Deloitte.

Consolidated Commentary

Budget 2016/17

Driving progress

South Africa

Preface

The South African Minister of Finance, Pravin Gordhan, delivered his 2016 Budget Speech to Parliament on Wednesday, 24 February 2016.

In this summary, we highlight some of the tax proposals mentioned in his speech and set out in the detailed Budget Review document.

Please do not hesitate to contact us, should you require any additional information relating to any aspect covered in this summary.

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General

The marginal tax rates applicable to individuals remain unchanged across all tax brackets.

However, as has been the case in the past, the tax brackets, tax rebates and the medical scheme contribution tax credits will be adjusted to reduce the effect of inflation on lower- and middle-income earners (see tax tables in Deloitte Quick Tax Guide - 2016/17). No fiscal drag relief will be provided to higher income earners.

Retirement reforms

The following amendments are proposed in relation to retirement reforms:

- The requirement for provident fund members to annuitise retirement benefits, made in respect of provident fund contributions, has been deferred from 1 March 2016 to 1 March 2018.
- The anomaly which currently exists because the value determined with reference to the prescribed formula (i.e. the amount subject to employees' tax) for a defined benefit fund may be higher than the amount actually contributed by the employer will be rectified.

  The amendment, which will be effective 1 March 2016, will result in the full value of the taxable fringe benefit, determined in accordance with the prescribed formula, qualifying as a tax deduction.
- Tax deductions in respect of retirement fund contributions will be allowed against passive/non-trading income.
- Contributions to a pension fund and retirement annuity fund which did not rank for a tax deduction up to 29 February 2016, will be able to be rolled forward and may qualify for a tax deduction under the new regime.
- Deductions for retirement fund contributions will be allowed against taxable income determined before the deduction for donations.
- It will no longer be necessary to seek tax directives from SARS for transfers from a pension fund to a provident fund. As the tax-free transfer from a pension fund to a provident fund has been deferred until 1 March 2018 in line with the annuitisation provisions, it remains to be seen if this proposal will be implemented.
- All retirement fund contributions made in relation to a member (whether made by an employer, employee or third party on behalf of the employer/employee) will comprise a taxable fringe benefit.
- Withdrawals as a result of divorce settlements will be proportionately attributed to the vested and non-vested components of the retirement fund savings.
- Any forced transfers from a provident fund to a pension/retirement annuity fund will not i mpact the ability of an individual (over the age of 55) from making future contributions which may be taken as a lump sum.
- The tax implications of contributions made to and pay outs from foreign retirement funds will be under review.

Comment:
While the annuitisation requirement has been postponed, we note that the tax proposals will be effective from 1 March 2016. The rules on fringe benefits and limitations on contributions to retirement funds as originally proposed will take effect from that date. As a result, employers should ensure that their payroll systems are ready to comply with these new rules.

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Voluntary disclosure programme

As discussed in more detail elsewhere in this Commentary, individuals with unauthorised foreign assets will have the opportunity to disclose offshore assets and income under a relaxed voluntary disclosure programme, which will apply for 6 months from 1 October 2016.

Comment:
This relief is welcomed as it will encourage those taxpayers who may still have significant amounts of cash and assets offshore, to bring those assets into the South African tax net and regularise their affairs.

Tax incentives – learnership and employment tax

The current learnership and employment tax incentive programmes are currently under review. The incentives, which are currently due to expire toward the end of 2016, may be extended by one year.

Comment:
Although the monitoring of these incentives may be administratively burdensome to employers, any extension in these incentive programmes would nevertheless be welcomed as it assists employers in employing and training a larger workforce

Increase in bursary threshold

It is proposed that limits for the provision of bursaries be increased so that tax exempt bursaries may be provided to the relatives of employees earning up to R400 000 (previously R250 000).

The amount of the bursaries that may be provided tax-free will also increase from R10 000 to R15 000 for NQF levels 1 – 4 and from R30 000 to R40 000 for NQF levels 5 -10.

Comment:
The increase in the limits will provide employers with a greater scope to award bursaries to employees without adverse tax consequences for those employees.

CGT increase

It is proposed that the Capital Gains Tax (CGT) inclusion rate be increased as follows:

- Individuals/Special Trusts/Individual policyholder funds: from 33.3% to 40%
- Other taxpayers: from 66.6% to 80%

The consequence of this amendment is that the effective tax rate on capital gains will increase to 16.4% (up from 13.7%) for individuals/special trusts/individual policyholder funds and to 22.4% (up from 18.6%) for other taxpayers (other than Trusts where the effective rate increases to 32.8% (up from 27.3%)).

In addition, the annual exclusion (which applies to individuals/special trusts) will increase from R30 000 to R40 000.

Comment:
The increase in inclusion rates will adversely impact the value generated in the growth of assets as taxpayers now need to pay higher tax on the sale of assets without a corresponding increase in asset value. Originally, the lower inclusion rates were to eliminate the effects of inflation on asset values. As the inclusion rates increase, the effect is that nominal increases in value are being taxed and not real increases.

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Transfer duties

The transfer duty rates on the sale of immovable property over R10 000 000 will increase from 11% to 13% with effect from 1 March 2016.

Tax-free investments

Government intends closing an unintended loophole which allows proceeds from tax free investments to be transferred to the nominated beneficiary of an endowment policy without being subjected to estate duty.

In addition, it is proposed that the requirement to file exempt dividend tax returns in respect of dividends derived from tax-free investments, will be done away with.

Transfers of tax-free investments between service providers will commence 1 November 2016 as opposed to 1 March 2016.

Comment:
The removal of the requirement to submit a dividends tax return will alleviate the administrative burden placed on taxpayers.

Employee share schemes

In order to resolve a potential anomaly, it is proposed that shares which are subject to the application of section 8C of the Income Tax Act, will be excluded from paragraph (c) of the "gross income" definition as this also included under paragraph (n) of the definition.

The current rules will be amended so that a dividend arising from the liquidation of a restricted share will not be exempt from income tax but will be taxed as ordinary income.

In addition, the remuneration definition for purposes of PAYE will be amended so as to specifically include taxable dividends received from restricted equity instruments.

Comment:
The clarity to be provided by this proposed amendment is welcomed.

Employees of foreign employers

Where a foreign employer, with employees in South Africa, does not withhold employees' tax, the Commissioner will notify such employees of their status as provisional taxpayers through a public notice (i.e. they will no longer receive individual notices alerting them of this change in status).

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Company tax and trusts

Capital gains tax

It is proposed that the Capital Gains Tax (CGT) inclusion rate for companies be increased from 66.6% to 80%. The consequence of this is that the effective tax rate on capital gains for companies will increase to 22.4% from 18.6% currently.

Hybrid debt instruments

Debt instruments subject to subordination agreements

It is proposed that debt instruments subject to subordination agreements be excluded from being regarded as section 8F hybrid debt instruments. Subordination agreements often result in repayments being suspended until the debtor is in a position to settle the outstanding amount. As section 8F of the Income Tax Act is currently worded, this could possibly result in such instruments being regarded as 8F hybrid debt instruments on the basis that repayment terms could possibly no longer fall within 30 years of issue of the debt instrument or due to the fact that repayment would be dependent on the market value of the assets of the debtor exceeding the market value of its liabilities.

Comment:
The proposed amendment provides relief to financially distressed debtors and clarifies the position that subordination agreements should not affect the contractual relationship between the debtor and the lender.

Proposal to address double non-taxation in hybrid debt instruments

It is proposed that measures be implemented to address mismatches associated with hybrid debt instruments. Existing tax rules allow for interest on a hybrid debt instrument paid by a company to be reclassified as a non-deductible dividend. Where the issuer is a non-resident, this results in a South African recipient receiving a dividend which would be tax-free in the hands of a company or favourably taxed in the hands of another taxpayer. As the non-resident is not subject to tax in South Africa, the re-characterisation of the interest as dividends in their hands has no effect on it. This clearly opens the possibility for tax avoidance and it is proposed that this loophole be closed.

Comment:
This proposal will close an unintended loophole which would otherwise be available.

Asset-for-share transactions for natural persons employed by a company

In order to benefit from the relief provided by section 42 of the Income Tax Act in respect of "asset-for-share transactions" it is necessary for the taxpayer to either hold a "qualifying interest" or be employed on a full time basis in the business of the company. Apparently, certain limitations to these qualifying conditions have arisen and consequently it is proposed that certain refinements or amendments be made to section 42 to clarify these qualifying conditions.

Comment:
There has been speculation as to whether the requirement for employment is restricted to the incorporation of professional service firms as the company is required to render a service. The proposal gives no indication of what the refinements or clarifications entail, but it is hoped that any continuing employee who receives shares in an asset-for-share transaction will qualify for the relief even if they do not otherwise hold a qualifying interest.

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Avoidance schemes in respect of share disposals

It is proposed that a review of certain arrangements involving share disposals be undertaken to determine if additional countermeasures are required to address the use of such arrangements to avoid the tax consequences of a direct share disposal. One such arrangement is where a person subscribes for shares in a company and at the same time the company buys back the shares from the existing shareholders which is in substance a share sale transaction. Such a scheme can have the effect that the existing shareholders whose shares have been repurchased not paying tax as they have either received an exempt dividend or a return of contributed tax capital. It is these sort of arrangements that Government is looking to address and consider whether any loopholes need to be closed.

Gradual extension of tax relief pertaining to securities lending arrangements

Currently there are no income tax and securities transfer tax implications on the transfer of a listed share in terms of a securities lending arrangement where the lending arrangement is for a limited period of 12 months. It is proposed that the 12 month period limitation be relaxed on a gradual basis. It is also proposed that the taxation of these lending arrangements be reviewed going forward to take into account corporate actions during the term of the lending arrangement.

Comment:
We agree with this proposal.

Third party backed shares

Section 8EA dealing with “third party backed shares” was introduced in 2012 to regulate the taxation consequences arising on the issue of certain preference shares which had ‘debt like’ features in that redemption of such shares was guaranteed by a third party. Generally speaking, the dividends paid on third party backed shares are taxed in the hands of the holder of such shares as ordinary revenue rather than dividends.

The provision applied to shares already in existence as well as to shares subsequently issued. The rules apparently are affecting certain legitimate transactions and arrangements, and consideration is being given to relaxing these rules in relation to transactions entered into before the provision became effective.

In addition, several schemes have apparently been identified where transactions have been structured to circumvent the anti-avoidance rules. Amendments are proposed to stop the circumvention of these rules.

Comment:
The provision is exceedingly complex and convoluted to interpret, and it is unlikely that the proposed amendments will make it any simpler. It is hard to understand exactly what mischief the provision seeks to address. The deletion of the entire section would be welcomed but, given the proposal to stop the circumvention of the rules, this hardly seems likely.

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Mineral and petroleum resources royalties

It is proposed that certain amendments and technical corrections be made to the Mineral and Petroleum Resources Royalty Act to align the payment of royalties more closely to the Fourth Schedule of the Income Tax Act with regards to provisional tax payments.

Transitional tax issues resulting from the regulation of hedge funds

Government recognises that the current relief offered to assist the transition of hedge funds to the new regulated tax regime is limited and not applicable to certain hedge fund trust structures. It has therefore been proposed that provision be made to address such limitations.

Comment:
There is no indication as to what the proposed provisions will be to address any current limitations for the transition of hedge funds to the new tax regime.

Taxation of Real Estate Investment Trusts (REITs)

Refinement of qualifying distribution rule
Currently, REITs and controlled companies are entitled to deduct certain qualifying distributions from taxable income. A REIT or controlled company is only entitled to this deduction if at least 75 per cent of the gross income received by the REIT or controlled company in its preceding year of assessment (or its first year of assessment if that year was the first year it qualified as a REIT or controlled company) constituted rental income. In terms of the existing REIT dispensation, no tax allowances can be claimed in respect of buildings. However taxpayers may in the past have claimed these allowances and the disposal of these properties would consequently give rise to recoupments. In circumstances where significant recoupments on the disposal of fixed property are included in gross income, it is possible that this threshold requirement may not be satisfied, resulting in distributions not qualifying for deduction. It is proposed that the definition of a qualifying distribution in section 25BB of the Income Tax Act be reviewed to remove this anomaly.

Interaction between REITs and section 9C

Section 9C of the Income Tax Act currently provides that where a taxpayer holds an equity share for more than 3 years, any amounts received by a taxpayer (excluding dividends) in respect of the disposal of that share are deemed to be on capital account. Section 9C(5) also requires the taxpayer to recoup expenditure previously claimed as a deduction in respect of such shares in the year of disposal. A misalignment arises in relation to shares held in REITs where dividends received from REITs are taxable, essentially resulting in the holder of the shares bearing a greater tax burden in relation to other classes of investors. It is proposed that section 9C be amended such that section 9C(5) does not apply to REITs.

Comment:
We agree with the proposals to remove the above anomalies.

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Solvency Assessment and Management framework (SAM) for long-term insurers

It is proposed that the tax liability valuation method for long-term insurers be brought in line with the SAM framework, due to come into operation in 2017 with the enactment of the Insurance Bill. The valuation basis for tax purposes is still being considered and final legislation will be introduced in 2016 once a decision has been made in consultation with the industry.

Comment:
The proposal gives no indication of what further considerations may apply.

Venture capital funding for small businesses

The application of certain provisions in the current venture capital company regime may result in potential venture capital investors not taking up the venture capital incentive. Consequently, it is proposed that measures to mitigate the unintended consequences of the application of these provisions be considered.

Comment:
The proposal gives no indication of what provisions may be problematic and does not elaborate on potential measures which may mitigate the negative consequences of these provisions.

Urban development zones (UDZ)

As mentioned elsewhere in this Commentary, It is proposed that the current UDZ incentive scheme be made available to more municipalities to promote urban renewal.

Comment:
We agree with this proposal.

Small business corporations in special economic zones

It is proposed legislation be amended to clarify that small business corporations located in special economic zones are subject to corporate income tax at the lower of the graduated rate applicable to small business corporations and 15 per cent. In order to qualify for the 15 per cent rate, however, small business corporations would still need to comply with the provisions of section 12R of the Income Tax Act.

Comment:
We agree with this proposal.

Tax treatment of national housing finance corporation

It is proposed that special tax exemptions be provided to the National Housing Finance Corporation and further proposals be made to ensure that the transfer of assets from the department's current development finance institutions to the National Housing Finance Corporation are tax neutral.

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Tax treatment of land donated under the land-reform initiatives

The current tax relief provided for land donated for land reform does not cover all government land reform initiatives. It is therefore proposed that amendments be made to cover other land reform initiatives, such as those set out in the National Development Plan.

Clarifying the tax treatment of government grants

As mentioned elsewhere in this Commentary, it is proposed that all government grants be treated as gross income and the Eleventh Schedule to the Income Tax Act will be the sole mechanism for determining whether or not government grants should be taxed.

Taxation of trusts

The Budget Review notes that trusts are often used by taxpayers to avoid paying estate duty and donations tax. This is generally done by way of the planner making interest-free loans to a trust to enable it to acquire assets which either generate an income and/or are expected to grow in value in the future.

To counter this perceived abuse it is proposed that "assets transferred through a loan to a trust are included in the estate of the founder at death" and "to categorise interest-free loans to trusts as donations".

Comments:
It is unclear what exactly is envisaged. Firstly, what would be the position where cash is transferred to the trust and the trustees use that cash to acquire an asset? The asset would not have been transferred to the trust but it would appear to be illogical to draw a distinction between the situation where the planner sells an asset to the trust and one where he advances money to the trust to enable it to acquire a third party's asset.
Secondly, although reference is made to categorising interest-free loans to trusts as donations presumably the intention is to levy donations tax on the notional interest foregone rather than the loan itself.

Thirdly, economic double taxation would arise if one was to tax both the asset in the trust and the interest foregone on the loan used to acquire the asset.
Finally, the proposal is to include the assets in the estate of the "founder". The founder of the trust is often a different person from the planner or "funder" who is the person who is likely to be disposing of assets to the trust. In addition, there may be multiple funders in which case it would be very difficult to attribute assets to a particular deceased particularly where the trust in question has been in existence for a substantial period of time.

These proposals are not in keeping with the preliminary recommendations of the Davis tax committee and one is going to have to wait for the draft tax amendments before getting greater clarity as to what exactly is envisaged. However, as Government has found out before when they previously announced measures to target trusts, it is very difficult to introduce legislation to counter perceived avoidance without impacting trusts that have been set up for legitimate non-tax avoidance purposes.

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Withdrawal of withholding tax on services

In 2013, it was proposed that a withholding tax on service fees payable to non-residents be introduced in South Africa, mainly for purposes of identifying foreign companies creating a taxable presence in South Africa through their activities here.

However, in many instances, South Africa would not have taxing rights on such fees in terms of our wide tax treaty network. Accordingly, it has been decided by Treasury not to implement the withholding tax on service fees, but rather to make the agreements between South African taxpayers and foreign service providers a "reportable arrangement" in certain instances

Comment:
Strong representations have been made to Treasury not to implement the withholding tax due to the administrative burden on South African taxpayers and potential decrease in South Africa's global competitiveness. It is therefore welcomed that the proposed implementation of the withholding tax has been withdrawn.
It is important to note that on 3 February 2016, a Government Gazette was published listing the following (amongst others) as a reportable arrangement (to be reported to SARS within 45 business days):

- *An arrangement for the rendering to a person that is a resident or to a non-resident with a PE in South Africa of consulting, managerial, technical, training etc. services in terms of which-*
    - o *A person that is not a resident or employee, agent or representative of that person was or is physically present (or is anticipated to be) in South Africa in connection with or for purposes or rendering those services; and*
    - o *The expenditure under that arrangement incurred or to be incurred by the resident on or after 3 February 2016 exceeds or is anticipated to exceed R10 million in aggregate and does not qualify as remuneration for purposes of South African PAYE.*

Qualification to the high-tax exemption in respect of Controlled Foreign Companies ("CFCs")

In determining the net income of a CFC to be included in a resident's South African income, a high-tax exemption will apply where the actual foreign tax payable by the CFC in a tax year is equal to at least 75% of the hypothetical South African income tax payable had the CFC been a South African resident. For purposes of the hypothetical tax calculation, any foreign group company losses reducing the taxable income of the CFC must be disregarded.

National Treasury is concerned that South African taxpayers may benefit from the high-tax exemption in cases where there is actually no foreign tax payable by the CFC due to the tax losses of the CFC's group companies. Further, National Treasury argues that had CFC income been imputed to a South African taxpayer in this scenario, no foreign tax credit would be available (as no actual foreign tax was payable by the CFC). Treasury therefore proposes to delete the above adjustment for foreign group losses in the high-tax exemption calculation.

Comment:
South African taxpayers relying on the high-tax exemption for not imputing CFC income should take note if the CFC's actual tax payable in the foreign jurisdiction is reduced by group company losses. In such cases, the proposed amendment may result in CFC income being imputed to the South African resident if no other exemption can be relied on by the taxpayer, e.g. the foreign business establishment exemption.

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CFCs and collective investment schemes

In terms of the South African CFC legislation, South African owners of foreign entities are, in broad terms, required to pay tax on profits made by such foreign entities, subject to certain exemptions. The current CFC rules result in adverse consequences for collective investment schemes that invest offshore. There is also uncertainty as to whether it is the collective investment scheme itself or the underlying investors who should be considered to be the holder of the participation rights for purposes of the CFC rules in these circumstances.

Given the adverse consequences of the CFC rules for local collective investment schemes, as well as the uncertainty in our law, it is proposed that collective investment schemes be excluded from having to apply the CFC rules

Comment:
This is welcome relief for all collective investment schemes which have offshore investments

Bad debt deduction

It is proposed that the Income Tax Act will be amended to make it clear that previously taxed foreign exchange gains on debts will qualify for a tax deduction if such debts become bad.

Comment:
This is a welcome relief for affected taxpayers, although we believe that the existing law already caters for this.

Transfer pricing, treaty misuse and inappropriate international transactions

The Minister specifically highlighted in the budget speech that SARS will continue to “act aggressively” against inappropriate transfer pricing and the misuse of tax treaties. The Minister has promised further measures to tackle such illicit profit shifting out of South Africa, including by way of reliance on the international agreements on information sharing between SARS and foreign tax authorities.

In particular, the Government is concerned about the following:

- the manipulation of the value or nature of cross-border transactions between related parties through improper transfer pricing practices in order to reduce or avoid tax payable in South Africa;
- treaty shopping or abuse, where related parties in different countries form an entity in a third country purely to take advantage of tax treaty benefits; and
- the use of financing structures that reduce taxpayers’ tax liability by way of inflated interest deductions.

South Africa is actively involved in international efforts to examine base erosion and profit shifting (“BEPS”) with the OECD and the G20. Further, South Africa is working with 93 other governments on a multilateral instrument that will enable preventative measures to be incorporated into our network of bilateral treaties to avoid treaty abuse.

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Government has taken the following steps in this regard:

- improving the information taxpayers have to provide to SARS in order for SARS to be able to identify inappropriate tax-planning schemes;
- focussing on transfer pricing - multinationals exceeding certain thresholds will be required to submit reports for each country in which they operate to the tax authority where the parent company is resident. The various tax authorities will share this information from 2018. SARS will therefore have access to the country-by-country reporting on all large multinationals operating in South Africa;
- enhancing CFC rules to impute income of CFCs to South Africa if they have no essential economic activity offshore; and
- introducing rules that limit excessive interest deductions.

Comment:
The erosion of the South African tax base through inappropriate tax avoidance and evasion by multinationals is a major concern for SARS and Government. We expect increased focus by SARS in this area of tax, especially once SARS starts sharing in-depth information with other tax authorities globally.

Multinationals should take care to demonstrate the economic substance of their transactions with related parties in a robust way, in particular by having proper transfer pricing documentation.

Exchange controls

Exchange Control changes and reforms highlighted or impacted upon by proposals in the budget speech include the following:

- The proposed relaxation of tax voluntary disclosure rules (see commentary under Administrative Issues and Other Taxes) will result in the Financial Surveillance Department of the Reserve Bank having to amend their policy with regard to penalties for voluntary disclosure by residents who may hold irregular foreign assets. Specifically, a 5% (if the assets are repatriated to South Africa) or 10% penalty (if the assets are kept offshore) will be applied on the current market value of the foreign assets. This penalty must be paid from foreign-sourced funds. To the extent that local assets are utilised to settle the penalty, an additional 2% penalty will be levied.
- A revised and simplified Financial Surveillance Manual will be published on the Reserve Bank's website during July 2016. This manual is based on the Exchange Control Rulings which is the document issued to Authorised Dealers containing, inter alia, details of authorities delegated to them and the limits applicable. It is most likely that the revised manual will be more user friendly and possibly mirror the Exchange Control Rulings.
- Certain institutions are defined as institutional investors. These are typically pension fund managers, investment/asset managers, collective investment scheme management companies, long term insurers etc. These institutional investors may make foreign investments in terms of prudential limits allocated to them. Should these limits be exceeded, they are required to rebalance their portfolios in order to stay within their allocated prudential limits. The recent depreciation of the Rand may have caused a number of these companies to exceed their prudential limits. The Minister has provided some relief to them in granting institutional investors a grace period of 12 months in which they will not be required to rebalance their portfolios i.e. they may thus remain in excess of their prudential limits but will not be able to make any further offshore investments until such time as they are within the prescribed limits.
- It was also announced that the South African Holding Company regime will be expanded. During the past two years, a concession has been announced whereby first JSE-listed entities, and later non-listed entities, could establish a South African holding company, which will not be subject to any exchange control restrictions but will be able to act as a holding company for offshore operations and/or as a treasury company. This concession has now been expanded to also include banking and insurance groups. This will, however, require specific approval from both the Bank Supervision and Financial Surveillance Departments.

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Grants and incentives

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There was not significant detail in the budget speech with respect to grants and incentives but items that were dealt with include the following:

Improved administration of R&D and other tax incentives

It was heartening to note that special mention was made of the administration of tax incentives and specifically of the Research & Development (R&D) allowances in section 11D of the Income Tax Act. This shows that Government is serious about the efficacy of incentives and that there is a desire to have effective incentives. With regard to section 11D, the establishment of a task team to focus on improving the administration of the R&D tax incentive was mentioned. It must be noted that the task team will present recommendations for improving the administration of the R&D tax incentive and that their work will be completed by April 2016.

Trade and investment promotion

It was announced that Minister Davies (Trade and Industry Minister) is introducing a new investment promotion agency to streamline administrative procedures and enhance our position as an African financial centre. In this regard, we note that the Government has also prioritised investment and trade promotion, with the establishment of two separate divisions under the Department of Trade and Industry - Investment South Africa and a separate Trade and Export Promotion division.

Agriculture

Programmes aimed at revitalising agriculture that were mentioned include spending on small-scale farming and developing agri-parks in rural economies. It is important that companies in the agri-processing industry take this into account when considering future expansions.

It was also announced that measures to strengthen tourism, agriculture and agro-processing are in progress. We will monitor developments in this regard with interest. It is noted that, over the next three years, R15 billion has been allocated for land acquisition, farm improvements and expanding agro-processing opportunities.

Special economic zones, employment and exports

Special Economic Zones (SEZ) and employment-intensive sectors with export potential have been prioritised for support by the Industrial Development Corporation (IDC).

R23 billion set aside to support black industrialists

It was announced that the IDC will continue to play a role in financing manufacturing and beneficiation and that R23 billion has been set aside to support black industrialists. The purpose of the Black Industrialists Scheme (BIS) is to ensure that we take advantage of the country's capacity to unlock the industrial potential that exists within black-owned and managed businesses that operate within the South African economy. The scheme is intended to fast track the increase and participation of black industrialists in the national economy through their contribution to growth, investments, exports and employment.

The Minister indicated that there would be a strong focus on and support for this programme.

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IDC – other

It has been indicated that the IDC will invest R100 billion over the next five years (including the amount of R23 billion set aside to support black industrialists).

Increased focus on supporting small business through public funding and other measures

In the budget speech, the Minister announced that an amount of R475 million has been reprioritised to the Department of Small Business Development for assistance to small and medium enterprises and cooperatives.

Other

A review of business incentives has been initiated, to strengthen their impact on growth, productivity, trade and competitiveness. In this regard, we trust that the review will show the need to support South African business with targeted, growth and employment creating incentives that will lead to the growth of South Africa's manufacturing industry.

Jobs fund

The Community Work Programme is expanding its reach, and Jobs Fund partnership projects of R12 billion have been approved. We await the potential of more Jobs Fund windows being announced.

Incentives' budget

There will be a 20% increase in the government incentives' budget over the next year, with the majority of this (64%) attributable to the manufacturing sector – mostly likely the two key programmes that require re-capitalisation (the Automotive Investment Scheme and the Manufacturing Competitiveness Enhancement Programme).

Under the SEZ programme, a total of R3.4 billion over the next 3 years has been set aside for SEZ incentives, most of which will be funding feasibility studies for SEZs and SEZ projects.

Carbon tax

The proposed Carbon Tax will remain revenue neutral until 2020. The draft Carbon Tax Bill was published in November 2015 with 90 comments received to date. The draft bill will be revised taking into account public comments and further consultation. No mention has been made of postponing the implementation date, currently 1 January 2017.

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Government grants

Certain grants that are not listed in the Eleventh Schedule to the Income Tax Act, can still not be subject to tax if they are of a capital nature. It is proposed that all government grants be included in gross income, and that a listing in the Eleventh Schedule will be the sole determination of whether such grants are taxable or not.

Although government grants listed in the Eleventh Schedule are exempt from tax, there are measures in place to reduce deductions from expenditure, the allowances that may be deducted in respect of the cost of the assets acquired or the base cost of capital assets on which allowances may not be claimed, in respect of amounts received as government grants.

Learnerships and employment tax incentives

These incentives will expire towards the end of 2016. A review of these incentives is being carried out and it is envisaged that the results will be presented to Parliament by the third quarter of 2016. If there are delays in completing these reviews, Government may consider extending the incentives by one year.

Urban development zones

It is proposed that the tax incentive for developments in urban development zones be extended to more municipalities.

Tax administration (including voluntary disclosure programme) and other taxes

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Tax administration

Special voluntary disclosure programme in respect of offshore assets and income

It is proposed that non-compliant taxpayers with undisclosed foreign assets and income earned will be provided with a further opportunity to regularise their tax affairs before the new OECD global standard for the automatic exchange of financial information comes into effect in 2017. Draft legislation for this purpose has been made available.

- It is proposed that a special voluntary disclosure programme will be introduced with effect from 1 October 2016 with a closing date of 31 March 2017.
- This special voluntary disclosure programme will allow qualifying non-compliant taxpayers holding any foreign asset on 29 February 2016 to voluntarily disclose their offshore assets and income.
- The foreign assets in question are those which were accumulated as foreign assets or transferred from South Africa in contravention of Exchange Control Regulations.
- Trusts will be excluded from the special voluntary disclosure programme. However, settlors, donors or beneficiaries of foreign discretionary trusts may participate in the special voluntary disclosure programme if they elect to have the trust's offshore assets and income deemed to be held by them.
- Persons will not qualify for relief if they are aware of a pending audit or investigation or an audit has commenced in respect of foreign assets or foreign taxes.
- Relief granted:
  - 50% of the total amount used to fund the acquisition of offshore assets will be subject to normal tax, if the applicant failed to comply with a tax Act and those assets were acquired before 1 March 2015;
  - Investment returns (interest, rental, foreign dividends or other investment income) in respect of those offshore assets received or accrued from 1 March 2010, will subject to normal tax;
  - Investment returns prior to 1 March 2010 will be exempt.
  - Interest on the outstanding tax debt arising out of the disclosure will commence from 1 March 2010;
  - No understatement penalties will be levied;
  - SARS will not pursue any criminal prosecution.
- Relief is similarly provided for the consequent exchange control contravention:
  - A levy of 5% of the current market value of the unauthorised foreign assets, if the assets or proceeds thereof are repatriated to South Africa.
  - A levy of 10% of the current market value of the unauthorised foreign assets, if the assets or proceeds thereof kept offshore.
  - The levy must be paid from foreign sourced funds. If there are insufficient liquid foreign funds, an additional 2% will be added to the extent local assets are used.
  - Individuals will not be able to deduct the R10 million foreign capital allowance.
  - If residents do not apply for relief in terms of the voluntary disclosure programme and voluntarily make a full disclosure to the Financial Surveillance Department of the South African Reserve Bank, they may have to pay a settlement ranging from 10% to 40% of the current market value of the unauthorised foreign assets.
  - If no disclosure is made the full amount of the unauthorised foreign assets may be recovered.

Comment:
While the relief provided by the special voluntary disclosure programme is welcomed, the proposed legislation giving effect to the special voluntary disclosure programme appears to contain several inconsistencies. It is uncertain whether administrative non-compliance penalties and penalties imposed under a tax Act, such as late payment penalties, may still be imposed. It is further unclear on what basis 50% of the amount used to fund the acquisition of the offshore assets will be subject to income tax.

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Voluntary disclosure programme

It is proposed that the general voluntary disclosure programme provisions contained in the Tax Administration Act will be amended to clarify the meaning of 'pending audit or investigation'. Currently, persons who are aware of a 'pending audit or investigation' may not apply for voluntary disclosure relief.

Comment:

The proposed clarification of the meaning of a 'pending audit or investigation' is welcomed as it will assist taxpayers in objectively determining whether they qualify for voluntary disclosure relief. Uncertainty exists specifically in cases where taxpayers have received a request for verification from SARS but have not received a formal notification of audit.

Extension of objection and condonation periods

It has been acknowledged that the current 30 business day period for lodging an objection is too short, particularly in complex matters, resulting in a large number of applications for condonation.

It is proposed that a longer period for lodging an objection and condonation be provided. Together with this change, the rules for failing to comply with the prescribed time periods may similarly be amended.

Comment:

The extension of the time periods to lodge an objection is a welcome change. However, as a consequence of this extension, it is likely that the provisions relating to future condonations will be restricted. Currently, it is SARS' practice not to condone the late filing of objections lodged after a 51 business day period. While taxpayers are penalised if they do not adhere to the timelines, no similar adverse consequences exist for SARS.

Understatement penalty provisions

Consideration will be given to the understatement penalty provisions in the Tax Administration Act to clarify their application in relation to general anti—avoidance matters.

Comment:

Currently, understatement penalties may be imposed for the behaviour category "gross negligence" and "intentional tax evasion". It is uncertain whether the clarification as regards general anti-avoidance will result in the creation of a new behaviour category and penalty percentage or will be included as part of one of the above-mentioned behaviour categories.

Commercial member to assist presiding officer in tax court

Currently, the Tax Administration Act only provides for commercial members in a tax court to have specialist expertise if the tax appeal relates to the business of mining or the valuation of assets. As other matters of a technical nature may also require a commercial member with expertise in the relevant field, it is proposed that this provision be extended to include a more generic provision for this purpose.

Comment:

It is suggested that similar amendments should be made in respect of commercial members of the tax board.

Legal costs recovered by state attorney

Currently, legal costs recovered by the state attorney on behalf of SARS are paid directly to SARS. It is proposed that all legal costs recovered by the state attorney on behalf of SARS be paid to the National Revenue Fund.

Small business desks

In order to support business development, SARS has introduced small business desks, designed a mobile tool to help small businesses register at their own premises, and implemented a single registration process to avoid the need to reregister for different taxes.

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Other taxes

Transfer duties

As indicated elsewhere in this Commentary, a new band is proposed to be introduced for property values exceeding R10 million. It has been proposed that the transfer duty rate on property sales above R10 million be increased from 11 per cent to 13 per cent. This new rate will apply to properties acquired on or after 1 March 2016.

Comment:
The increase to the transfer duty rate for property sales above R10 million appears to be in keeping with the perceived focus on extracting additional tax from high net worth individuals, especially when considered in light of the increases to the capital gains tax inclusion rates and the stated intention to target tax planning through trusts.

Diesel rebate system
In the 2015 Budget Review, it was noted that the diesel refund system would be delinked from the VAT system in order to address concerns regarding eligible firms being unable to benefit from the system, while others appeared to make disproportionate refund claims. Secondly, a reduction in diesel fuel levy refunds from 80 per cent to 20 per cent of the general fuel levy for those beneficiaries conducting land mining activities, and a reduction from 100 per cent to 50 per cent for the generation of electricity by Eskom's open cycle gas turbines was proposed. These changes were to be effective from 1 April 2016.

Comment:
No further commentary in relation to the above proposals was noted in the 2016 Budget Review. It is assumed that these proposed changes will still take effect on 1 April 2016.

Value-added tax

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Notional input tax on goods containing gold

In 2014, the definition of "second hand goods" in the VAT Act was amended to exclude goods containing any gold in order to curb the abuse in claiming notional input tax on such goods. It is now intended to remove goods which contain minimal gold content from this exclusion.

Taxation of non-executive directors

There has been some debate whether non-executive directors should be treated as employees receiving remuneration and subjected to employees' tax, or whether they may instead be regarded as being independent of the employer and liable to register as VAT vendors and account for output tax where their fees exceed the R1 million annual threshold. It has been proposed that this issue will be investigated and clarified if necessary.

Grants from national skills fund

Grants allocated by sector education and training authorities (SETA's) are currently zero-rated and it has been announced that consideration will be given to similarly including in this category grants made through the National Skills Fund.

Loyalty programmes

Loyalty programmes have become increasingly popular and generally provide for the granting of goods or services upon the redemption of accumulated points. Existing provisions in the VAT Act provide for VAT consequences where any "token, voucher or stamp" is redeemed. It is proposed that these provisions be reviewed and amended if necessary in order to accommodate the treatment of all loyalty programmes.

Determined value of company cars

The granting of a fringe benefit by an employer to his employee is deemed to be a supply for VAT purposes and the value of such supply is determined in accordance with a formula set out by the Minister in VAT Regulation 2835. This formula is based on the "determined value" of the vehicle which excludes any finance charges, interest or VAT. The calculation of the value of a motor vehicle for the purposes of calculating fringe benefit tax is also based on the "determined value" of the motor vehicle. Such "determined value" as defined in the Seventh Schedule to the Income Tax Act excludes finance charges and interest but includes VAT.

This means that administrators are obliged to use two separate methods in calculating the determined value of company cars. In order to reduce this administrative burden, it is intended that VAT Regulation 2835 will be aligned with the provisions of the Seventh Schedule to the Income Tax Act and that the calculation of the determined value of the motor vehicle will include VAT and exclude finance charges and interest. This will mean that the determined value will be the same for both VAT and employees' tax purposes.

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Waivers and cancellation of debt

Financial services are exempt from VAT. One such service includes "the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security". It is not clear whether this description covers the waiver or cancellation of a debt and it is intended to investigate this and introduce amendments in order to effect such inclusion if necessary.

Alignment of prescription periods

In general terms, a vendor may deduct any input tax within five years from the date that a tax invoice should have been issued for that supply. It is proposed that an input tax claim be limited in certain instances to the tax period in which the time of supply occurred. It is not clear in which instances it is intended that the prescription periods be limited. It is also intended to clarify a time limit for the payment of refunds.

Indirect exports

Where a vendor who elects to zero rate the supply of indirectly exported goods fails to obtain the prescribed documentation within the prescribed time limits, he is obliged to account for output tax on the supply. Where he subsequently obtains the requisite documentation, he is entitled to claim an input tax adjustment. The VAT Act does not currently make provision for such adjustment and it has been announced that it will be amended accordingly.

Imported goods lost, destroyed or damaged

The VAT Act was amended to exempt goods from VAT on importation if they are unconditionally abandoned to the Commissioner or destroyed with the Commissioner's permission. It is proposed to expand this exemption to include imported goods lost, destroyed or damaged as a result of circumstances deemed by the Commissioner to be exceptional.

Alternative documentary proof

During 2015, section 16(2)(g) of the VAT Act was introduced which provides that a deduction may be allowed where the vendor is not in possession of the prescribed supporting documentation if the vendor is in possession of alternative documentary proof acceptable to the Commissioner. The Commissioner's discretion is limited to circumstances where the vendor is unable to obtain the documents prescribed in terms of section 16(2)(a) to (f) of the Act. It is proposed that the scope of the Commissioner's discretion to accept alternative documentary proof be widened to go beyond situations where the vendor is unable to obtain the prescribed documentation.

Removal of goods from a Customs Controlled Area (CCA)

In order to support the investment in a special economic zones (SEZs), it is proposed to allow for the VAT-free movement of goods which have been imported into a CCA to a manufacturing duty rebate user provided that the ultimate sale is subject to VAT.

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Customs and excise duties

Specific excise duties ("sin taxes")

Alcoholic beverages

Increases in excise duty on alcohol range between 6.7 and 8.5 per cent, as summarized below:

- Malt beer - 11c per 340ml can (increase 8.5%)
- Unfortified wine - 18c per 750ml bottle (increase 8%)
- Fortified wine - 27c per 750ml bottle (increase 6.7%)
- Sparkling wine - 59c per 750ml bottle (increase 8%)
- Ciders and alcoholic fruit beverages - 11c per 340ml bottle (increase 8.5%)
- Spirits - R3.94 per 750ml bottle (increase 8.2%)

Tobacco products

Increases in excise duty on tobacco range between 6.7 and 7 per cent, as summarized below:

• Cigarettes	82c per packet of 20 (increase 6.7%
• Cigarette tobacco	94c per 50g (increase 6.8%)
• Pipe tobacco	27c per 25g (increase 7%
• Cigars	R4.32 per 23g (increase 6.7%)

Provisions in the Customs and Excise Act referring to the maximum allowed weight of cigarettes that may be imported or manufactured will be updated to 0.8g per cigarette in order to more accurately reflect volumes of inputs.

Sugar-sweetened beverages

Government proposes to introduce a tax on sugar-sweetened beverages on 1 April 2017. The purpose of this tax is to attempt to curb excessive intake of sugar due to South Africa having the worst obesity ranking in sub-Saharan Africa.

This tax will probably be imposed in the form of a specific excise duty and the actual rate of duty and implementation date will presumably be published during the next budget speech.

Fuel taxes and environmental levies

Road Accident Fund (RAF) levy

No mention was made in the budget speech of an increase to the RAF levy. We deduce that this levy will remain unchanged at R1.54 per litre for both petrol and diesel.

The RAF levy increased by 50c per litre last year.

The RAF's long-term liabilities of R117.6 billion are projected to grow to R233.10 billion over the next three years.

In 2015, Government concluded consultations with the National Economic Development and Labour Council to replace the RAF with the Road Accident Benefit Scheme (RABS). The RABS will be more equitable and affordable, providing limited income, medical, rehabilitation and funeral benefits.

Funded through the fuel levy, RABS is based on social security principles, moving away from the current liability insurance system.

The change introduces benefits to all accident victims, regardless of the nature of the accident or the assumed fault of the driver. As a result, less time and money will be spent on accident investigation and legal services.

The Department of Transport is expected to table a RABS Bill in 2016/17.

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Motor vehicle emissions tax

The motor vehicle emissions tax aims to encourage consumers to use more fuel-efficient, low-carbon-emitting vehicles, as well as to encourage manufacturers to improve fuel efficiency. To maintain this strategy, Government proposes that a combined inflationary adjustment based on the 2013–2015 period be implemented, effective 1 April 2016.

For passenger vehicles, this will increase the tax rate from R90 to R100 for every gram of emissions/km above 120 gCO2/km and, for double cabs, the tax rate will be increased from R125 to R140 for every gram of emissions/km in excess of 175 gCO2/km.

Carbon tax

As indicated elsewhere in this Commentary, no mention has been made of postponing the implementation date of the proposed new Carbon Tax, currently scheduled for 1 January 2017. The main aim of the carbon tax is to put a price on the environmental and economic damages caused by excessive emissions of greenhouse gases and a secondary aim is to change the behavior of firms and consumers, encouraging them to use cleaner technology.

The draft Carbon Tax Bill was published in November 2015. With 90 comments received to date, it is expected that the draft bill will be revised taking into account public comments and further consultation. The proposed carbon tax will remain revenue neutral until 2020.

Environmental levy on tyres

Government proposes the introduction of an environmental levy on new and re-treaded pneumatic tyres with effect from 1 October 2016. This environmental levy shall be payable in addition to any duty currently payable on these products and shall replace the current fee arrangement for tyres as regulated by the Department of Environmental Affairs.

The environment levy on tyres will be levied at R2.30 per kilogram (net) of tyre and shall be included under Part 3 of Schedule 1 of the Customs and Excise Act.

The purposes of the proposed levy is to reduce waste, while encouraging reuse, recycling and recovery, as well as discouraging disposal into landfills.

The levy shall apply to the following:

i. New, used or retreaded tyres imported into the Republic;
ii. Tyres fitted to or presented with imported vehicles or chassis specified in Chapter 87;
iii. Tyres fitted to or presented with imported road wheels fitted with tyres, wheel rims fitted with tyres specified in tariff heading 87.08;
iv. Tyres imported in terms of Chapter 98; and
v. New and retreaded tyres manufactured in the Republic.

General customs and excise matters

General anti-avoidance rules

In order to enhance enforcement and compliance with customs duties and excise taxation, a general anti-avoidance provision will be added to the Customs and Excise Act. The design of the anti-avoidance clause will be in line with similar provisions in other indirect tax legislation and will consolidate anti-avoidance efforts in customs and excise administration.

Revision of the Southern African customs union revenue-sharing formula
In the 2015 fiscal framework report, the committees recommended that the National Treasury considers reviewing the revenue-sharing formula with regards to the Southern African Customs Union (SACU).

Discussions within SACU about the implementation of its six-point plan, including the review of the revenue-sharing formula, reached a deadlock in July 2013 due to a lack of consensus on the decision-making process.

South Africa assumed the chairpersonship in 2015, after which National Treasury officials entered into bilateral engagements with their counterparts within the SACU member states to explore technical components of the review of the revenue-sharing formula.

The review of the formula is only one aspect of the six-point plan. Other aspects include reforming the revenue-sharing arrangement so that it underpins regional industrialisation, the equitable distribution of the common revenue pool and sustainable regional integration.

To this end, SACU's council of ministers has convened a ministerial retreat for June 2016 to discuss the implementation of the six-point plan in its entirety.
The outcome of the retreat will determine how the review of the revenue-sharing formula is to proceed.

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