C

Miscellaneous tax amendments

Tax expenditure statement: February 2011

This abbreviated tax expenditure statement provides a first step towards greater transparency of expenditures incurred through the tax system. Such tax expenditures can take the form of tax exemptions, accelerated depreciation, additional allowances, reduced rates, tax deferrals and / or tax credits.

A tax expenditure statement serves three broad objectives:

- Increases fiscal transparency and accountability
- Creates comparability between direct and indirect government expenditures
- Assists in the design of tax policy by promoting and informing public debate.

The first *Katz Commission Report* in 1994 argued that tax expenditure analysis holds fundamental implications for tax policy in South Africa. An attempt by the commission to quantify the cost of incentives was abandoned "due to the lack of useful and accurate data and a serious manpower shortage in revenue offices. This is a most unfortunate development which must be changed if South Africa is to develop a rational tax policy" (par. 13.5.2). The commission reported that where data was available, the cost of tax expenditures seemed to be substantial (par. 13.5.3). The commission recommended that steps be taken to provide the necessary computer facilities and staff to undertake a comprehensive audit of all incentives. The report included an appendix, listing provisions of the Income Tax Act (1962), the Value-added Tax (VAT) Act (1991) and the Customs and Excise Act (1964) that were considered tax expenditures. A list of tax expenditure provisions was also published in the 2003 and 2006 *Budget Reviews*.

What is a tax expenditure?

Tax expenditures are indirect government expenditures that are not reported in the normal budget process. They are tax provisions that reduce the amount of tax revenue that could otherwise have been collected.

Tax expenditures can be defined as deviations from the benchmark of a current standard tax legislative framework. A benchmark is a reference point against which the nature and extent of a concession can be identified – it is the standard taxation treatment that should apply to similar taxpayers or types of economic activities. Tax expenditures deviate from this benchmark of a good tax system that adheres to the basic principles of neutrality and equity.

A less robust but more practical approach is to define tax expenditures merely as a deviation from the basic tax structure, without reference to an ideal benchmark. For example, the United States Treasury's definition of a tax expenditure states that a tax expenditure must: (a) be special in that it applies to a narrow class of transactions or taxpayers; and (b) have a general provision and a specific provision that provides an exemption.

Once tax expenditures have been identified, one of the three methods below can be used to measure the estimated loss to the fiscus:

- Revenue foregone
- Revenue gain
- Outlay equivalence.

The revenue foregone method estimates tax expenditures by calculating the amount of tax revenue that would have been collected in the absence of the tax expenditure, and assumes that the behavioural response of taxpayers remains unchanged. This is the most commonly used method to measure tax expenditures because of its relative simplicity, and it was used in this draft report.

The revenue gain method measures tax expenditures by calculating tax revenue that would have been collected in the absence of the tax expenditure, taking into account behavioural responses associated with the removal of a tax expenditure provision. However, modelling taxpayer behaviour is quite complex.

With the outlay equivalence method, tax expenditures are measured by estimating the amount of direct government expenditures that would be required to provide the same benefit to taxpayers. This approach allows for a comparative analysis with direct expenditures to provide the same level of benefits.

The attached preliminary estimates are not exhaustive or complete, but a summary of the major tax expenditure items. These estimates do not take into account possible behavioural changes that may result from removing a particular tax provision.

Estimates of tax expenditures

The following table is a summary of tax expenditures in terms of the Income Tax Act 58, the VAT Act 89 and the Customs and Excise Act.

Table C.1 Tax expenditure estimates - R million

	2005/06	2006/07	2007/08	2008/09
Personal income tax				
Pension and retirement annuity[1]	12 722	13 538	15 464	18 349
-pension contributions employees	*4 711*	*4 911*	*5 495*	*6 567*
-pension contributions employers	*5 298*	*5 523*	*6 180*	*7 386*
-retirement annuity	*2 713*	*3 105*	*3 790*	*4 397*
Medical	9 155	12 841	5 753	6 742
-medical contributions & deductions employees	*3 521*	*4 939*	*5 753*	*6 742*
- medical contributions - employers [2]	*5 634*	*7 902*	*n/a*	*n/a*
Interest exemptions	1 290	1 715	2 283	3 033
Secondary rebate (65 years and older)	739	739	769	828
Donations	141	178	230	282
Capital gains tax (annual exclusion)	74	98	121	69
Total: Personal income tax	**24 122**	**29 109**	**24 620**	**29 303**
Corporate income tax				
Small business corporation tax savings	178	627	747	675
Research and development (R &D)	183	313	286	219
Learnership allow ances	179	221	324	193
Strategic Industrial Policy[3]	513	281	228	61
Film incentive	186	194	319	n/a
Urban development zones (UDZ)	28	65	90	85
Total: Corporate income tax	**1 267**	**1 701**	**1 995**	**1 233**
Value-added tax				
Zero-rated supplies				
19 Basic Food items[4]	10 036	11 376	13 107	13 907
Petrol[5]	6 837	7 763	9 176	10 524
Diesel[5]	586	736	948	1 249
Paraffin[5]	430	454	516	520
Municipal property rates	–	2 618	3 008	3 774
Reduced rates for "commercial" accommodation	80	85	95	113
Subtotal: zero-rated supplies	**17 969**	**23 032**	**26 849**	**30 086**
Exempt supplies (Public transport & education)	**604**	**682**	**785**	**832**
Customs duties and excise				
Motor vehicles (MIDP, including IRCCs)[6]	15 438	13 179	16 169	12 089
Textile and clothing (Duty Credits - DCCs)[6]	2 189	1 563	1 829	2 024
Furniture and fixtures	120	145	166	128
Other customs [7]	924	636	1 141	1 231
Diesel refund (mining, agriculture and fishing)	753	811	1 205	1 181
Total customs and excise	**19 425**	**16 335**	**20 509**	**16 653**
Total tax expenditure	**63 387**	**70 859**	**74 758**	**78 107**
Tax expenditure as % of total gross tax revenue	**15.2%**	**14.3%**	**13.1%**	**12.5%**
Total gross tax revenue	**417 196**	**495 549**	**572 815**	**625 100**
Tax expenditure as % of GDP	**3.9%**	**3.9%**	**3.6%**	**3.4%**

1. Some of this tax expenditure is recouped when amounts are withdrawn as either a lump sum or an annuity

2. Employer contributions after the introduction of the monetary caps is difficult to estimate.

3. The amount for 2005/06 includes that for the previous two years

4. VAT relief in respect of basic food items based on an independent study

5. Based on fuel volumes and average retail selling prices.

6. MIDP=Motor industrial development programme, DCC=Duty credit certificate

7. Goods manufactured exclusively for exports, television monitors and agricultural goods exempted.

The accelerated depreciation of business assets is a potentially significant tax expenditure item, particularly the immediate deduction in mining capital expenditures, which has not been included in the above statement. In this case, the tax relief relates to the time-value of money and would require a comparison of the depreciation allowed in terms of the Income Tax Act, against the economic depreciation of the relevant capital assets. Data to undertake such an exercise is not readily available at present.

Estimates from the 2005/06 Income and Expenditure Survey by Statistics South Africa (StatsSA) suggest that the poorest 20 per cent of households accounted for about 7.9 per cent of total expenditure on food and non-alcoholic beverages, and the top 20 per cent of households accounted for 39.9 per cent. Assuming that the poorer households' share of expenditure that is VAT zero rated on the list of "basic food items" is slightly higher (about 10 per cent), the monetary benefit that accrued to them was about R1.4 billion (10 per cent of R13.9 billion) in 2008/09, while the upper 20 per per cent of households received a benefit of R5 billion (about 36 per cent of R13.9 billion).This is not the most effective form of relief for the poor.

Direct tax proposals

Personal income tax rate and bracket structure

The primary rebate is increased to R10 755 per year for all individuals. The secondary rebate, which applies to individuals aged 65 years and over, is increased to R6 012 per year. A third rebate, which applies to individuals aged 75 years and over, is introduced at R2 000 per year. The resulting income tax threshold, below which individuals are not liable for personal income tax, is increased to R59 700 of taxable income per year for those below the age of 65, and to R93 150 per year for those aged 65 and over. The tax threshold for individuals aged 75 years and over is R104 261. The rates for the 2010/11 tax year and those proposed for 2011/12 are set out in Table C.2.

Table C.2 Personal income tax rate and bracket adjustments, 2010/11 – 2011/12

2010/11		2011/12	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
R0 - R140 000	18% of each R1	R0 - R150 000	18% of each R1
R140 001 - R221 000	R25 200 + 25% of the amount above R140 000	R150 001 - R235 000	R27 000 + 25% of the amount above R150 000
R221 001 - R305 000	R45 450 + 30% of the amount above R221 000	R235 001 - R325 000	R48 250 + 30% of the amount above R235 000
R305 001 - R431 000	R70 650 + 35% of the amount above R305 000	R325 001 - R455 000	R75 250 + 35% of the amount above R325 000
R431 001 - R552 000	R114 750 + 38% of the amount above R431 000	R455 001 - R580 000	R120 750 + 38% of the amount above R455 000
R552 001 and above	R160 730 + 40% of the amount above R552 000	R580 001	R168 250 + 40% of the amount above R580 000
Rebates		**Rebates**	
Primary	R10 260	Primary	R10 755
Secondary	R5 675	Secondary	R6 012
Tax threshold		Third rebate	R2 000
Below age 65	R57 000	**Tax threshold**	
Age 65 and over	R88 528	Below age 65	R59 750
		Age 65 and over	R93 150
		Age 75 and over	R104 261

The proposed tax schedule compensates individuals for the effect of inflation on income tax liabilities and results in reduced tax liability for taxpayers at all income levels. These tax reductions are set out in Tables C.3, C.4 and C.5. The average tax rates (tax as a percentage of taxable income) for individuals are illustrated in Figures C.1, C.2 and C.3.

Table C.3 Income tax payable, 2010/11 (taxpayers below age 65)

Taxable income (Rands)	2010 rates (Rands)	Proposed rates (Rands)	Tax deduction (Rands)	% reduction
60 000	540	45	-495	-91.7%
65 000	1 440	945	-495	-34.4%
70 000	2 340	1 845	-495	-21.2%
75 000	3 240	2 745	-495	-15.3%
80 000	4 140	3 645	-495	-12.0%
85 000	5 040	4 545	-495	-9.8%
90 000	5 940	5 445	-495	-8.3%
100 000	7 740	7 245	-495	-6.4%
120 000	11 340	10 845	-495	-4.4%
150 000	17 440	16 245	-1 195	-6.9%
200 000	29 940	28 745	-1 195	-4.0%
250 000	43 890	41 995	-1 895	-4.3%
300 000	58 890	56 995	-1 895	-3.2%
400 000	93 640	90 745	-2 895	-3.1%
500 000	130 710	127 095	-3 615	-2.8%
750 000	229 670	225 495	-4 175	-1.8%
1 000 000	329 670	325 495	-4 175	-1.3%

Figure C.1 Average tax rates for taxpayers under age 65

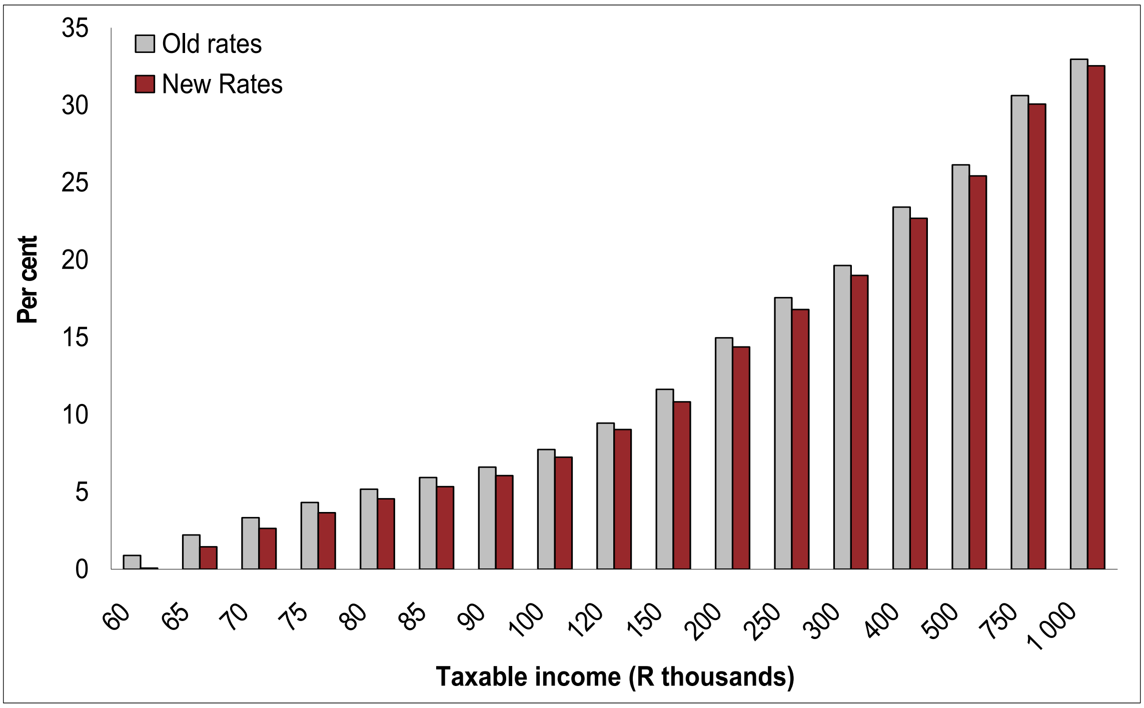


Table C.4 Income tax payable, 2010/11 (taxpayers age 65 and over)

Taxable income (Rands)	2010 rates (Rands)	Proposed rates (Rands)	Tax deduction (Rands)	% reduction
90 000	265	–	-265	-100.0%
100 000	2 065	1 233	-832	-40.3%
120 000	5 665	4 833	-832	-14.7%
150 000	11 765	10 233	-1 532	-13.0%
200 000	24 265	22 733	-1 532	-6.3%
250 000	38 215	35 983	-2 232	-5.8%
300 000	53 215	50 983	-2 232	-4.2%
400 000	87 965	84 733	-3 232	-3.7%
500 000	125 035	121 083	-3 952	-3.2%
750 000	223 995	219 483	-4 512	-2.0%
1 000 000	323 995	319 483	-4 512	-1.4%

Figure C.2 Average tax rates for taxpayers age 65 and over

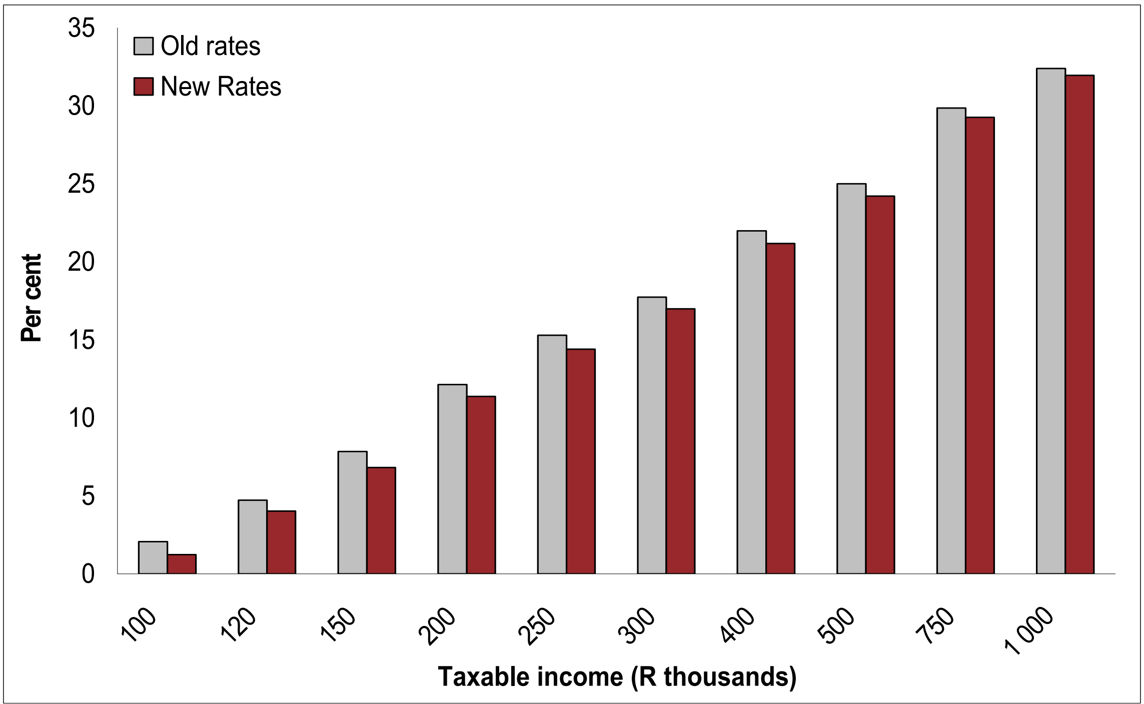
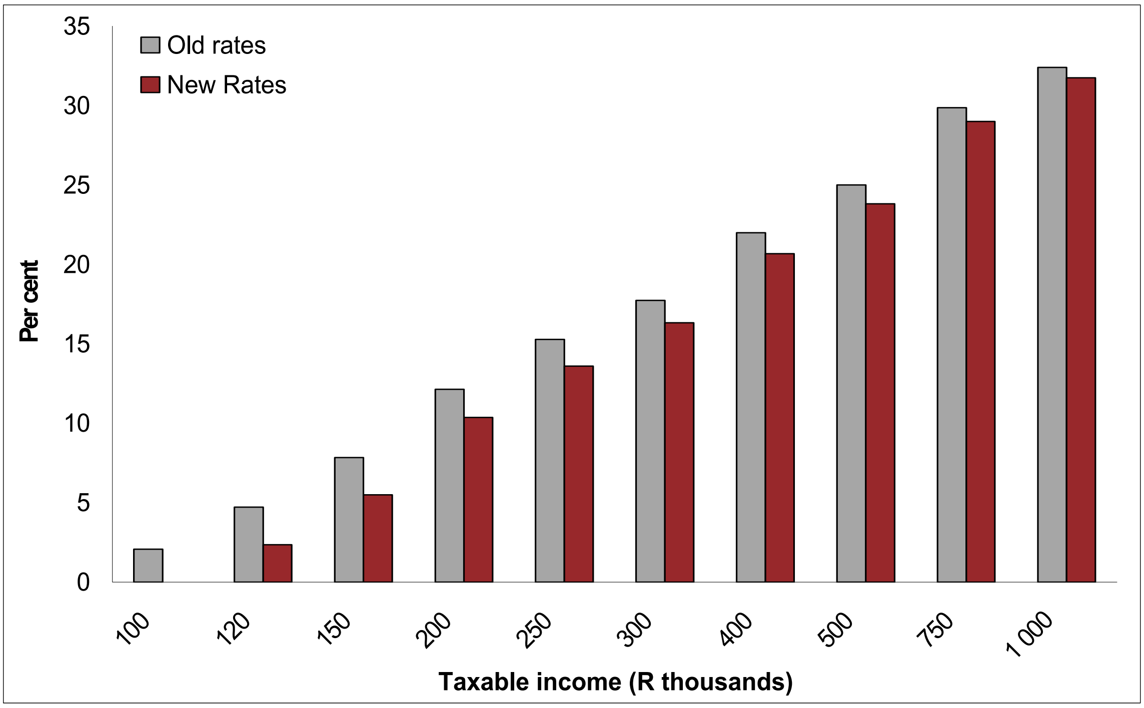


Table C.5 Income tax payable, 2011/12 (taxpayers age 75 and over)

Taxable income (Rands)	2010 rates (Rands)	Proposed rates (Rands)	Tax deduction (Rands)	% reduction
100 000	2 065	–	-2 065	-100.0%
120 000	5 665	2 833	-2 832	-50.0%
150 000	11 765	8 233	-3 532	-30.0%
200 000	24 265	20 733	-3 532	-14.6%
250 000	38 215	33 983	-4 232	-11.1%
300 000	53 215	48 983	-4 232	-8.0%
400 000	87 965	82 733	-5 232	-5.9%
500 000	125 035	119 083	-5 952	-4.8%
750 000	223 995	217 483	-6 512	-2.9%
1 000 000	323 995	317 483	-6 512	-2.0%

Figure C.3 Average tax rates for taxpayers age 75 and over



Indirect tax proposals

It is proposed that the customs and excise duties in the Customs and Excise Act 91 (schedule 1, part 2 of section A) be amended with effect from 23 February 2011 to the extent shown in Table C.6.

Table C.6 Specific excise duties, 2010/11 – 2011/12

Tariff item	Tariff head-ing	Description	2010/11 Present rate of duty		2011/12 Proposed rate of duty	
			Excise	Customs	Excise	Customs
104.00		**Prepared foodstuffs; beverages, spirits and vinegar; tobacco**				
104.01	19.01	Malt extract; food preparations of flour, groats, meal, starch or malt extract, not containing cocoa or containing less than 40 per cent by mass of cocoa calculated on a totally defatted basis, not elsewhere specified or included; food preparations of goods of headings 04.01 to 04.04, not containing cocoa or containing less than 5 per cent by mass of cocoa calculated on a totally defatted basis not elsewhere specified or included:				
.10		Traditional African beer powder as defined in Additional Note 1 to Chapter 19	34,7c/kg	34,7c/kg	34,7c/kg	34,7c/kg
104.10	22.03	Beer made from malt:				
.10		Traditional African beer as defined in Additional Note 1 to Chapter 22	7,82c/li	7,82c/li	7,82c/li	7,82c/li
.20		Other	R50.20/li aa	R50.20/li aa	R53.97/li aa	R53.97/li aa
104.15	22.04	Wine of fresh grapes, including fortified wines; grape must (excluding that of heading 20.09):				
	22.05	Vermouth and other wine of fresh grapes flavoured with plants or aromatic substances:				
.02		Sparkling	R6.67/li	R6.67/li	R6.97/li	R6.97/li
.03		Unfortified wine of heading 22.04, with an alcoholic strength by volume exceeding 6.5 per cent vol. but not exceeding 16.5 per cent vol.	R2.14/li	R2.14/li	R2.32/li	R2.32/li
.04		Unfortified wine of heading 22.05, with an alcoholic strength by volume exceeding 6.5 per cent vol. but not exceeding 15 per cent vol.	R2.14/li	R2.14/li	R2.32/li	R2.32/li
.05		Fortified wine of headings 22.04 and 22.05 with an alcoholic strength by volume exceeding 15 per cent vol. but not exceeding 22 per cent vol.	R4.03/li	R4.03/li	R4.33/li	R4.33/li
.06		Other	-	-	R93.03/li aa	R93.03/li aa

Table C.6 Specific excise duties *(continued)*

Tariff item	Tariff head-ing	Description	2010/11 Present rate of duty		2011/12 Proposed rate of duty	
			Excise	Customs	Excise	Customs
104.17	22.06	Other fermented beverages (for example, cider, perry and mead); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included:				
.03		Sparkling beverages	R5.15/li	R5.15/li	R6.97/li	R6.97/li
.05		Traditional African beer as defined in Additional Note 1 to Chapter 22	7,82c/li	7,82c/li	7,82c/li	7,82c/li
.15		Other fermented beverages, unfortified, with an alcoholic strength by volume not exceeding 9 per cent vol.	R2.52/li	R2.52/li	R2.71/li	R2.71/li
.16		Other fermented beverages, unfortified, with an alcoholic strength by volume exceeding 9 per cent vol. but not exceeding 15 per cent vol.	R2.52/li	R2.52/li	R2.71/li	R2.71/li
.17		Other fermented beverages, fortified, with an alcoholic strength by volume exceeding 15 per cent vol. but not exceeding 23 per cent vol.	R5.15/li	R5.15/li	R38.00/li aa	R38.00/li aa
.22		Other, mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, with an alcoholic strength by volume not exceeding 9 per cent vol.	R2.52/li	R2.52/li	R2.71/li	R2.71/li
.25		Other, mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, with an alcoholic strength by volume exceeding 9 per cent vol. but not exceeding 15 per cent vol.	R2.52/li	R2.52/li	R2.71/li	R2.71/li
.90		Other	R5.15/li	R5.15/li	R93.03/li aa	R93.03/li aa
104.20	22.07	Undenatured ethyl alcohol of an alcoholic strength by volume of 80 per cent volume or higher; ethyl alcohol and other spirits, denatured, of any strength:				
	22.08	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 per cent volume; spirits, liqueurs and other spirituous .				
.10		Wine spirits, manufactured by the distillation of wine	R84.57/li aa	R84.57/li aa	R93.03/li aa	R93.03/li aa
.15		Spirits, manufactured by the distillation of any sugarcane products	R84.57/li aa	R84.57/li aa	R93.03/li aa	R93.03/li aa
.25		Spirits, manufactured by the distillation of any grian products	R84.57/li aa	R84.57/li aa	R93.03/li aa	R93.03/li aa
.29		Other spirits	R84.57/li aa	R84.57/li aa	R93.03/li aa	R93.03/li aa
		Liqueurs and other spirituous beverages:				
.41		With an alcoholic strength by volume exceeding 15 per cent vol. but not exceeding 23 per cent vol.	–	–	R38.00/li aa	R38.00/li aa
.42		Other	R84.57/li aa	R84.57/li aa	R93.03/li aa	R93.03/li aa

Table C.6 Specific excise duties *(continued)*

Tariff item	Tariff heading	Description	2010/11 Present rate of duty Excise	Customs	2011/12 Proposed rate of duty Excise	Customs
104.30	24.02	Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes:				
	.10	Cigars, cheroots and cigarillos containing tobacco:				
.01	2402.10.10	Imported from Switzerland	-	R2 072.31 /kg net	-	R2 196.65 /kg net
.03	2402.10.90	Other	R2 072.31 /kg net	R2 072.31 /kg net	R2 196.65 /kg net	R2 196.65 /kg net
	2402.20	Cigarettes containing tobacco:				
.05	2402.20.10	Imported from Switzerland	-	R4.47 /10 cigarettes	-	R4.87 /10 cigarettes
.07	2402.20.90	Other	R4.47 /10 cigarettes	R4.47 /10 cigarettes	R4.87 /10 cigarettes	R4.87 /10 cigarettes
	2402.90.1	Cigars, cheroots and cigarillos of tobacco substitutes:				
.09	2402.90.12	Imported from Switzerland	-	R2 072.31 /kg net	-	R2 196.65 /kg net
.11	2402.90.14	Other	R2 072.31 /kg net	R2 072.31 /kg net	R2 196.65 /kg net	R2 196.65 /kg net
	2402.90.2	Cigarette of tobacco substitues:				
.13	2402.90.22	Imported from Switzerland	-	R4.47 /10 cigarettes	-	R4.87 /10 cigarettes
.15	2402.90.24	Other	R4.47 /10 cigarettes	R4.47 /10 cigarettes	R4.87 /10 cigarettes	R4.87 /10 cigarettes
104.35	24.03	Other manufactured tobacco and manufactured tobacco substitutes; "homogenised" or "reconstituted" tobacco; tobacco extracts and essences:				
	2403.10	Smoking tobacco, whether or not containing tobacco substitutes in any proportions:				
.01	2403.10.10	Pipe tobacco, in immediate packings of a content of less than 5 kg	R108.08 /kg net	R108.08 /kg net	R119.16 /kg net	R119.16 /kg net
.03	2403.10.20	Other pipe tobacco	R108.08 /kg net	R108.08 /kg net	R119.16 /kg net	R119.16 /kg net
.05	2403.10.30	Cigarette tobacco	R194.60 /kg	R194.60 /kg	R210.51 /kg	R210.51 /kg
	2403.99	Other:				
.07	2403.99.30	Other cigarette tobacco substitutes	R194.60 /kg	R194.60 /kg	R210.51 /kg	R210.51 /kg
.09	2403.99.40	Other pipe tobacco substitutes	R108.08 /kg net	R108.08 /kg net	R119.16 /kg net	R119.16 /kg net

** Please note that the Notes to Part 1 of Schedule No. 1 will be amended to provide for the following:*

1. *"Fortified wine" means wine which is the final product of the alcoholic fermentation of the must of fresh grapes, to which a spirit obtained by distilling grape wine or grape marc has been added to such an extent that the alcohol strength by volume thereof is at least 15 per cent vol. but not exceeding 22 per cent vol.*
2. *Tariff item 104.20.41 shall only apply to liqueurs, cordials and other spirituous beverages with a-*
   (a) fermented alcoholic base (other than those made from beer of heading 22.03 or wine of headings 22.04 and 22.05); or
   (b) wine spirit base, to which other non-alcoholic ingredients have been added.

The taxation of lump sums upon retirement

The revised rates for the taxation of lump sums upon retirement and involuntary retrenchments are set out in Table C.7.

Table C.7 Taxation of lump sums

Proposed rates Taxable lump sum	Rate of tax
0 - R315 000	0 per cent of amount
R315 001 - R630 000	R0 plus 18 per cent of amount exceeding R315 000
R630 001 - R945 000	R56 700 plus 27 per cent of amount exceeding R630 000
R945 001 and above	R141 750 plus 36 per cent of amount exceeding R945 000

Miscellaneous tax amendments

Provided below is a series of miscellaneous tax amendments proposed for the upcoming tax legislative cycle. These amendments eliminate small anomalies to ensure a more workable tax system within the current framework (these amendments do not represent fundamental policy shifts).

Employment, individuals and savings

The anti-avoidance rules regarding share incentive schemes are constantly being refined. Well-established anti-avoidance rules exist to ensure that executives cannot readily convert salary (taxable as ordinary revenue) into capital gain. Nonetheless, this area of the law continues to give rise to tax issues because of the variety of plans and sizeable sums involved. At present, two sets of issues have emerged.

- It is arguable whether deferred taxation of share incentive schemes should give rise to the Skills Development Levy or required Unemployment Insurance Fund contributions once employees have left the employment that gave rise to the shares. The goal would be to free ex-employees of these ancillary dispensations.
- Employer-provided employment trusts appear to result in unintended double taxation and allow for the conversion of disguised salary into tax-free dividends. The goal is to ensure that one level of ordinary tax properly applies.

Refinement of employer-provided long-term insurance plans

In 2010, amendments were introduced to clarify the legal distinction between plans that protect employers against lost profits and plans covering employees (and their families) against death and disability. This distinction is important because plans for the benefit of employees should trigger fringe benefit tax for them (while employer coverage has no adverse consequence for employees). Despite these changes, certain ambiguities and peripheral issues remain, relating to potential capital gain and the use of employer plans to fund the buy-out of key deceased shareholders/partners. It is proposed that these concerns are rationalised.

Exemption for private employment compensation entities

Compensation for death or personal injury suffered under contract of employment is largely regulated by the 1993 Compensation for Occupational Injuries and Diseases Act (COIDA). Most employees are covered by the government-controlled Compensation Fund. In addition, contributions and payouts by two privately-owned entities (both of which predate the Compensation Fund) are equally covered by COIDA. The provision of the same income and VAT exemptions as the Compensation Fund is being considered, as these entities are offering the same benefits.

Termination of the capital gain foreign currency rules

To ensure theoretical consistency, capital profits from foreign currency adjustments should be fully taxed when they are realised. Because taxing currency based on realisation can be extremely onerous, a currency pooling concept was introduced that defers any foreign currency capital gain/loss until that foreign currency is converted into a different currency. Despite this deferral, taxing individuals on their currency gains is simply impractical. The cost of compliance typically outweighs any revenue to the fiscus. Given these concerns, it is proposed that the capital gain charge for foreign currency be completely removed.

Relief for long-term commuting by the judiciary

Employees receive tax relief for company vehicles associated with work travel, but not for private travel or ordinary commuting to work. Even though this exclusion for commuting is theoretically sound, it creates unfair results for judges presiding over multiple courts or over a court that is located a long distance from the judge's home. Government provides judges with vehicles to cover these costs, and it is proposed that this unusual work-travel arrangement be eligible for tax relief.

Business

Completion of dividends tax

As discussed in Chapter 5 of the *Budget Review*, the new dividends tax is set to replace the secondary tax on companies from 1 April 2012. To date, most issues have been resolved with the assistance of public consultation. In 2011, final issues will be resolved, most notably:

- *Inbound foreign dividends* – The proposed taxation of inbound foreign dividends remains unresolved. Generally, foreign dividends are taxable at varying levels. Some dividends are exempt and others are taxable at top marginal rates (40 per cent or 28 per cent). Given the proposed changes to the taxation of domestic dividends, the exemptions and rates need to be adjusted in line with the new dividends tax.
- *Foreign-owned South African branches* – Foreign-owned South African branches are currently subject to tax at a 33 per cent rate instead of the standard 28 per cent rate for local companies. The 33 per cent rate serves as a simplified alternative to a branch profits tax for physical branch repatriations. However, this higher level of tax is only made possible by certain exceptions made to various non-discriminatory provisions within tax treaties. At this stage, it must be determined whether the change from a secondary tax on companies for dividends to a new dividends tax renders these exceptions null-and-void for treaty purposes, thereby calling into question the 33 per cent branch rate as a whole. When the new dividends tax comes into effect, it is proposed that this rate be repealed if discriminatory.

Revised tax rules for capital distributions and for pre-2001 capital gain assets

Dividend distributions are subject to the secondary tax on companies, while capital distributions are subject to the capital gains tax. The capital gains tax impact on capital distributions has had a checkered history. In essence, the most appropriate (and internationally acceptable) result is for capital distributions to reduce the distributing share base cost, with gains only taking effect once base cost is exceeded. However, this result has proven elusive over the years, as the pre-2001 capital gains tax rules prevent taxpayers from knowing the base cost of pre-2001 assets until disposal. Therefore, a revised and simplified system for determining the base cost of pre-2001 assets will be considered that does not require the base-cost determination of pre-2001 to be deferred until disposal. If this is achieved, the rules for capital distributions can be realigned with international practice.

Transfer of contingent liabilities

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

Taxation of debt

The tax rules for interest were altered several years ago to close certain avoidance schemes. However, this alteration has given rise to technical difficulties, especially concerning debt with indefinite or indeterminable maturities. This problem exists because the interest calculation requires a set term period that is lacking. It is therefore proposed that a special calculation be used in these circumstances to reach an appropriate yield without reliance on a set a term date. It is also proposed that the disposal of debt instruments before their maturity generate ordinary revenue because the gain or loss reflects implied interest differentials to overall market rates.

Film incentive revision

Film investors are entitled to claim a full upfront deduction for production and post-production expenditure incurred due to film ownership costs. Unfortunately, this incentive has been widely abused over the years by many taxpayers who claimed deductions based on artificial expenditure. Due to previous weaknesses in the incentive, taxpayers inflated their expenditure by borrowing through artificial non-recourse loans or by incurring excessive costs imposed by connected persons. In view of these difficulties, the incentive will be transformed into a tax incentive that encourages profits.

Income tax relief for international shipping

National Treasury announced the intention to provide tax relief for the shipping industry in the 2005 *Budget Review* to stimulate South African shipping transport. While National Treasury remains committed in this regard, it is fully understood that tax is only one contributing factor to the shortfall in the South African shipping register. A working group consisting of all relevant government stakeholders was formed to reformulate government's policies and rebuild South Africa's shipping industry. This effort will lead to engagement with the industry and a revision of legislation, including tax relief (such as a proposed tonnage tax).

Government grants to private stakeholders

The Income Tax Act exempts certain government grants if they are approved by the Minister of Finance. This approval depends on a list of factors, but the main issue is distinguishing between: (i) grants representing an indirect form of compensation for goods and/or services that should be taxed, and (ii) other grants designed as a subsidy mainly for the benefit of the grantee. It is proposed that a new set of clear and transparent principles be established to determine this distinction.

International

Offshore cell companies

In 2010, National Treasury announced its intent to review offshore cell companies due to concerns of large-scale avoidance. After discussions with stakeholders, it is proposed that offshore cells be taxed according to their substance – as multiple-investment entities. This will trigger imputed income for each party controlling each offshore cell. Consideration will also be given to enhancing the recoupment system when funds are directly or indirectly returned to the insured parties paying the premiums.

Completion of the cross-border withholding tax

In 2010, South Africa enacted a 10 per cent withholding tax on cross-border interest payable by residents to foreign persons, while retaining the current exemption for cross-border portfolio debt. The new tax will become effective from January 2013 (the delay caused by the need to renegotiate certain tax treaties). In the meantime, the withholding enforcement mechanisms will be adjusted to enhance future South African Revenue Service (SARS) enforcement and taxpayer compliance.

Tax treaty coordination of similar taxes

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

Company-structured management investment funds

Mutual and private equity funds are showing an increased interest in Africa, including the use of South African management to channel these funds. Unfortunately, this use of South African management triggers significant additional South African tax, even though the investment funds have a foreign origin and destination. While tax changes in 2010 have sought to alleviate certain intermediary partnership and conduit entities, the vast majority of funds use offshore intermediary companies that fall outside this new relief. It is proposed that these intermediary companies receive tax relief from the effective management test to remove the negative tax consequences associated with South African management.

South African multinational offshore restructurings

Many South African multinationals seek to restructure their offshore operations. These restructurings often occur when multinationals acquire foreign companies with inconveniently located subsidiaries and move to more efficient locations within the South African multinational group. In light of the current economic downturn, these restructurings have accelerated to reduce costs and increase efficiency. Because many of these offshore restructurings give rise to immediate tax, even if the restructured offshore entities remain wholly under the control of the South African group, it is proposed that tax relief be provided in these circumstances.

Currency transactions indirectly connected to certain foreign hedges

Foreign currency held for business use is largely taxed on an annual mark-to-market basis with certain exemptions and deferrals until actual disposition. For example, certain loans to offshore foreign subsidiaries fall outside the mark-to-market regime, as do certain currency hedges against the purchase of foreign shares. In essence, once certain assets linked to currency gains and losses are exempt, all linked instruments should also be exempt. It is proposed that a further set of linked arrangements be excluded from mark-to-market taxation. These newly exempt arrangements will include foreign bank loans used to fund further intra-group loans, the latter of which already fall outside mark-to-market taxation.

Value-added tax

VAT and transfer duty nexus

A notional VAT input credit may be claimed when a VAT vendor buys a fixed property from a non-VAT vendor. To combat abuse, this notional VAT input is currently limited to the transfer duty paid by the purchasing VAT vendor. It is proposed that the notional VAT input credit be delinked from the transfer duty payable, and that the quantum of the notional VAT input credit is set equal to the tax fraction (14/114) of the lower of the:

- Selling price (consideration) payable for the property

- Open-market value of the property
- Current municipal value of the property
- VAT-inclusive acquisition price, including improvements, by the non-vendor selling the property.

Synchronising VAT and customs for temporary import relief

The VAT exemption for temporary imports is encountering operational barriers in the case of customs duty-free imported goods. This is due to coordination issues between the VAT and customs rules. The lack of relief for temporary imports is causing problems for mining and manufacturing operations that temporarily import and upgrade foreign goods, which undermines South Africa's ability to export value-added goods. To address this issue, technical adjustments will be made to the applicable customs item number to accommodate duty-free goods.

Minimum exemption for imported services

VAT is payable on the import of goods and services into South Africa. VAT provides for a R100 minimum threshold exemption for certain imported goods, but lacks any minimum threshold exemption for imported services. A similar exemption will be introduced for the import of services, easing SARS enforcement and taxpayer compliance. Both exemptions will be set at R500.

Value correction for warehoused goods entered for home consumption

If goods in a storage warehouse are sold to a buyer and the buyer subsequently enters the goods for home consumption, VAT (and possibly customs) applies. However, the VAT Act fails to specify the value on which VAT is calculated in this case. Due to this lack of specificity, many taxpayers claim that the value is based upon entry into the warehouse, not the actual sales value. It is proposed that actual sales value be used as the most accurate value.

Relief for outstanding debt between group members

Most VAT vendors operate on an invoice (i.e. accrual) basis for calculating output tax and input credits. When a VAT vendor makes a purchase, the vendor has a "grace period" of 12 months to pay the invoice, failing which the purchaser must return the input tax claimed to SARS on the theoretical assumption that the debt will probably never be paid. Purchases between VAT vendors within a single group of companies are an issue, as the 12-month period is often commercially unrealistic with intra-group loans clearing at a later date (e.g. two to three years later). Relief from this 12-month claw-back is being considered; provided the selling group member is prevented from claiming a VAT refund before the purchaser is subject to the claw-back of VAT input credits.

Removal of mining right conversion rules

The Mineral and Petroleum Resources Development Act (2002) requires holders of old-order mineral rights to convert their rights into new-order rights after approval by the Department of Mineral Resources. New-order mineral production rights cannot last for more than 30 years, but holders can obtain approval for renewal. Although the current zero rating for conversions and renewals is designed to protect mineral-rights holders from being subject to VAT due to regulatory compliance, the zero rating is unnecessary and misplaced. These conversions and renewals should simply be viewed as a non-event (i.e. a non-supply) in line with common law and without specific legislative relief. It is proposed that the zero rating for mineral-right conversions or renewals be removed to prevent the distortion of collateral VAT issues (e.g. the VAT turnover calculation).

Manufacturer/producer rebates for retail goods

Manufacturers (or producers) may issue coupons that customers redeem when purchasing goods from dealers (or retailers). These coupons (often referred to as a rebate) are used to offset the purchase price of the goods. The question of how to fully account for these three-party relationships in VAT terms is an issue. More specifically, the customer should be prevented from claiming input credits for this full amount. These input credits should only be available for the non-coupon consideration actually incurred by the customer.

Revised starting date for alternative apportionment methods (administration)

If a vendor utilises goods or services for both taxable and other non-taxable purposes (mixed purposes), only a portion of the VAT may be claimed as input tax credits. In this regard, SARS has prescribed the use of the turnover-based method as the default method, and SARS has the discretion to approve alternative methods with retrospective effect. In theory, however, any retroactive input credits caused by the alternative method should be accompanied by a reduction in income tax offsets for the same prior periods. But this corresponding income tax reduction rarely occurs, with taxpayers receiving VAT refunds without any corresponding tax increase (i.e. without amending previously submitted tax returns). It is proposed that retroactive changes of apportionment be limited to periods within current open years of income tax assessment.

Limiting month-end cut-off changes

Vendors account for VAT according to tax periods that generally end on the last day of a calendar month, and the VAT Act allows a vendor to change the month-end cut-off date to another fixed date. This other fixed date must be within 10 days before or after the month end. However, some vendors are regularly changing their end dates solely to reduce VAT. These constant changes were never intended and are a drain on SARS enforcement. It is therefore proposed that end dates should not be changed more than once per 12-month period.

Securities transfer tax: miscellaneous legislative proposals

Clarifying the broker exemption

Members of a stock exchange (brokers) are exempt from securities transfer tax. While the exemption has existed for years, its initial intent is not entirely clear. Upon review of industry practice, it appears that the exemption is used by brokers as market makers for shares to enhance liquidity and to facilitate the role of banking institutions. It is now proposed that the exemption be revised to clarify that it applies solely to players engaged as market makers.

Technical corrections

In addition to the amendments described above, the 2011 tax amendment bills (like all annual amendment bills) will contain various technical corrections. The main thrust of these technical corrections is to cover inconsequential items. These items remedy typing errors, grammar, punctuation, numbering, misplaced cross-references, misleading headings and definitions, differences between the two language texts of legislation, updating or removing obsolete provisions, the removal of superfluous text and the incorporation of regulations and commonly accepted secondary interpretations into formal law. Technical corrections further include changes to effective dates and the proper coordination of transitional tax changes.

A final set of technical corrections relates to modifications that account for practical implementation of the tax law. Although tax amendments go through an intensive comment and review process, new issues arise (including obvious omissions and ambiguities) once the law is applied. Issues of this nature typically arise when returns are prepared for the first time after legislation is implemented. Technical corrections of this nature are almost exclusively limited to recent legislative changes.

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