (k)** – any PCISS ("portfolio of a collective investment scheme in securities");
- **para (l)** – any person "to the extent that the dividend constitutes income of that person". Consequently, if a person is subject to income tax on a dividend as a result of the **s10(1)(k)(i)** exemption having been denied in respect of that dividend, that person will not be subject to double tax in the form of DT on that dividend;
- **para (m)** – to the extent that the dividend was subject to STC.

As regards the claiming of exemptions and reduced (treaty) rates, the required "*undertaking*" from the dividend-recipient is extended. This is dealt with in **s64G(2)(*a*)(*bb*) & (3)(ii) and s64H(2)(*a*)(*bb*) & (3)(ii)**. Previously the requirement was simply an undertaking to inform the declaring company or RI

("*regulated intermediary*") if the BO "*ceased to be*" the BO. Now, however, the undertaking must also cover any change in the "*circumstances affecting the exemption applicable to*" that BO.

PwC comment: This would cover scenarios like, for example, where the BO is a SA-resident company and then subsequently changes residence (but remains the BO).

Consequentially, the undertaking referred to in the exemption rules for *in specie* dividends is also amended to reflect the same extended requirements (**s64FA(1)(*a*)(ii) & (2)(*b*)**).

Where a RI pays a dividend to a vesting trust whose sole beneficiary is also a RI, the paying RI is absolved from withholding any DT as long as it receives a declaration to that effect. (**s64H(2)(*a*)(*aa*)**)

Effective date: 1-Jan-13

Another exemption is added (**s64F(*n*)**), for fidelity and indemnity funds which are tax exempt under s10(1)(*d*)(iii).

PwC comment: S10(1)(d)(iii) also offers income tax exemption to other entities like trade unions and chambers of commerce, but the specific DT exemption (n) does not extend to those other entities. These entities can however claim the normal company exemptions s64F (a) for DT where they are incorporated as such.

For dividends *in specie* also, another exemption is added (**s64FA(1)(*d*)**), for the disposal of share block fixed property by a share block company to a share block shareholder.

PwC comment: The amendment contains a technical error in that it refers to a disposal "contemplated" in para 67B(1) whereas it should actually be referring to sub-para (2) of para 67B.

Effective date: 1-Apr-13

A temporary exemption is added as a new **s64F(2)** for cash dividends paid by "*REITs*" or "*controlled property companies*", as long as those dividends are received/accrued before 1-Jan-14. Consequentially, a new **subsection (1)** is added into **s64F**, to house all the existing s64F exemptions.

2.4 STC Credits

Effective date: 1-Apr-12

In **s64J(2)(*a*)**, the rules to determine the STC-credit opening balance (1-Apr-12) are reworded. The reference to "*dividends accrued*" (up to 31-Mar-12) is qualified by:

- "*as contemplated in s64B(3)*", which contains the old STC calculation of the "*net amount*"—which was the net of dividends declared and dividends accrued; and also by
- the exclusion of dividends accrued that were not creditable in the STC "*net amount*" calculation, i.e. the dividends accrued (and thus the STC-credit) must be determined "*without regard to any dividend contemplated in section 64B(3A)*".

PwC comment: This is a direct attack on an interpretation (of the original wording of s64J(2)(a)) that "dividends accrued" up to 31-Mar-12 —and thus the STC-credit— could include all dividends accrued, irrespective of whether those dividends were creditable for STC purposes. For example, if a SA holding company received a dividend from its 100% subsidiary, and they elected for that dividend to be exempt from STC in terms of s64B(5)(f), then the dividend still represented "dividends accrued" in the hands of the recipient holding company. Thus (the argument was that) the dividends in question would still be counted in determining the STC-credit balance of the holding company, despite no STC having been paid when the dividend was originally declared by the subsidiary.

Foreign dividends are also now expressly excluded from the STC-credit calculation. A new **s64J(6)** is added to specify that only SA dividends can count towards the STC-credit, i.e. only dividends "*contemplated in paragraph (a)*" of the s64D "*dividend*" definition (which means only dividends from SA-resident companies, according to the s1 "*dividend*" definition).

Furthermore, where any DT is not withheld as a result of an incorrect determination of the STC-credit by the declaring company, that company is liable for that DT. (**New s64J(7)**) The main liability provision in **s64EA(1)** is also specifically made subject to s64J(7).

As regards the subsequent increase in a company's STC-credits when it receives a dividend, the requirement (in **s64J(2)(*b*))** for the declaring company to give the recipient company formal notification of the STC-credit transferred, is amended as follows:

- Even though there is still a requirement for the declaring company to issue the notification of the STC-credit, the responsibility for the notification is now also placed upon the recipient company to some degree. Whereas the old text relied on whether "*the person paying the dividend submits a written notice*", the revised requirement focuses on the recipient company having "*received a notification*". (**(2)(*b*)(i))**

- The requirement for the notification to be "*written*" is removed. (Thus SENS announcements from listed companies would also qualify.) (**(2)(*b*)(i))**

- The timing requirement is adjusted slightly, i.e. submission of the notice by the payer "*prior to*" payment, is now replaced with receipt by the recipient "*no later than*" the dividend payment date. (**(2)(*b*)(ii))**

The withholding rules are amended to clarify that STC-credited dividends are excluded from the withholding obligations imposed upon companies and RIs. (**s64G(1)(*b*) and s64H(1)(*b*)**)

2.5 DT Anti-avoidance

Effective date: 1-Sep-12

- These rules apply to all transactions entered into (e.g. cession agreements, etc.) from 1-Sep-12 onward.
- However, transactions entered into before Sep-12 will also be caught, but only in respect of "*amounts paid*" on after 1-Oct-12.

Apart from the deemed dividend rule in s64E(4), an entirely new **s64EB** is inserted to deal with a separate category of deemed dividends. Specifically, these rules deal with dividend cessions and borrowed shares, and

are restricted to scenarios where the dividend is received by an *exempt* beneficial owner (i.e. "*a person who is a beneficial owner contemplated in section 64F*").

Dividend cessions

Where an exempt BO (beneficial owner) acquires the right to a dividend by way of cession, and the dividend was announced or declared *before* the cession, **s64EB(1)** deems the dividend to have been paid to the cedant (i.e. "*the person ceding that right*"). A ***proviso*** is added to exclude the cession of the actual share, where the dividend- right is ceded together with "*all the rights attaching to that share*".

PwC comment:

(1) Presumably, the deemed date of the deemed dividend is the same date as the actual dividend payment (not the date of the cession payment, if any) but this is not expressly specified.

(2) Presumably, also, the intention is not just that the original BO (cedant) is "reinstated" to be the BO, but also that the exempt BO (cessionary) is simultaneously deemed not to be the BO for exemption purposes. However, the actual text of s64EB(1)(b) simply deems the dividend to be "paid for the benefit of" the original BO (cedant). Unless this is clarified, it is not clear whether there is an actual change in BO —i.e. the exempt BO is not expressly disqualified from being the BO— so it is not clear whether the dividend-declaring-company or regulated intermediary will become aware of who the "deemed" BO actually is. No additions to the declaration obligations in s64G and s64H have been made.

(3) Note also that the dividend will be fully subject to income tax in the hands of the exempt-BO (cessionary) where it is a company, by virtue of the dividend exemption being dis-applied in proviso (ee)(A) to s10(1)(k)(i).

Borrowed shares

Two types of "share lending" arrangements are addressed separately in **s64EB(2) & (3)**. The first deals with actual borrowing and the second deals with acquisition-and-resale deals.

Where an exempt BO has borrowed a listed share and a dividend was announced or declared *before* that borrowing, **s64EB(2)** deems any amount paid by the borrower (exempt BO) to the lender "*in respect of that borrowed share*" to be a dividend paid "*for the benefit of the lender*" —but only to the extent that the payment to the lender does not exceed the dividend.

PwC comment: Presumably, this rule should be restricted to the dividend that is declared/announced in respect of that borrowed share, but this is not expressly specified.

In addition, the corresponding actual dividend received will be fully subject to income tax in the hands of the recipient where it is a company. That is, the s10(1)(*k*)(i) dividend exemption is denied by virtue of a reworded ***proviso* (*ff*) and (*gg*)**—but only to the extent that the dividend does not exceed the compensation payment made by the share borrower.

PwC comment: In summary, the dividend received by the share-borrower is taxed in full as income, and the compensation payment from the borrower to the lender, limited to the amount of the actual dividend, is treated as a dividend payment that is subject to DT.

Where an exempt BO acquires a listed share after a dividend is declared/announced in respect of that share, and that share (or a share of the same kind or of the same or equivalent quality) must be sold back to the seller, then **s64EB(3)** deems that dividend to be paid to that seller. More specifically, **s64EB(3)(*b*)** contemplates:

- an acquisition (of a listed share, after the dividend announcement/declaration)
- that is part of an arrangement in terms of which
- that share, or a share of the same kind, or of the same or equivalent quality
- must be disposed of to
- the original seller, or any company in the same "*group of companies*" as that seller.

PwC comment: As with subsection (1) earlier, concern is expressed over whether the original BO (i.e. seller) has been clearly and effectively reinstated as the BO, and whether there has been a clear and effective disqualification of the exempt BO (i.e. purchaser). In fact, the concern might be more pronounced in subsection (3) —because, whereas subsection (1) deems the payment to be paid "for the benefit of" the original BO, subsection (3) only deems the dividend to be paid "to" the original BO.

It is noted that the same concern does not seem to apply to subsection (2). Whereas:

• subsections (1) and (3) focus on the actual existing dividend payment and seeks to alter who the BO of that dividend is;

• subsection (2) focuses on the borrowing consideration paid by the exempt BO, and deems that payment to be a "dividend".

In other words, (1) & (3) do not affect the nature of the payments but deems a different person to be the BO, whereas the subsection (2) alters the nature of a payment but does not disturb the question of who the BOs are. Thus, subsection (2) does not have the problem/confusion of a single payment that could be argued to have uncertain or multiple BOs.

In addition, the dividend received will —from 1-Apr-13— also be fully subject to income tax in the hands of the recipient where it is a company. That is, the s10(1)(*k*)(i) dividend exemption is denied by virtue of a newly-inserted ***proviso* (*hh*)**.

2.6 DT compliance

Effective date: Date of promulgation

S64(1)(*d*) is amended to ensure that the obligation to submit a dividends tax return is not subject to dividends tax becoming payable but rather when a dividend is paid. Thus even if a dividend is exempt, a dividend tax return must be submitted.

S64L(1A) (company) & **s64M(1A)** (regulated intermediary) are inserted to provide for a refund by the payor company or regulated intermediary where a rebate (limited to the dividend tax amount (**s64N(3)**) was not deducted from the dividends tax amount. The claim must however be submitted within 3 years from the

date of payment of the dividend. The refund is payable to the person to whom *the dividend was paid* and not to the beneficial owner of the dividend who would need to submit the proof of foreign taxes.

S64N(5) is also inserted (*Effective 1 April 2012*) which imposes an obligation on the payor company or regulated intermediary to obtain proof, as prescribed by the Commissioner, of any foreign taxes payable by the beneficial owner before a refund or deduction against dividends can be done by the payor.

3 Income Tax - General

3.1 Revised share definition

Effective date: 1-Jan-13

The **definition of "*share*" (s1)** is amended to eliminate the circular reference to a share or similar equity interest. A share is now defined any unit into which the proprietary interest in a company is divided.

PwC comment: The change is textual and does not amend the meaning of the definition in any way, although it does clarify the meaning in the context of those entities that constitute companies for tax purposes but are not companies in the ordinary sense, e.g. co-operatives.

3.2 Hybrid and Third-party backed Shares

Note that any references to dividends under this heading should be construed as including a reference to foreign dividends.

The use of hybrid debt/equity instruments has become of increasing concern to SARS and the National Treasury. In order to address perceived avoidance, 2 amendments were introduced in the Taxation Laws Amendment Act, 2011 in the form of an extension of the hybrid equity instrument concept in **s8E** and the introduction of a new concept of a third-party backed share in a new **s8EA**, the former effective from 1 April 2012 and the latter from 1 October 2012.

As a result of on-going concerns and further refinements being required to both sections, the provisions have been revised and the effective dates postponed to years of assessment commencing on or after 1 January 2013 (**note, however, the anti-avoidance rule contained in the effective dates discussed below**).

Hybrid equity instruments (s8E)

Effective Date: 1-Apr-12

As a first step s8E is amended to reinstate the section to the position that applied prior to the 2011 amendments. The effect is that the majority of 2011 amendments are repealed, the exceptions being some textual changes and, notably, the extension of s8E to also include "*foreign dividends*" (in addition to "*dividends*").

Effective Date: Tax years commencing on/after 1-Jan-13

In essence, a hybrid equity instrument is currently defined as:

- a non-equity share which is compulsorily redeemable, redeemable at the option of the holder or in respect of which the holder has a right of disposal within 3 years from the date of issue; or
- any other share where the holder has a right of disposal exercisable within 3 years or the existence of the issuer is or is likely to be terminated within 3 years from the date of issue and the share does not rank *pari passu* with any ordinary shares as regards dividends or the dividends are calculated with reference to a specified rate of interest, the capital subscribed or the amount of any loan advanced by the shareholder.

As a starting point, in **s8E(1)**, the concept of a right-of-disposal is discarded in the **definition of "*hybrid equity instrument*"** (this concept is to some extent effectively incorporated into the concept of a third-party backed share). While the 2 existing types of hybrid equity instruments remain in place (in **paras (*a*) & (*b*)** of the definition), these are now defined solely with regards to redemption rather than a right of disposal.

In addition, a new type of hybrid equity instrument is introduced (as a **new para (*c*)**) in the form of any ***"preference share"*** where the share is secured by a ***"financial instrument"*** or subject to an arrangement in terms of which a ***"financial instrument"*** may not be disposed of. Importantly, unlike with the other types of hybrid equity instruments, there is no 3-year rule for this type of hybrid equity instrument.

A ***"preference share"*** is defined as any share other than an equity share or an equity share where *any* dividend is based on or determined with reference to a specified rate of interest or the time value of money. A ***"financial instrument"*** is defined for the purposes of **s8E** as an interest-bearing arrangement or a financial arrangement based on or determined with reference to a specified rate of interest or the time value of money.

PwC comment: The rationale for the introduction of the new type of hybrid equity instrument is that these types of shares are being used to effectively convert deductible interest payments into tax-free dividends. The 2012 version is more closely targeted at the types of security of concern.

However, a share will not be a ***"preference share"*** and will therefore not be a hybrid equity instrument solely on the grounds that it is secured by a financial instrument if the share was issued for a ***"qualifying purpose"*** as defined in s8EA (see below), essentially being to fund the acquisition of shares in an operating company.

PwC comment: The rationale for this exclusion is that preference shares are commonly used as a tax-efficient mechanism to fund the acquisition of shares and for BEE transactions in particular.

The third change is in **s8E(2), namely** that the dividend will no longer be re-characterised as interest in the hands of the recipient, but is simply deemed to be "*income*" with the effect that any exemption is disallowed.

The final change (also **s8E(2)**) is that the provisions will apply to any dividends received or accrued during a tax year if the share was a hybrid equity instrument "*at any time during that year*". Previously, the provisions only applied to dividends received or accrued at a time when the share was a hybrid equity instrument.

The effective date for the introduction of the new s8E contains an anti-avoidance provision. The general rule is that the new provision will apply to dividends received or accrued during years of assessment commencing on or after 1 January 2013. However, the postponement of the introduction of the provision necessitated a rule to address schemes that were put in place to circumvent the new provisions in relation to existing arrangements by accelerating the declaration of dividends, although these dividends would only be paid at later dates. The new provisions therefore apply to dividends received in cash during years of assessment commencing on or after 1 January 2013 where the dividend accrued on or after 1 April 2012 and is received 3 months or more after the date of accrual.

PwC comment: Presumably the understanding of "to the extent that" is implicit in this rule, i.e. if a single dividend was declared but actually paid out on a piecemeal basis (e.g. so that only a portion is paid out in a tax year starting after 1-Jan-13) then only the relevant portion of the dividend should be recharacterised under s8E.

Third-party backed shares (s8EA)

Effective Date: 10-Jan-12

As a first step s21 of the Taxation Laws Amendment Act, 2011 is repealed in order to delete the version of **s8EA** that was to come into effect on 1 October 2012.

Effective Date: Tax years commencing on/after 1-Jan-13

Any dividend (foreign or domestic) received or accrued in respect of a third-party backed share is deemed **by s8EA(2)** in relation to the recipient to constitute **"*an amount of income*"**. In effect, the exemptions for dividends are denied. The provision applies where the share was a third-party backed share at any time during the year.

A **"*third-party backed share*"** is essentially (according to the **s8EA(1) definition**) any ***"preference share"*** where:

- the *holder* has a fixed or contingent right
- to require any person, other than the issuer of the share
- to either:
  - acquire the share; or
  - make a payment in respect of the share in terms of a guarantee or indemnity; or
  - procure, facilitate or assist with the foregoing
- as a result of any amount of any dividend or return of capital in respect of the share not being received or accrued to the person entitled thereto.

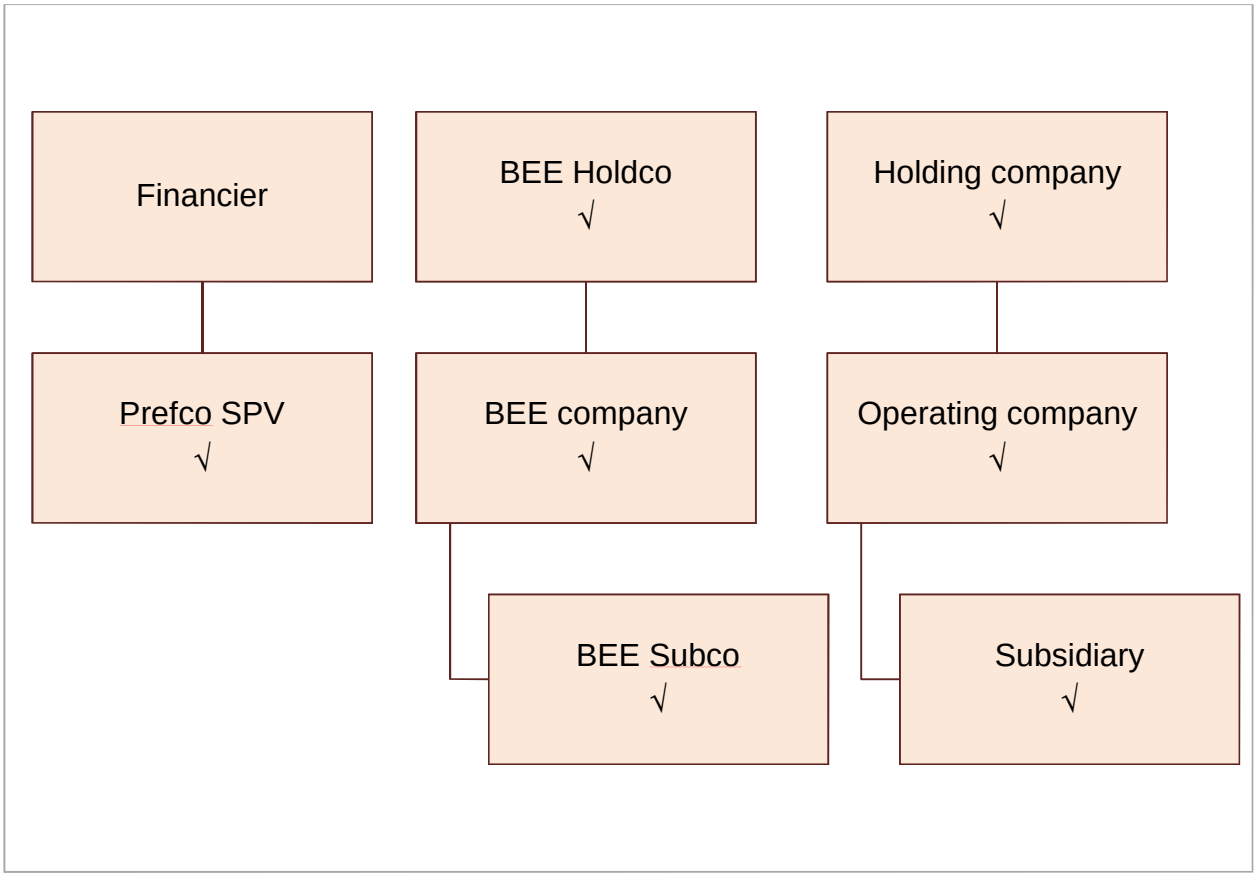
It seems clear that the share will only be caught if the exercise of the enforcement right is only triggered by certain payment commitments not being met.

However, an exclusion from the deeming provisions —i.e. ***proviso*** to the definition of "*third-party backed share*"— is provided for certain shares used by the issuer to directly or indirectly acquire equity shares in an **"*operating company*"** in order not to penalise the efficient structuring of finance for the purchase of such shares (a ***"qualifying purpose"***). This exclusion also applies to the refinancing of debt and shares used to acquire an equity share in an operating company. An **"*operating company*"** is **defined in s8EA(1)** as any company that continuously carries on business of providing goods or services for consideration, any controlling group company in relation to such a company or any listed company. In order for the exclusion to apply, not only must the shares have been issued for a "*qualifying purpose*", but also the security in question must be provided by:

- the operating company;
- an issuer of a preference share for purposes of the direct or indirect acquisition of an equity share in an operating company by any person;

- any person directly or indirectly holding at least 20% of the equity shares in the operating company, the issuer or an issuer in the second bullet point above;
- a company in the same group of companies as the operating company, the issuer or an issuer in the second bullet point above;
- a natural person; or
- a non-profit company, trust or association.

The diagram below is a non-comprehensive illustration of the persons who could stand security for the preference shares issued by BEE company and Prefco SPV issued to fund an acquisition of equity shares by BEE company in Operating company.



The effective date of **s8EA** contains an anti-avoidance provision identical to that for **s8E** outline above.

3.3 Asset-for-Share Transactions

Assumed debt

Effective date: 1-Apr-12

Where the purchaser-company assumes a liability from the seller, as another part of the consideration for the asset, the general rule is that the assumed liability triggers normal tax outside of the s42 relief. However,

certain types of qualifying debt are protected (i.e. the full asset transfer is covered by s42) —but then s42(8) deals with the assumed debt when the shares are eventually sold.

S42(8) is now adjusted to re-instate the previous rule that (effectively) the assumed debt represents additional proceeds at the time when the shares are eventually disposed of. Specifically, if the shares were capital, the assumed debt would simply be additional disposal proceeds (i.e. "*an amount received or accrued*"), and if the share were trading stock it would be an income-inclusion in the year of disposal.

Qualifying interest

Effective date: Transactions on/after 1-Jan-13

The definition of an ***"asset-for-share transaction"*** in **s42** requires that, in the context of disposals to resident companies, the seller must hold a qualifying interest at the end of the day on which the disposal takes place (an exception applies to disposals by natural persons to companies rendering services).

A ***"qualifying interest"*** includes shares in a listed company, a collective investment scheme in securities, a group company or an interest in at least 20% of the equity shares and voting rights of any other company. The threshold for the last type of qualifying interest is now reduced to 10% of the equity shares and voting rights.

3.4 Share-for-Share Recapitalisations

Effective date: Transactions on/after 1-Jan-13

The rules relating to relief for changes in the capital structure of companies are broadened by extending the relief to shares held as trading stock and extending the types of recaptilisations that qualify for relief.

Previously, **para 78(2)&(3), 8th Sch.** provided relief from CGT for shares in a company issued in substitution for other shares in that company by reason of subdivision, consolidation or a conversion of close corporation or co-operative to a company. These provisions are now deleted and replaced with a new **s43**.

PwC comment: Para 78, which has 3 sub-para's, is in fact deleted in its entirety. The para 78(1) rule —i.e. cap-issue shares have a cost of nil for the shareholder— is replicated into the new s40C.

S43(2) provides for rollover relief where a person disposes of a ***"share interest"*** in a company and acquires another ***"share interest"*** in that company in terms of a ***"substitutive share-for-share transaction"***.

A ***"share interest"*** is essentially any share or shares. A ***"substitutive share-for-share transaction"*** is defined as a transaction:

- between a person and a company
- in terms of which the person disposes of:
  - an equity share interest in exchange for another equity share interest; or
  - a non-equity share interest for another non-equity share interest; and

- the replacement share interest is acquired as:
  - a capital asset or trading stock where the share interest disposed of was a capital asset; or
  - as trading stock where the share interest disposed of was trading stock.

PwC comment: There appears to be some suggestion that s43 can also be used to protect par-to-no-par-value conversions, as some companies are undertaking in terms of the Companies Act. On the one hand, given that SARS has recently given a Binding Private Ruling that such a conversion is not a disposal, s43 may well be unnecessary in this case. On the other hand, given that a conversion that results in a variation of rights would probably be considered to be a disposal, s43 may well be in point. Note, however, if the variation-of-rights necessitates a compensation payment, s43(4) would in any event dis-apply the roll-over relief proportionately.

The relief only applies to subdivisions or consolidations in the case of non-equity share interests, while the relief is broader for equity share interests. Where a person becomes entitled to consideration other than a share interest, the rollover relief will not apply to the extent of that other consideration.

For purposes of s43, an equity share includes a linked unit in a real estate investment trust (REIT). The effect of this is that a REIT can substitute its linked units comprising of shares and debentures for other equity shares on a tax neutral basis.

3.5 Value Mismatches Involving Share Issues

Effective date: Transactions on/after 1-Jan-13

Concerns have been expressed that the disposal of assets in exchange for the issue of shares can result in the avoidance of tax where there is a mismatch between the value of the asset and the value of the shares issued as consideration for the asset. . To address these concerns, sections 24BA and 40CA are being inserted.

PwC comment: Generally, these provisions appear to be an initial move from Treasury to "test the water" with the ultimate aim of introducing domestic transfer pricing rules.

S24B(1) currently provides that where an asset is exchanged for the issue of shares, the company acquiring the asset is deemed to have incurred expenditure equal to the lesser of the market value of the asset and the market value of the shares issued as consideration. The seller of the asset is in turn deemed to have disposed of the asset for an amount equal to the market value of the shares. This situation can result in discrepancies between the cost of the asset to the company, the amount of the consideration for the seller and the cost of the shares for the seller.

As a consequence of the above, **s24B(1)** is deleted and a new set of provisions are introduced in an attempt to address the concern. The provisions of **s24B** relating to cross-issues of shares remain, however.

Firstly, a new **s40CA** is inserted. This section provides that where a company acquires an asset in exchange for the issue of shares by that company, the company is deemed to have incurred expenditure equal to the market value of the shares issued as consideration. Contrary to s24B(1)(*a*), no regard is had to the market value of the asset acquired.

PwC comment: The issue of the disposal proceeds in the hands of the seller —currently covered by s24B(1)(b)— does not appear to be addressed. Presumably, general principles will determine that the MV of the shares received would represent the "amount received/accrued" —but it is submitted that debate might be re-opened on the issue of whether share-MV should be taken before or after the asset-transfer (although it is also submitted that in most cases the post-transfer value would be more appropriate). However where connected persons are involved, conflict arises between s40CA and para 38 of the 8th Sch where transactions are not at arm's length as no preference is given in either provision, i.e. neither provision is stated as being subject to the other. This results in conflicting value determinations as para 38 deems the value to be the MV of the asset disposed of and does not value it in relation to the MV of the consideration received, namely the shares.

In addition, **s40CA** also addresses the situation where a company issues debt as consideration for an asset. In this situation the company is deemed to have incurred expenditure equal to the amount of the debt.

PwC comment: The provisions relating to issues of debt add nothing to the existing position.

Secondly, a new **s24BA** is introduced in order to address mismatches in value between an asset disposed of in exchange for an issue of shares and the value of the shares issued as consideration. **S24BA** applies where a company acquires an asset in exchange for the issue of shares by that company and the consideration differs from the consideration that would have applied between independent persons dealing at arm's length. In applying this provision, no regard is had to any other transaction that directly or indirectly affects the consideration.

PwC comment:

(1) The reason for isolating the asset-for-share transaction from any other related transactions is that concern has been expressed that compensation for the mismatch in value on such a transaction can be compensated for through a related transaction that benefits from the mismatch.

(2) There are some questions and uncertainties around the MV of the shares. Even though the point-of-departure for the "excess" calculations in s24BA(3) is the MV of the shares AFTER they've been issued (to be compared against the pre-transfer MV of the asset), there is : (i) No express rule that the seller's disposal proceeds must be the post-issue shares-MV (as there was in s24B(1)(b)); and (ii) No express link between the post-issue shares-MV and the uses of the word "consideration" in s24BA(2). Thus (it may be argued that), if the parties agree on a "consideration" that's based on the PRE-transfer MV of the shares —and that consideration is acceptable as being "arm's length"— then s24BA(3) can find no application even if there is a difference between the asset-MV and the POST-issue share MV.

Where the MV of the asset exceeds the MV of the shares issued as consideration (**(3)(*a*)**), the excess is deemed to be a capital gain for the company on the issue of the shares (and the non-disposal on an issue of shares is disregarded). For the seller of the asset, the tax cost of the shares received as consideration is reduced by the excess.

PwC comment: The provision effectively results in double tax for the company when it sells the asset as there is no step-up in the tax cost of the asset for the amount of the excess on which the company is taxed at inception.

Where the market value of the shares issued exceeds the market value of the asset (**(3)(*b*)**), the excess is deemed to be a dividend *in-specie* for purposes of the dividends tax with the effect that the company is liable for dividends tax unless the seller of the asset is a person that is exempt from dividends tax.

PwC comment: This provision potentially results in economic double taxation as the seller will be subject to tax based on the market value of the shares issued, the excess value of the shares will be subject to dividends tax and the seller will only have a tax cost in the shares equal to the market value of the asset. This is somewhat offset by the fact that the company will have an inflated tax cost in the asset.

In both "excess" calculations above ((3)(*a*) and (3)(*b*)), the MVs to be used are:

- for the asset, the MV immediately *before the disposal*; and
- for the shares, the MV immediately *after the issue*.

PwC comment: The share-MV to be taken into account as expenditure (in s40CA) is the MV immediately after "acquisition", whereas the share-MV to be used in the s24BA(3) "excess" calculations is the MV immediately after "issue". It is not yet clear whether this may turn out to be significant.

Although the corporate restructuring provisions in ss41 to 47 will override the basic s40CA rule, they do not override **s24BA**. However, **s24BA**, does not apply to transactions between companies in the same **s1** "***group of companies***", regardless of whether the transaction is in terms of the corporate restructuring provisions or otherwise.

PwC comment: The implications of s24BA are potentially harsh as a result of the double tax implications and caution should be exercised in any asset-for-share transactions where there is a possibility that the consideration is not considered to be arm's length.

3.6 Debt Reductions For Less Than Full Consideration

Effective date: YOA commencing on/after 1-Jan-13

The various provisions relating to debt reduction are reformed with the purpose of introducing a more fair and efficient system and to consolidate the relevant provisions scattered through the Act into a central locations.

With this in mind, 2 new provisions are inserted into the Act, **s19** dealing with the income tax implications and **para 12A 8th Sch.** dealing with the CGT implications. As a result, the following existing provisions are amended as follows:

- S8(4)(*m*) is deleted and s8(4)(a) amended to exclude any recoupment to the extent that it reduces any cost or expenditure in terms of the new **s19**;
- The proviso to s20(1)(a) is deleted;
- S24J(4A)(*b*) is made subject to the new **s19**;
- Para 3(*b*)(ii), 8th Sch. is amended to exclude debt reductions;

- Para 12(5), 8th Sch. is deleted;
- Para 20(3)(*b*), 8th Sch. is amended to take into account reductions in the cost of trading stock;
- Para 56, 8th Sch is amended.

Income tax implications of debt reductions

A new **s19** is inserted and introduces new income tax implications and ordering rules that apply where a debt is reduced for less than full consideration (a "***reduction amount***") and the debt was used directly or indirectly to fund deductible expenditure or expenditure in terms of which an allowance was granted.

PwC comment: Unlike s8(4)(m), s19 does not require a direct connection between the debt and the expenditure before the provision applies. Therefore, where a loan is obtained from a third party to fund any expenditure, the provisions of s19 will apply to any reduction in that loan where the loan funded any expenditure contemplated in the section.

The income tax implications are as follows:

- If the debt was used to fund trading stock that is still held and not disposed of, the reduction amount reduces the tax cost of the trading stock taken into account for purposes of s11(*a*) or s22 (per **s19(3)**);
- To the extent that the reduction amount in respect of debt for trading stock held and not disposed of exceeds the cost of such trading stock, the excess is a recoupment for purposes of s8(4) (per **s19(4)**);
- Where the debt was used to fund any expenditure other than trading stock that is held and not disposed of or allowance assets, a recoupment arises to the extent of any deduction or allowance granted (per **s19(5)**) —so this subsection would apply to debt that funded other general revenue expenditure, like trading stock that has already been sold or other operating expenses;
- Where the debt was used to fund an allowance asset, the reduction amount gives rise to a recoupment (per **s19(6)**) to the extent that a deduction or allowance was granted *and* the expenditure for CGT purposes has been reduced to nil as a result of the reduction amount in terms of para 12A.

PwC comment: The text of s19(6) is unclear and confusing, especially the requirement in para (ii). Specifically, in the case of a debt that funds an allowance asset, it is not clear what the relationship is between s19 and para 12A —in two respects: (a) What prevents the double-counting of the debt-reduction in both s19 and para 12A? And (b) even once it is clear that there can be no double-counting, what is the order-of-preference rule between s19 and para 12A?

For example: An allowance asset with a cost of R1,000 was fully funded by third-party debt, and allowances of R900 have already been claimed, and the debt is now reduced by R300.

The two questions that arise are: (a) What prevents the R300 from being double-counted in s19 and para 12A; and (b) If it is clear that the R300 can only be used once in total, then what are the apportionment rules between s19 and par 12A?

Based on the EM, it appears that the intention of s19(6)(ii) is to ensure that (in this example), R100 out of the R300 will be caught by par 12A (being the un-depreciated expenditure), and the balance of R200 will

be a recoupment under s19(6). However, it is submitted that the text of s19(6)(ii) does not actually achieve this.

- In addition (per **s19(7)**), the aggregate of allowances in respect of that allowance asset may not exceed the expenditure incurred less the reduction amount and less the allowances previously allowed.

PwC comment: Where the reduction amount exceeds the tax value of the asset (i.e. the sum of the reduction amount and the claimed allowances exceeds the original acquisition expenditure), there does not appear to be any recoupment of the negative amount. This is because s19(7) is simply a "limitation" provision, but without the express requirement that negative amounts must be added back. For example: An asset is acquired for R1m in Year 1, and by Year 2 the total accumulated depreciation is R600,000.

(a) During Year 2, the R1m debt is reduced to R750,000, i.e. a reduction amount of R250,000. In this case, it is clear that the maximum allowances that can still be taken after Year 2 is limited to only R150,000 [i.e. R1m – (R600k + 250k)].

(b) However, if the reduction amount in Year 2 is (say) R500,000 then s19(7) produces a negative amount of R100,000—but there does not seem to be any provision to recoup the negative amount.

S19 does not apply to:

- any tax debt (per the **s19(1)** definition of "***debt***");
- any debt owed by a person that is an heir or legatee of a deceased estate to the extent that the debt is owed to the estate, the debt is reduced by the estate and the debt forms part of the property of the estate for estate duty purposes (per **s19(8)(*a*)**);
- any debt reduced by way of donation or deemed donation (**(8)(*b*)**); or
- any debt owed to an employer where the reduction is fringe benefit (**(8)(*c*)**).

PwC comment: Apparently, s19 does not apply to any debt reduced by way of donation. S19 does not, however, require that donations tax be payable, merely that a donation is made. It is therefore conceivable that in circumstances where a debt waiver takes place in respect of a debt owed by a South African resident to a non-resident, donations tax will not be payable since the donation is made by a non-resident and section 19 will also not apply.

CGT implications of debt reductions

The CGT implications of debt reductions are addressed in a new **para 12A** of the 8th Schedule which replaces **para 12(5)**.

Para 12A applies to any reduction amount in respect of a debt that was used to directly or indirectly fund any expenditure:

- other than expenditure in respect of which a deduction or allowance was granted; or
- to acquire and create an allowance asset.

In effect, the intention seems to be that para 12A does not apply to any reduction amount to which the provisions of s19 are applicable.

PwC comment: The legislation in respect of "allowance assets" is not clear as allowance assets are covered by both s19 and para 12A. Although the most appropriate interpretation is that s19 can apply only to recoup the depreciation already taken on the allowance and that para 12A can apply only to the undepreciated expenditure, it is submitted that the text (especially in s19(6)) is not entirely clear —see the PwC comment above in respect of s19(6). Most importantly however, even though the EM suggests that para 12A takes preference over s19 when it comes to depreciable assets —i.e. a debt reduction must have a CGT application first and only the balance of the debt reduction must be considered for s19 recoupment purposes— this preference is not evident in the text of the legislation.

Where the debt was used to fund expenditure on an asset that is held at the time of the reduction, the expenditure on that asset for base cost purposes is reduced by the reduction amount (**para 12A(3)**). If the asset is NOT an "*allowance asset*", then to the extent that the reduction amount exceeds the expenditure or where the asset has been disposed of at the time of the reduction, the reduction amount reduces any assessed capital loss for the year of assessment in which the reduction takes place (**12A(4)**).

PwC comment: Presumably, the fact that reduction amounts related to the acquisition of "allowance assets" cannot be set off against the assessed loss (in para 12A(4)) means that the unutilised reduction amounts remain available to be applied as recoupments under s19(6).

Furthermore, given that para 12A(4) cannot apply to debt that funded "allowance assets", it is not clear how common it would be for the reduction amount to exceed the expenditure (per s12A(4)(b)(ii). This implies that the borrowing would have exceeded the base cost expenditure. The only immediately obvious example is shares, where a "return of capital" can reduce base cost expenditure and thus create the situation that base cost expenditure drops below the outstanding borrowing on those shares.

Para 3(b)(ii), which includes any base cost of an asset disposed of in a previous year of assessment that has been recovered or recouped as a capital gain is amended such that it does not apply to any reduction of a debt. As such, where a debt is reduced after the year of assessment in which the asset is disposed of, no capital gain will arise.

Where the reduction takes place in the same year as the disposal of the asset or an earlier year, the provisions of para 20(3)(b) may also apply. This provision requires expenditure in respect of an asset to be reduced by any amount which has been reduced or recovered to the extent not taken into account as a recoupment. However, para 20(3)(b) requires, in our view, a direct connection between the debt being reduced and the expenditure on the asset. Where the connection is indirect, no reduction of expenditure can be made in terms of this provision.

PwC comment: The interaction between para 20(3)(b) and para 12A is unclear. It is possible that both provisions could apply to debt reductions where there is a direct connection between the asset and the debt and the asset is not disposed of at the time of the reduction or is disposed of in the same year as the reduction. Which provision then takes precedence is debatable.

The overall implication of the new CGT rules for debt reductions is that they will never give rise to a capital gain as a result of the reduction.

PwC comment: There is seemingly a gap in the legislation insofar as assets disposed of prior to the reduction are concerned. For example, if an asset was acquired for R1 000 funded by a third party loan of the equivalent amount, disposed of for an amount of R1 200 and, prior to the disposal, the loan is waived, the base cost of the asset would be reduced to nil and a capital gain of R1 200 would arise on disposal (in line with the economic reality). However, if the loan is waived after the disposal the capital gain is only R200 and the waiver of the loan has no implications in the absence of an assessed capital loss for the year.

Para 12A(4) contains special rules insofar as the treatment of debt reductions for pre-valuation date assets (1-Oct-01) are concerned. In terms of those rules, the taxpayer is deemed (only for purposes of re-establishing base cost and time of acquisition) to have disposed of the asset immediately before the debt reduction for its market value at that time and to have immediately reacquired for an expenditure equal to its market value, less any capital gain plus any capital loss that would have arisen had the asset been disposed of for its market value at that time. The debt reduction rules are then applied to the re-determined expenditure.

PwC comment: There seems little doubt that this can only apply to pre-CGT assets that are still held at the time of the debt-reduction (i.e. it can't apply if the debt is only waived in a subsequent tax year after the disposal) —but this is not expressly clarified.

Para 12A does not apply to:

- any tax debt (per the **para 12A(1)** definition of "***debt***");
- any debt owed by a person that is an heir or legatee of a deceased estate to the extent that the debt is owed to the estate, the debt is reduced by the estate and the debt forms part of the property of the estate for estate duty purposes (**12A(6)(*a*)**);
- any debt reduced by way of donation or deemed donation for donations tax purposes (**(6)(*b*)**);
- any debt owed to an employer where the reduction is fringe benefit (**(6)(*c*)**);
- any debt owed to a company in the same s41 "*group of companies*" unless as part of certain schemes to avoid tax (**(6)(*d*)**); or
- any debt owed by a company to a connected company reduced to enable winding up of the company, provided certain requirements are met (**(6)(*e*)**).

PwC comment: See comment above regarding section 19 and donations tax.

Para 56(2) 8th Sch., the exclusions from the disregarded capital loss on a disposal of a debt owing by a connected person, is amended to provide that a capital loss will not be disregarded to the extent that the amount of the debt represents an amount applied to reduce the base cost of an asset or an aggregate capital loss in terms of para 12A. The other relevant exclusions in para 56(2) continue to apply, the most relevant being where the reduction is included in the gross income of the debtor (as a recoupment). No relief is granted where there is a reduction in the tax cost of trading stock or in allowances available on an allowance asset.

PwC comment: The reference in para 56(2) to a reduction of an "aggregate" capital loss is presumably an error and the correct reference should be to a reduction in the "assessed" capital loss. The failure to

provide relief where the debtor will be liable to tax on disposal of trading stock held at reduced value or will not be entitled to allowances to the extent of a debt reduction gives rise to economic double taxation.

3.7 Debt-financed acquisitions of controlling share interests

Effective Date: acquisitions on/after 1-Jan-13

Generally, interest incurred in respect of debt used to acquire shares is not deductible unless the shares are acquired as trading stock. However, a simple process which allows for the successful deduction of such interest exists through using **s45** rollover provisions, which ultimately allows for the deduction through the use of a three-step procedure, a so-called debt pushdown structure.

In order to eliminate the need for this process in the situation where the purchasing company has taxable income which it could shelter with the interest, a special rule is introduced for interest incurred where that interest is associated with debt used to acquire controlling share interests in terms of a **new s24O**.

The deduction of the interest will continue to be in terms of s24J. However, in order to overcome the trade and income requirements of that section, **s24O(2)** deems the interest to have been incurred in the production of income, in respect of amounts that constitute income and for the purposes of trade, provided the requirements of that section are met.

S24O has the following requirements, per **s24O(2)** read together with the **s24O(1) definition of "*acquisition transaction*"**:

- the acquirer must be company;
- the target shares must be equity shares;
- the target company must be an "*operating company*", being (defined in **s24O(1)**) a company that carries on business continuously in the course of which it provides goods or services for consideration or a controlling group company in respect of such a company;
- the acquiring company must be a controlling group company in relation to the operating company at the close of the day; and
- the acquiring company and the operating company must form part of the same s41 "*group of companies*".

PwC comment: The requirement that the acquirer must "become" the OpCo's controlling co (see para (b) of the s24O(1) definition of "acquisition transaction") presumably means that: (i) if the purchaser already held some shares (but less than 70%) in the OpCo, then the interest on the debt funding for the original shareholding will NOT be permitted by s24O; and also that (ii) if the target OpCo and purchaser are already "group" companies before the acquisition of additional shares, then the funding for those additional shares will also NOT be covered by s24O. However, compare the following two examples. In both examples, the purchaser acquires 100% of the OpCo in three tranches, i.e. 50% + 30% + 20%. In Example 1, the three tranches are completely separate and unrelated, and in Example 2 it is one single deal that is structured as three consecutive steps. It seems that, in Example 1, only the 2nd batch is covered by s24O, whereas in Example 2 we might argue that the entire deal is covered. (But as noted below, SARS approval is required before the deduction is allowed.)

If any of the last 3 requirements mentioned above cease to be met after the acquisition, then per **s24O(3)** the relief provided by s24O will cease to apply from that time.

The provisions of s24O also apply to any replacement debt (**s24O(2)(*b*)**).

Importantly, s24O is subject to the provisions of s23K and a directive will need to be obtained from SARS before a deduction can be obtained for interest in terms of s24J read with s24O. The purchaser-company in a s23O "*acquisition transaction*" is specifically included as a **new para (*c*)** into the **s23K(1) definition of "*acquiring company*"**.

The net impact of this regime is that taxpayers will have two options when acquiring controlling share interests in a target company. They may either undertake a debt pushdown transaction or apply the provisions of s24O.

PwC comment: s23K has a sunset date of 31-Dec-13. However, this sunset date does not apply in respect of s24O. It is expected that this is unintentional.

3.8 Transfer of depreciable assets between connected persons

Effective Date: acquisitions on/after 1-Jan-13

After the introduction of CGT, **s23J** was introduced to eliminate the scattered set of anti-avoidance rules relating to depreciable assets in favour of a single regime. **S23J** limits the depreciable cost of an asset purchased from a connected person to the cost incurred by the connected person seller plus all ordinary recoupments and the portion of includible capital gains triggered by the seller upon the connected person change.

This new regime gave rise to certain anomalies however. In view of the increase in the CGT inclusion rate, the arbitrage opportunity for connected person depreciable asset sales is greatly reduced.

S23J has therefore been deleted.

3.9 Conversion of Share Block interests to Full Title

Effective Date: 1 January 2013

Para 67B, 8th Sch. provides for rollover relief where an interest in a share block company is exchanged for a unit in a sectional title scheme.

There are, however, several ways to convert the share block company into a more direct ownership scheme. One way is to divide the property into sectional title units in exchange for the shares in the share block company, the company being later liquidated. Another way is for the share block company to alienate or cede the property directly to the owners (the exclusive use areas having already been subdivided) with the common use areas remaining under control of the company. The existing rollover relief does not cater for this type of conversion.

Accordingly, **para 67B** has been substituted for a provision that covers all types of share block conversions where the shareholder acquires the property in respect of which the right of use is conferred. This rollover relief essentially defers the capital gain until the former shareholder actually disposes of the immovable

property, by providing the former shareholder with the same base cost associated with the former shareholder's total interest in the underlying property. Relief is also provided for VAT and transfer duty.

3.10 Passive Holding Companies

Effective Date: 21-Oct-08

The Passive Holding Company regime was introduced as an anti-avoidance measure to counter the arbitrage of rates between individuals versus the combined effective rates on corporate earnings (i.e. corporate income tax rate at 28% and dividends tax).

The increase in the rate of dividends tax from 10% to 15% means that the arbitrage opportunity between individual rates and combined company rates has been almost eliminated. The passive holding company regime has therefore been deleted and will never come into effect.

4 Financial institutions

4.1 Investment policies disguised as short-term policies

Effective Date: premiums incurred or benefits received/accrued on or after 1-Jan-13

S23L is added to the ITA, dealing with the taxation of policyholders who enter into short-term insurance policies that are not classified as insurance policies for purposes of IFRS.

The section will apply to an "investment policy" which is a policy of insurance that is not a long-term policy of insurance, as defined in the Long-term Insurance Act and which is not an insurance contract as defined by IFRS. In essence a contract will not be classified as an insurance contract under IFRS unless the insurer accepts a significant risk to the insurer in the event of the happening of the event that is insured.

PwC comment: Concerns exist with the definition of an "investment policy", particularly insofar as cell captives are concerned where shareholder agreements are taken into consideration in determining whether an insurance contract exists for IFRS purposes. Amendments are expected to correct unintended anomalies in this regard.

The mechanics of s23L are straightforward:

- S23L(2) disallows a deduction in respect of premiums paid under an investment policy; and
- S23L(3) includes in gross income the aggregate policy benefits under the policy in the current and previous years of assessment, reduced by the aggregate amount of policy premiums disallowed under ss(2) and the aggregate amount of policy benefits that were included in gross income in any previous year of assessment.

PwC comment: In effect, premiums are still deductible, but limited to the amount of policy benefits, and the policy benefits are taxable. The main impact of the section is therefore to defer the deduction of premiums and to cap the deductible amount.

Assume that the taxpayer has incurred premiums in year 1 of R1 000 000, and receives policy benefits of R520 000 in Year 3 and R600 000 in Year 4 in terms of a policy of insurance that is an "investment policy".

Year 1 – Premiums incurred will be disallowed as a deduction.

Year 3 – The amount to be included in gross income is R520 000 – R1 000 000 = 0

Year 4 – The amount to be included in gross income is (R520 000 + R600 000) – (R1 000 000 + R0) = R120 000

The effect in taxable income terms is the same as currently applies. However, the timing of deduction is deferred and the premiums are deductible on a basis that is matched to the receipt of policy benefits.

The amendments will come into operation on 1 January 2013, and apply in respect of premiums incurred and policy benefits received or accrued on or after that date.

PwC comment: The effective date will not be likely to have an adverse effect on the treatment of policy benefits under contracts in existence at 1 January 2013, as the proceeds from short-term policies are typically included in gross income.

4.2 Fair value accounting for financial institutions

Effective date: 1-Jan-14

S24JB is added to the ITA, dealing with the requirement for specified financial institutions ("*covered persons*") to account for the value of financial assets and liabilities at fair value at the end of the year of assessment ("*mark-to-market*"). The intention is to align the taxable income of financial institutions more closely with income as reported in the annual financial statements.

PwC comment: It is notable that the effective date for this new regime is only for years of assessment commencing on or after 1-Jan-14.

"Covered persons" include:

(i) Any authorised user as described in section 1 of the Securities Services Act, 2004 (authorised member of the JSE), that is a company;

(ii) Any bank, branch, branch of a bank or controlling company as defined in section 1 of the Banks Act, 1990.

In **24JB(1)**, the terms **"*derivative*"**, **"*financial asset*"**, **"*financial instrument*"**, **"*financial liability*"** and **"*financial reporting value*"** are as defined in International Financial Reporting Standard 9 (IFRS 9).

PwC comment: There are now 2 definitions of "financial instrument" in the ITA. The s1 definition applies for all purposes other than s24JB. The interpretation of IFRS terms incorporated by reference in the ITA will become the domain of the technical experts in accounting and not in law.

The charging section (**s24JB(2)**) requires that there must be included in or deducted from the taxable income of any covered person for any year of assessment commencing on or after 1-Jan-14 all amounts in respect of financial assets and liabilities that are recognised through profit and loss in the statement of comprehensive income, excluding any:

(i) share not held for trading;

(ii) endowment policy;

(iii) interest in a collective investment scheme;

(iv) interest in a trust

that is not hedged.

PwC comment: As currently worded, this provision would have the effect that dividends will be included in taxable income, notwithstanding that they would ordinarily be exempt.

S24JB(3) specifically excludes any such amounts from being taken to account in determining gross income, allowable deductions, taxable income or capital gain or loss.

PwC comment: This effectively by-passes the general tests to determine whether the amount is or is not gross income, an allowable deduction or a capital amount or loss. By virtue of the accounting treatment alone, the amount is taxable or deductible on income account.

An exception from the standard s24JB(2) rule arises (in **s24JB(4)**) where a financial asset or liability:

(i) arises in respect of a derivative where the counterparty is not a covered person;

(ii) the covered person and the counterparty form part of the same group for purposes of IFRS; and

(iii) the covered person is not a party to any financial instrument that gives rise to a right or obligation that serves as a hedge to the financial asset of liability.

Transitional provisions are necessary to effect a phased transition from the current practice of taxing financial assets and liabilities on a realisation basis to taxing them on the mark-to-market basis so as to eliminate double taxation or non-taxation. This is to be achieved by requiring covered persons to determine the difference between the value for IFRS and the tax value of the financial assets and liabilities at the end of the "realisation year" of the company. 25% of the difference so determined must be included in or deducted from taxable income in the realisation year and each of the 3 succeeding post-realisation years. An exception arises where the financial asset or liability:

(i) arises in respect of a derivative where the counterparty is not a covered person;

(ii) the covered person and the counterparty form part of the same group for purposes of IFRS; and

(iii) the covered person is not a party to a financial instrument that gives rise to a right or obligation that serves as a hedge to the financial asset of liability.

PwC comment: The realisation year is defined as the year immediately preceding the year of assessment commencing on or after 1-Jan-13 in the case of a taxpayer who is a covered person or becomes a covered person during that year of assessment. Effectively, this is the year of assessment ending in 2013 for most taxpayers —with the exception of December year-ends, in which case it is the 2012 tax year.

The alternative basis for the taxation of interest-bearing instruments for the purposes of s24J (**s24J(9)**) is to be replaced by this new regime and is therefore to be deleted.

PwC comment: There appear to be two transitional problems:

(1) First, it is considered that the transitional provisions cannot be applied to years of assessment that end prior to the commencement date. That is, for most covered persons s24JB will start applying from their 2014/15 tax year —whereas s24JB(5) & (6) requires the transitional adjustments to start in the 2012/13 tax year.

(2) It is likely that the transitional provisions will have to be amended as there are gaps in the implementation which may result in amounts being untaxed and creating permanent differences. Specifically, if the new rules start applying from the 2014/15 tax year, then the "realisation year" works out to be the 2012/13 tax year —with the result that the differences in the 2013/14 tax year will

never be accounted for. It is unlikely that Treasury will permit this position and further amendment relating to the effective date and the provisions of this new section may be expected.

4.3 Once-off mark-to-market for Long-term Policyholder Funds

Effective date: 29 Feb 2012

S29B is added to the Act. The effect of the new amendment will be to tax unrealised gains and losses of insurers in respect of assets held and not disposed of at 29-Feb-12 at the rate applicable to the lower inclusion percentages of 25% (individual policyholder fund) and 50% (company policyholder fund) and apply the current, higher, inclusion rates to any portion of the gains or losses that arise on or after that date.

The provisions of section 29B apply to "an **insurer**" (**s29B(2)**). However the provisions do not apply in respect of assets held by an insurer that is a Category III Financial Services Provider (administrative FSPs) in its capacity as such (**s29B(6)**).

The mechanism that is to be applied is that insurance policyholder funds will be deemed to have realised and reacquired their assets, subject to certain exceptions, at the market value on 29 February 2012. The exceptions are:

(i) an instrument as defined in s24J(1);

(ii) an interest rate agreement as defined in s24K(1);

(iii) a contractual right or obligation that derives its value by reference to an instrument or interest rate agreement described above or a particular rate of interest;

(iv) trading stock; or

(v) a policy of reinsurance.

The notional disposal will not be taken into account for the purposes of determining the amount of any deductions or allowances to which the taxpayer may be entitled in respect of that asset or any recoupment in respect of that asset (i.e. the disposal of allowance assets will not be regarded as a disposal and reacquisition and the cost of the asset will be deemed to be rolled over for purposes of capital allowances only).

The unrealised gains and losses by reason of the notional disposal must be included in taxable income in the following manner: 18.75% of the aggregate capital gain or loss deemed to arise from the deemed disposal must be taken to account in determining the taxable capital gain of the taxpayer in the year of assessment of the deemed disposal and each of the three succeeding years of assessment.

PwC comment: The purpose of this amendment is to ensure that unrealised capital gains of insurers as at 29-Feb-12 are not subject to tax at the higher effective CGT rates introduced in the budget. The increase in the inclusion rate for CGT purposes would otherwise result in a disadvantage for policyholders who are still policyholders when the asset is realised, as compared to policyholders who have been paid out prior to 1-Mar-12.

The old inclusion rates for companies and individuals are 75% of the new inclusion rates (25/33.3 or 50/66.6 = 75%). The intention of s29B is therefore to include 25% of the notional gain or loss in the

aggregate capital gain or loss in each of the four years and to account for the notional capital gain or loss at the old inclusion rate. To do so, the section requires insurers to include 18.75% (75% of 25%) and apply the new inclusion rate to the notional amount.

The inclusion rates for insurer's policyholder funds in para 10, 8th Sch. are accordingly increased to bring these in line with the inclusion rates for natural persons and other persons. These new inclusion rates apply to the deemed disposals on 29-Feb-12 and any disposals after that date.

4.4 REITs (real estate investment trusts)

Effective date: 1-Apr-13

A new **s25BB** is to be introduced into the Act, together with a new definition "**REIT**", in **s1**. Under the existing system there are 2 types of publicly traded property investment instruments, namely property unit trusts (PUT) and property loan stock companies (PLS). The former are regulated by the FSB whereas the latter are generally subject to the Companies Act.

The PUT is effectively taxed as a conduit. Current income is taxed at the ordinary corporate rate, but a deduction is allowed for amounts distributed to the investor within 12 months of accrual or receipt, and such amount is taxed as ordinary income in the hands of the investor. The PUT is exempt from CGT, and is denied access to the corporate relief provisions in the Income Tax Act. Investors are liable to CGT on the disposal of PUT units.

The PLS is capitalised by linked share and debenture units where the debenture represents the substantial investment amount and the share subscription is nominal (typically 99:1). The debenture is entitled to interest on a regular basis subject to there being available profit, and is typically non-redeemable. The debenture interest is distributed in terms of the debenture deed and is a deductible expense that effectively transfers the rental income of the PLS to the shareholders who are taxed thereon, subject to the annual exemption. The PLS is subject to CGT on disposal of assets.

A new regime is therefore made to unify the taxation of investments in these investment vehicles.

The regime essentially involves a unification of both the regulatory and the tax requirements.

Regulatory

A PLS must be listed on the JSE as a REIT. The requirements for listing are:

(i) a specified minimum amount of its gross assets must comprise directly (ownership) or indirectly (property leases) of fixed property;

(ii) it may only hold investments in immovable property and financial instruments typically used to hedge the risks associated with fixed property investment;

(iii) it must distribute most of its profits annually; and

(iv) it must not have excessive borrowing in relation to the total gross asset value.

These requirements must be incorporated in the Trust Deed or Memorandum of Incorporation. In addition, the directors will be required to submit a certificate of compliance to the JSE annually.

Taxation

The taxation treatment will extend to companies listed as a REIT on the JSE and domestic controlled property companies ("CPCs" —i.e. subsidiaries)

(i) the company must be a resident listed as a REIT on the JSE (definition of "REIT" in s1 ITA);

(ii) REITs will be exempt from capital gains tax in respect of disposals of immovable property, shares in REITs and CPCs (subsidiaries) (s25BB(5));

(iii) however, all income from financial instruments including proceeds on disposal (other than investments in a REIT, controlled property company or associated property company) and dividends will be taxable as ordinary income of a REIT or controlled property company, without exemption (s25BB(4));

(iv) REITs may not claim deductions under s11(g), s13, s13*bis*, s13*ter*, s13*quat*, s13*quin*, s13*quin* or s13*sex*; (s25BB(4))

(v) Distributions by a REIT or controlled property company (subsidiary) in relation to a REIT will be deductible if they meet a timing and gross income requirement, in that not less than 75% of the gross income in the immediately preceding year consists of rental income ("rental income" includes qualifying distributions from controlled property companies or associated property companies in relation to a REIT and dividends from REITs) (s25BB(2) and the s25BB(1) definition of "rental income");

(vi) Interest payable by a REIT on linked debentures will be deemed to be a dividend and will not be treated as interest for purposes of the interest withholding tax;

(vii) Distributions payable to residents —including other REITs— are denied the exemption in terms of the amended proviso (aa) to s10(1)(k)(i), are not subject to the dividends tax (s64F(l)), and will be taxed as ordinary income. On the other hand distributions to non-residents will be subject to the dividends tax in all cases from 1 January 2014;

(viii) The taxable income of the REIT will be taxable at the standard corporate rate of tax.

An additional exemption from dividends tax applies in terms of a new s64F(2), which provides that any dividend (other than a dividend *in* specie) paid by a REIT or controlled property company as contemplated in s25BB that is received or accrues before 1 January 2014 is exempt from the dividends tax.

PwC comment: The provisions will level the playing field in respect of listed property investment instruments. They will also address concerns that existed previously concerning the deductibility of interest by PLS. In effect property investment income distributed within one year of accrual in relation to resident shareholders will be taxable as ordinary income as if the investor held a direct interest in the underlying property investments. Capital gains will be taxed when the investors dispose of the units or shares and will not be recognised in the REIT. These amendments are a pragmatic approach to an issue that has been the subject of some debate.

The new s25BB will come into operation on 1 January 2013 and apply in respect of years of assessment commencing on or after that date. The amendments relating to the denial of the dividend exemption (1 April 2013 in respect of dividends received or accrued on or after that date) and the grant of dividends tax

exemption (1 April 2012) come into effect on different dates. Finally, the temporary dividends tax exemption in s64F(2) comes into effect on 1-Apr-13.

PwC comment: There are anomalies in the effective date provisions that require clarification. The year of assessment to which the amendment applies needs clarification as there are two taxpayers affected by the provisions, namely the REIT itself and the shareholder/unit holder. There is a period, 1-Jan-13 to 31-Mar-13, in which a distribution from a REIT may be exempt from tax in the hands of the shareholder and deductible to the REIT. It should also be noted that no DT will arise in respect of dividends (other than in specie dividends) from a REIT received or accrued between 1-Apr-13 and 31-Dec-13.

4.5 Short-term insurance business

Effective date: 1-Jan-14

S28(2) is substituted and a new **s28(3)** is inserted. These provisions govern the determination of the taxable income of a short-term insurer. This will be subject to the general provisions of the Act, subject to certain special requirements.

S28(2) provides a number of basic principles, as follows:

(i) premiums received before the commencement of the risk cover under the policy are deemed to accrue on the date that the risk cover commences;

(ii) expenditure incurred in respect of the refund of a premium may only be deducted to the extent that the premium was included in the gross income;

(iii) **s23(c)** and **s23H** do not apply in respect of any expenditure incurred by a short-term insurer in respect of a short-term policy issued by the taxpayer;

(iv) **s23H** does not apply in respect of any expenditure incurred in respect of any reinsurance policy entered into by the taxpayer;

(v) an amount payable by a taxpayer in respect of any claim under a short-term policy may only be deducted under **s11(a)** on the date that it is paid; and

(vi) an amount recoverable in respect of a claim under a short-term policy will only be included in income when the amount is received.

S28(3) provides for special deductions applicable to short-term insurers in respect of reserves, notwithstanding the prohibition in **s23(e)**, namely:

(i) the amount estimated to become payable as contemplated in **s32(1)(a)** of the Short-term Insurance Act, limited to the amount which it is estimated will be recoverable under policies of reinsurance (claims incurred but not paid and claims incurred but not reported); and

(ii) the amount of the unearned premium provision contemplated in **s32(1)(b)** of the Short-term insurance Act, subject to the following provisos:

(a) consideration payable in respect of all reinsurance policies entered into by the taxpayer must be taken into account; and

(b) a reserve for a cash back bonus contemplated in paragraph 4.1.1 of Board Notice 169 of 2011 may only be taken into account if the reserve is determined in accordance with a method comprising a best estimate and a risk margin and the method is approved by the FSB.

Amounts deducted in terms of s28(3) must be included in income in the next succeeding year of assessment (**s28(4)**).

S28(6) is repealed.

PwC comment: The current treatment of short-term insurers is considered to be inequitable, partially because the tax rules apply the principles used for regulation of the short-term insurers, which require reserves to be determined on a prudential basis, tending towards over-reserving, and partially because SARS has a discretion to disallow the deduction of reserves, leading to uncertainty.

The FSB is developing a risk-based approach – Solvency Assessment and Maintenance (SAM) for regulating the insurance industry which will require that short-term insurers maintain reserves sufficient to ensure that they will retain investments that are appropriate to the nature of their liabilities. It is anticipated that the effect of the SAM principles will reduce the risk of over-reserving inherent in the prudential approach.

The new approach will require that the tax computation is derived from the regulatory calculation of income before tax, and any divergences from the regulatory methodology will be based on a policy decision and specifically legislated.

Finally, s28(5) will be repealed. This repeal will come into operation on 1 January 2014 and apply in respect of years of assessment commencing on or after that date (i.e. one year after the other amendments become operative).

PwC comment: The repeal of s28(5) one year after the repeal of the other subsections is to ensure that deductions in respect of reserves under the current regime claimed prior to the introduction of the new regime are added back in the first year of assessment that the new regime becomes operative.

5 Allowances and special provisions

5.1 Depreciation of supporting structures for energy projects

Effective date: 1-Jan-13

The 50:30:20 three year write-off allowance granted under **s12B(1)(*h*)** in respect of assets used to generate electricity from renewable energy is extended to include any foundation or supporting structure of such asset.

A ***proviso***, similar to para (iiA) of the *proviso* to s11(*e*), is added to **s12B(1)** to deem the foundation or the supporting structure to be part of the asset where the foundation/support is:

- Designed for such asset and constructed in such a manner that it should be regarded as being integrated with the machinery;
- The useful life of the foundation or supporting structure is or will be limited to the useful life of the asset mounted thereon or affixed thereto; and
- The foundation or supporting structure was bought into use on or after 1-Jan-13.

PwC comment: There is some confusion caused by interaction between this brought-into-use date specified in the new proviso and the actual effective date of the amendment as specified in s 23(2) TLAA. It seems that it might not be sufficient simply that the foundation/support is brought into use on/after 1-Jan-13. Rather, this new rule is only applicable to tax years starting on/after 1-Jan-13. Thus, in the case of (for example) a 30-Jun year-end, the allowance can only be taken for the first time in the 2014 tax year. In other words, even if a foundation is brought into use in February or March 2013 (for example), the related allowances cannot be taken in the tax year ended 3-Jun-13. .

The amendments further tidy up the type of renewable energy categories with minor textual changes to the list of projects in **s12B(1)(*h*).**

Subsequent improvements to those foundations/supports will also be depreciable under s12B, as a result of a **new para (*b*)** added into **s12B(1)(*i*)**.

5.2 Industrial Policy Projects Incentive

Effective date: 1-Jan-12

In order to clarify and streamline the Industrial Policy Projects ("IPP") incentive, minor amendments have been enacted:

- **S12I(3) paras (*a*)** and **(*b*)** are amended to clarify that the ceilings for greenfield and brownfield projects apply *from the date of approval* (of the IPP). This is intended to remove the technical concern that the ceiling was an annual ceiling instead of an aggregate ceiling.
- The requirement in **s12I(7)(*b*)** to obtain a tax clearance certificate for the company and any other person that forms part of the same group of companies is removed, due to the excessive burden this exacts.

5.3 Revised energy efficiency allowance

Effective date: Date to be determined by the Minister by notice in the *Gazette*

The **S12L** allowance, which was enacted in 2009 and not yet in operation, is substantially revised. S12L grants a deduction from income to offset increased taxable income that would result from implementing energy efficiency savings measures.

The deduction formula is completely removed and replaced with a deduction of 45 cents per kilowatt hour (or kWh *"equivalent")* of energy efficiency savings.

To claim the deduction a certificate issued by an approved body contemplated in the regulations (issued in 2011) must be obtained (the regulations prescribes SANEDI – South African National Energy Development Institute). The certificate must disclose the following:

- The baseline at the beginning of the year;
- The reporting period energy use at the end of the year of assessment;
- The annual energy savings expressed in kilowatt hours or kilowatt hours equivalent for the year of assessment;
- The methodology used to calculate the energy efficiency savings;
- Any other information the regulations may prescribe.

The regulations stipulate that a taxpayer will have to appoint a verification specialist in order to measure the energy efficiency savings.

The baseline amount, as prescribed by the regulations, is determined by data collected between the first and last day of the year of assessment preceding the first year of assessment in which the allowance is claimed. This baseline is adjusted for each year the allowance is claimed with reference to the energy savings in the preceding year of assessment and in accordance with the methodology in South African National Standard 50010.

PwC comment: This remains a controversial issue. That is, irrespective of the capital and other expenditure invested by the taxpayer into energy efficiency, the s12L tax incentive is only available for one year —because at the end of the first year the base line is re-adjusted (to the energy usage for that first year) so that the second and subsequent years will register no additional savings unless other new measures are implemented.

The deduction is still denied if the taxpayer receives any *concurrent benefit*, as prescribed in the regulations, in respect of the energy efficiency savings. (The regulations prescribe that any credit, allowance, grant or other benefit granted by any sphere of government constitutes a *concurrent benefit*).

5.4 Deductions on improvements not owned by the taxpayer

Effective date: 1-Jan-13

The deduction for incurring an obligation to effect an improvement on land or buildings in terms of a Public Private Partnership or land and buildings owned by the government or tax exempt entities is extended to include improvements to land and buildings in terms of the Independent Power Producer Procurement Programme administered by the Department of Energy.

S12N(1) is further amended to rectify the non-inclusion of S12B in a list of sections for which the taxpayer is deemed to the owner of the improvements completed. This rectification is effective in respect of rights of use or occupation granted on or after 2 November 2010 (i.e. the date S12N was introduced).

5.5 Taxation of Government grants and subsidies

Effective date: 1-Jan-13

In order to rationalise the provisions relating to the taxation of grants and subsidies a consolidation is introduced in **S12P** and a new **Eleventh Schedule** listing of tax exempt government grants. Sections **10(1)(*y*)**; **10(1)(*z*A)**; **10(1)(*z*B)** and **para 64A(b)** of the **Eighth Schedule** are consequently deleted.

A government grant definition is introduced (**s12P(1)**)to include:

- a grant-in-aid;
- subsidy; or
- contribution

by the national or provincial sphere of government.

Government grants are exempt from tax under **s12P(2)** if that grant is listed in the 11th Schedule, or is identified by the Minister in the *Gazette* with effect from a date specified by the Minister. The Minister is required to have regard to the implications for the National Revenue Fund and any tax implications in the allocation of the grant.

To counter potential "double-dipping" opportunities that may result from the acquisition of assets from tax exempt grants, **s12P(3) and (4)** contains a mechanism to reduce the base cost of any allowance asset, or any **s11(*a*)** deduction or **s22(1) or (2)** amount in respect of trading stock, where the government grant exempted under **s12P(2)** is received or accrued for the acquisition, creation or improvement, or as a reimbursement for expenditure incurred in respect of such allowance asset or trading stock.

The reduction in base cost or limitation of the s11(a) or s22 amount is reduced to the extent the government grant is applied to the acquisition, creation or improvement of the asset.

Further, in respect of allowance assets, the aggregate deductions or allowances claimable in respect of that allowance asset is limited by **s12P(4)** to:

- The aggregate expenditure incurred on that asset, **Less**

- the **sum** of:
  - the amount of the government grant; and
  - the aggregate of deductions and allowances previously allowed in respect of that allowance asset.

For assets other than allowance assets or trading stock contemplated in **s12P(3)** and **(4)** (i.e. non allowance capital assets), the base cost of the said asset must be reduced to the extent the government grant is applied to the acquisition, creation or improvement of the asset.

s12P(6)(*a*) reduces any **S11** deduction allowed in respect of assets not contemplated under sub-sections 3, 4 and 5, to the extent of the government grant contemplated in **s12P(2).** The "excess" of the government grant after the application of **s12P(6)(*a*)** is carried forward to the following year for the purposes of determining the **s12P(6)(*a*)** limitation.

Allowance assets are defined to mean an asset defined in paragraph 1 of the 8th Schedule, excluding trading stock, in respect of which a deduction or allowance is allowable for purposes other than the determination of any capital gain or loss.

The mechanism in **s12P(3) – (6)** does not apply in respect of grants-in-kind (i.e. non-cash grants).

5.6 S13quat extended sunset clause

Effective date: 30-Mar-14

The sunset clause on the allowance for the erection or improvement of buildings in Urban Development Zones in terms of S13*quat*(5)(*c*) is extended by replacing the 31 March 2014 sunset with a 31 March 2020 sunset.

5.7 Alignment of Oil and Gas provisions to Dividends Tax

Effective date:
Changes to rate of tax: 31-Mar-13
Dividends Tax alignment: 1-Apr-12
Thin Capitalisation: 1-Jan-14

The provisions relating to the Oil & Gas industry in **s26B** and the **10th Schedule** are updated to align the provisions with the Dividends Tax, as the provisions were still modelled on the STC regime.

Para 2 of the Schedule is amended to remove the 31% rate of tax applicable to non-residents (branches). This is in line with the removal of the 33% branch rate for all other non-resident companies (branches).

S26B and **para 3** are updated to remove any STC reference and impose the applicable Dividends Tax provisions. The rate of Dividends Tax is still 5% as was the STC that was previously imposed (and 0% in respect of dividends attributable to income from an OP26 right).

Para 6, concerning the thin capitalisation of Oil and Gas companies, has been revised with reference to the provisions of **S31**. Where an Oil & Gas company receives financial assistance that constitutes an affected

transaction, the Commissioner has a discretion to deem the financial assistance to have been entered into on arm's length conditions.

5.8 Repeal of S12G Strategic Industrial Projects

Effective Date: 1-Jan-13

S12G, which provided the additional industrial investment allowance on qualifying strategic industrial projects, is repealed. S12G was essentially replaced by s12I.

6 International

6.1 Further refinement to the Headquarter Company ("HQ-Co")regime

Effective date: 1-Apr-12

In respect of interest incurred by a HQ-Co, the loss-ring-fencing rule in s20C(2) is limited to only interest paid to non-resident lenders who are also shareholders (not all non-resident lenders). Specifically, the interest deduction is only ring-fenced in respect of financial assistance granted by a non-resident who holds at least 10% of HQ-Co's equity and voting rights ("*directly or indirectly … whether alone or whether together with any other person forming part of the same group of companies …*").

PwC comment: This means that if a HQ-Co borrows (at interest) from an unrelated non-resident lender, and on-lends the funds to its qualifying investments targets (i.e. foreign companies in which it holds 10%) at no or low interest, then the resulting loss might be permitted to be set off generally against the HQ-Co's other income.

Effective date: 1-Jan-13

A number of refinements are made to the HQ-Co regime.

The current **s9I(2)** rules are relaxed by:

- Removing the **s9I(2)(*a*)** "10% shareholder " test in respect of previous years of assessments. This removes the "all or nothing" approach, and effectively means that a company can be disqualified from being a HQ-Co in one year and then re-qualifies in another year, and so on.

  PwC comment: Thus it is only the "total assets" test (in (2)(b)) that remains a requirement to be fulfilled continuously from the inception of the company and each and every year (i.e. just one year of non-compliance results in permanent loss of HQ-Co status). But the other two requirements —i.e. the shareholder test in (2)(a) and the "total receipts" test in (2)(c)— need only be fulfilled on a year-to-year basis. However, even the "total assets" test is also slightly softened (see below).

- In addition (also in **(2)(*a*)**), for the purposes of the "10% shareholder" test for the year when the company commences trade, no regard is required for the period of the year before the company commenced trading. This is in recognition that certain start-up companies or companies that were previously shelf companies would automatically be disqualified from the HQ-Co regime.

- A *de minimus* exclusion to the 80% "total assets" qualification rule is inserted as a **second *proviso*** to **s9I(2)(*b*).** In determining whether a company complies with the 80% asset qualification, no regard must be had for tax years in which the market value of the assets of the company did not exceed R50,000.

  PwC comment: Note that even though the "total assets" test in (2)(c) must be done "at the end of" each tax year, the tax years to be exempted from this test are only those year where the MV of total assets was below R50,000 for the entire tax year (i.e. did not exceed R50,000 "at any time during such year").

Interest & Royalties

A further addition is made to **s31(5)** by the inclusion of paras (*c*) and (*d*), which switches off the transfer pricing provisions in respect of back-to-back royalties, in the same way that s31(5)(*a*) & (*b*) disapplies the transfer pricing rules for back-to-back financial assistance. Specifically, the transfer pricing rules are dis-applied where:

(a) a non-resident licenses IP to the HQ-Co (i.e. the HQ-Co pays royalties), as long as the HQ-Co *only* on-licenses that IP to its qualifying investment targets (i.e. foreign companies in which the HQ-Co holds at least 10%) —**para (c)**; or

(b) the HQ-Co licenses IP to its qualifying investment targets (i.e. is expected to receive royalties) —**para (*d*)**.

PwC comment: As with the same concession for interest (in paras (a) & (b)), only the "expenditure" concession is dependent upon there being a back-to-back arrangement, whereas the "income" concession is available with or without a back-to-back arrangement. That is:

- *For royalties paid by the HQ-Co, the transfer pricing rules are only switched off if there is an actual-back-to-back on-licensing of the IP to the qualifying investment targets.*
- *But for royalties potentially receivable from qualifying investment targets, the original source of the IP is irrelevant —i.e. could be back-to-back on-licensing of IP licensed from a non-resident, or could be the HQ-Co's own (owned) IP, or could be licensed from a SA-resident, etc.*

The HQ-Co loss-ring-fencing provisions in **s20C** are re-written to extent the rules to apply royalties incurred and received by a HQ-Co (i.e. in addition to the existing rules that address interest).

- **S20C(2A)** is inserted to potentially limit the HQ-Co's royalty-deductions to only the amounts of royalty-income received from qualifying investment targets. However —as with the recent amendment to the interest restriction— this ring-fencing applies only to royalties paid to a non-resident licensor who also holds at least 10% of the HQ-Co.
- **S20C(3)** allows for the carry forward of excess interest and royalties to be deducted in the succeeding year of assessment.

In **s37K(1)(a)(1)(cc)** and **s49D(b)**, withholding tax relief is extended to HQ-Cos where interest and royalties paid are not subject to the s31 transfer pricing rules by virtue of the back-to-back "switch off" provisions of S31(5).

6.2 Foreign tax credit

Effective date: 1-Jan-12

S6quin

An override in **s6*quin*(1)** is inserted to disregard the application of the provisions of an applicable DTA when determining whether income is from a SA source – i.e. one must consider SA domestic source rules when ascertaining whether an amount is from a source within SA.

PwC comment: One of the requirements in s6quin is that it covers only SA-source services income (i.e. whilst s6quat covers foreign-source income). Where the actual source of the income is SA but the relevant DTA deems the source to be foreign, the expected default position is that s6quat (not s6quin) applies. However, where such a DTA nonetheless restricts the foreign country from charging tax (e.g. perhaps because the SA recipient has no PE there) but the foreign authority still "incorrectly" charges tax, s6quat cannot offer credit relief because it contains a correctness requirement (i.e. the foreign tax must be "proved to be payable"). Hence the need to extend s6quin to cover this type of "incorrect" foreign tax.

S6*quin*(1)(b) is amended to clarify that it applies to a country with which SA has **not** concluded a DTA. (Sub-para (*a*) applies to countries with which SA has concluded a DTA).

In order to address the discrepancy that results from the receipt and accrual basis of taxation (applied in SA) versus the cash basis with which withholding taxes are often imposed, **s6*quin*(5)** introduces a timing mechanism to cater for the receipt of refunds or discharges from liabilities of withholding tax that may arise in a subsequent year of assessment. The refund or the discharge from liability (limited to the amount of the rebate) is deemed to be an amount of normal tax payable by that taxpayer in respect of that subsequent year of assessment.

S6quin and S6quat

S6*quat*(1C) is amended to remove the mandatory wording "shall" and is replaced with an election to apply the deduction. There was concern that current wording of s6quat(1C) would override the availability of s6quin. S6*quin*(3) is in addition expanded to exclude the operation of the S6*quin* rebate where the tax has been taken into account in determining the amount of the s6*quat*(1) rebate.

S6quat(1A)

Effective date:

Natural persons, deceased estates, insolvent estate or trusts: 1-Mar-12

Other persons (e.g. companies): 1-Apr-12

The ***proviso*** to **s6*quat*(1A)** is adjusted by adding **para (ii)** to the *proviso*, to exclude the application of the foreign dividend exemption in s10B(3) to the determination of the amount of income which is included in the taxpayer's income. This ensures that the SA taxpayer get the full credit for foreign taxes on foreign dividends despite a portion of the dividends being exempt under s10B(3).

PwC comment: The need for this amendment is created by the fact that s10B(3) is actually a rate-reduction mechanism rather than a "true" exemption. If s10B(3) was viewed as an actual exemption then, if for example, the foreign dividend was subject to a 15% (or more) foreign withholding tax then some portion of the foreign tax would be disqualified from the rebate and the SA-resident would end up still having to pay some SA tax (despite having suffered 15% foreign tax). This amendment effectively addresses this problem and ensures that the full foreign tax is available. (Note that if the foreign dividend is exempt under one of the specific exemptions in s10B(2), then the related foreign tax remains disqualified from s6quat.)

S6sex

Effective date: 1-Apr 2012

The amendment to **S64F**, which now exempts dividends from Dividends Tax where the dividends are instead subject to normal tax, renders **S6*sex*** unnecessary, and it is consequentially deleted.

6.3 CFC relief

Effective date: 1-Jan-08

High-tax exemption

In the co-called "high-tax exemption" (**para (ii)** of the ***further proviso*** to **s9D(2A)**), the calculation of the CFCs notional SA taxable income is retrospectively adjusted. Specifically, where the CFC in question is itself also a shareholder in any other CFC(s), the "*net income*" attributable to the lower-tier CFCs can be ignored. Thus the CFC's notional SA tax liability (to be compared against the actual tax paid in its local jurisdiction) will be based on only its own operations. This is achieved in a **new sub-para (*cc*)**.

Effective date: 1-Jan-13

Place of Effective Management relief for high taxed CFCs

To strengthen the measures aimed at reducing potential double tax and to facilitate SA multinational competitiveness, the **s1 "*resident*" definition** is amended to "switch off" the application of the Place of Effective Management ("PoEM") test for certain SA-controlled companies.

The resident definition is amended to exclude any company that is:

- incorporated, established, or formed
- in a country other than SA; AND
- the PoEM is in SA, AND
- but for the PoEM being in SA, the company would have been a CFC with a FBE ("*foreign business establishment*") as defined in s9D(1), AND
- the company meets the so-called "high tax" test.

The high tax test is essentially the same as the high tax exemption in the S9D(2A) *proviso*, but without the most recent amendment to that exemption (para (ii)(*cc*) of the 2nd *proviso* to s9D(2A) —see above).

PwC comment: The para (ii)(cc) referred to above deals with the exclusion of the "net income" from lower tier CFCs. It is not clear why this exclusion has not been repeated in the high tax concession that will now appear in the s1 "resident" definition.

Relief from Transfer Pricing for high taxed CFCs

Similarly, the provisions of S31 are switched off (by the **new s31(6)**) for any resident (other than an HQ-Co) that grants:

(a) financial assistance; or

(b) the use of IP (or the right/permission to use) IP;

to a CFC, if:

- the resident (alone or together with "*group*" companies) holds at least 10% of the CFC;
- the CFC has a FBE; and
- the CFC meets the high-tax test (see above).

The other important amendments to s9D include:

- Adjusting the CGT inclusion rate (in **para (*f*)** of the **1st proviso to s9D(2A)**)—in cases where shareholder is a natural person, special trust, etc.—from 25% up to 33.3%. [1-Mar-12]
- Exempting (in **s9D(9)(*f*)**) interest and royalties that are subject to withholding tax (see later). [1-Jul-13]
- A technical correction regarding the *de minimus* permitted passive income for FBEs (in s9D(9A)(a)(iii) — correcting the wording to set the 5% as the limit. (The previous wording set the 5% as a *threshold*). [1-Apr-12]
- For a FBE-CFC that "*directly and regularly creates, develops or substantially upgrades*" IP, the additional requirement that the IP in question must not be "*tainted*" (per s23I), is added to the royalty exemption (**s9D(9A)(*a*)(v)**), but removed from the capital-gain-from-disposal-of-IP exemption (**s9D(9A)(*a*)(vi)**). [1-Apr-12]

6.4 Rationalising the withholding taxes

Effective Date: 1-Jul-13

With the withholding tax on royalties long in force and the dividends withholding tax in force since 1-Apr-12, and the interest withholding tax pending, National Treasury have taken stock of the various rates, processes and procedures applicable with a view to rationalising these. Using the new DT (Dividends Tax) rules as a point-of-reference, the interest and royalty withholding taxes are substantially revised and aligned to the 15% DT. The pending interest withholding tax, which was due to come into force on 1-Jan-13 has been postponed to 1-Jul-13 along with the introduction of the revised royalty withholding tax.

Withholding tax on interest ("WTI")

PwC comment: Although the WTI is not yet in effect, the relevant provisions are already legislated as Part IA of Chapter II (s37I – s37N) ITA. Furthermore it was announced in the 2013 Budget Review that the effective date will be further postponed to 1 March 2014.

The first major change is that effective date is deferred (from 1-Jan-13) to 1-Jul-13[1]. Perhaps because of this proposal, the format of this year's amendments is the repeal of the entire Part IA and the re-insertion of essentially the same provisions. The "liability" provisions (**s37I – s37K** of **Part IA**) are replaced in the TLAB[2] and the administration rules (**s37L – 37N**) are replaced in the TALAB[3]**.**

The specific amendments are discussed in more detail further below, but "overall" the new provisions are structurally similar to the original provisions. In some cases, existing rules are simply transferred into new locations (not discussed below).

S37J is substantially reworded to levy the withholding tax at a rate of 15% of the amount of any SA-source interest that is "*paid … to or for the benefit of*" any foreign person —as opposed to the old rules that referred to "*received by or accrued to*" the foreign person.. In terms of **S37(J)(3),** the withholding tax on interest is a "*final tax*"**.**

Interest is deemed to be paid in terms of **S37J(2)** on the earlier of the date on which the interest is paid or becomes due or payable. This is in line with the Dividends Tax.

Exemptions

The **S37K** exemptions remain largely unchanged. An exemption is added for interest paid by the Industrial Development Corporation and the Development Bank of Southern Africa. (**s37K(1)(*a*)(1)(*bb*)**)

The exemptions for:

- the 183 day physical presence of foreign natural persons (**s37K(3)(*a*)**); and
- a permanent establishment in SA (**s37(3)(*b*)**);

are both delinked from a particular year of assessment. Instead the review period is "*the twelve-month period preceding the date that the interest is paid*". (This accords with the amendments to the income tax exemption, in s10(1)(*h*), for SA-source interest received by non-residents —see also […].)

Removal of CFC exemption

The WTI exemption for interest (and royalties) paid to CFCs has been removed (from **s37K(3)**), thus rendering CFCs subject to the same WTI treatment as any other foreign company. Consequentially, the CFC exclusions in the **s37J** charging provision and in the **s37L** withholding provision, are both removed. The intention appears to be to rather collect the tax as withholding tax rather than let the income potentially escape the CFC net. **S9D(9)(*d*)** is consequently inserted to exclude from the income imputation of a CFC any income that is subject to the interest withholding tax (and royalties withholding tax).

Administration

The administration provisions in s37L – s37N are largely unchanged. A new **s37O** addresses the payment of WTI in a foreign currency. The WTI amount withheld (and paid to SARS in terms of s37M(2)) must be converted at the spot rate on the date the tax is withheld

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[1] *Postponed to 1 March 2014 in 2013 Budget Review*
[2] *Clause 69*
[3] *Clause 11*

Withholding tax on royalties ("WTR")

A new **Part IVA** is inserted (**s49A - s49G**) and will replace the **s35** WTR from 1-Jul-13[4]. The new WTR provisions largely mirror the WTI in its structure.

The withholding tax is levied at a rate of 15% on any SA-source royalty paid by any person for the benefit of a foreign person. A "*royalty*" is defined (in **s49A**) as any amount received or accrued in respect of:

- the use (or right or permission to use) any "*intellectual property*" as defined in s23I; or
- the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information.

The tax is regarded as a final tax (**s49B(3)**). The ultimate liability for the WTR is upon the foreign recipient (**s49C(1)**).

PwC comment: It was announced in the 2013 Budget Review that all the amendments, including the increase in the rate to 15%, will be postponed to 1 March 2014. Consequently s35 and the current 12% rate will continue to apply till then.

Exemptions

S49D exempts the foreign recipient from the WTR (as with the WTI), if:

- That foreign person is a natural person who was physically present in SA for a period exceeding 183 days in aggregate during the 12 month period preceding the date on which the royalty is paid; or
- If the foreign person carried on business through a PE in SA at any time in the 12 month period preceding the date on which the royalty is paid; or
- The royalty qualifies for the HQ company exemption from the transfer pricing provisions in respect of back-to-back license arrangements (in s31(5)(*c*)&(*d*)).

Administration

The obligation to withhold the tax is placed on the person making payment (**s49E(1)**) of the royalty notwithstanding that the liability remains on the foreign person who receives or accrues the amount.

PwC comment: The provision does not limit the obligation to withhold to the person who is liable to the payment of the royalty. Thus if Group Co A pays the royalty incurred by Group Co B to C then A must still withhold. A, not B, is then the withholding agent for the purposes of s156 TAA.

The withholding obligation applies to payments to foreign persons but also payments for the benefit of foreign persons.

[4] *Postponed to 1 March 2014 in the 2013 Budget Review*

PwC comment: It is unclear what the extent of "for the benefit" requirement is. For example if Foreign Co A is a beneficiary of SA Trust Z, must SA Co B withhold tax on the payment to Z or will this only occur if Z has a vested right? It does however seem to cover scenarios where SA Co B pays an SA creditor of foreign Co A in settlement of the debt.

The application of the exemption (**s49D(2)**) or reduced rate provisions (**s49D(3)**) are similar to dividends tax in that it requires a declaration of exemption/reduced rate by the foreign person before the date stated by the payor or the date of payment if the former is not stated.

S49F(1) (read with **s49C**) does not only impose the liability of the tax on the foreign person but also imposes a concurrent obligation, to pay such tax by the end of the following month, on both agent and the foreign person, with the foreign person only being exempt from the payment obligation if the withholding agent makes payment.

PwC comment: The concurrent obligation of payment imposed by s49F(1) on the foreign person does raise the question as to who is liable for any penalties (no penalty prescribed in the tax Act itself) and interest on late payment where the amount was or was not withheld as the foreign Co is only exonerated on actual payment to SARS by the withholding agent. In this instance it seems that both foreign person and withholding agent could be liable, however no recovery right against the adverse party is provided for. For example if agent A withholds the tax but pays late, SARS can collect the interest from the foreign person but the latter seems to have no statutory right of recovery against the agent.

S49G provides for refunds by SARS to the person to whom payment was made where a declaration for exemption or reduction was not filed and the foreign person to whom payment was made or for whose benefit payment was made files the declaration with SARS within three years from date of the original payment.

PwC comment: It should be noted that although the person entitled to approach SARS to file the declaration is the foreign person to whom or for whose benefit payment was made, the refund is to the person to whom payment was made originally. Thus it seems that if payment was made by SA Co A to SA Trust B for the benefit of foreign Co C, then to claim the refund C must file the declaration to SARS but SARS will refund B.

6.5 CGT on assets bought or sold in Foreign Currency

Effective date: 1-Jan-13

In an attempt to move more generally to a "full gain"[5] basis of dealing with currency conversion, **para 43, 8th Sch.** ITA is amended. In other words, this is an even further extension of the general default rule in s25D which requires that expenditure, receipts and accruals must be converted into SA Rand at the respective spot rates (immediately at the time of the transactions).

[5] *The "full gain" calculation essentially refers to the scenario where the acquisition expenditure and disposal proceeds are converted separately into ZAR, at the respective conversion rates applicable at the date of the acquisition or disposal (as the case may be). Thus the CG/CL calculation is actually done in ZAR because the proceeds and expenditure would already first have been restated into ZAR. (Compare "real gain" calculation.)*

The existing exception in **para 43(1)** is to be substantially restricted. Previously, this sub-para provided that when an asset is acquired and sold in the same foreign currency, then the CG/CL must be determined on a "real gain"[6] basis —that is, the CG/CL must first be determined in the foreign currency and then only the final CG/CL is converted into SA Rand in the year of the disposal. The new amendment will limit this exception to only "*a natural person or a trust that is not carrying on a trade*".

For companies and trading trusts, a new **sub-para (1A)** is inserted into para 43, to essentially restate the s25D concept —i.e. that expenditure and proceeds must be converted separately into SA Rand (and thus the CG/CL calculation happens in SA Rand from the start). The only departure from the s25D rule is that the taxpayer is not restricted to only the respective spot rates, but in fact also has the option of *average* exchange rates. Specifically:

(a) the proceeds must be translated at **either** the "average exchange rate for the year of assessment in which that asset was disposed of" **or** at the "spot rate on the date of disposal"; (**para 43(1A)(a)**) and

(b) the expenditure incurred must be translated at **either** the "average exchange rate for the year of assessment during which that expenditure was incurred" **or** at the "spot rate on the date on which that expenditure was incurred". (**para 43(1A)(b)**)

Consequentially **sub-para (4)** is deleted. Sub-para (4) used to maintain a list of items where the full gain rule would always apply irrespective of the exception in sub-para (1). This included FEIs (foreign equity instruments) and any asset in respect of which the disposal-CG/CL would be SA-source (see s9(2)(*j*)&(*k*) ITA).

PwC comment: Presumably, now that the "real gain" exception in para 43(1) is restricted to a very narrow application, the need for sub-para (4) is considered to be essentially non-existent. It appears that —for companies and trading trusts— the only scenario when the "real gain" will be determined is in 43(2)(c) when an asset is acquired in one foreign currency and sold in a different foreign currency. The "full gain" calculation applies in the other three scenarios, i.e. disposal and sale in the same foreign currency (para 43(1A)) and only one leg (either disposal proceeds or acquisition proceeds) in foreign currency while the other leg is in local currency.

As a separate but related matter, **s24I(11) ITA** is deleted. This was the provision that prevented the recognition of exchange differences on debts used to fund the purchase of "real gain" assets.

PwC comment: This means that mismatches on "real gain" assets will now arise, i.e. no exchange differences will be recognised in the actual purchase and sale of the asset (para 43) while exchange differences will now be recognised on the corresponding purchase liability.

[6] *The "real gain" calculation seeks to exclude the impact of currency fluctuations. Thus if an asset is acquired in a foreign currency and then sold in that same foreign currency, then the "real gain" calculation would be to first calculate the CG/CL in that foreign currency, and then only convert the calculated gain/loss into ZAR.*

6.6 Foreign Currency – Intra-group exchange items

Effective date: Tax years starting on/after 1-Jan-13

The treatment of exchange differences between connected persons, group companies, etc. is to be reviewed. Specifically, **s24I(10)** is amended and a new **s24I(10A)** is inserted.

PwC comment: The EM states that the 10-year spreading rule in sS24I(7A) will be terminated immediately, but there does not seem to be anything in the legislation to do this. It is noted that, under existing rules, subs (7A) will terminate automatically by 2015 (i.e. 10-year spread of 2005 balances), so it is not clear what the urgent need would be to terminate it prematurely.

As opposed to the blanket deferral-to-realisation rule in s24I(10), the new **subsection (10A)** will permit or deny unrealised year-end exchange differences based on principles more closely aligned to IFRS (to some degree). The ambit of new s24I(10A) is more limited, so many of the exchange differences that would previously have been deferred under the old s24I(10) will now be taken into account immediately on a mark-to-market basis.

The first narrowing is in **s24I(10A)(*a*)**, namely that the new rules apply only to *debts*, i.e. only to an "*item contemplated in paragraph (b) of the definition of 'exchange item'*" (so not to FECs, etc.) —whereas s24I(10) applied to *any* exchange item.

More specifically, the actual application/ambit of the new sub-section (10A) is that no exchange difference will be included/deducted on a debt if (**(10A)(*a*)**):

(i) the debtor and creditor are in the same "*group of companies*" or are "*connected persons*";

and

(ii) the debt is either:

(aa) not a *current* asset or liability for IFRS purposes (i.e. is a long term debt); or

(bb) internally funded (i.e. not funded by debt due to a 3rd party lender/creditor);

and

(iii) the debt is not hedged by an FEC or FCOC.

PwC comment:

(1) The exclusion of FECs, FCOCs, and any debts that are hedged, is significant. Thus, even if the transactions are between related parties, and irrespective of the IFRS treatment, the realised and unrealised exchange differences are recognised in full under the basic s24I principles.

(2) The fact that CFCs are not expressly mentioned might not be significant. That is, CFCs are in any event likely to be included in the concepts of "group" and "connected person".

The deferred differences will be taken into account in a "*subsequent*" tax year, when either:

(a) s24I(10A)(*a*) ceases to apply, e.g. de-grouping, or the debt becomes *current*, etc. (**s24I(10A)(*b*)(ii)(*aa*)**); or

(b) the debt is "*realised*" (**s24I(10A)(*b*)(ii)(*aa*)**).

In determining the exchange difference amount to be recognised, **s24I(10A)(*b*)** provides that:

- This amount is determined as the difference between:
  - the most recent "*translation*" rate (i.e. the year-end just before the realisation or just before s24I(10A)(*a*) ceases to apply); and
  - the original transaction rate.

PwC comment: In effect, this adjustment simply recognises —in the current year— all the aggregated (deferred) unrealised exchanges gains and losses up until the end of the previous year. A second difference will then also be automatically recognised in the current year (under the standard application of para (b) the s1 "exchange difference" definition), depending on whether the debt is realised or whether it is still outstanding (and thus translated) at year-end.

- However, adjustment is made for differences that might already have been taken into account previously.

PwC comment: Presumably, this might cover (for example) :

- *debts that were initially or temporarily not subject to s24I(10) or (10A)(a) —and in respect of which foreign differences were taken into account— which then subsequently became subject to s24I(10A)(a) resulting in further denial of differences; or*
- *pre-2005 debts subject to the 10%-per-year rule in s24I(7A).*

The intention is also that the application of **s24I(10)** is to be terminated. A further proviso to s24I(10) is added to deem the realisation of all the exchange items (to which subsection (10) applies) at the end of the last tax year before tax years starting on/after 1-Jan-14.

PwC comment:

(1) For December year-ends, therefore, the deemed realisations will be triggered at the end of 2013. For all other year-ends, it will be the 2014 tax year. This is the same tax year in which the new subsection (10A) comes into effect.

(2) The deemed realisation seems to apply to ALL items covered by subsection (10) —even items that fall within the ambit of the new (10A). It is submitted that the deemed realisation in (10) should be "subject to" (10A), so that debts that were caught under subsection (10) and then remain to be caught under the new (10A) should NOT be realised. That is debts that are picked up by (10A) should simply be excluded from the deemed realisation, i.e. so that the deferral simply continues under the new (10A).

(3) There does not appear to be anything that actually terminates subsection (10), i.e. nothing prevents it from continuing to be applied after subsection (10A) comes into effect (despite the deemed realisation in 2013/14).

6.7 Foreign Investment Funds – Using SA Fund Managers

Effective date: Tax years starting on/after 1-Jan-13

This follows on from previous concessions to offer protection from SA tax to foreign investment funds investing in and/or through SA. Foreign investment funds will now also be protected from being "tainted" by the SA activities of their SA fund managers.

PwC comment: Previous concessions have included the s1 definitions of "foreign partnership" and "qualifying investor", and carve-outs from the s1 definition of "permanent establishment".

In determining whether a "*foreign investment entity*" ("FIE") is SA-resident, certain fund management services rendered by SA service-providers may be ignored. Specifically, a new **further *proviso*** is added to the **"*resident*" definition** in **s1**, to provide that in determining whether a FIE has its PoEM ("*place of effective management*") in SA:

- "no regard must be had to"
- any "financial services" activity (or certain specified "incidental" services)
- carried on by a licensed "financial service provider".

Note that, in the context of this new further *proviso*, the references to:

- "*financial service*" means as defined in s1 FAISA[7];
- "*incidental*" services means those in respect of financial products that exempt from the FAISA, as contemplated in s1(2) FAISA; and
- "*financial service provider*" ("FSP") means as defined in s1 FAISA;

and that the contemplated services activity must be carried on in terms of the licence issued to the FSP under s8 FAISA.

A definition for a FIE (**"*foreign investment entity*"**) is also added into s1 ITA. A FIE is a person(other than a natural person) which fulfils the following requirements:

(a) Not incorporated, established or formed in SA.

(b) Its assets must be held *"for investment purposes"* and must not consist of anything other than a combination of:

  (i) cash or cash equivalents;

  (ii) financial instruments that are either issued by listed companies, the SA government (whether national, provincial, or local), or that are publicly traded;

[7] *The Financial Advisory and Intermediary Services Act (No 37 of 2002)*

(iii) financial instruments that derive the value from the financial instruments referred to above; or

(iv) rights to receive any of the above.

(c) No more than 10% of its ownership ("*shares, units or other form of participatory interest*") can be held by SA-residents ("*directly or indirectly*").

(d) It may not have any employees (at all) and may not have any full-time directors or trustees engaged in its management on a full-time basis.

6.8 Foreign dividends and ROCs

Amendments are made to the **s1** definitions of "*foreign dividend*" and "*foreign return of capital*" and to the foreign dividend exemption rules in **s10B**.

Effective date: [1-Jan-11]

Capitalisation issues

Capitalisation shares —i.e. an amount which "*constitutes shares in that foreign company*"— are excluded from both the "*foreign dividend*" and the "*foreign RoC*" definitions (**s1** ITA). This is to align with the rule that scrip dividends are excluded from the domestic "*dividend*" and "*RoC*" definitions and thus not subject to tax.

PwC comment: The fact that cap-issue shares are excluded from the "dividend" and RoC definitions simply means that they are not caught by those specific special provisions. It does not change the fact that they might still be considered to be "amounts received or accrued" and potentially caught under the basic gross income rules. It is submitted that specific clarification should be sought from NT. That said, this same uncertainty (cap-issues) has existed for many years in the context of domestic (SA) "dividends" — and it seems that the SARS view is to simply ignore cap-issues.

Effective date: [1-Mar-12 / 1-Apr-12]

Tax-deductible foreign dividends

The treatment for payments (from a foreign company) that are tax-deductible in the foreign company's home jurisdiction (place of effective management) is amended. Instead of the previous rule that simply excludes such payments from the "*foreign dividend*" definition :

- the exclusion (**item (ii)**) is deleted from the "*foreign dividend*" definition in **s1** —so thus such deductible payments can indeed be foreign dividends; and

- a ***proviso*** is added to **s10B(2)** to prevent the participation and same-country exemptions ((2)(*a*)&(*b*)) from applying. Thus the exemptions are denied "*to the extent that the foreign dividend is deductible by the foreign* [declaring] *company*".

PwC comment:

It was always NT's intention to prevent such deductible foreign distributions from qualifying for SA's participation exemption (especially in light of their round-tripping concerns). On the one hand, this new approach is more elegant and appropriate (although it still does not address the root of the problem). On the other hand, it does mean that these distributions now qualify for the other dividend exemptions, notably the general s10B(3) rate-reduction exemption.

In respect of "foreign ROCs", the previous position remains, i.e. that a tax-deductible RoC will simply be seen as an undefined receipt or accrual in the hands of the SA taxpayer, and thus subject to the basic gross income rules—although it is submitted that these types of distributions are likely to be slight more obscure in practice.

Foreign Dividends: General rate-reduction exemption

The general exemption (rate-reduction) formula in **s10B(3)(*b*)** is amended to deal with:

ordinary trusts; and

insurers.

Ordinary trusts are to be covered by the $^{25}/_{40}$ exemption ratio in **(3)(*b*)(ii)(*aa*)** —not the $^{13}/_{28}$ ratio in (ii)(*bb*). Specifically, the references to "*special*" are deleted in (*aa*) and (*bb*) so that the $^{25}/_{40}$ exemption ratio is applicable to *all* trusts (not just special trusts).

As regards foreign dividends received by the "*corporate*" fund and by the two taxable "*policyholder*" funds of insurers, the exemption in s10B(3) is amended:

- a new **sub-item (B)** is added to **(3)(*b*)(ii)(*bb*)** to confirm that the $^{13}/_{28}$ ratio will apply to the corporate fund as well as to the company policyholder fund;
- in the case of the individual policyholder fund, a new exemption ratio of $^{15}/_{30}$ ratio is created through the insertion of a new **item (*cc*)** into **(3)(*b*)(ii)**.

Foreign dividends received by or paid by CFCs

The same-country exemption is **s10B(2)(*b*)** is clarified to be applicable only where the recipient shareholder is a "*foreign*" company.

PwC comment: Although s10B(2)(b) does not expressly use the term "controlled", it is submitted that the only scenario where a foreign dividend received by a "foreign company" could be potentially taxable in SA (and thus be in need of a specific exemption) is if that foreign company (shareholder) is in fact a CFC.

The dividends-from-CFCs exemption in **s10B(2)(*c*)** is amended by the addition of a ***proviso***, to address the treatment of foreign dividends that had previously been earned by the declaring-CFC. Specifically, in the determination of the declaring-CFC's "net income"—i.e. to determine the maximum (2)(c) exemption— the general rate-reduction exemption in s10B(3) must be disregarded. Thus, even though s10B(3) exemption might have been applied in the actual original s9D net income calculation for that CFC, that exemption must ignored when determining the (2)(c) exemption for foreign dividends on-declared by that CFC. Naturally, this is to ensure that the full amount of the gross foreign dividends received by the CFC can flow through without additional SA tax at the time of the on-declaration by the CFC.

Foreign Dividends: Anti-avoidance

The anti-round-tripping provision in **s10B(4)(*a*)** is clarified slightly. The reference to the original payment (i.e. out of which the eventual foreign dividend is ultimately sourced) being "*deductible*", is clarified to mean deductible "*from the income*" of the payer. Furthermore however, payments for the purchase of trading stock will not be targeted.

PwC comment: These amendments address two of the PwC objections that have been raised previously. First, the unqualified reference to "deductible" could arguably even have caught payments that were tax-deductible in the home jurisdiction of the declaring foreign company —whereas it seems clearer now that they are targeting only amounts that were originally deductible against the SA tax base. The second objection (trading stock purchases) is self-explanatory, and the related amendment is welcomed.

Subsection (5) is also amended to narrow the disqualification. Instead of dis-applying the entire s10B in respect of payments sourced out of foreign dividends, **s10B(5)** now only prevents the application of s10B(2) to such payments.

PwC comment: It is submitted that this amendment is inadequate to address the concerns raised by PwC previously. On the one hand, it is understandable that on-payments (whether dividends, interest, salaries, or any other payment) that are sourced out of an exempt foreign dividend should not be exempt purely by virtue of being sourced out of an exempt foreign dividend. On the other hand, however, where the on-payment happens to be a foreign dividend that qualifies for exemption in its own right, then s10B(5) should not prevent the exemption from applying.

6.9 Participation exemption – para 64B, 8th Sch.

Several amendments, primarily to address technical issues, are made to para 64B, with four different effective dates. However, the main set of amendments is the revision of the whole of para 64B with effect from 1-Jan-13.

Effective date: 1-Jan-12

The main amendments back-dated to 1-Jan-12 are in respect of HQ-Cos. Whereas the previous exemption for foreign-share-disposals by a HQ-Co was contained as a **sub-item (iv)** in **sub-para (2)(*b*)**, sub-item (iv) is now deleted —and a separate new **sub-para (2A)** is inserted.

The new rule maintains the position that disposals by the HQ-Co are exempt, but the big difference is that the new rule (para 64B(2A)) does not contain the 18-month requirement that is in sub-para (2)(*a*)(ii) for disposals by non-HQ-Cos.

The remainder of the amendments are textual, consequential and technical, etc.

Effective date: 1-Jan-13

Para 64B is substituted to re-adjust slightly the focus and ambit of the participation exemption.

Para 64B will no longer cover disposals to CFCs (the old (2)(*b*)(iii)) nor will it cover deemed disposals that arise when a CFC ceases be a CFC (the old (2)(*b*)(ii)). Thus the participation exemption will be restricted to only:

- disposals *to* any non-resident (but not a CFC) – **para 64B(1)**; and
- disposals *by* a HQ-Co – **para 64B(2)**.

PwC comment: The deemed disposal rules for CFCs ceasing to be CFCs are now covered in s9H.

The transfer of shares to CFCs is now covered in the reorganisation rules (s42, etc.). Note that the reorganisation regime is one of deferral/roll-over, not a full exemption as para 64B previously offered.

The 10% holding requirement (equity shares and voting rights) is retained in both exemptions. The 18-month rule is retained for only the "primary" exemption (sub-para (1)) —so disposals by HQ-Co's (sub-para (2)) do not need to fulfil the 18-month requirement.

An important aspect of the new regime is that the disposal of shares in a FFIHC ("*foreign financial instrument holding company*") will now also qualify for the exemption. Whereas FFIHCs were previously disqualified (excluded) in para 64B(2) —and defined in para 64B(1)— there is no reference at all to FFIHCs in the new version of para 64B.

The other major change is that the primary exemption (sub-para (1)) will now require a "*market value*" disposal proceeds. (**Para 64B(1)(*b*)**) This appears to be the main anti-avoidance measure and, consequentially, the claw-back rules (the old (sub-paras (3) & (4)) are effectively terminated —i.e. retained but restricted to apply only to para 64B-exempt disposals that happened up to 31-Dec-12. (**Para 64B(3)**)

The application to foreign ROCs is retained (old sub-para (5); new **sub-para (4)**). Similarly, the disqualification of foreign unit trusts is also retained (old sub-para (6); new **sub-para (5)**).

Effective dates: 1-Jan-11 and 1-Apr-12

The amendments are textual, consequential and technical, etc.

6.10 CFCs – Corporate Reorganisations

Important: Please also note that there are some general amendments to the re-organisation rules —see, for example, section 3.3 of these notes— which have an impact on both domestic and CFC restructures. In the commentary below, we focus solely on the amendments relevant to CFC restructures.

Asset-for-share Transactions (s42)

Effective date: 1-Jan-13

Whereas initially s42 would have covered the transfer of foreign shares held either as trading stock or as capital, the relief will now be limited to *only* capital assets. The amendment is in **para (*b*)** of the definition of "*asset-for-share transaction*" ("AFS") **s42(1)**.

The required relationship between the transferor and transferee is also revised. First, it is clarified —at the start of **para (*b*)** of the definition— that the transferor must be a company (although it is submitted that it was impossible to interpret the old rule other than to assume that the transferor must be a company).

Furthermore, whereas the old rules specified that certain relationships must exist between the transferor and the transferee both before *and* after the AFS transaction, the new position is to:

(i) test the relationship between the transferor and transferee only *before* the AFS transaction —and the actual requirements are also amended slightly; and

(ii) impose a new "after" test which focuses on the relationship between the overall SA-group (on the on hand) and, on the other hand, either the transferee-CFC or the target foreign company.

The specifics are set out below.

Whereas the initial rule was to require the transferor to hold a QI ("*qualifying interest*") in the transferee both before and after the transfer, the new rule will remove any requirement for (or, for that matter, reference to) QI. That is, the "*holds a qualifying interest in*" requirement is **deleted from para (*b*)** of the AFS definition. Consequentially also, the actual QI definition in s42(1) is substituted in its entirety in a way that omits any reference to para (*b*) of the AFS definition. (There are also other impacts of the new QI definition, relevant in the context of domestic AFSs —see section 3.3 of this document.)

However, the requirement for the transferor and the transferee-CFC to be in the same "*group*" before the transfer, is still confirmed in para (*b*) of the AFS definition. In summary then, the required relationship between the transferor and transferee (before the AFS transaction) is simply that:

(a) both companies must be in the same s1 "*group of companies*" (**(*b*)(i)(*aa*)**); and

(b) the transferee must be a CFC in relation to any SA-resident in that same "*group*" (**(*b*)(i)(*aa*)**).

PwC comment: So the transferor company can be SA-resident or foreign.

As regards the post-transfer situation, a new set of requirements is added —in the form of a new **item (ii)** of para (*b*) of the AFS definition— namely that "*at the close of the day*" of the AFS transfer:

(a) more than 50% of the target foreign equity shares must be held by a single SA-resident (**(*b*)(ii)(*aa*)**); OR

(b) more than 70% of the transferee-CFC must be held by a single SA-resident (**(*b*)(ii)(*bb*)**).

Note that the requirement for the ownership by a single SA-resident means "directly or indirectly ... whether alone or together with any company forming part of the same group of companies as that resident".

The post-transfer requirement discussed above must be preserved for at least 18 months after the AFS transaction. The existing 18-month rule in **s42(6)** is completely rewritten. Para (a) deals with domestic AFS transactions (not discussed here). In the context of transfers to a CFC, **s42(6)(b)** deals with the result of breaching either the 50% rule or the 70% rule —see (a) and (b) above— as the case may be.

- If, in either case, "*that requirement is no longer met*" within 18 months after the AFS transfer, then the transferor is deemed to have disposed of the equity shares (in the CFC-transferee) that it still holds (**s42(6)(*b*)(*aa*)**) and deemed to immediately re-acquire those shares (**(*b*)(*bb*)**).

- Both the deemed disposal and the deemed re-acquisition are deemed to occur for amounts equal to at the MV of those shares as at the date of the original AFS transaction.

- However, if the 50% or 70% rules are breached as a result of a s45, s46 or s47 transaction, or an involuntary disposal covered by par 65, 8th Sch., then the ***proviso* to s42(6)(*b*)** ensures that the deemed disposal will not be triggered.

Amalgamation Transactions (s44)

Effective date: 1-Jan-13

The definition of "*amalgamation transaction*" (in **s44(1)**) is amended and extended to deal more clearly with three separate amalgamation scenarios.

SA-to-SA

The existing **para (*a*)** is amended to specify that the "AmCo" ("*amalgamated company*") must be "*a resident*". Given that para (*a*) already requires that the "ResCo" ("*resultant company*") must also be SA-resident, this now confirms that para (*a*) permits only SA-to-SA amalgamations.

Foreign-to-SA

The existing **para (*b*)** —which used to cover foreign-to-foreign amalgamations— is amended to require that the ResCo must be "*resident*". Combined with the fact that para (*b*) requires that the AmCo must be a "*foreign company*", para (*b*) is thus converted into covering inward (foreign-to-SA) amalgamations.

Two additional requirements are added to require that:

(i) If the ResCo held any shares in the AmCo before the amalgamation transaction, the ResCo must have held those AmCo shares "*as capital assets*" (**sub-para (ii)** of para (*b*)); and
(ii) Inherent losses from AmCo may not transferred to ResCo (i.e. foreign losses cannot be brought onshore into SA). Specifically, newly inserted ***provisos* to s44(2)(*a*) & (*b*)** dis-apply the rollover relief in respect of any asset with a MV that is less than its base cost.

PwC comment: The effect of this is not to completely prevent the application of the s44 relief. Rather, only the so-called loss assets will be excluded from the roll-over and will instead be expected to be transferred across at their (lower) MVs.

In summary, the old para (a) has now been split into two. The original para (a) contemplated scenarios where the ResCo was SA-resident, but kept open the possibilities that the AmCo could be either SA-resident or foreign. Those two possibilities are confirmed but will now be separated into para (*a*) and para (*b*). However, in respect of the foreign-to-SA (para (*b*)) amalgamations, two additional requirements have been added (see above) which are not required in para (a).

Foreign-to-foreign

Transfers between CFCs were previously covered by para (*b*) which has now been re-assigned as discussed above. A **new para (*c*)** is now inserted to cover foreign-to-foreign amalgamations —i.e. both AmCo and ResCo must be "*foreign*" companies. Furthermore, the requirements that used to exist in para (*b*) are substantially amended in the new para (*c*).

Specifically, **paras (*c*)(ii)(*aa*) & (*bb*)** set out separate requirements to be complied with before and after the amalgamation transaction.

The pre-requisites *before* the amalgamation transaction —in **(*c*)(ii)(*aa*)**— are that:

(A) AmCo and ResCo must be in the same "*group of companies*" as defined in s1. This is similar to the old (*b*)(ii)(*aa*), but with the notable difference that the old rule required a 95% holding (instead of 70%). The new rule simply refers to the s1 definition and thus sticks with the standard 70% threshold.

(B) ResCo must be a CFC in relation to a SA-resident in the same "*group*" referred to above. This requirement is almost identical to the old (*b*)(ii)(*bb*).

(C) An new pre-requisite is that, if ResCo held any shares in AmCo, those AmCo shares must have been held as capital assets by ResCo.

Immediately *after* the amalgamation, **para (*c*)(ii)(*bb*)** requires that more than 50% of ResCo's equity shares must be held by a SA-resident ("*directly or indirectly … whether alone or together with any other person that is a resident and that forms part of the same group of companies as that resident*").

Intra-group Transactions (s45)

Effective date: 1-Jan-13

When the reorganisation rules were opened up to CFCs in 2012, s45 was excluded. However, s45 is now extended to CFCs from 1-Jan-13.

In the "*intra-group transaction*" definition in **s45(1)**, the existing **paras (*a*) & (*b*)** —which contained the requirements for a *domestic* intra-group transaction— are renumbered as **para (*a*)(i) & (ii)**. Thus it seems that para (*a*) is intended to cover domestic (SA-to-SA) transactions whereas the newly inserted para (*b*) would cover foreign and cross-border transfers.

In what is now **para (*a*)(i)**, the requirement for the transferee company to be a "*resident*" is deleted.

PwC comment: Despite our expectation of what National Treasury intended para (a) to permit (i.e. only SA-to-SA transfers) the deletion of the "resident" requirement opens up the possibility of outbound transfers, i.e. SA-to-foreign. A retrospective technical correction is expected to rectify this unintended consequence.

The newly inserted **para (*b*)** of the definition permits CFC-to-CFC transfers as well as both inbound (CFC-to-SA) and outbound (SA-to-CFC) transfers. However, the requirements are more stringent than the standard domestic (para (*a*)) rules. Specifically, in para (*b*) of the definition:

(i) The only asset-transfer contemplated is an "*equity share … in a foreign company*". (**(*b*)(i)**)

(ii) The target shares must have been held by the transferor as a capital asset and must be acquired by the transferee as a capital asset. (**(*b*)(i)&(ii)**) Consequentially also, the rules in **s45(2)(*b*) & (3)(*a*)** — that transferred assets must retain their nature as either as trading stock or as allowance assets— are amended to refer only to domestic (para (*a*)) transfers. Similarly, **s45(3)(*b*)** is also amended to confirm that the reference to "*a contract … as part of a business as a going concern*" refers only to para (*a*) transfers.

(iii) The consideration given by the transferee must be the issue of either debt or non-equity shares. (**(*b*)(i)**)

(iv) The transferor must be in the same "*group of companies*" (s1 definition) both before the transfer, and at the end of the day of the transfer. (**(*b*)(iii)(*aa*)**)

(v) The transfer can be in any direction, namely inbound (CFC-to-SA), or outbound (SA-to-CFC), or CFC. Specifically, the transferor must be either SA-resident or a CFC, and the transferee must be either SA-resident or a CFC —as long as they are both in the same "*group*".

PwC comment: Technically, para (b) could also apply to SA-to-SA transfers, but the use of para (b) is unlikely to be considered in practice, since para (a) is far less restrictive.

(vi) In the case of inward transfers (CFC-transferor to SA-resident-transferee), a ***proviso*** is added to **s45(2)(*a*)** to prohibit the roll-over relief for loss assets. That is, if the base cost of the target foreign equity shares exceeds the MV of those shares, the s45(2) roll-over relief "*does not apply*".

The anti-avoidance rules in **s45(3A)**—which limits the deemed base cost of debt provided to fund a s45 transfer— will not apply to para (*b*) transfers. Specifically, a restriction is inserted into s45(3A) so that it targets only para (*a*) transfers.

PwC comment: The asset-transfer in question can only be equity shares acquired as a capital asset, and thus the related borrowing costs for the purchaser (transferee) will not be deductible.

The de-grouping charge provisions are also replicated for the purposes of para (*b*) transfers. First, in **s45(4)(*b*)**, the existing de-grouping charge is to be restricted to only para (*a*) transfers. Then, a **new s45(4)(*b*A)** is inserted to target specifically assets that were transferred in terms of para (*b*). The new (4)(*b*A) is similar to the existing (4)(*b*), but subject to a few differences:

- The de-grouping watershed is 6 years (same as (4)(*b*));
- The charge is triggered if the transferee separates from either the transferor or any of the transferor's s1 "controlling group companies" (**(4)(*b*A)(i)(*aa*)**). This is almost a replication of the corresponding requirement in (4)(*b*), the only difference being that the "controlling group companies" in (4)(*b*) does not relate to the s1 "group of companies" definition but to the s41 definition;
- In addition, the charge can also be triggered if the transferee ceases to be a CFC ((**(4)(*b*A)(i)(*bb*)**, a requirement that is not applicable in (4)(*b*) because section 45(1)(*a*) transfers do not, by definition, involve CFCs);
- The actual charge is determined on an identical basis to that in (4)(*b*)(i) —i.e. comparing the various capital gains that might have been determined when the asset was previously transferred under s45. However, (4)(*b*A) will contain no equivalent of (4)(*b*)(ii)&(iii), i.e. the portions of the de-grouping charge calculation that looks at recoupments or taxable income inclusions. This is because the only asset in question under para (*b*) can be a capital asset, and thus only capital gains can be in point.
- A new **s45(4)(*d*)** is added to provide that if the transferor or transferee is liquidated, and the holding company holds at least 70% of the liquidated transferor/transferee, then the holding company and transferee/transferor are deemed to be one-and-the-same company for the purposes of (4)(*b*A). Thus the de-grouping charge would not be triggered in the case of such liquidations. (This is simply a replica of the existing s45(4)(*c*), which is now amended to apply only to para (*a*) transfers.)
- The 2-year de-grouping rule in **s45(4A)** —which deals with the transferor's disposal of the consideration given by the transferee— will not apply to para (*b*) transfers. An amendment to s45(4A) restricts the application of that subsection to only para (*a*) transfers (i.e. only the s45(4)(*b*) de-grouping).

Unbundling Transactions (s46)

Effective date: 1-Jan-13

Background – TLAA-11 amendments[8]:

Unlike the other corporate reorganisation rules that were extended to CFCs on 1-Jan-12 (i.e. s42 AFS, s44 amalgamations and s47 liquidations), the s46 provisions already —before 2012— catered for the possibility of unbundling CFCs in certain limited circumstances.

When the other rules (ss42, 44 & 47) were opened up to CFCs in the TLAA-11 (to take effect on 1-Jan-12), the amendments also make changes to s46 to broaden the application to CFCs. However, the s46 amendments in the TLAA-11 were only due to take effect on 1-Jan-13 (not 2012). Thus, because the TLAA-12 amendments (below) are also due to take effect on 1-Jan-13, they effectively override the TLAA-11 amendments —so some of the TLAA-11 amendments will effectively never come into effect.

The commentary below presents the position as from 1-Jan-13 and also compares it with the existing law in force up to 31-Dec-12. However, please note that the position as at 1-Jan-13 represents a combination of unchanged TLAA-11 amendments and also new TLAA-12 amendments.

The existing rule (to 31-Dec-12) is that a CFC can be unbundled if at least 95% of that CFC is held by the unbundling company and if the shareholder receiving the CFC shares holds at least 95% of the unbundling company.

In the **s46)(1)** definition of "*unbundling transaction*", **para (*a*)** will be restricted to address only scenarios where the unbundling company and the unbundled company are both SA-resident. (This is a TLAA-11 amendment and is not changed in the TLAA-12.)

In **para (*b*)** of the definition, the unbundled company can be any "*foreign company*" —i.e. does not have to be a CFC— but there are several pre-requisites and restrictions:

(i) Any shareholder of the unbundling company (i.e. any company to whom the unbundled shares are distributed) must be either:

- a SA-resident in the same "*group of companies*" (s1 definition) as the unbundling company; or
- a CFC in relation to a SA-resident that is in the same group as the unbundling company.

(**para (*b*)(i)(*aa*)&(*bb*)**)

(ii) Immediately *before* the unbundling, the unbundling company holding in the unbundled company's equity shares must be:

- more than 50% of the unbundled company's equity shares; *and*
- held by the unbundling company as "*a capital asset*".

(**para (*b*)(ii)(*aa*)&(*bb*)**)

(iii) If the unbundling company is not SA-resident:

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[8] *The 2011 Taxation Laws Amendment Act (No 24 of 2011)*

- that unbundled company must be a CFC in relation to a SA-resident in the same s1 "*group*"—i.e. 70% owned by a single SA group (**para (*b*)(ii)(*cc*)**); and
- immediately *after* the unbundling, more than 50% of the unbundled company's equity shares must be owned by a single SA-resident ("*directly or indirectly … whether alone or together with any other resident that forms part of the same [s41] group of companies as that resident*"). (**para (*b*)(iii)**)

The reference in **s46(7)(*b*)(i)** to non-residents being potentially "disqualified" shareholders is amended. This links to the rule in s46(7)(*a*) which dis-applies the s46 relief if more than 20% of the unbundled company ends up being held by a "*disqualified person*". Whereas previously any non-resident would be a disqualified person, the amended rule contains an exception for CFCs that are more than 50%-owned by a single SA-resident ("*directly or indirectly … whether alone or together with any other resident that forms part of the same [s41] group of companies as that resident*"). (The 2011 amendment originally softened the disqualification by allowing an exception for all CFC, whereas the 2012 amendments will now tighten up the rule by limiting the exception to only the specified 50%-owned CFCs.)

In summary, when comparing the existing (old) rules on the one hand, with the 2011 amendments read together with the 2012 amendments:

- The 2011 amendment (which reduces the required relationship between the unbundling company and its shareholders from 95% to the lesser "*group*" requirement (70%)), is retained. The 2012 amendments also add the additional requirement that if the unbundling company is non-resident, it must be a CFC.

- Although the 2012 amendments dispense with the 2011 requirement that the unbundled company must be CFC, the requirement that the unbundled company must be 50%-owned by the unbundling company is still retained (to replace the existing rule that the unbundled company must be 95%-owned).

- The requirement that the unbundled shares must be held as capital assets is a new (2012) requirement.

- Another new 2012 amendment is that more than 50% of the unbundled company must end up being held by a SA-resident ("*directly or indirectly … whether alone or together with any other resident that forms part of the same [s41] group of companies as that resident*"), although this is only relevant if the unbundling company is non-resident.

Liquidation Transactions (s47)

Effective date: 1-Jan-13

In the **s47(1)** definition of "*liquidation distribution*", **para (*a*)** is now confirmed as applying only to SA-to-SA liquidations. Specifically, the "*liquidating company*" is now expressly required to be "*a resident*". (The requirement for the "*holding company*" to be SA-resident is already in para (*a*).)

In **para (*b*)** of the definition —which deals with CFC liquidations— there will now be an express requirement that the liquidating company must be a CFC. Furthermore:

(i) The holding company does not necessarily have to be a CFC, but could be either a SA-resident in the same "*group of companies*" (s1 definition) as the liquidating company, or a CFC. (The existing para(*b*)(i) is split into **para (*b*)(i)(*aa*) & (*bb*)**.)

PwC comment: This addresses the objection that the previous version of para (b) permitted only CFC-into-CFC liquidations but did not cater for CFC-into-SA liquidations.

(ii) The existence of minority shareholders in the liquidating company will not prevent the relief from applying to a qualifying holdco. Specifically, the "*if*" preface to **para (*b*)(i)** —discussed above— is replaced with "*to the extent that*".

(iii) A new requirement (**(*b*)(ii)**) is added that, immediately *before* the liquidation, the holdco's interest in the liquidating company must be held "*as a capital asset*".

(iv) If, immediately *after* the liquidation, the holdco is a CFC —see (i) above— then the new **(*b*)(iii)**) requires that, immediately *after* the liquidation, more than 50% of the holdco's equity shares must be held by a single SA-resident ("*directly or indirectly … whether alone or together with any other resident that forms part of the same group of companies as that resident*").

(v) A **new *proviso*** is added to **s47(2)** to prevent losses from being transferred into SA. That is, if the holdco is a SA-resident, then the roll-over relief will not apply to any asset with a cost in excess of its MV. (**Para (*a*)** of the *proviso* deals with capital assets and **para (*b*)** covers trading stock.)

6.11 Exit charge

Effective date: 1-Apr-12

It is clarified that, as regards any SA-resident who becomes non-resident, the exit charge is dealt with exclusively by s9H ITA —not by para 12(2), 8th Sch. **Para 12(2)(*a*), 8th Sch.** is amended by the deletion of the reference to cessation of residence. Rather, para 12(2)(*a*) covers only scenarios where:

(i) any person commences being SA-resident;

(ii) a company commences being a CFC; and

(iii) a CFC ceases to be a CFC.

PwC comment: This amendment is backdated to coincide with the original introduction of s9H ITA. From 1-Apr-12, the cessation of residence for any SA-resident person was governed by s9H, but there was an overlap in that para 12(2), 8th Sch. also covered that. This overlap is now removed.

Note, however, that there are further changes from 8-May-12 (see below).

Effective date: 8-May-12

The existing exit charge in **s9H** ITA is rewritten entirely. These new provisions are essentially a further extension of the 2011 substitution of some of the exit charge rules in para (12)(2)(*a*), 8th Sch.

In the 8th Sch., the ambit of **para 12(2)(*a*)** is reduced. As regards CFCs ceasing to be CFCs, the broader coverage of all categories of cessation-of-CFC-status is replaced with the narrower "*as a result of becoming a resident*".

On the other hand, the new s9H deals separately with the following exit events:

(i) any SA-resident natural person or trust (i.e. a person "*other than a company*") who becomes non-resident (**s9H(2)**);

(ii) any SA-resident company who becomes either (**s9H(3)(*a*)(i)**):

- non-resident; or
- a headquarter company; and

(iii) any CFC that ceases to be a CFC —other than by becoming SA-resident (**s9H(3)(*a*)(ii)**).

Against this, the previous version of s9H did not deal with CFCs. Rather, it dealt only with "*a person*" who "*ceases to be resident*" or "*becomes a headquarter company*". Thus it is really only item (iii) that is a major change.

PwC comment: The separation between items (i) and (ii), i.e. between companies and "other", is consequential upon the intention to deem a dividend distribution by companies (see below).

It is thus convenient to compare s9H and para 12(2)(*a*), 8th Sch. to understand which events are addressed by which provisions:

Commencing SA residence (any person)		para 12(2)(*a*)
Ceasing to be SA-resident (any person, incl. SA company becoming a CFC)		s9H
Foreign company commencing to be a CFC		para 12(2)(*a*)
Ceasing to be a CFC	because the CFC became SA-resident	para 12(2)(*a*)
	any other reason, i.e. reduced control by SA-residents	s9H
SA-resident company becomes a HQ-Co		s9H

Apart from the changes referred to above, no other changes are made to para 12(2)(*a*), so the rest of the commentary below focuses exclusively on the new s9H.

In summary, there are potentially two exit charges in s9H, namely the tax that results from:

(a) deemed disposal of assets; and

(b) deemed dividend distribution (by companies).

Item (a) above (deemed asset-disposal) is not new. Rather, it is the deemed distribution which represents the main change.

Furthermore, the other major change is the deemed termination of the person's tax year.

Deemed disposal of assets

As regards the assets owned by the person at the date of the exit, the person is treated as

- having disposed of each of their assets

- on the date before the exit event
- at market value (as at the day before the exit);
- and then
- to have reacquired those assets
- on the next day (i.e. on the date of the exit event)
- at the same MV (i.e. as at the day before the exit).

(**s9H(2)(*a*)** for individuals & trusts, and **(3)(*b*)** for SA companies and CFCs.)

PwC comment: As indicated earlier, this is not a change. This rule is identical to the previous version of s9H and the initial intention of the exit charge as it originally existed in para 12(2) 8th Sch.

Certain categories of assets remain excluded from the exit charge. **S9H(4)** replicates almost *verbatim* the exclusion list previously contained in the old s9H(3). Essentially, this refers to:

- SA immovable property (or interest therein);
- assets of a SA permanent establishment; and
- shares, instruments and rights that would be subject to tax under s8A, s8B or s8C ITA (e.g. executive share schemes , etc.).

A technical amendment (broadening) is made to the concept of "*interests*" and "*rights*" in SA immovable property. The old wording (s9H(3)(*a*)) could be argued to have caught only indirect shareholding interests (i.e. shares in a company that owns fixed property), because it referred only to —i.e. seems to have been restricted to— para 2(2), 8th Sch. The new **s9H(4)(*b*)** has a more expanded text, referring to "*any interest or right of whatever nature*" before continuing to include the para 2(2) interest.

PwC comment: The new text seems more reflective of the comprehensive ambit determined by reading together paras 2(1)(b)(i) and 2(2), as opposed to reading para 2(2) in isolation.

Deemed distribution

For a SA-resident company that ceases to resident or becomes a headquarter company, the new **s9H(3)(*c*)(iii)** now also imposes an additional exit charge in the form of DT (Dividends Tax) on a deemed dividend distribution —on the date before the exit event.

PwC comment: The concept of a deemed distribution upon exit is not new. Under the old STC rules there was a deemed dividend upon exit. In the last few years before the coming-into-effect of DT (when the DT legislation was already available) NT made it clear that they were dispensing with the deemed-distribution-on-exit, and thus it was never included in the DT rules. Thus this represents, in effect, a policy U-turn. Besides the dissatisfaction with the change-in-policy itself, it is also considered objectionable that it is backdated to 8-May-2012.

The distribution is deemed to be a dividend *in specie*, which means that DT liability falls upon the company, not the shareholder. The deemed distribution is also deemed to be made to the shareholders in their respective shareholding proportions.

PwC comment: Presumably the exemptions in s64FA remain equally available. For example, to the extent that the shareholder is another SA-resident company, the dividend should be exempt from DT.

The amount of the deemed dividend is determined in **s9H(3)(*c*)(iii)(*aa*)** to be:

(All values determined as at the day before the exit event)	
	MV of the company ("*all of the shares*")
LESS:	Sum of contributed tax capital (all classes of shares)
EQUALS:	**Amount of deemed dividend subject to DT**

Termination of tax year

The new s9H now also deems the year of assessment (of the exiting person) to have ended on the day before the exit event, and a new tax year is deemed to commence on the date of the exit.

[**s9H(2)(*b*)&(*c*)** – individuals & trusts; **(3)(*c*)(i)&(ii)** – SA companies; and **(3)(*d*)** – CFCs.]

PwC comment: This is an attempt to neutralise concerns about the SCA decision in the Tradehold case (CSARS v Tradehold Ltd 74 SATC 263). National Treasury is concerned that the effect of the Tradehold judgment is that a DTA could entirely override the exit charge —also overriding the deemed backdating of the deemed disposal. It is submitted that (if indeed this is the implication of Tradehold) that the creation of another fiction —i.e. the deemed termination of the tax year as an artificial barrier to protect the deemed backdating of the deemed disposal— does not achieve anything. That is, if Tradehold does indeed override the artifice of backdating the deemed disposal, there is no basis for assuming that the artificial interposition of a year-end will prevent the application of that Tradehold principle.

CFCs

As indicated earlier, the exit charge is not applicable to a CFC that ceases to be a CFC as a result of becoming SA-resident. (**s9H(3)(*a*)(ii)**) There are also four other scenarios in which the exit charge will not apply to CFCs that cease to be CFCs.

If the cause (of the loss of CFC status) is that shares in a CFC are disposed of, then the exit charge will not apply if the CFC-share-disposal in question is CGT-exempt under the so-called participation exemption (para 64B, 8th Sch.) —**s9H(5)**. This would apply irrespective of whether the CGT-exempt disposal is a direct or indirect holding in the CFC that ceases to be CFC (**(5)(*c*)**), and thus also ensures that where a single disposal higher up in the chain results in several underlying CFCs ceasing to be CFCs, all those underlying CFCs would also be protected from the exit charge.

PwC comment: It seems that the duplication of multiple CFC exits is not similarly covered if a SA HoldCo migrates. If a SA HoldCo (with several CFCs) becomes non-resident, not only will the HoldCo itself be subject to the exit charge, but the cessation-of-CFC-status for each and every one of the underlying CFCs would also be separately subject to the exit charge.

If a CFC is terminated as part of a s44 "*amalgamation transaction*", the termination will not trigger the exit charge. Similarly, if a CFC is terminated as part of a s47 "*liquidation distribution*", the termination will not trigger the exit charge. (**s9H(6)(*a*)**)

Where a SA-resident company becomes non-resident (and immediately/automatically becomes a CFC) as a result of the 2012 amendment to the "*resident*" definition —see 6.3 above— the event will not be subject to the exit charge (**s9H(6)(*b*)**).

PwC comment: Although this protects companies that already qualify for the residence concession (i.e. already fulfil the requirements as at the time of the definition-change), it does not apply to companies who only qualify later.

Where a SA-resident company becomes a CFC as a result of becoming non-resident (i.e. by moving its place of effective management ("PoEM")) it appears that all the general s9H exit charge rules will apply. There is nothing to prevent the application of s9H(3)(*a*), (*b*) and (*c*).

PwC comment: Remember to distinguish between (on the one hand) the scenario where actual PoEM remains in SA but the PoEM is nonetheless disregarded in the s1 "resident" definition (see 6.3 earlier), and where, on the other hand the actual PoEM moves outside SA. Only in the former case is the s9H exit charge disregarded.

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7 VAT

7.1 Instalment Credit Agreement

Effective date: 1-Jan-13

For "*lease agreements*" in **para (*b*)** of the definition of an **"*instalment credit agreement*" in s1** VATA, sub-para (ii) is amended to provide that the sum of money stipulated in the agreement can now also include "*any amount determined with reference to the time value of money*" (and not only finance charges).

Para (*b*)(v) of the definition is also amended with the addition of a **new item (*bb*)**, providing that the *lessor* can now also accept the full risk of destruction or loss (or other disadvantage to the goods)ll risk of maintenance and repair of those goods and reimburses the lessor for the insurance of those goods, while the agreement remains in force.

The definition of "*instalment credit agreement*" has been broadened to include Sharia compliant (Iijarah) financing agreements as it is becoming more apparent as a form of financial assistance.

PwC comment: Lease agreements, under the amendment, are to include all amounts which are determined by the time value of money and not only finance charges. The definition has also been broadened to take into account differently worded agreements where the substance of the agreement still requires the lessee to be responsible for the full risk of destruction or loss of the goods supplied, as the lessee is ultimately liable for the cost of insurance.

As discussed in the EM, the change eliminates the disadvantage of entering into Sharia compliant (Iijarah) finance agreements as opposed to other forms of financing. VAT will only be charged on the capital sum (i.e. asset cash price) and not on the implicit finance charge, achieving consistency over all financing arrangements for VAT purposes.

7.2 Credit Notes & Debit Notes

Effective date: Supplies made on or after 1-Jan-13

A **new para (*e*)** is added into **s21(1)** VATA to allow credit and debit notes to be issued where "*an error has occurred in stipulating the amount of consideration agreed upon*" for the supply. The corrections will cover the issue of credit notes for incorrect overcharges and the issue of debit notes for incorrect undercharges.

PwC comment: The amendment makes it possible to rectify any mistake done at the time of invoicing. It would also make it possible to include information previously omitted on the tax invoice, e.g. VAT registration numbers etc. as required in terms of s20(4) and s20(5), which address the information requirements for a valid tax invoice for VAT purposes.

7.3 Goods removed from CCAs – Double VAT charge

Effective date: 1-Jan-13

Current legislation prescribes that a vendor, being a CCA ("Customs Controlled Area") enterprise or an IDZ ("Industrial Development Zone") operator is deemed to supply goods in the course or furtherance of an enterprise where movable goods, situated in the Republic, are removed from the CCA or IDZ.

However, if such goods are returned to the CCA or IDZ within a period of 30 days as stated in the *proviso* to s8(24), i.e. temporarily removed, no deemed supply exists.

The amendment adds a further *proviso* to s8(24) to exclude the following from being a deemed supply under this section:

- Goods that are imported for home consumption (as referred to in paragraph (i) of the proviso to s13(1)); or
- Goods to which s18(10) previously applied, being:
  - Certain zero-rated supplies made to a CCA enterprise or IDZ operator (e.g. goods or services for exclusive use, delivery (etc) within a CCA (s11)(1)(*c*), (*m*) & (*m*A) and s11(2)(*k*)); or
  - goods that are exempt from import VAT under s13(3) read with Schedule 1 to the VAT Act;
  - where a VAT adjustment was required to be made.
- The only change made to s18(10) is that it now applies in the alternative to circumstances where a deduction of input tax would have been denied in terms of s17(2) OR (and no longer "AND") to the extent that such goods or services acquired by a CCA enterprise or an IDZ operator, were not wholly for consumption, use or supply by the said CCA or IDZ vendor for the making of taxable supplies.

PwC comment: The amendment essentially removes the 30 day rule for goods previously deemed to be imported. Goods (both imported goods and goods acquired locally at the zero-rate by a CCA or in an IDZ, subject to the further conditions of s18(1)) where a VAT adjustment was previously required will also not be subject to the 30 day rule. S18(10) has broadened its scope to provide in the alternative for goods acquired where input tax is denied in s17(2) or used wholly for non-taxable purposes.

7.4 Imported goods sold by non-residents before entry into SA

Effective date: 1-Jan-13

Currently, a non-resident that supplies goods in SA may be required to register for VAT if their activities are continuous or regular (even though the non-resident may not have a permanent establishment in SA). This is especially problematic where supplies are made within SA territorial land and waters, but before formal entry through customs clearing locations. This potentially triggers a VAT registration obligation for non-resident suppliers despite the fact that they goods are not entered by them into SA for home consumption.

The amendment to **s12(*k*)** allows the supply, made by a non-resident who is not a vendor, to be exempt from VAT where the goods have not been entered for home consumption.

PwC comment: The amendment will have the effect that VAT is paid by the SA buyer/vendor who enters the goods for home consumption (as the pre-entry sales by the foreign person are now exempt from VAT). At a policy level, the intention is to avoid VAT registration for wholly foreign entities as they would become reluctant to trade with South Africa if they are forced to undertake VAT registration without meaningful South African physical operations.

7.5 Relief for Bargaining Councils

Effective date: 1-Jan-13

As the activities of both bargaining councils and employee organizations are materially similar, supplies by a bargaining council (established in terms of s27 of the Labour Relations Act) to any of its members to the extent that membership contributions are received as consideration, will be exempt in terms of the new **s12(*l*)** VATA.

However, given that bargaining councils may now be exempt and thus cease to be vendors, there would have been a concern that the s8(2) deemed supplies rule would be triggered. Therefore, a new **subsection (2F)** is added into **s8** to deem the supply value to be Nil —if the cessation happens on/after 1-Jan-13 as a result of the new s12(*l*) exemption.

Even though the amendments have a 1-Jan-13 effective date, they might also have some retrospective effect. With the new **s40C**, the bargaining council may, by a written application, get an assessment (for tax, additional tax, penalty or interest), as a result of supplies by the bargaining council before 1-Jan-13, reduced by the Commissioner as long as the reduction does not result in a refund.

The amendments thus attempt to provide clarity on the VAT treatment of bargaining councils and have aligned it with the VAT treatment for employee organizations based on the substance of their activities.

7.6 Relief for Political Parties

Effective date: 1-Jan-13

The amendment allows the membership contributions to a political party (registered in terms of s15 of the Electoral Commission Act No. 51 of 1996) to be exempt from VAT in terms of the new **s12(*m*)** VATA.

The same consequential rules follow s12(*m*) supplies as those for bargaining councils (s12(l)) discussed earlier —i.e. the rules regarding the s8(2) deemed supplies (and the **new s8(2F)**) and the **s40C** retrospective impact.

7.7 Share-block companies

Effective date: 1-Jan-13

The amendment to **s8(19)** clarifies the circumstances where the supply of immovable property by a share block company or the supply of services through the waiving of rights against a share block company to that share block company is deemed to be made otherwise than in the course or furtherance of carrying on an enterprise. This will now also cover the transfer of the actual unit of immovable property to the share block shareholder (see also 3.9 earlier).

8 Securities Transfer Tax ("STT")

8.1 Broker-dealer Exemption

Effective date: 1-Jan-13

The STT exemption for brokers ("authorised users") on the JSE is to be redesigned. Instead of the focus on the principal-versus-agent roles of brokers, the basis of the STT exemption will now be determined with reference to the "stock account" categories in which the broker holds the securities. This also means a greater reliance on JSE rules, since the stock account categorization is governed by the SSA (Securities Services Act, No 36 of 2004).

In summary, the STT rules will recognise five (5) categories of "stock accounts". Acquisitions into, and transfers between, four out of these stock accounts will be STT-exempt, and the 5th will be fully subject to STT.

The four ***exempt*** stock accounts are:

- *Unrestricted stock accounts:* Broker must own the shares and have full ability to acquire and dispose of those shares without direct or indirect approval. The existence of hedged derivatives will be ignored when making this determination.

- *Bank restricted stock accounts:* Broker requires approval from a domestic bank (within the same financial consolidated group of companies as the broker) for disposing shares. The rule also applies to foreign bank imposed restrictions if the foreign bank is subject to the same regulatory standard.

- *Security restricted cash loan stock accounts:* Where money is borrowed by a broker to acquire the shares, the broker will require approval from the money lender to dispose thereof (as the shares are pledged/ceded to the money lender).

Security restricted share loan stock accounts (STT exempt): Where shares are borrowed by a broker in terms of a share lending arrangement, the broker cannot dispose of the shares as it is held as collateral. This form of restriction is permissible as long as the yield is based on time-value-of-money principles and the obligation to repay is independent of the value of the collateralized shares.

Acquisitions, or transfers, into the "***general restricted stock account***" (i.e. the 5th category) will be fully subject to STT.

PwC comment: Put differently, the stock accounts could be viewed initially under two main categories, namely unrestricted and restricted —with the former (unrestricted) automatically qualifying as exempt. As regards restricted stock, the exemption depends on the type of restriction. Whereas in the past it would probably have been (simplistically speaking) all restricted stock that was taxable, the big change now is that three types of restricted stock are also exempt (i.e. bank-restricted stock and the two types of "security-restricted" stock). Thus the "general restricted" stock remains taxable.

In order to recognise these categorisations and enact the exemptions, the following amendments to the STTA (Securities Transfer Tax Act No. 25 of 2007) are made:

- S1 introduces new definitions of "bank restricted stock account", "exchange rules" "general restricted stock account", and "unrestricted and security restricted stock account"—which all rely on the SSA meanings.

PwC comment: Note that even though the EM and the explanatory commentary above refers to four categories of exempt stock accounts, the definitions cover all four in only two definitions, namely "bank restricted" and "unrestricted and security restricted".

- The charging rules in **s2** are extended to also cover internal transfers by brokers from one of their exempt stock accounts into the taxable account —i.e. from either the "*bank restricted*" or "*unrestricted and security restricted*" accounts into the "*general restricted*" stock account. A **new para (*b*)** is added to **s2(1)** to achieve this.

- The exemption provision in **s8(1)(*q*)** is substituted to grant the exemption. Specifically, where the recipient of the security is "*a member*" (i.e. a broker) who acquires the security and allocates it to their "*bank restricted*" or "*unrestricted and security restricted*" stock accounts.

Effective date: 1-Jan-08 to 31-Dec-12

As part of the overall review of the broker-dealer exemption, an additional exemption is introduced retrospectively to cover the 5-year period between 1-Jan-08 and 31-Dec-12.

An additional sub-para (ii) is added to **s8(1)(*q*)** to cover certain hedging and derivative-related share-transfers to brokers. Specifically, the exemption applies if the broker (i.e. "*the member*"):

- purchased the security to provide an equity hedging facility to a third party; or

- makes the security available for reward to a non-member, by means of a derivative instrument, to enable that non-member to provide an equity hedging facility to a third party;

Note that **s8(1)(q)** is then substituted in its entirety (i.e. from 1-Jan-13) as part of the new regime discussed above.

8.2 Other exemptions

Effective date: 1-Jan-11

A new **para (*s*)** is inserted into **s8(1)** to exempt the transfer of shares in a "*headquarter company*" as defined in s1 ITA.

Effective date: 1-Apr-13

A new **para (*t*)** is inserted into **s8(1)** to exempt the transfer of share in a "*REIT*" as defined in s1 ITA.

9 Other adminstration

Note: *Many administration changes have already been dealt with in the topic-specific commentary above.*

9.1 Exempt entities – Offence for non-compliance

In relation to PBOs (s30), recreational club (s30A), associations (s30B) and any entity qualifying for deductible donations (s18A), there is now an express compulsion to comply with both the relevant ITA provisions as well as the relevant constitution or establishment deed (etc.) of the relevant entity. Specifically, "*any person who is in a fiduciary capacity responsible for the management or control … who intentionally fails to comply … shall be guilty of an offence*". The sanction in all cases is either a fine or a 24-month jail term. (**Newly inserted s18A(7), s30(11), s30A(9) and s30B(10)**.)

9.2 Registration of tax practitioners

A new requirement is introduced into **s240 TAA** that will require tax practitioners to be registered —by 1 July 2013— with a recognised controlling body in addition to being registered with SARS as currently required. All persons required to register as tax practitioners after that date will have to register with a recognised controlling body within 21 business days after being required to register as a tax practitioner.

A recognised controlling body is, according to the **new s240A**, any of the following:

- the Independent Regulatory Board for Auditors;
- a Law Society;
- the General Council of the Bar, a Bar Council and a Society of Advocates;
- a similar statutory body the details of which are published in the *Gazette*; or
- a 'controlling body' for natural persons that provide tax advice or complete returns recognised by the Commissioner.

In order for a controlling body to be recognised certain minimum requirements will need to be met with regards to qualification and experience requirements, continuing professional education, codes of ethics and conduct, disciplinary procedures and number of members.

PwC comment: It is expected that professional bodies such as SAICA, SAIPA and SAIT (etc.) will be approved as recognised controlling bodies.

Additional powers are granted to SARS to lodge complaints with controlling bodies in relation to the conduct of registered tax practitioners. (**s241**)

9.3 International agreement enactment

Effective date: Date of promulgation of TALAA12

S1 TALAA12 provides for general enactment of international agreements into SA legislation without the agreement having to be specifically enacted into each statute. Rather, the question of whether (and which) SA statutes are treated as having enacted the international agreement is determined with reference to which "powers and functions" need to be exercised (to give effect to the international agreement). So the actual SA law governing those specific "powers and functions" will be considered to have automatically enacted the international agreements.

PwC comment: The general nature of this provision is worrisome as it creates legal uncertainty as to which Acts are affected by an international agreement on border control posts and which powers may be exercised by whichever official in terms of those Acts to give effect to the international agreement. It also creates legal uncertainty as to which actions will in fact give effect to and whether the international agreement is in fact reconcilable with what the official wants to give effect to.

9.4 Tax administration & customs

Effective date: 1-Oct-12

S2 TALAA12 makes the certain aspects of the TAA applicable to administrative Customs matters as well. Specifically, review by the Tax Ombud (s14 TAA) and the rules around compromise and write-off of tax debts are extended to the SA Customs regime.